Comment on the Consultative Paper:

Proposal on the Future Constitution, Role and Function of Ombudsmen in the Financial Services Sector

The dictionary definition of ombudsman is "an official investigator of complaints against government bodies or employees". In the UK this function is performed by the Parliamentary Commissioner for Administration. The important factor to be drawn from this definition is that the function of an ombudsman is to investigate complaints against government bodies or employees. A person carrying out such a function, which entails intervening between administrative arms of government and the general public, requires legal authority in order to do so. The role and authority of the government ombudsman must therefore necessarily be legislated. Private organisations, consisting of businesses in particular industries, have borrowed the word to describe individuals appointed by them to investigate and rule on complaints by customers against members of their own organisations. Although the role they perform may have a superficial resemblance to that of a government ombudsman, they are very different. Citizens with complaints against government bodies very often have no recourse to the courts for resolution of their complaints. The government ombudsman has therefore been introduced by democratic governments to act as the champion of the helpless citizen who faces an intractable and unsympathetic bureaucracy.

Private organisations appoint and pay "ombudsmen" and generally give them a level of autonomy and power that satisfies customers that they will be given a fair and independent hearing regarding complaints. The industry objective is to provide customers with a level of comfort regarding complaints: a feeling that they have a champion who is part of the industry, understands it, and will intercede on their behalf up to a point. That point is exceeded when the matter is of such a nature that it can clearly only be resolved by recourse to the courts. The industries do not appoint "ombudsmen" to rule their lives and instruct them how they should or should not conduct their businesses. That is the reason why industry members do not agree to bind themselves regarding the rulings of the appointed individuals. Where they disagree with a ruling they retain the right to have the matter settled in a court of law.

The system described in the above paragraph functions perfectly well and saves many customers from having to use the courts to obtain satisfaction. It goes further, in that customers will not have to exhaust the avenues open to them within the individual company before turning to the "ombudsman" for relief. Publicity-shy customers can also avoid the trauma of using the press to try and obtain relief regarding their complaints against suppliers.

The paper prepared by the Financial Services Board contains proposals that would destroy the most important attributes of the existing industry dispute resolution system. The proposed conditions for exemption are extremely unattractive and appear to be designed specifically for the purpose of forcing all industries into the statutory net.

Loss of independence
Much is made of the supposed lack of independence of the industry "ombudsman" who is appointed and paid by the industry. Yet judges and magistrates are appointed by the state and paid out of taxes and in a properly functioning democracy they have the independence they need to carry out their duties impartially. Naturally, they are compelled to come to their decisions on the basis of their interpretation of the law and the statutes. To the extent that statutes are in conflict with the fundamental tenets of just law, judges and magistrates who differ in principle with the statutes they are expected to enforce, may find that their independence is impaired. Nevertheless, judges and magistrates build their reputations on the soundness of their decisions and not on who appoints and pays them.

Industry "ombudsmen" are chosen for their reputations for integrity and independence of thought. A person of questionable character and reputation would be of no value whatsoever to the firms paying their salaries and other expenses. The industry purpose is to give the customers greater confidence in their industry and there would consequently be no purpose in appointing someone with a visible bias towards the firm - someone who fails to base decisions on the facts. Businesses are not in the habit of wasting their money on such futile exercises. Their purpose is to enhance their reputations for fair dealing and that is what they expect the "ombudsman" to deliver - very often at the cost of their own discomfort. In fact, if they were not on occasion compelled to rectify the errors of staff members in their dealings with customers they would conclude that the "ombudsman" was not doing her/his job.

The conclusion reached in paragraph 8.1 is totally unjustified:

"The present system where ombudsmen are appointed and funded by particular industries creates a perception, wrongly at present, that the ombudsman is beholden to the industry. It is nevertheless necessary that this perception be corrected and avoided in future, simply to avoid the negative result"

The contemplated actions described in paragraphs 8.2 and 8.3 are consequently inappropriate. They are not only unnecessary but destructive.

The paper is contradictory in that Paragraph 5 of the paper says: "It is feared that if the ombudsmen lose their informality they will become bogged down in legal technicality as a result of which the system's efficiency in dispute resolution will disappear". The paper does not divulge who expressed such a fear but the sentiment is obviously not shared by the drafter/s who do not respond to the concern and thereafter studiously ignore it. Also, it is more than informality that would be lost if the proposals in the rest of the paper were to be adopted. The "ombudsmen" would not gain independence, they would lose it:

- Industry "ombudsmen" currently function according to a set of rules which they themselves negotiate on an ongoing basis with the industry they serve, continuously adapting the rules to keep pace with changing conditions in the industry. If their functions were to be set out in legislation this dynamic process would be lost. It takes a long time to change legislation.

