REVIEW OF FINANCIAL PRODUCTS AND PROVIDERS:

CONSUMER DISPUTE RESOLUTION AND REDRESS

Discussion Document

September 2006

This discussion document has been prepared by the Ministry of Consumer Affairs. The Ministry of Consumer Affairs is an operating branch of the Ministry of Economic Development

ISBN 0478284934

First Published September 2006
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1. EXECUTIVE SUMMARY

1. A robust and efficient financial sector, where the public has a strong basis for being confident in the sector, is an essential prerequisite for a strong and dynamic economy. In the context of dispute resolution and redress, three further policy objectives support the overarching aim of a robust and efficient financial sector:

- Promote consumer/investor confidence in financial markets;
- Reinforce market incentives, within a competitive environment, to encourage fair and reasonable behaviour by financial providers towards their customers;
- Maintain resilience and stability of financial markets.

2. Effective dispute resolution and redress mechanisms are essential to encouraging consumers to participate in financial markets and promoting market discipline for financial providers.

3. Recent consumer surveys show that while the level of consumer problems with misleading or unfair treatment by financial providers is relatively low, there are significant problems with consumers seeking redress. Common reasons given by consumers include “did not know who to complain to”, “did not think it would make a difference”, and “couldn’t be bothered”. This shows that further work is needed to improve access to redress in order to promote consumer confidence in financial markets. Submissions are invited from stakeholders on the nature and magnitude of current problems with consumer complaints resolution and redress.

4. Existing voluntary industry-based dispute resolution schemes, such as the Banking Ombudsman and Insurance & Savings Ombudsman, provide effective access to redress for consumers. These two schemes cover the vast majority of existing financial transactions; however, they do not currently extend to building societies, credit unions, finance companies, financial intermediaries and some superannuation schemes. It is possible that dispute resolution and redress mechanisms in these other sectors may arise under a voluntary regime. The paper notes, however, there are strong arguments for government intervention to ensure that adequate standards of consumer protection are met.

5. The paper considers a number of options. Submissions are invited from stakeholders on the best option to achieve the objectives sought.

- **Status quo** (voluntary, sector-specific dispute resolution). This option is the least restrictive in a regulatory sense, but doesn’t cover all sectors and doesn’t address problems of consumers knowing where to go to seek redress.
- **Consumer education and information**. This option addresses the problem by building capability of consumers to make informed choices so that consumers will avoid unsuitable products, thus reducing the number of disputes. This option is seen as a long-term solution, rather than achieving immediate improvements in consumer confidence. This option

will not address problems of maladministration or misrepresentation. It also may be difficult to implement, for example it would be difficult to compel firms to provide generic education, rather than product-specific information.

- **Enhanced civil remedies and courts**. This option considers adopting simplified court procedures (for example, through a specialist Disputes Tribunal) to improve consumer access to courts to seek redress. The main disadvantage of this option is that it does not encourage industry commitment, particularly because it does not leverage off the goodwill of the existing industry-based dispute resolution schemes.

- **Industry-based dispute resolution**. Under this option, all financial providers would be required to join an industry-based dispute resolution scheme. Industry funding of dispute resolution arrangements means firms will seek to lower costs of the scheme by improving customer service behaviour to reduce the number of disputes. The paper proposes three possible structures for an industry-based dispute resolution regime:

  - **Multiple industry-based dispute resolution schemes**. All financial providers would be required to join a dispute resolution body; however, they are free to join any scheme (subject to approval by the Minister that the scheme meets minimum acceptable criteria). By allowing the various sectors of the financial industry to establish their own schemes, this option provides for the greatest degree of industry involvement and commitment.

  - **Multiple schemes with shared resources/systems**. This extends the previous option through the sharing of resources and systems by the various sectoral dispute resolution schemes to take advantage of economies of scale.

  - **Single industry-based dispute resolution scheme**. This option establishes a single dispute resolution scheme which all financial providers are required to join. Given the small size of the New Zealand financial industry, a single scheme could provide best use of economies of scale to achieve efficiency gains. This scheme will require the greatest degree of government involvement, as a single industry-wide scheme may not attract a high level of industry involvement or commitment.

2. INTRODUCTION

6. The key objective for the Review of Financial Products and Providers (RFPP) is to develop an effective and consistent framework for the regulation of non-bank financial institutions, financial intermediaries and financial products that promotes confidence and participation in financial markets by investors and institutions, and results in a sound and efficient financial sector.

7. The RFPP considers the regulation of insurance (health, life and general), superannuation, collective investment schemes, non-bank financial institutions (friendly societies, credit unions, building societies, finance companies, industrial and provident societies), the offering of securities and consumer redress.

8. The discussion document *Review of Financial Products and Providers: Overview of the Review and Registration of Financial Institutions* outlines the objectives of the RFPP. Information on how to make a submission to the review is available in that paper.

3. POLICY OBJECTIVES

9. A robust and efficient financial sector, where the public has a strong basis for being confident in the sector, is an essential prerequisite for a strong and dynamic economy. In the context of consumer dispute resolution and redress, three further policy objectives support the overarching aim of a robust and efficient financial sector:

- Promote consumer/investor confidence in financial markets;
- Reinforce market incentives, within a competitive environment, to encourage fair and reasonable behaviour by financial providers towards their customers;
- Maintain resilience and stability of financial markets.

10. Effective dispute resolution and redress mechanisms are essential to achieving these objectives.

3.1 CONSUMER/INVESTOR CONFIDENCE IN FINANCIAL MARKETS

11. The principles of consumer confidence have been outlined by the Ministry of Consumer Affairs in the report *Creating Confident Consumers*.[1] This report found that consumer confidence relies on three elements:

- Consumers' expectations of transactions are met by suppliers;
- Consumers and suppliers have confidence in market rules and institutions; and
- Consumers have effective access to redress.

12. Consumers enter into transactions with certain expectations. These expectations are formed as a result of the consumer's existing knowledge and capability, but are also based on information available to the consumer. If those expectations are met, consumers' confidence in the particular supplier, and in the market overall, is likely to be reinforced. When consumer confidence in the market is reinforced, it is likely to spread to other consumers.

13. Ideally, consumers and suppliers have confidence in the market as a whole. Confidence is self-reinforcing: if market participants believe the market works well, they act with confidence and that tends to reinforce confidence and further strengthens the market. Rules and institutions that contribute to well-functioning markets can reinforce consumer confidence by influencing the weighting consumers give to different assumptions when making decisions in the face of imperfect information. Market rules and institutions may also operate to align suppliers'

[1] www.consumeraffairs.govt.nz/aboutus/review/report/report.pdf

performance with consumers' expectations and vice versa. Confidence in rules and institutions may not play a major direct role in a consumer's decision to transact, but they are important for giving effect to the assumptions which underlie consumers' behaviour.

14. Accessibility of redress mechanisms may reduce consumers' assessment of the risks of transacting with a supplier they do not know or trust (or have imperfect information about) because they are aware they can seek a remedy if things go wrong. In this context, redress mechanisms might include:

- Supplier-based mechanisms such as refunds under the Consumer Guarantees Act 1993, and internal complaints-handling mechanisms;
- Industry-based dispute resolution mechanisms;
- Traditional mechanisms such as civil justice through the courts or disputes tribunals.

15. Note that it is not the goal of regulation to ensure that consumers never lose their money. Rather, the dispute resolution system should be aimed at ensuring consumers' reasonable expectations are met. That is, holding suppliers accountable to consumers for the promises they make.

16. Redress mechanisms can also result in reduced levels of product and service failure, by providing an incentive for suppliers to meet consumer expectations about product and service performance. If suppliers know there is a real likelihood of their having to provide redress in the event of product or service failure, that can act as an incentive for them to take steps to avoid that failure. Precedents established through formal dispute resolution procedures can also provide a measure of consistency and predictability in decision making, allowing suppliers to shape their own conduct accordingly.

17. The relationship between the three elements of consumer confidence is illustrated in Figure 1. Consumer confidence occurs when the regulatory system, redress mechanisms and financial capability combine to create a well-functioning market. The regulatory system establishes the market rules and institutions, including reinforcing institutional capability and financial strength, and, together with consumers' financial capability, shapes consumers' expectations of the transaction. The dispute resolution system provides access to redress if the consumers' expectations of the transaction are not met. The dispute resolution system also sets out rules and institutions which promote consumer confidence.

18. The purpose of dispute resolution is to provide an avenue for complaints in order to, if appropriate, compensate consumers who have suffered a loss as a result of the behaviour of a trader. Enforcement is a separate issue. Enforcement concerns ensuring that the rules of the regulatory system are followed, irrespective of any actual loss suffered by a consumer. Effective enforcement promotes consumer confidence in the market rules and institutions of the overall regulatory system.

19. This paper concerns dispute resolution mechanisms. Enforcement of regulatory arrangements are discussed, where relevant, in other RFPP discussion documents.

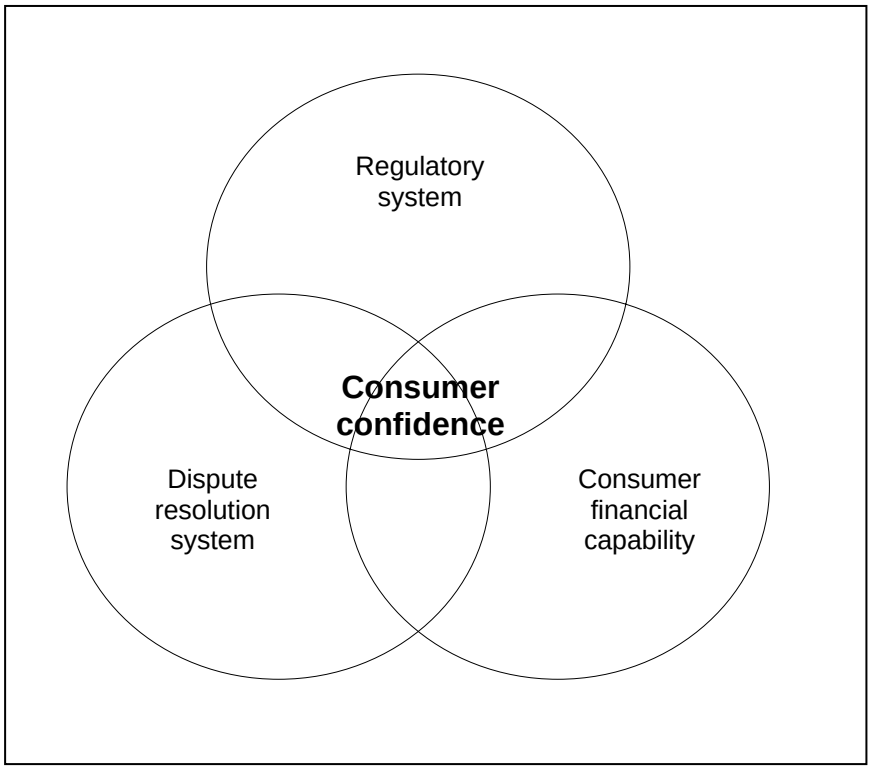

Figure 1: Consumer confidence in financial markets

3.2 COMPETITION AND MARKET INCENTIVES

20. Consumer protection provisions, such as those contained in the Fair Trading Act 1986 and the Consumer Guarantees Act, support the promotion of competitive markets by setting out rules which firms must follow in supplying products and services to consumers, including the advertising of those products and services.