- Trial and error, which is an integral part of the functioning of business, would be excluded.

- Members of the industry would be disinclined to make exceptional concessions for public relations reasons as they would be afraid of establishing onerous precedents - they would be compelled to take a harder line.

- Every case coming before the ombudsman would no longer be dealt with on a "what's good for the business" basis by a senior executive of the firm concerned but would as a matter of course become a matter to be examined by the legal department.

- The "ombudsman's" ability to persuade firms to make concessions on compassionate grounds would disappear.

- Customers would lose more than they gain.

A voluntary, alternative dispute resolution mechanism
In paragraph 4.1 the drafters of the paper once again correctly describe the mechanism: "The mechanism of an ombudsman is essentially that of a voluntary, alternative dispute resolution mechanism. It does not seek to duplicate a court system of dispute resolution and therefore functions as an adjunct to the formal legal system. The legal difficulties referred to arise as soon as it is attempted to deviate from this fundamental role, for instance by attempting to make the rulings of the ombudsmen binding by statute" (emphasis added).

Without explaining why, the drafter/s then proceed to deviate. The proposals in the paper would not create only the legal difficulties mentioned in 4.1 but would make the "ombudsman" a government bureaucrat, effectively destroying her/his independence from government interference. The process would no longer be voluntary, it would no longer be alternative: it would become part of the currently-slow-expensive-and-poorly-functioning-legal-system. The stark question that arises is: why not leave well enough alone?

Conditional exemption of voluntary schemes from the statutory regime
This stratagem is sometimes known as the "softly, softly catchee monkey" method of achieving an objective. Allay fears by appearing to be reasonable, knowing full well that the ultimate objective is to bring all victims into the net. Experienced civil servants know that those who are subjected to a particular piece of legislation will not rest until all exemptions are withdrawn. Often those who at the outset are promised exemptions if they support a particular measure find that somewhere between their acquiesence and

the adoption of legislation the exemption is deleted. Their last-minute protestations have no effect.

Another stratagem being used is that of offering exemption on condition that the "beneficiaries" of the exemption comply with rules that differ from their existing rules. So we see the following conditions being introduced:

- that a significant majority of product suppliers in a sector subscribe to a scheme (why should existing and successfully operating schemes take in others in order to qualify for exemption?)

- that rulings of the ombudsman are accepted as binding (why should this be a requirement for exemption when recourse to the courts is available to a customer that does not receive satisfaction? If this requirement is to be imposed on voluntary schemes that do not already subscribe to such a provision would the FSB not be acting in a malâ fide manner, given the contents of paragraph 4.1 which recognises that "The legal difficulties referred to arise as soon as it is attempted to deviate from this fundamental role, for instance by attempting to make the rulings of the ombudsmen binding by statute"? Would the purpose perhaps be to make voluntary schemes untenable?)

- the ombudsman is appointed by an independent body (why should the members of an industry organisation hand over their right to appoint someone whose salary and expenses they are paying - risking the possibility that the "independent body" could appoint an inappropriate person who may cause harm to their industry instead of helping them to build the better reputation they are seeking?)

- the funding of the office is done on a basis that preserves the independence of the office (is this an oblique way of saying that the industry organisation should not fund the office directly but by some circuitous means that will allow everyone, including the "ombudsman", to pretend that the funding does not come from the industry? Is the Financial Services Board seeking the power to tax in addition to the vast discretionary powers it already possesses?)

- objective criteria are established and applied in the appointment (What kind of objective criteria are being referred to here? The FSB has steadfastly, and wrongly, refused to establish objective criteria for appointments in terms of all other legislation it has produced in recent times? Has it now recognised the error of its ways or is it merely suggesting a variation in this instance?)

- the jurisdiction (terms of reference) conferred is not less than that proposed in the statutory system (do we not in this provision have the instrument for destroying a well-functioning voluntary system, which may be compelled by such a provision to extend the functions of the "ombudsman" beyond what it knows to be healthy and effective?)

- the basis of functioning is not different from the statutory arrangements (is this another way of saying that exemption will be granted only to those schemes that slavishly follow whatever scheme is conceived by the FSB?)