21. Competition provides incentives for firms to be responsive to their customers needs and behave in a way that is fair and reasonable. It is important the dispute resolution and redress mechanisms support the incentives inherent in competitive markets. By providing compensation to consumers when those rules are broken, dispute resolution and redress mechanisms hold firms accountable for the promises they make. This protects consumers from unfair business practices, as well as protecting honest businesses from unfair competition.

22. As well as external dispute resolution mechanisms, internal complaints handling procedures are also an essential element of good customer service. By ensuring customers have an avenue for having their concerns heard, a business will promote confidence in that firm, and in the market as a whole. Effective internal complaints handling can also allow the speedy and efficient management of issues before they become major problems. This benefits both the consumer and the firm.

23. The Ministry of Consumer Affairs has published a guide for businesses on *Handling Customer Complaints*.[2] This publication contains some simple guidelines to help business owners and managers establish their own policies and systems to resolve consumer complaints effectively.

3.3 RESILIENCE AND MARKET STABILITY

24. Dispute resolution is also important in contributing to the objective of maintaining the resilience and stability of the financial system. Dispute resolution, especially when accompanied by effective monitoring, can provide an early indication of potential instability of a firm. For example, an increase in the number/extent/type of complaints against a firm by its customers may indicate that the firm is potentially experiencing difficulties or is unstable.

3.4 EVALUATION CRITERIA

25. The overarching objectives of this project are to promote consumer confidence in the financial sector, reinforce market incentives for financial providers, and maintain resilience and stability of financial markets. To assist in assessing the options against these policy objectives, the following evaluation criteria have been developed.

- **Accessibility**. Dispute resolution and redress mechanisms should promote consumer awareness of rights and responsibilities, and facilitate consumer access to redress. Access to redress should be available across all sectors of the financial industry.

- **Independence and fairness**. Consumers and financial providers should have confidence that dispute resolution and redress mechanisms will make decisions in an unbiased manner. Decisions will be complied with and enforced. Governance arrangements will promote accountability.

- **Market incentives**. Dispute resolution and redress mechanisms must reinforce and not undermine market incentives for firms to behave in a fair and reasonable manner towards their customers. Dispute resolution and redress mechanisms should not inhibit competition between firms. Dispute resolution and redress mechanisms should be designed so as to encourage industry commitment to their success.

- **Cost effective**. The regulatory framework for dispute resolution and redress mechanisms should be targeted to well-defined objectives and go no further than meeting those objectives; in particular, the regulatory framework should aim to minimise compliance and transaction costs, including identification and analysis as to who bears the costs and the impact of those costs.

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[2] *Handling Customer Complaints*, Ministry of Consumer Affairs, April 2004, www.consumeraffairs.govt.nz/businessinfo/serviceandcomplaints.html

- **Flexibility**. Dispute resolution and redress mechanisms should be sufficiently flexible to let firms, markets and products innovate and move with technological change.

- **Transparency**. The regulatory framework for dispute resolution and redress should be clearly understood by all stakeholders (industry, consumers and government) so that well-informed decisions can be made.

- **Reduce regulatory arbitrage**. Dispute resolution and redress mechanisms should not create incentives for providers to structure products or services solely to take advantage of favourable regulatory treatment.

- **Systemic overview**. Dispute resolution and redress mechanisms should facilitate the identification of issues which may pose risks to the resilience or stability of financial markets.

26. Appendix 2 provides an analysis of the proposed options against the evaluation criteria.

4. EXISTING REGIME FOR DISPUTE RESOLUTION AND REDRESS

27. This section examines the existing regime for consumer dispute resolution in the financial sector, looking at consumer experiences of financial providers and the effectiveness of existing dispute resolution and redress mechanisms.

4.1 CONSUMER EXPERIENCES OF FINANCIAL PROVIDERS

4.1.1 National Consumer Survey on Awareness and Experience of Consumer Legislation

28. In 2005, the Ministry of Consumer Affairs conducted a survey of consumers to understand their experiences of various goods and services.[3] The survey asked about situations where they had been misled, treated unfairly or supplied substandard or unsafe products. It also covered consumers' responses to such treatment, including questions about whether the situation was satisfactorily resolved and where they would go to seek help.

29. It should be noted that the survey questioned respondents on their perception of their experiences, rather than undertake an objective assessment of whether the supplier's behaviour was illegal. However, perceptions and expectations are relevant in shaping the degree of confidence in the market.

30. The survey asked questions about four different financial products/situations:

- When you claimed insurance, for example interpretation of the terms or value of damage;
- When you used a finance company (not a bank) to get a private loan, e.g. what they led you to understand about the fees, security or repayments;
- The risk or returns on an investment scheme or savings scheme being different from what you were led to understand; and
- The terms, charges or actions of your bank.

31. It should also be noted that the survey was not a comprehensive study of consumers' attitudes towards all types of financial product or providers. Comments are invited from stakeholders on the nature and magnitude of consumer problems in particular financial markets.

[3] National Research Bureau Ltd, *National Consumer Survey on Awareness and Experience of Consumer Legislation*, October 2005, www.consumeraffairs.govt.nz/policylawresearch/research/awareness/nrb/index.html

32. The survey results indicate that around one in eight consumers who purchased a specified non-bank financial product perceived they had experienced a problem relating to misleading or unfair treatment or substandard product. The survey reported that 14 percent of insurance consumers experienced dissatisfaction when making a claim, 15 percent of customers of finance companies experienced problems, and 11 percent of consumers who invested in an investment or savings scheme experienced risk or returns different from what they were led to understand. Adverse consumer experiences were greater in the banking sector, with 24 percent of consumers reporting an adverse experience with their bank.

33. As well as consumers' experiences, the survey also questioned consumers on their expectations that they would encounter a situation where they were misled, unfairly treated, or supplied substandard or unsafe product. One third of respondents expected that such events would never happen, and a further third expect only one in any year. The average expected number of adverse events is 1.4 in any given year. Note that this figure concerns all consumer transactions, not just financial transactions.

34. In the context of all consumer transactions entered into over the course of a year, this low level of expected problems suggests that on the whole people have confidence in the New Zealand market environment. The fact that the level of expected adverse events is lower than the actual experience of adverse events is perhaps a reflection of consumers' expectations that firms will deal responsively with consumer complaints.

35. The survey also questioned whether the problems experienced by consumers were satisfactorily resolved by the supplier. Insurance companies and banks were most responsive to consumer complaints, with 45 percent and 44 percent respectively responding by doing most of what the consumer felt was fair in the circumstances. Only 33 percent of finance companies and 31 percent of investment or savings schemes satisfactorily responded to the consumer complaint.

36. These results show that in over half the situations where consumers experience a problem with a financial service, it was unable to be satisfactorily resolved between the consumer and the supplier. This indicates that further work may be needed to improve consumer confidence in their use of financial services.

37. The survey also reported that up to a quarter of consumers of financial products simply put up with misleading or unfair treatment (28% of investment or savings scheme customers, 23% of bank customers, 17% of finance company borrowers and 12% of insurance claimants). The survey did not delve deeper into the reasons consumers walked away, such as whether this shows a lack of confidence in consumers' ability to obtain redress or a lack of awareness of avenues for resolving the dispute.

4.1.2 Task Force on Financial Intermediaries Initial Questionnaire

38. In its review of the regulation of financial intermediaries, the Task Force on Financial Intermediaries also conducted a consumer survey.[4] The questionnaire was not a statistical survey, but does illustrate some common issues and concerns. The questionnaire revealed that, in the past five years, 30 percent of consumers had thought about making a complaint about a financial intermediary. However, 33 percent of those consumers did not actually make the complaint. Common reasons given by consumers for not making the complaint included "did not know who to complain to", "did not think it would make a difference", and "couldn't be bothered".

39. The questionnaire did not ask for details of specific complaints, so it is difficult to quantify the extent of the consumer detriment. However, the survey does provide support for the notion that there is a problem with consumer access to effective dispute resolution in the financial intermediaries sector.

4.2 CONSUMER ACCESS TO DISPUTE RESOLUTION AND REDRESS

40. Under the existing regulatory regime, dispute resolution mechanisms and access to redress differ for consumers depending on the type of financial institution they are dealing with. There are two main industry-based dispute resolution bodies in the financial sector, the Banking Ombudsman (BO) and the Insurance & Savings Ombudsman (ISO). Membership of these bodies is voluntary; however, it is worth noting that these schemes' members cover a significant part of the financial industry. The New Zealand financial sector is dominated by banks, managed funds and insurance companies, accounting for 95 percent of total assets held.[5] The majority of these financial institutions are members of one of the existing schemes. Comparable statistics on the number of customers who are currently able to access industry-based dispute resolution schemes are not available; however, it is likely that these schemes cover a vast majority of the financial industry.

41. The main gaps in the financial sector where consumers do not have access to industry-based dispute resolution include finance companies, building societies, credit unions, financial intermediaries and some superannuation schemes. Customers of these financial institutions must resort to the court system to obtain redress.

42. While the court system (including the Disputes Tribunal) generally works well for most types of consumer disputes, it does have some disadvantages in the case of financial services. For example, the time, cost and complexity of initiating court action may dissuade some consumers from standing up for their rights. The Disputes

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[4] Task Force on Financial Intermediaries Initial Questionnaire, www.med.govt.nz/templates/Page____7813.aspx

[5] Review of the regulation and performance of New Zealand's major financial institutions, www.rbnz.govt.nz/finstab/banking/supervision/1498932.html

Tribunal addresses these issues of cost and complexity; however, the monetary limit of $7,500 (or $12,000 with the agreement of the parties) for Disputes Tribunal claims will exclude many financial disputes.

4.3 EFFECTIVENESS OF EXISTING INDUSTRY-BASED DISPUTE RESOLUTION SCHEMES

43. Recent reviews of the BO and ISO have shown that these schemes provide effective access to redress for consumers.

44. The 2006 independent review of the Banking Ombudsman scheme concluded that "the scheme is a sound one, which has operated successfully in the New Zealand context for a number of years, coming to be respected by both consumers and the banking community".[6]

45. While the Banking Ombudsman and the ISO provide effective redress mechanisms for those complaints which fall within their terms of reference, problems of inadequate coverage have been raised in relation to the ISO.[7] For example, the ISO terms of reference prevent the hearing of complaints relating to group or employer superannuation schemes.

46. It should be noted that the existing schemes deal with a relatively small number of complaints, with the ISO receiving 168 complaints and the BO 150 for 2004/05.

4.4 NEED FOR GOVERNMENT INTERVENTION

47. BO and ISO member firms currently encompass the vast majority of the financial sector. The fact that these firms have voluntarily chosen to establish industry-based dispute resolution shows a commitment to customer service and improving standards in those sectors. As noted, however, not all sectors have established consumer dispute resolution schemes. It is likely that the absence of effective dispute resolution in these sectors is having a detrimental effect on consumer confidence. For example, the Task Force on Financial Intermediaries found that effective and comprehensive dispute resolution procedures are crucial to promoting consumer confidence in the financial intermediary industry.

48. As the RFPP will involve major changes to the regulatory system for many industry groups, it is possible that this may serve as a catalyst for them to develop dispute resolution schemes. For example, under the proposed changes to the regulation of financial intermediaries, an industry group which becomes an Approved Professional Body may adopt procedures for resolving disputes between member firms and consumers or the sector may develop its own ombudsman scheme. However, it is important to ensure that the procedures and governance arrangements

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[6] Anand Satyanand, *Independent Review of the New Zealand Banking Ombudsman Scheme*, March 2006, www.bankombudsman.org.nz/documents/bank-ombudsman-review.pdf

[7] Review of the Insurance and Savings Ombudsman Scheme, March 2003, www.iombudsman.org.nz/pdfs/2003_ISO_review.pdf

adopted will be sufficiently independent or accountable so as to improve consumer confidence in the market. Therefore legislative backing or government endorsement may be needed to ensure consumer confidence in the system.

49. The existing schemes have generated a high level of commitment from their member firms. It will be important that any government intervention builds on the goodwill and industry commitment currently engendered through the existing schemes.

Questions for Submission

1. What are the types of problems currently experienced by consumers in the financial sector? What problems do consumers experience in obtaining redress from financial providers?

2. Are the gaps in the current dispute resolution system inhibiting consumers' access to redress and affecting consumer confidence?

3. Is there a need for government intervention to promote consumer confidence in financial sector dispute resolution and redress? What is the appropriate role for government?

4. What effect will other regulatory changes proposed under the Review of Financial Products and Providers have on consumers' access to redress? Do these changes support greater or lesser government intervention with respect to dispute resolution and redress?

5. OPTIONS

50. This discussion document identifies several options for improving the dispute resolution and redress mechanisms so as to promote consumer confidence in the financial sector, reinforce market incentives for financial providers, and maintain resilience and stability of financial markets. These options are:

- Status quo (voluntary industry-based dispute resolution schemes)
- Consumer education and information
- Enhanced civil remedies and courts
- Mandatory industry-based dispute resolution system, comprised of either:
  - Multiple dispute resolution schemes
  - Multiple schemes with shared resources
  - A single dispute resolution scheme.

5.1 OPTION 1: STATUS QUO

51. As noted, at present some sectors of the financial industry have established voluntary industry-based dispute resolution schemes. There are two main industry-based dispute resolution bodies in the financial sector, the Banking Ombudsman (BO) and the Insurance & Savings Ombudsman (ISO). Membership of these bodies is voluntary; however, it is worth noting that these schemes' members cover a significant part of the financial industry.

52. Customers of firms which are not members of either the BO or ISO must resort to the court system to obtain redress. The court system (including the Disputes Tribunal) generally works well for most types of consumer disputes, however, it does have some disadvantages in the case of financial services. For example, the time, cost and complexity of initiating court action may dissuade some consumers from standing up for their rights.

53. The Disputes Tribunal goes some way to addressing these issues of cost and complexity through simplified procedures. However access to the Disputes Tribunal is limited by the monetary limit of $7,500 (or $12,000 with the agreement of the parties), which will exclude many financial disputes.

54. While the BO and ISO have been very effective in improving consumer confidence in those sectors through the resolution of consumer complaints, the current system of voluntary schemes does not provide full coverage across the financial system. Gaps in coverage do not help address problems of consumer confusion as to where to go to seek redress, potentially creating negative perceptions across financial providers, although to date this has not happened. In addition, the voluntary nature of the schemes mean that decisions lack binding force, as firms may withdraw if subject to adverse decisions.

55. Voluntary schemes have the advantage of being less restrictive in a regulatory sense. They provide a competitive advantage for firms and sectors who wish to differentiate themselves on the basis of superior customer service. However, this may not be effective in raising standards if consumers lack the capability to make informed decisions.

56. One of the objectives of the Review of Financial Products and Providers is to reduce regulatory arbitrage. This means that all parts of the financial system should be subjected to equivalent regulatory protections, so that regulation does not create incentives for firms to structure products solely to take advantage of favourable regulatory treatment. A system of voluntary schemes with patchy coverage will not provide equal access to redress across the whole financial system. In addition, where a voluntary dispute resolution scheme forms a closed club, this may inhibit the entry of new firms in the market.

57. Voluntary schemes may not be as effective in enabling a systemic overview. Their private nature may raise issues about the quality of data they provide, and the various schemes may provide inconsistent or non-comparable data.

58. The status quo approach may improve coverage of dispute resolution over time, as redress mechanisms may arise voluntarily. For example, as the RFPP will involve major changes to the regulatory system for many industry groups, it is possible that this may serve as a catalyst for them to develop dispute resolution schemes. However, there is no guarantee that the procedures and governance arrangements adopted will be sufficiently independent or accountable so as to improve consumer confidence in the market. Therefore, the status quo cannot be relied on to ensure consumer confidence in the system.

59. This option also has fewest costs for industry. The fact that some sectors have voluntarily established dispute resolution schemes suggests that those sectors have found that the benefits outweigh the costs.

60. This option has the fewest costs for government. Since the government is not involved in funding the voluntary industry-based schemes, no costs are incurred by government. The government incurs costs in operating the court system.

61. As mentioned previously in this paper, consumers currently experience costs in respect of inadequate access to redress, particularly in relation to those sectors for which an industry-based dispute resolution scheme does not exist. This potentially creates a lack of confidence in the financial sector as a whole.

Question for Submission

5. Do you think the current framework of voluntary dispute resolution schemes works well? Do you think it could be improved? How should the gaps be addressed?

5.2 OPTION 2: CONSUMER EDUCATION AND INFORMATION

62. This option retains the current system of voluntary schemes, and includes improvements to consumer education and information. This could be delivered either by government or by industry (or a combination).

63. As consumers become better educated and more financially capable, they will make better decisions in choosing products which meet their needs and expectations. This will lead to a reduction in disputes. Education will also lead to better awareness by consumers of their rights and responsibilities, thus improving confidence in the financial system.

64. However, while consumer education should lead to consumers making better decisions and thus to a reduction in the number of disputes, it will be impossible to completely eliminate all disputes. For example, there will likely still be instances of maladministration or misrepresentation (whether deliberate or inadvertent). In these circumstances, it will still be necessary for consumers to have an avenue for resolving disputes. This option does not address the problems of access to redress described earlier in this paper.

65. This option is not incompatible with the other options presented in this discussion document. As discussed earlier, capability is an integral part of consumer confidence. However, the question is whether improved financial capability is sufficient, in the absence of other improvements to redress mechanisms, to improve consumer confidence in the financial sector. Information and education are better thought of as having a longer term effect, rather than being capable of achieving immediate improvements in consumer confidence.

66. As well as addressing consumer financial capability, education and information programmes could also be aimed at financial providers as a means of raising their awareness of consumer law and the duties they have as providers of financial services.

67. A fine line distinguishes financial education/information from product disclosure. General education/information is intended to improve the financial capability of consumers. This means that consumers can make better decisions as to what type of product is best for them. Product disclosure provides specific information about the actual product being contemplated by a consumer. Disclosure obligations are intended to inform consumers about the actual product so the consumer can make a decision between competing products. However, product disclosure will also have a general education component to some extent, in that consumers' financial capability will improve as they become exposed to a range of financial products.

68. The financial sector consists of a large number of providers offering a wide range of products. If the obligation to provide consumer education falls on industry, firms will have an incentive to focus their education/information efforts on information specific to the products they offer. This will not assist consumers in making choices between competing products and suppliers or whether a product meets their return and risk needs. As well, given the disparity in interests among the various financial

providers, it would be difficult to obtain voluntary agreement from firms on the content or style of consumer education programmes needed.

69. Therefore, requiring individual firms to deliver consumer financial education programmes does not seem a feasible option. As financial information and education has some public good characteristics, under this option financial education programmes should be delivered or coordinated by government. A number of financial education programmes currently operate in New Zealand, including the Retirement Commission's Sorted, as well as work by the Securities Commission through their enforcement and compliance role.

70. If consumer education is coupled with data capture about consumer problems, this may help provide a systemic overview. However, there are currently no easily available means to obtain such data and it would be costly to establish.

71. It is difficult to quantify the benefits for consumers of improved consumer education, although it should be noted that the benefits will not be evenly distributed across all consumers. Education and information will have a proportionately bigger benefit for those consumers who have better ability to make use of information in their financial decisions, as well as those consumers who have access to a wide range of options in choosing financial products or providers. However, this option will not prevent those disputes arising out of maladministration or misrepresentation by firms.

72. On the one hand, it can be argued that by reducing the number of disputes between consumers and financial providers, this option will have benefits for government by reducing the number of cases brought through the Disputes Tribunal and courts. On the other hand, given the current low level of consumer awareness and use of the Disputes Tribunal, further consumer education may encourage consumers to make use of the Disputes Tribunal, thus increasing costs to government.

73. Compared with the status quo, this option involves additional costs in developing and delivering consumer financial education programmes. These costs could be borne either by government or funded through industry levies or licence fees. If costs are charged to financial providers as licence fees, they will be passed through to consumers.

Question for Submission

6. Would more consumer education and information sufficiently address the concerns with the status quo approach to consumer dispute resolution? Who should be responsible for such consumer education and information and its funding?