- that it demonstrates itself to be a credible, functioning alternative to the statutory scheme on an ongoing basis (is the statutory scheme similarly to be abandoned if it does not demonstrate that it is a credible, functioning alternative to the voluntary scheme?)

Industries with voluntary schemes would do well to oppose this scheme in its totality. They will be making a serious error if they conclude that the conditional exemption that they are being offered will for all time confer on them a privileged exempt status. The heading could well read "conditional temporary exemption of voluntary schemes".

Full coverage of the financial sector
The Americans have a saying: "If it ain't broke, don't fix it". There is a great deal of wisdom in the saying. If there are industries in the financial sector that do not have "ombudsmen", they do not need them. They should consequently not have such a mechanism forced on them. The "one-size-fits-all" approach does not work in the market-place and legislators should take care not to destroy or disturb mechanisms that are working. Alternatively, if complaints from customers were to dwindle to a negligible level, an industry should be free to dispense with the function and close the office. Circumstances, and not legislation, should dictate.

Statutory schemes
Without supporting argument the paper suddenly leaps in Paragraph 5.1 to a conclusion contained in the sentence "To achieve full coverage of the financial sector, the following must be done:" - and then proceeds to set out the basis for destruction of the existing voluntary dispute resolution systems set up by some of the financial sector industries.

According to the consultative paper the idea for creating a "compulsory alternative dispute resolution" system arose whilst the ill-conceived Financial Advisers' Bill was being crafted. So we have an economically destructive proposed piece of legislation giving its drafters an idea for another piece of legislation that will harm the economy of the country.

Proposed legislation and the intentions of the proposers should be subjected to the same careful scrutiny that is applied to private industry. In addition, cost-benefit analyses should be done in which the proposers of legislation are compelled to prove their case. If they cannot show that the benefits to the economy exceed costs, the proposals should be shredded. What is more, the legislation should be subject to periodic review, and if it fails the cost-benefit test, it should be subject to automatic repeal.

The gallows test

The gallows test, used in ancient times to keep the law relevant and pure, was a harsh method of avoiding unnecessary legislation. Proposers of new laws were required to stand on a gallows with a rope around their necks whilst explaining their proposal to the voters. When they had finished explaining, a vote would be taken. If the voters adopted the new law the rope would be removed. If the voters turned down the legislation, they hung the proposer.

Needless to say, very few new laws were proposed. And if anyone was brave enough to propose a new law, the proposer made sure that it would be of significant value to the voters.

Naturally, this comment does not suggest that similar rough methods should be used in the modern age. Yet some method needs to be devised to ensure that civil servants take great care about proposing new legislation or regulations. They may well consider whether they would pass the "gallows test".

The Public Choice school of economics has taught us that, far from working selflessly to promote the interests of the general public, civil servants tend to promote their own interests. In evaluating proposals for new legislation the wary observer must necessarily ask the question: how will the proposers, their superiors or their department, benefit from the legislation.

The Financial Services Board has been particularly active in drafting proposals for new legislation. In every case, there has been a requirement for a rash of new appointments. This tendency is distressing given the parlous state of the economy. South Africa needs exceptionally high growth in order to absorb the large number of people who are currently unemployed. The potential source of jobs for the unemployed lies not in the Financial Services Board, or anywhere else in the civil service, but with the firms from whom taxes are taken to pay the salaries of the civil servants. Every extra Rand of tax that is taken for this purpose is a Rand less in the job-creating productive sector of the economy.

Government expenditure and economic growth

An analysis of OECD countries for the period 1960 to 1996, carried out for the Joint Economic Committee of the US Congress, showed a direct (negative) correlation between size of government and economic growth. As government expenditure (at all levels of government) rose, growth rates declined. In order for South Africa's GDP to grow at 6% per annum, as mentioned in GEAR, government should consume no more than 25% of GDP, the study shows. Expenditure is presently approximately 35%, which means that excessive expenditure is in the order of R60 billion. That excessive expenditure is like a millstone round the neck of the South African economy. Every piece of legislation that adds to that expenditure, reduces the potential growth of the economy, and reduces the potential for job creation.

Does the Financial Services Board take such factors into consideration when it proposes new legislation? Does it weigh up the dubious benefits of interfering in private dispute resolution mechanisms against the economic growth and jobs that will be destroyed? Does it consider that any extra burden imposed on any industry is a burden to be carried by South Africa's consumers and is ultimately a destroyer of jobs?

The situation is so serious that the "gallows test" may well be justified.

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