5.3 OPTION 3: ENHANCED CIVIL REMEDIES AND COURTS

74. Under this system, the current court system would be enhanced to enable better resolution of financial disputes.

75. While the court system (including the Disputes Tribunal) generally works well for most types of consumer disputes, it does have some disadvantages in the case of financial services. Cost and complexity may dissuade some consumers from initiating court action. These disadvantages were identified by the Financial Intermediaries Task Force[8], and include: evidential difficulties, particularly where advice or recommendations are given orally, and the factual background is complex; difficulties in establishing and/or quantifying loss, particularly where other factors, such as market fluctuations, have contributed to loss; disputes often focus on a highly specialised area of knowledge; and limitation issues – it may take a significant amount of time for problems with financial advice and information to become evident, so that claims may fall outside limitation periods.

76. The Disputes Tribunal addresses some of these issues of cost and complexity; however, the monetary limit of $7,500 (or $12,000 with the agreement of the parties) for Disputes Tribunal claims will exclude many financial disputes.

77. An option may be the establishment of a special branch of the Disputes Tribunal to consider consumer finance disputes. This could be similar to the approach under the Motor Vehicle Sales Act, which established the Motor Vehicle Disputes Tribunal.

78. Specialist tribunals allow the accumulation of specialist expertise in considering the types of problems particular to that industry. This will often lead to greater consistency in decisions. A special tribunal would also be able to have jurisdictional limits that better fit the industry. For example, it may be appropriate to have a monetary limit of up to $200,000 for matters taken to a consumer finance tribunal. However, as it would still be part of the court system, a specialist tribunal would still face the same problems currently experienced by courts, such as evidential difficulties and time limitations.

79. The advantage of a court-based dispute resolution system lies in the binding nature of court decisions and the general gravitas associated with court proceedings. However, statutory backing of an industry-based dispute resolution system could also have the same effect.

80. A disadvantage of this option is that the establishment of a new court is a government-led approach. It is questionable whether this option would generate industry commitment and incentives for firms to improve their approach to customer service.

81. This option would involve significant costs to government in establishing a new branch of the Disputes Tribunal. It is expected that this would increase the number of

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[8] Financial Intermediaries Task Force, *Confidence, Change and Opportunity: Final Report of the Task Force on Financial Intermediaries*, July 2005, www.med.govt.nz/templates/MultipageDocumentTOC____13788.aspx, page 24

consumers taking court action and, while there would be a drop in the number of District Court cases as these claims could be heard in the new tribunal, there is likely to be a net increase in the costs for government in operating the court system.

82. Under this option there would be no costs to industry in establishing the new tribunal. It is expected that simplifying consumer access to a dispute resolution mechanism will result in an increase in consumers seeking redress, and this will mean increased costs for industry.

83. There will be some benefits to consumers under this option as it will enable consumers to take disputes to the Disputes Tribunal rather than the District Court. This will make dispute resolution easier and probably increase the number of complaints made by consumers. This option would retain existing Disputes Tribunal processes, such as a $50 filing fee.

Question for Submission

7. How do the advantages and disadvantages/costs and benefits of enhanced civil remedies and improvements to the court system for consumer dispute resolution weigh against the status quo?

5.4 OPTION 4: INDUSTRY-BASED DISPUTE RESOLUTION SYSTEM

84. Unlike the status quo, this option would require all financial providers to participate in an industry-based dispute resolution system. Mandatory participation ensures that consumers have confidence in dealing with all firms across the financial industry.

85. Many other countries, including Australia[9], United Kingdom[10] and Ireland[11], have established regulatory requirements for mandatory participation by financial providers in an industry-funded, industry-based dispute resolution system.

86. Industry-based dispute resolution schemes provide an effective alternative to court action. The involvement of industry participants in the operation of the dispute resolution body encourages the adoption of customer service-oriented attitudes. Unlike the regular court system (or a new court such as a consumer finance Disputes Tribunal discussed in the previous option), an industry-based dispute resolution body can adopt practices which suit consumers and firms in that industry, such as an informal and inquisitorial style rather than a formal and adversarial style. This could

[9] See Australian Securities & Investments Commission, www.asic.gov.au/asic/asic_polprac.nsf/byheadline/Complaints+resolution+schemes?openDocument

[10] Financial Ombudsman Service, www.financial-ombudsman.org.uk

[11] Financial Services Ombudsman, www.financialombudsman.ie

allow, for example, an approach involving a survey of standard business practices, which would not be possible under a court process.

87. Participation would be mandated through licensing requirements. That is, legislation would provide that participation in the dispute resolution system is a required condition for obtaining a licence for financial providers who are required to obtain a licence. Registration of financial providers is discussed in the RFPP discussion document *Overview of the Review and Registration of Financial Institutions*.

88. Mandatory participation is recommended under this option because of the desire to have consistent regulatory treatment across all sectors of the financial industry. As mentioned earlier, some sectors have already established voluntary industry-based dispute resolution schemes, and this shows a commitment to consumer confidence and improving standards in those sectors. The absence of effective dispute resolution in other sectors is likely to be having a detrimental effect on consumer confidence.

89. As the RFPP will involve major changes to the regulatory system for many industry groups, it is possible that this may serve as a catalyst for them to voluntarily develop dispute resolution schemes. However, there is no guarantee that the procedures and governance arrangements adopted will be sufficiently independent or accountable so as to improve consumer confidence in the market. Therefore legislative backing or government endorsement may be needed to ensure consumer confidence in the system.

90. The existing schemes have continued to be successful because of the high level of commitment from their member firms. The decline in numbers of complaints over the years following the establishment of these schemes shows that member firms have become better at handling customer complaints internally. It will be important that any government intervention builds on the goodwill and industry commitment currently engendered through the existing schemes.

91. This discussion document proposes three options for the structure of an industry-based dispute resolution system: a system of multiple dispute resolution bodies; multiple bodies with some shared resources; or a single scheme covering the entire financial industry. These options are discussed further below (Options 4A, 4B and 4C).

Question for Submission

8. Should participation in an industry-based dispute resolution system be mandatory or voluntary for financial providers?

92. The following points relate to industry-based dispute resolution generally. Later in this paper are specific points relating to each option.

5.4.1 Funding

93. The general principle of industry-based dispute resolution schemes is that they are funded primarily by industry. This is because the benefits of the scheme, in terms of increased confidence and willingness of consumers to transact in financial markets, flow through to firms. This could be through, for example, an annual fee attached to registration and/or case levies based on the number of complaints made against a firm.

94. Industry funding provides an incentive for firms to become more responsive to consumer concerns so as to reduce the number of disputes they have with consumers. For example, many disputes arise because consumers do not understand the information provided to them by firms at the beginning of a transaction. If firms are required to pay the full cost of resolving a dispute, they will be incentivised to pay closer attention to the level and accuracy of information they provide to consumers.

95. Industry funding also provides incentives for the industry itself to weed out rogue traders who would otherwise "free ride" on the system.

96. Specific issues relating to funding are discussed further under Options 4A, 4B and 4C below.

Question for Submission

9. How should an industry-based dispute resolution system be funded?

5.4.2 Jurisdiction and Scope

97. The jurisdiction and scope of the proposed mandatory industry-based dispute resolution system under this option must be targeted to achieving the specific objectives of promoting consumer confidence, reinforcing market incentives for financial providers, and maintaining resilience and stability of financial markets.

98. The issues below discuss minimum standards only – the industry (or particular sectors) may voluntarily choose to accept higher standards to promote confidence.

5.4.2.1 Who Can Lodge a Complaint

99. As with the BO and ISO schemes, adjudication would be expected to occur where a customer and their financial service provider have reached a deadlock through their initial attempts to reach a solution over a dispute. Where a complainant to the dispute service has not initially engaged with their financial service provider, the dispute service should refer the complainant to the service provider to address the complaint in the first instance.

100. The customer who brings a complaint to the dispute service should already have, or have had, some form of prior existing relationship with the service provider they are making a complaint about, such as ongoing fund management, advice provision or insurance arrangement. This includes customers who have had their

bona fide relationship with a service provider cut in some fashion, such as a wrongfully discontinued insurance coverage dispute.

101. An objective of this project is to promote consumer/investor confidence in financial markets. This means that it is aimed at providing reassurance to those people who do not have the knowledge, experience or resources to allow them feel confident enough to bring forward a complaint against a financial service provider of their own accord. A consumer who knows they will be listened to and receive a fair hearing will feel such confidence.

102. Therefore, it will be important to establish a definition of "consumer". Under the Consumer Guarantees Act a consumer is defined as a person who acquires goods or services of a kind ordinarily acquired for personal, domestic or household use or consumption. The Securities Act concept of "offering to the public" may also be relevant in defining a consumer.

103. A monetary limit may also be appropriate in screening out those consumers who, because of their wealth, are able to adequately seek redress elsewhere. Monetary limits are commonly used in other dispute resolution systems. For example, the current Banking Ombudsman and ISO have monetary limits of $120,000[12] and $150,000 respectively.

104. Comments are invited on whether these guidelines should fix a monetary limit, either in dollar terms or by reference to an independent index (such as the median house price). Alternatively, it could be left for the scheme itself to determine a monetary limit, depending on the type of members it has and disputes it hears.

Question for Submission

10. What is the appropriate definition of "consumer" for the purpose of determining access to the dispute resolution system?

5.4.2.2 Types of Complaints

105. The level of fees and charges and the exercise of commercial judgement (for example whether and on what terms the financial institution accepts a particular person as a customer) go to the heart of an open, dynamic, competitive market.

106. The commercial judgments of a financial service provider should be its to make alone. The provider is in commerce and so has every incentive to make the best decisions. This includes an assessment of risk, and decisions to implement procedures for setting charges or payment processes.

107. Since investment performance can fluctuate for reasons beyond a firm's control, the scope of the dispute resolution system should not include the performance of an

[12] Note the recommendation of the March 2006 independent review of the Banking Ombudsman scheme to raise limit to $200,000.

investment. However, the scheme should be allowed to consider a complaint that the firm misled the consumer or failed to take into account the consumer's risk preferences, or has failed to properly administer the investment.

Question for Submission

11. What type of cases should be within the scope of an industry-based dispute resolution system?

5.4.2.3 Non-Regulated Products or Providers

108. As mentioned above, the dispute resolution system would have mandatory effect through licensing/registration requirements. Therefore, the scope of the dispute resolution system should mirror the scope of the licensing/registration requirements. That is, products or services for which a licence is not required would not be subject to dispute resolution arrangements.

109. It is acknowledged that this may cause confusion for some consumers if a firm does not voluntarily choose to be subject to dispute resolution arrangements in relation to non-regulated products. Note that the scope of the system outlined above is a minimum standard only, and firms may choose to submit to an extended voluntary jurisdiction.

110. At the moment, the main financial product which is beyond the proposed scope of the dispute resolution arrangements is credit/lending activities. The regulatory regime for consumer credit was recently reformed by the Credit Contracts and Consumer Finance Act 2003 (CCCFA), which came into force in 2005. The CCCFA adopted a "negative licensing" approach, rather than requiring registration of credit providers. The Ministry of Consumer Affairs is currently monitoring the implementation of the CCCFA, and will report on this in 2007. Options for registration of credit providers may be considered at that time.

Question for Submission

12. Which financial products or providers are outside the proposed scope of the dispute resolution system? Should mandatory participation extend to these products and/or providers?

5.4.3 Costs and Benefits

111. While it is difficult to quantify the costs and benefits of the proposal, it is clear that substantial costs will be incurred by firms, whether directly through the costs of disputes or through financing the cost of the dispute resolution system.

112. The benefits will accrue mainly to consumers, although firms will also benefit through lower litigation costs.

113. The financial industry, and the economy more widely, will also benefit from greater consumer/investor participation in financial markets as a result of enhanced confidence.

5.4.3.1 Costs and Benefits for Financial Providers

114. It is anticipated that financial providers would incur three types of costs:

- Transitional costs
- Internal costs incurred in responding to complaints through the dispute resolution body
- Membership fees levied by the dispute resolution body – whether fees are levied on a "per case" basis or consist of a general membership levy.

115. It is difficult to estimate internal costs for financial providers, as no figures are publicly available. A study in the United Kingdom indicated that these costs ranged between GBP50 and GBP1700, depending on the size of firm and the type and volume of business it does.[13] Comments (on a confidential basis if requested) from financial providers are welcomed to help illuminate this issue.

116. This option does not impose additional costs for firms' internal costs incurred in responding to complaints through the dispute resolution body. These costs would be incurred by the firm regardless of the form of dispute resolution. For example, the firm would face the same costs in defending an action in the courts or Disputes Tribunal. Firms may experience increased costs if, as expected, this option would result in an increase in complaints from consumers who would otherwise have been reluctant to complain through the courts or Disputes Tribunal. Improving ease of access to dispute resolution will undoubtedly increase the number of consumers seeking redress. This may be thought to also lead to an increase in frivolous or vexatious complaints, however the experience of existing schemes has generally been that these complaints can be weeded out quite easily.

117. The current BO and ISO operate on budgets of approximately $1.2m and $1m respectively. As mentioned earlier, members of these schemes account for around 95 percent of the size of the New Zealand financial industry. It is expected there may be a large initial increase in additional complaints as a result of the expanded coverage of the dispute resolution system; however, these numbers should drop over time.

118. While it is difficult to quantify the expected costs and benefits of industry-based dispute resolution for financial providers, the fact that the banking, insurance and savings sectors have voluntarily established dispute resolution schemes suggests that those sectors have found the benefits outweigh the costs. Other sectors, such as financial intermediaries, have not voluntarily established such regimes; however, this

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[13] Financial Ombudsman Service, *Complaints handling arrangements: feedback statement on CP33 and draft rules*, May 2000, www.fsa.gov.uk/pubs/cp/cp49.pdf, page 51

may be because these sectors are more fragmented and difficult to reach industry-wide consensus than banking or insurance.

5.4.3.2 Costs and Benefits for Consumers

119. While the establishment of an industry-based dispute resolution mechanism would not impose any direct costs on consumers, it is likely that any additional costs to financial providers would be passed through to consumers.

120. As mentioned at the start of this discussion document, access to redress is one of the three elements of consumer confidence. Therefore, it is essential that the dispute resolution system does not create barriers to consumers making complaints to the scheme.

121. Virtually all existing industry-based dispute resolution schemes are free of charge to consumers. Schemes also put very few formal obstacles in the way of consumers seeking to use their services. For example, most schemes allow consumers to make contact by telephone or through the internet.

122. The ease of access to current industry-based dispute resolution schemes can be contrasted with the court system, where consumers must pay a fee to lodge a claim. The official forms for lodging claims can also be confusing and intimidating for some consumers.

123. The industry-based dispute resolution option would involve considerable benefits for consumers. For example, a free complaints service would enable consumers to obtain redress for small-value claims, as they would otherwise put up with the problem rather than commence court action. This is especially beneficial to low-income consumers. An informal dispute resolution style, in conjunction with an awareness-raising campaign, would encourage consumers to make complaints. It is difficult to quantify the detriment currently suffered by consumers as a result of inability to access redress.

124. An increase in the number of consumer complaints would indicate an increasing degree of consumer sophistication. This has flow-on benefits for financial providers and the community in improving service standards in the industry.

5.4.3.3 Costs and Benefits for Government

125. There would be few costs to government under this option. While some costs would be incurred in monitoring the dispute resolution system, this would ordinarily be incurred anyway as part of the normal government oversight function.

126. Costs and benefits of each option (multiple schemes, multiple schemes with shared resources, and a single scheme) are further discussed below.

Questions for Submission

13. What are the advantages and disadvantages of an industry-based dispute resolution system? What are the costs and benefits?

14. What is the appropriate form of an industry-based dispute resolution system, i.e.

multiple schemes, multiple schemes with shared resources, or a single scheme?

5.5 OPTION 4A: MULTIPLE INDUSTRY-BASED DISPUTE RESOLUTION SCHEMES

127. Under this option, all financial providers would be required to join a dispute resolution body, however, they would be free to join any suitable scheme. It is likely that schemes would be established on a sectoral basis, although there would be no regulatory impediments to the breadth or coverage of each scheme. It would be up to each scheme (and its members) to decide on the appropriate membership for that scheme.

128. The main advantage of this approach is that sectoral schemes would allow the development of a body of specialist expertise particular to that sector. This would have the advantage of promoting more efficient resolution of disputes. This option would also leverage off the goodwill and strong commitment currently existing in the BO and ISO and their members.

129. Industry cohesiveness is an important ingredient in developing an effective industry-led regulatory scheme. Where members of a scheme have common interests and objectives they will be better able to establish an efficient and workable industry-led scheme. This creates incentives for members to adopt sound practices so as to keep costs low. It is also expected that a sectoral approach will help promote industry commitment to a scheme, as all scheme members have interests in common which are not shared with non-members.

130. A sectoral approach means that the various schemes can adopt rules and practices which are appropriate to that sector. For example, the types of consumer complaints may be more complex for some sectors than others, with resulting higher costs for operating a dispute resolution scheme. A sectoral approach enables appropriate costs to be borne by the relevant firms and industry sectors.

131. It is possible that under this option a particular firm may find it difficult to obtain membership of any scheme. For example, the existing members of a scheme may put up barriers to entry in order to retain their “closed club”, and refuse to accept new members into the scheme.

132. Rejection of membership may also be the case if a firm has a history of bad behaviour. This will act as an incentive for firms to improve their complaints handling. It is not proposed that the government establish a “default” scheme for firms which are unable to obtain membership of a scheme. It is also not proposed to force existing schemes to accept new members. The forced acceptance of new members is unlikely to enhance the cohesiveness of the scheme.

Question for Submission

15. What are the advantages and disadvantages of a mandatory system of multiple industry-based dispute resolution schemes?

133. This option raises some questions regarding access to redress for consumers. A plethora of schemes may confuse consumers into not knowing which scheme to lodge a complaint with. This is especially the case if there are multiple financial providers involved in a particular transaction with a consumer.

134. As well as access in lodging a complaint, this option may also raise problems with regard to potentially inconsistent decisions of multiple schemes. For example, if a consumer complaint involves firms which are members of different dispute resolution schemes, it is possible that different schemes will make different decisions with regard to liability and/or the amount of compensation.

135. As it is up to firms to choose which scheme to join, firms may simply withdraw from a scheme if they receive an adverse decision. However, this will likely make other schemes reluctant to accept the firm as a member. This pressure will encourage compliance by firms with the scheme's decisions.

Question for Submission

16. What procedures are needed to ensure consistent decisions between different schemes, and mutual recognition of schemes' decisions?

5.5.1 Approval of Schemes

136. This option is a primarily industry-led approach, in that firms will be responsible for establishing and operating dispute resolution schemes. To ensure that the dispute resolution system achieves the objective of consumer confidence, it would be necessary to have minimum acceptable criteria which schemes must meet. Government intervention may be necessary to ensure that consumers have confidence across all sectors of the financial industry.

137. A possible approach might be for legislation to set out the role and functions of dispute resolution schemes, as well as to provide power for the Minister to approve schemes. The legislation would set out broad principles to be satisfied before the Minister could approve a scheme. These principles could be drawn from the Australian *Benchmarks for Industry-Based Customer Dispute Resolution Schemes*, for example:

- **Accessibility**. The scheme makes itself readily available to consumers by promoting knowledge of its existence, being easy to use and having no cost barriers.
- **Independence**. The decision-making process and administration of the scheme are independent from scheme members.
- **Fairness**. The scheme produces decisions which are fair and seen to be fair by observing the principles of procedural fairness, by making decisions

on the information before it and by having specific criteria upon which its decisions are based.

- **Accountability**. The scheme publicly accounts for its operations by publishing its determinations and information about complaints and highlighting any systemic industry problems.

- **Efficiency**. The scheme operates efficiently by keeping track of complaints, ensuring complaints are dealt with by the appropriate process or forum and regularly reviewing its performance.

- **Effectiveness**. The scheme is effective by having appropriate and comprehensive terms of reference and periodic independent reviews of its performance.

138. In addition to broad principles set out in legislation, guidelines could be published separately by the government to provide further information to industry relating to the structure, procedures and operation of a scheme to assist in satisfying the broad principles. The guidelines could cover issues such as: appropriate governance arrangements to ensure independence and accountability; appeals from a decision of the scheme; enforcement of the scheme's decisions; evidence and processes; awareness/promotion/education; reporting by the scheme to regulators on systemic issues; reporting to stakeholders, including government; issues regarding the efficient and effective operation of the scheme.

139. Comments are also invited on the regulatory arrangements that would be needed to support the Minister's approval function. The regulatory arrangements would also need to consider the ability of regulators to obtain data for effective systemic oversight. The data provided by the various schemes may be inconsistent or non-comparable.

Question for Submission

17. What procedures would need to be put in place to ensure that dispute resolution schemes meet appropriate standards to ensure consumer confidence? Should the Minister be responsible for approving schemes?

140. The following sections discuss potential issues for the content of approval guidelines. These issues are sketched in broad form at this stage. If this option is adopted, more detailed consultation will be undertaken in the development of guidelines prior to their finalisation.

5.5.1.1 Governance

141. Governance deals with the leadership, direction and control of an organisation and with ensuring that its purpose and objectives are known and achieved. In the particular context of dispute resolution schemes, the rules under which the scheme operates are an integral part of the governance arrangements. The interest of the public might lie in the way in which, through those rules, there is accountability of the scheme and its staff.

142. This issue relates to arrangements to ensure that dispute resolution schemes are independent of the industry and of parties who may make a complaint to the scheme. This is to ensure that the processes and decisions of the scheme are objective and unbiased. Governance arrangements must be appropriate so that the scheme's governing board as a whole has the necessary expertise to effectively manage the scheme.

143. Participation by consumer representatives in the governance of an industry-based scheme is essential to promote consumer confidence in the scheme. Consumer confidence will only be promoted if the governance responsibility lies with a body which is accountable to both the industry and consumers.

144. A scheme should adopt governance procedures which promote accountability to both industry and consumers. As a minimum, the following governance procedures would be appropriate: the scheme should establish a board of directors to oversee the scheme; the scheme should provide for the effective representation of consumers in its governance arrangements; and the decision maker in respect of consumer complaints should be independent of the board.

145. Ongoing monitoring and review of a scheme is essential to ensure it is, and continues to be, effective in meeting its objectives. The scheme must establish procedures for ongoing monitoring to ensure that the scheme is effective. The procedures should provide for periodic and regular review of the scheme.

5.5.1.2 Appeals

146. While governance arrangements involving consumer representation can be effective in promoting consumer confidence in the scheme, there may still be perceptions that an industry-based scheme is captured by members. To alleviate these concerns, consumers should have an opportunity to take alternate action through the court system if unsatisfied with the decision of the scheme. The rules of the dispute resolution system must not preclude a consumer from pursuing court action against a member, whether before or after the dispute resolution system has issued a decision. A decision of a dispute resolution system should be binding on the member in relation to whom it is made.

147. This is the current practice adopted by the BO and ISO in New Zealand, as well as by overseas financial dispute resolution services such as the Australian schemes and the UK Financial Ombudsman Service.

5.5.1.3 Enforcement of Decisions

148. Options for enforcement include:

- enforcement by a regulatory agency;
- enforcement by the scheme itself through the courts;
- enforcement as a debt by a consumer through the courts.

149. For non-compliance with the current voluntary industry-led regulatory scheme in the banking sector, the only formal sanction provided is the power for the Banking

Ombudsman Commission to expel a participant who fails to comply with an award made by the Banking Ombudsman.

150. This is possibly not a realistic option where participation in a dispute resolution scheme is mandatory for financial providers, so ejecting a non-compliant firm may merely shunt them to another dispute resolution scheme, with the effect being that consumers have not received adequate redress in the first instance, and this is likely to continue if the firm does not improve its act when it joins another scheme.

151. A more indirect sanction could be the public reporting of the number of complaints received by the dispute resolution scheme in a given reporting period. In competing for customers, the banking industry often uses customer satisfaction as a means to attract custom. The introduction of reporting of customer complaints could incentivise the financial service industry to improve areas of their business regimes which cause consumer complaints.

152. A decision of a dispute resolution scheme should be primarily enforceable as a debt by a consumer through the court system. The scheme and the relevant regulatory agency may also levy sanctions against a member who fails to comply with a decision.

5.5.1.4 Evidence and Processes

153. A major advantage of industry-based dispute resolution schemes over the court system is that they allow for specialized and simplified processes.

154. As part of the resolution process, the dispute resolution scheme should be free to consider any information or make enquiry as it sees fit. Reference should be given to what the scheme considers fair and reasonable in the circumstances. To help determine what is fair and reasonable, consideration could be given to:

- the personal, cultural and educational circumstances of the consumer as may be relevant to the complaint;
- the manner in which the consumer and the financial provider have dealt with each other prior to the complaint being laid with the dispute resolution scheme;
- the degree of control the financial provider had of the system or procedure that has resulted in, or are the subject of, the complaint.

5.5.1.5 Awareness/Promotion/Education

155. A dispute resolution scheme will only be effective if it is known, accessible and considered credible by consumers. As mentioned earlier, around a quarter of consumers of financial products simply put up with misleading or unfair treatment. A common reason given for putting up with it was that the consumer did not know where to go to help resolve the dispute.

156. Therefore, it is essential that steps be taken to promote awareness of the scheme amongst consumers. This means the scheme should promote itself, and

should also require member firms to inform customers of the existence of the scheme.

5.5.1.6 Reporting on Systemic Issues

157. Systemic issues can be identified as “wider issues” which may be affecting several firms in the industry or the industry as a whole (and hence consumer outcomes) rather than any one specific consumer complaint before the dispute resolution scheme. It is important that systemic issues are addressed properly, because they may affect a large number of consumers or firms, may have an effect on common industry practice, or may relate to an issue of interpretation of the rules of the dispute resolution scheme.

158. As well as identifying issues which have a similar affect on a number of firms, a dispute resolution scheme is also able to identify an increase in complaints about an individual firm which may signal underlying problems with the stability of the firm. For example, significant numbers of complaints about price/premium increase could indicate that the firm is experiencing financial difficulties.

159. It is not expected that the dispute resolution scheme would itself address systemic issues; rather the scheme would report these issues to the appropriate regulatory body.

5.5.1.7 Reporting to Stakeholders (Including Government)

160. Along with the scheme’s governance arrangement, reporting to stakeholders (including government) is an important element in demonstrating accountability. This includes publicly setting out its constitution and rules, as well as regular reporting on the number and type of disputes handled by the scheme.

5.6 OPTION 4B: MULTIPLE SCHEMES WITH SHARED RESOURCES/SYSTEMS

161. This option extends the previous option by providing for the sharing of some resources between separate dispute resolution schemes. In order to be effective, a dispute resolution scheme must have a number of essential “back office” systems, such as a telephone/internet contact service, case management system, staff training, knowledge management, member information services. These systems are expensive to develop and maintain, and it would seem possible that sharing these resources and systems could lead to cost savings and efficiencies.

Question for Submission

18. Do you see sharing resources amongst dispute resolution schemes as a plausible option? What are the advantages and disadvantages?

162. A key shared resource could be a single entry point for consumer complaints. This would require all dispute resolution bodies to jointly establish a contact centre to

take consumer complaints and then filter those complaints to the appropriate dispute resolution body. The contact centre could also provide general consumer information.

163. A single entry point would help consumers overcome the problem of where to go. If there are several financial service providers all attempting to create awareness and public identity, it is possible consumers may find themselves confused over which dispute resolution scheme to turn to for assistance. A well-known single entry point portal may help overcome such a problem. A unique brand identity could be developed which makes it easy for consumers to identify that a dispute resolution service is available to them. This is especially important if there are multiple parties involved in the financial transaction and belonging to different dispute resolution schemes. For example, a transaction may involve a financial intermediary, a financial institution, and the consumer's employer. These parties may all belong to different dispute resolution schemes.

164. Sharing of resources and systems could help reduce regulatory arbitrage and assist in providing a systemic overview. For example, common systems would reduce the differences between schemes, thus helping create a consistent regulatory framework across the financial industry. Also, a single entry point would also have the advantage of facilitating the collection of industry-wide data that allows a systemic overview.

165. If this option is implemented, the single entry point must be careful to ensure that it does not dilute individual schemes' or firms' identities, or commitment to success of the individual schemes. For example, the existing schemes have established significant commitment from their members, and this option must be careful not to weaken that commitment through the sharing of resources or systems.

166. A single entry point approach has been adopted in Australia, where the Banking and Financial Services Ombudsman, the Insurance Enquiries and Complaints Scheme and the Financial Industry Complaints Scheme fund a joint contact centre. This approach has resulted in significant efficiency gains for participating schemes.[14] Given the small size and scale of the New Zealand financial system, similar efficiency gains would likely be obtained through the establishment of a single entry point.

167. While the Australian schemes have voluntarily adopted a single entry point, consideration should be given to whether it is appropriate to mandate a single entry point for New Zealand due to the small size of the New Zealand market.

168. As discussed above, minimum standards and approval of schemes are necessary to ensure that the various dispute resolution schemes are effective in promoting consumer confidence. Similar considerations also apply with regard to the effectiveness of a single entry point.

[14] Colin Neave, "Working Together – Scheme Co-operation", presentation to FICS 3rd Annual Conference, 6 October 2005, www.fics.asn.au/docs/Presentation%20-%20Colin%20Neave.pdf

Question for Submission

19. Should a single entry point be mandatory or voluntary? Should there be government approval and/or minimum standards for the single entry point? What are the costs and benefits?

169. Other resources could also be shared by the various schemes, such as IT infrastructure or accommodation. Consideration would need to be given regarding whether these resources could be integrated in the short term, as the existing schemes, the BO and ISO, have to date developed their own systems and processes in these areas.

170. A disadvantage of shared resources or systems is the potential to constrain the ability of individual schemes to adapt to changing circumstances and develop new procedures appropriate to its sector, particularly if that sector is faced with new problems which do not arise in other sectors of the financial industry.

Question for Submission

20. What resources and functions should be shared by schemes?

5.7 OPTION 4C: SINGLE INDUSTRY-BASED DISPUTE RESOLUTION SCHEME

171. This option involves the establishment of a single dispute resolution body covering the entire financial system. Membership of the scheme would be mandatory for all financial providers. This approach is similar to the United Kingdom Financial Ombudsman Service.

172. The main advantage of this option is that a single scheme may be cheaper to operate due to efficiencies of scale, producing advantages for both financial providers and consumers. This is particularly significant given the relatively small size of the New Zealand financial industry and number of consumer complaints. For example, the scheme would be able to shift resources from one area to another if there was a sudden increase in one type of complaint. Under the multiple schemes option, a particular scheme would not be able to rapidly adapt if it experienced a sudden increase in complaints. A single scheme would allow better knowledge sharing, particularly in informal situations, since all case officers and other staff are employees of the one organisation.

173. A single dispute resolution scheme would create a level playing field in terms of regulatory treatment. This would provide coverage across all sectors of the financial industry. This option would also address unnecessary barriers to entry that may hinder access for some firms to membership of a dispute resolution scheme.

174. However, a one-size-fits-all approach may lack specialization or be too blunt to effectively deal with varying industry practices. This could be alleviated by establishing various divisions within the organisation, such as investigation teams and ombudsmen along product or provider lines. This would still allow specialization,

but with the added benefit of better communication between teams because they are part of a single organisation.

175. A single scheme would have an advantage over the multiple schemes option in promotion, as it would present a single brand to raise awareness of the scheme amongst consumers and industry. This would help address the consumers' problem of not knowing where to go to seek redress. Also, as with a single entry point under Option 4B, a single dispute resolution scheme would have the advantage of facilitating the collection of industry-wide data that allows a systemic overview.

176. A disadvantage of this option is that it may not build on the existing voluntary dispute resolution and redress mechanisms. The BO and ISO have built up considerable industry commitment, and this commitment may be lost if financial providers are forced into a single scheme.

177. In contrast with the multiple schemes approach, firms have no choice which scheme to join under this option. This could have implications for industry commitment to the success of the scheme, for example, if firms come to see themselves as "regulated entities" rather than "members". A single scheme will likely not have the same incentives in terms of industry commitment, although this could be addressed through industry participation in governance and standards setting.

178. A particular issue regarding industry commitment concerns the incentives of firms to comply with decisions of the scheme as a condition of membership, which may be diluted under a single scheme compared with the multiple schemes option. Particular attention will need to be given to the sanctions available to the scheme.

179. There are a wide range of types of financial providers, from small businesses through to large banks and insurance companies. It may be difficult to achieve industry cohesion or a common understanding of the rules to be followed. This suggests that this option would require a greater degree of government intervention than the other options.

Question for Submission

21. What are the advantages and disadvantages of a single mandatory dispute resolution scheme? What are the costs and benefits?

5.7.1 Governance

180. As with other industry-based schemes, the scheme's governing board should consist of a mix of industry and consumer representatives. This will ensure that the board is objective and unbiased. Comments are invited on the appropriate composition of the scheme's governing board.

181. There are a number of options for appointment of industry representatives:

- election by members
- appointment by the regulator(s)

- appointment by the Minister.

182. The number and diversity of member firms suggest that it may be difficult for members to agree on who should represent industry on the board. Similarly, there will be a number of regulatory agencies supervising various sectors of the industry. Therefore, it is may be appropriate that industry representatives be appointed by the Minister.

183. Similarly, there are a number of options for appointment of consumer representatives:

- ex officio appointment of designated consumer organisations
- appointment by the Minister.

184. There are a number of different consumer organisations which have an interest in the rights of consumers in the financial sector, including the Consumers Institute, Citizens Advice Bureaux and the New Zealand Federation of Family Budgeting Services. It would be difficult to choose an appropriate body as the right one to supply board members ex officio.

185. Therefore, it may be appropriate that consumer representatives be appointed by the Minister. This accords with the current situation where the Minister of Consumer Affairs appoints consumer representatives to the boards of the Banking Ombudsman and Insurance and Savings Ombudsman.

Question for Submission

22. What procedures should be adopted for appointment of the governing board of a single industry-based dispute resolution scheme?

5.7.2 Scheme Rules

186. If this option is adopted, it will be necessary for the scheme to make rules pertaining to its operation. These rules would be developed in conjunction with industry, consumers, government and regulatory agencies. The rules would cover similar issues to those discussed above in relation to approval of schemes under Option 4A, such as appeals from a decision of the scheme; enforcement of the scheme's decisions; evidence and processes; awareness/promotion/education; reporting by the scheme to regulators on systemic issues; reporting to stakeholders, including government; issues regarding the efficient and effective operation of the scheme.

187. While these rules will primarily apply to all firms, specialization could be enhanced where appropriate through sector-specific codes of practice. These codes of practice could address issues such as funding or investigation processes, for example, if these issues require different approaches in different sectors.

Question for Submission

23. What scheme rules would be needed to ensure that the dispute resolution scheme promotes consumer confidence?

APPENDIX 1: SUMMARY OF QUESTIONS FOR SUBMISSION

1. What are the types of problems currently experienced by consumers in the financial sector? What problems do consumers experience in obtaining redress from financial providers?

2. Are the gaps in the current dispute resolution system inhibiting consumers' access to redress and affecting consumer confidence?

3. Is there a need for government intervention to promote consumer confidence in financial sector dispute resolution and redress? What is the appropriate role for government?

4. What effect will other regulatory changes proposed under the Review of Financial Products and Providers have on consumers' access to redress? Do these changes support greater or lesser government intervention with respect to dispute resolution and redress?

5. Do you think the current framework of voluntary dispute resolution schemes works well? Do you think it could be improved? How should the gaps be addressed?

6. Would more consumer education and information sufficiently address the concerns with the status quo approach to consumer dispute resolution? Who should be responsible for such consumer education and information and its funding?

7. How do the advantages and disadvantages/costs and benefits of enhanced civil remedies and improvements to the court system for consumer dispute resolution weigh against the status quo?

8. Should participation in an industry-based dispute resolution system be mandatory or voluntary for financial providers?

9. How should an industry-based dispute resolution system be funded?

10. What is the appropriate definition of "consumer" for the purpose of determining access to the dispute resolution system?

11. What type of cases should be within the scope of an industry-based dispute resolution system?

12. Which financial products or providers are outside the proposed scope of the dispute resolution system? Should mandatory participation extend to these products and/or providers?

13. What are the advantages and disadvantages of an industry-based dispute resolution system? What are the costs and benefits?

14. What is the appropriate form of an industry-based dispute resolution system, ie

multiple schemes, multiple schemes with shared resources, or a single scheme?

15. What are the advantages and disadvantages of a mandatory system of multiple industry-based dispute resolution schemes?

16. What procedures are needed to ensure consistent decisions between different schemes, and mutual recognition of schemes' decisions?

17. What procedures would need to be put in place to ensure that dispute resolution schemes meet appropriate standards to ensure consumer confidence? Should the Minister be responsible for approving schemes?

18. Do you see sharing resources amongst dispute resolution schemes as a plausible option? What are the advantages and disadvantages?

19. Should a single entry point be mandatory or voluntary? Should there be government approval and/or minimum standards for the single entry point? What are the costs and benefits?

20. What resources and functions should be shared by schemes?

21. What are the advantages and disadvantages of a single mandatory dispute resolution scheme? What are the costs and benefits?

22. What procedures should be adopted for appointment of the governing board of a single industry-based dispute resolution scheme?

23. What scheme rules would be needed to ensure that the dispute resolution scheme promotes consumer confidence?

APPENDIX 2: ASSESSMENT OF OPTIONS AGAINST EVALUATION CRITERIA

	Option 1: Status quo	Option 2: Consumer education and information	Option 3: Enhanced civil remedies and courts	Option 4A: Multiple industry-based dispute resolution schemes	Option 4B: Multiple schemes with shared resources/systems	Option 4C: Single industry-based dispute resolution scheme
Accessibility	Voluntary schemes do not provide full coverage – consumer confusion as to where to go to seek redress.	Improved consumer awareness of rights and responsibility should lead to better informed decisions and reduced level of disputes.	Costly, time consuming and complex process of court action discourages consumers from seeking redress. A specialist tribunal could assist.	Multiple schemes may cause consumer confusion as to where to go to seek redress. Full coverage of financial industry achieved through mandatory membership.	Single entry point clarifies consumer access to redress. Full coverage of financial industry achieved through mandatory membership.	Single scheme provides clarity about access to redress for consumers. Full coverage of financial industry achieved through mandatory membership.
Independence and fairness	Voluntary schemes can make own governance/decision making rules – can only be effective if clearly show fairness. No regulatory backing if a firm doesn't abide by a decision of dispute resolution body, e.g. firm may withdraw from membership.	Information provided by firms will focus on that firm's products, rather than promoting general consumer confidence in financial markets.	Independence and fairness are inherent features of courts. Authority of court system encourages firms to comply with court decisions.	Approval by Minister before a scheme can operate ensures governance/decision making rules are independent and fair. Non-compliance may lead to expulsion and reluctance of other schemes to accept firm.	Same as option 4A.	Government appointment of board would ensure independence from industry. Regulatory backing needed to ensure compliance with scheme's decisions.

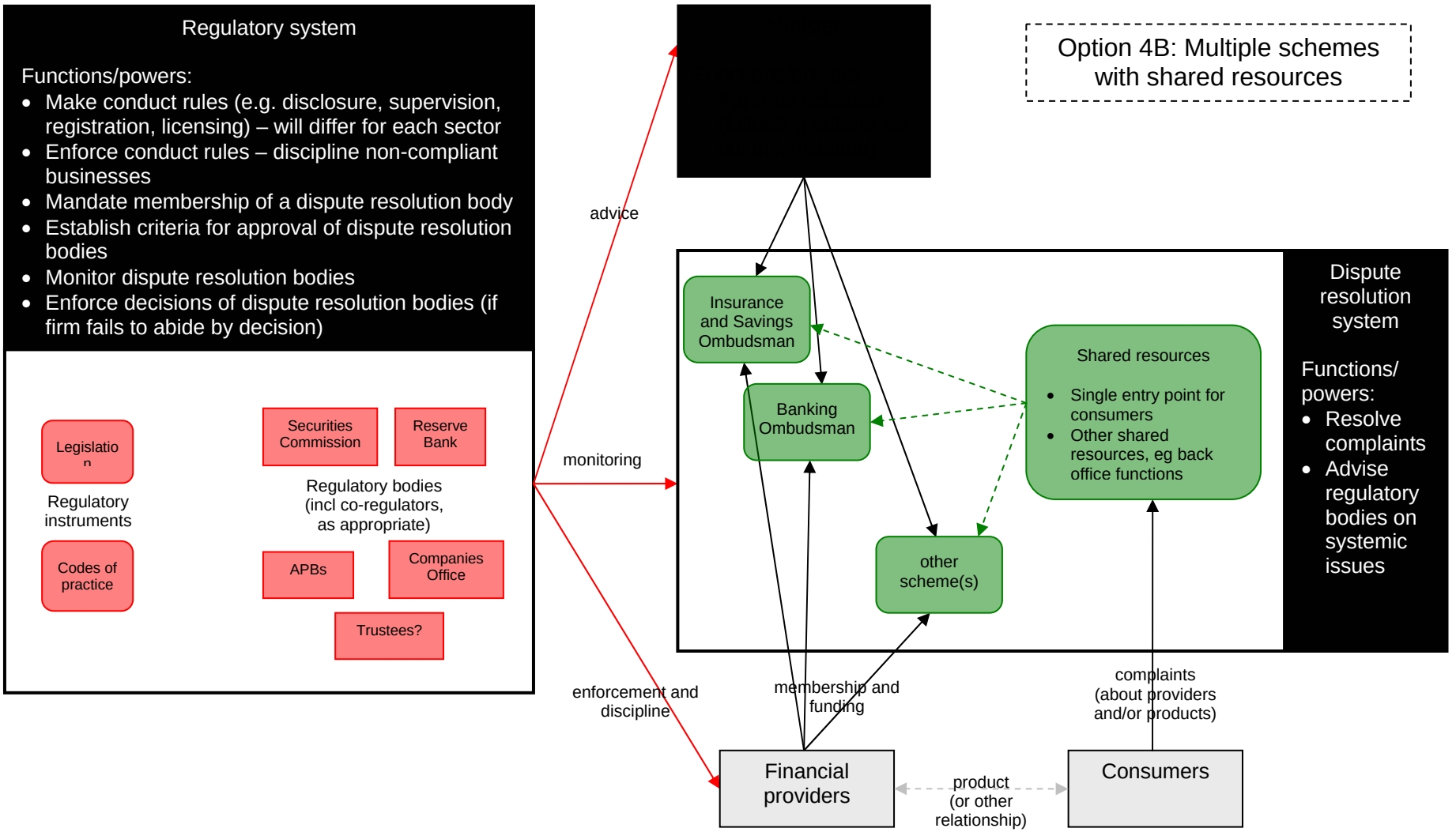
	Option 1: Status quo	Option 2: Consumer education and information	Option 3: Enhanced civil remedies and courts	Option 4A: Multiple industry-based dispute resolution schemes	Option 4B: Multiple schemes with shared resources/systems	Option 4C: Single industry-based dispute resolution scheme
Market incentives	Voluntary membership encourages firms to commit to scheme and improve customer service as a point of competitive advantage. Competitive pressure may not be effective in raising standards if consumers lack capability to make informed decisions. Closed "club" may prevent entry of new firms into market.	Provides incentives for firms to improve disclosure, but does not address complaints handling practices. Competitive pressure may not be effective in raising standards if consumers lack capability to make informed decisions.	Firms less likely to alter behaviour on a systematic basis.	Multiple schemes allow differentiation between schemes – incentive for firms to adopt sound practices so as to keep scheme costs low. Industry-based schemes encourage industry participation and commitment to schemes' success.	Single entry point may dilute individual schemes' or firms' branding – reduce industry commitment.	Industry-based scheme encourages industry participation, however less effective than under option 4A.

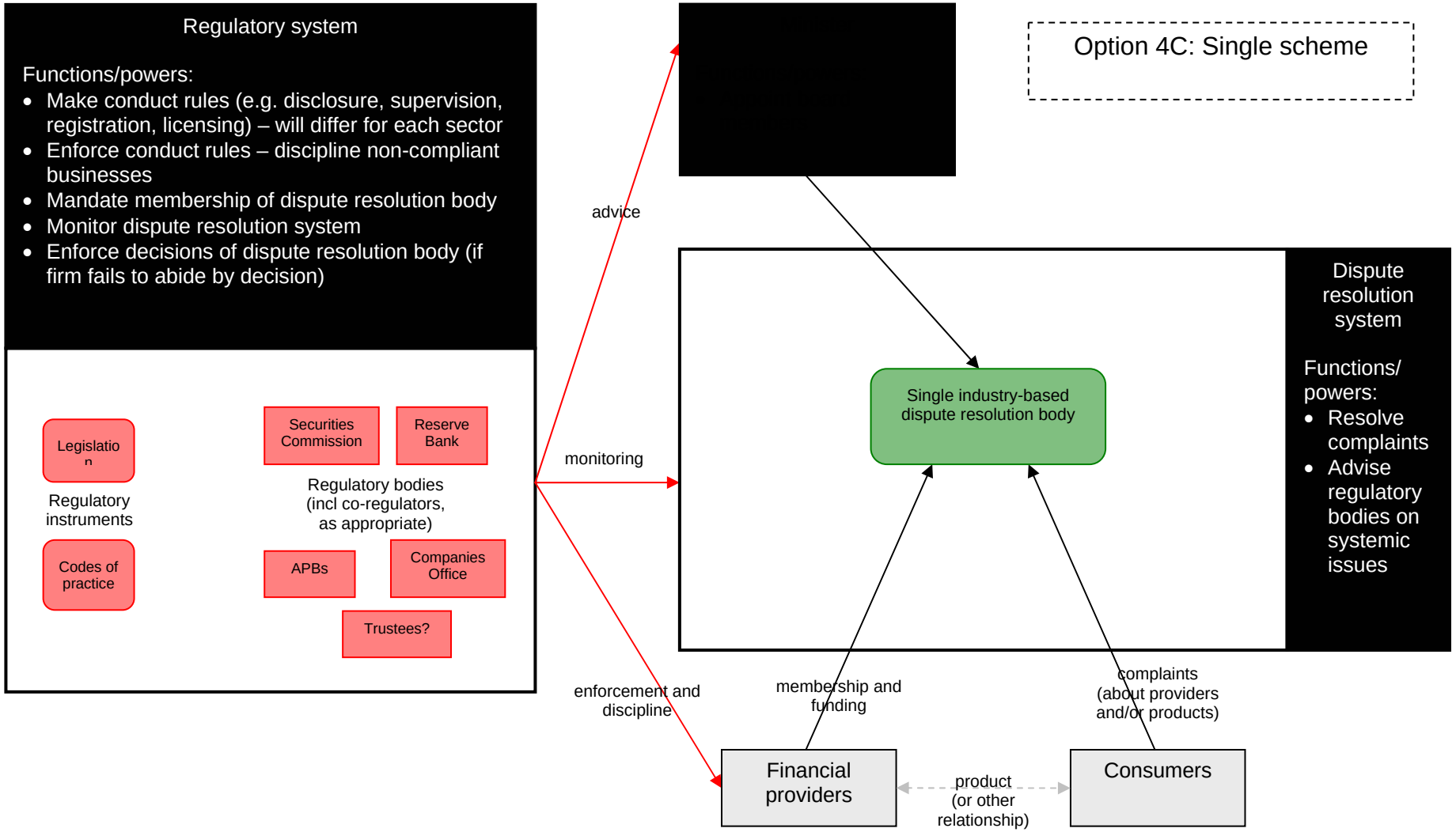
	Option 1: Status quo	Option 2: Consumer education and information	Option 3: Enhanced civil remedies and courts	Option 4A: Multiple industry-based dispute resolution schemes	Option 4B: Multiple schemes with shared resources/systems	Option 4C: Single industry-based dispute resolution scheme
Cost effective	Voluntary membership means firms will only join a scheme if benefits outweigh costs.	Information has a public good character – difficult and expensive to target those who most need it. May be difficult to strike appropriate balance of industry/government provision of information.	Cost of a new tribunal would be borne by government.	Industry funding of dispute resolution schemes means firms will seek to lower costs of scheme by improving customer service behaviour to reduce number of disputes. Multiple schemes enables appropriate costs to be borne by different firms and industry groups.	Sharing resources/ systems allows economies of scale in back office functions, leading to reduction in costs for firms and consumers.	Industry funding of dispute resolution scheme means firms will seek to lower costs of scheme by improving customer service behaviour to reduce number of disputes. Larger size of scheme allows economies of scale. May be difficult to determine amount or proportion of levy for firms conducting different activities.
Regulatory flexibility	Status quo imposes no regulatory fetters on design of dispute resolution bodies.	Does not restrict product offerings.	Dispute resolution processes subject to normal court rules – unable to develop procedures specific to financial sector.	Each scheme is able to set its own rules.	Sharing of resources and systems may constrain ability of schemes to adapt to changing circumstances.	One size fits all approach may be too blunt, but could be addressed through sector-specific codes of practice.

	Option 1: Status quo	Option 2: Consumer education and information	Option 3: Enhanced civil remedies and courts	Option 4A: Multiple industry-based dispute resolution schemes	Option 4B: Multiple schemes with shared resources/systems	Option 4C: Single industry-based dispute resolution scheme
Regulatory transparency for firms and consumers	Voluntary dispute resolution schemes – no regulatory compliance necessary for firms.	May be difficult for financial providers to distinguish between their obligations to provide product disclosure and general consumer education.	Disputes Tribunal has simplified court processes compared with District Court.	Approval of schemes subject to scheme satisfying appropriate criteria, e.g. publication of its constitution and rules.	Same as option 4A	Level playing field requires that all firms understand legislation and compliance requirements.
Reduce regulatory arbitrage	Voluntary schemes provide patchy coverage – firms may choose not to join, or only join under favourable conditions.	Government-provided education could be designed to cover all sectors; regulatory requirements for industry-provided information could be designed to be consistent across all providers and/or products.	All consumers and financial providers subject to identical court procedures.	Mandatory membership of a dispute resolution scheme, but potential for firms to join a more "favourable" scheme, e.g. to avoid higher/ stricter standards. Individual schemes may raise barriers to entry to shut out new members.	Shared resources and systems may reduce differences between schemes.	Single scheme is a unified/coordinated approach to regulation across all sectors.

	Option 1: Status quo	Option 2: Consumer education and information	Option 3: Enhanced civil remedies and courts	Option 4A: Multiple industry-based dispute resolution schemes	Option 4B: Multiple schemes with shared resources/systems	Option 4C: Single industry-based dispute resolution scheme
Systemic overview	Voluntary schemes are private – quality of information uncertain. Patchy coverage – unable to obtain picture of the industry as a whole.	Doesn't facilitate identification of systemic issues.	Courts use case-by-case approach.	May be difficult to coordinate data from multiple schemes.	Single entry point allows unified approach to capture of industry-wide data.	Single schemes allows capture of industry-wide data.

APPENDIX 3: STRUCTURE DIAGRAMS




Regulatory system
Functions/powers:
• Make conduct rules (e.g. disclosure, supervision, registration, licensing) – will differ for each sector
• Enforce conduct rules – discipline non-compliant businesses
• Mandate membership of dispute resolution body
• Monitor dispute resolution system
• Enforce decisions of dispute resolution body (if firm fails to abide by decision)
Legislation
Regulatory instruments
Codes of practice
Securities Commission
Reserve Bank
Regulatory bodies (incl co-regulators, as appropriate)
APBs
Companies Office
Trustees?
Option 4C: Single scheme
advice
monitoring
enforcement and discipline
Single industry-based dispute resolution body
Dispute resolution system
Functions/ powers:
• Resolve complaints
• Advise regulatory bodies on systemic issues
membership and funding
complaints (about providers and/or products)
Financial providers
product (or other relationship)
Consumers