

# **ABF MODEL AND CONSUMERS DISPUTES RESOLUTION**

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## Plan of the lecture, and a caveat

- The (economic) value of justice
- The role of ADRs
- The Italian Banking and Financial Ombudsman (ABF)
  
- I am not a lawyer, I am an economist
- I am a member of the Italian Banking Ombudsman

# The economic value of justice

## Moving away from courts: justice vs. efficiency?

- In principles, a trial must be risky, otherwise it would not be started
- If my counterpart knows that I have the right to obtain what I am asking, she has an incentive to give it to me without going to court, losing and paying the expenses
- But if procedures are inefficient, going to court may bring a positive side effects, such as:
  - the possibility that a wrong decision is taken
  - the delay in honoring my obligation
- The trade-off between justice and efficiency is becoming increasingly relevant

## Costs and benefits of different legal systems

- The economic literature has increasingly stressed the importance of “efficient” legal systems
- Some of the key indicators considered in the Doing Business report of the World bank analyze the efficiency of the legal system (typically abstracting from any notion of “fairness”)
- The search for alternative solutions to legal disputes is an answer to the problem of the inefficiency of traditional legal systems

## Trials and the value of swift decisions

- Trials are necessarily risky, but they are also complicated
- Only thorough analyses guarantee a fair outcome, and typically this requires time
- Judges are a common goods: (almost freely) available to every citizen, but highly excludible
- The benefits of making the judge a private good, so as to obtain a swifter decision, depend on the costs of the delay, which are likely an increasing function of the amount which is disputed
- When the amount at stake is high and the cost of the delay is relevant, arbitrations are more likely to be chosen

## Fixed costs and the value of decisions: similar counterparties

- Trials are also expensive, and they involve heavy fixed and sunk costs, which are independent on the amount at stake
- As a result, disputes on small amounts are unlikely to be taken to court, and even less likely to be the object of arbitrations
- As an outcome, resolution of disputes on small amounts among similar counterparties may trade-off rigor and costs, with simplified procedures

## Fixed costs and the value of decisions: different counterparties

- Often, the two counterparties in disputes of small amounts are very different, e.g. consumers against large corporations
- If consumers are unwilling to start a dispute because of the large fixed and sunk costs involved, large corporations could profit from their inaction, with potentially very large profits
- Corporations' incentives are thus distorted towards making "small injustices" to consumers
- Alternative dispute resolution systems (ADRs) are a possible solution



# The role of ADRs

## Why alternative dispute resolution systems (ADR)?

- ADRs, typically originated in Common Law systems, are one solution to the failure in the market for justice which results from the presence of fixed and sunk costs to go to court
- Obviously, the solution is far from perfect, and ADRs have their own problems; for example:
  - they are typically managed by independent State authorities
  - it is unlikely that they offer similar warranties as court procedures, which have been refined in centuries of experience
  - their decisions are not binding, allowing the applicants to file the same case in court, leading to a duplication
- But “the best is the enemy of the good”, and ADRs may turn out in practice to guarantee more justice than courts

## ADRs and courts: friends or foes?

- Defining ADRs as “alternative” might suggest an opposition with the court system
- But such view would be wrong
- ADRs and courts work together:
  - ADRs typically decide according to the law
  - courts often take into consideration the jurisprudence of ADRs and, if the case is file in court, their previous decisions
- ADRs can therefore be seen as an additional leg in the system of justice

## Deciding according to the law

- ADRs must decide according to the law:
  - in principles, because it is ineffective to apply different legal systems at the same time and in the same country
  - in practice, because if ADRs' decisions are not binding, if they were taken against the law they would be almost certainly taken to the court

## Influencing the decisions of courts

- ADRs ability to influence the decisions of courts comes from two main factors:
  1. ADRs are specialized in specific sectors of activity, in which they may gain better knowledge than generalist judges, producing as a result better grounded jurisprudence
  2. a previous decision by an ADR on a specific case gives a starting point if the case is taken to court, that judges will likely take into consideration
- Once a decision is taken by an ADR, the uncertainty in a possible following decision by a court is lower, and this reduces the incentives to file the case

## A (quasi-)regulatory function of ADRs

- So far we have considered the role of ADRs in deciding on bilateral disputes
- But the decisions of ADRs often have an additional impact in shaping market regulation and supervision standards, thus urging banks to improve their practices
- Banking supervision often is required to use the analysis of the complaints filed with the ADR to drive its activity
- In this sense, ADRs perform a (quasi-)regulatory function, giving indirectly to customers some degree of regulatory capacity (“regulation by litigation”)

## From cross-subsidization to positive externalities

- The role of ADRs in shaping market regulation and supervision standards is crucial also to limit the risk that the decisions turn out to be simple cross-subsidizations
- The costs incurred by financial intermediaries to enforce the decisions of ADRs are typically translated into higher prices on all customers
- The benefit for who has a favorable decision on his complaint is often paid by all other customers
- However, to the extent that ADRs can induce financial intermediaries to adopt better standards, any decision related to the single complaint has a positive externality on all actual and potential customers

## The private and public roles of decisions

- The decisions of ADRs are aimed therefore at:
  - safeguarding private interests
  - providing a public good
- For this reason, contrary to the case of arbitrates, the decisions of ADRs must be public
- In principles, if these decisions were transparent and uniform, there should be no complaints filed with an ADR, because financial intermediaries would prefer to settle the case beforehand
- Of course, this amount to assuming that there is no uncertainty, an unachievable outcome



# The Italian Banking and Financial Ombudsman (ABF)

## The ABF: basics (1)

- ABF is an out-of-court settlement scheme for disputes between customers and banks and other financial intermediaries, organized as an independent body, assisted in its work by the Bank of Italy
- Participation in the system is mandatory for all financial intermediaries authorized to provide payment services
- The maximum value of disputes is capped at 100.000 euros (the average value is much smaller, the median even smaller)

## The ABF: basics (2)

- The decisions of ABF are based only upon the documents provided by the parties, who do not need to be assisted by lawyers (although they may do so if they wish)
- Decisions by ABF are not legal judgments and are not legally binding: incentives to enforcement come from negative publicity, because non-compliance is made public
- Before submitting a dispute to the ABF, the customer must lodge a dispute with the financial intermediary
- If any of the parties is not satisfied with the ABF's decision, it can submit the dispute to the civil courts

## ABF: origins

- The Bank of Italy instituted the Ombudsman in 2009, implementing Article 128-bis of the Consolidated Law on Banking, introduced by the Investor Protection Law (Law 262/2005)
- The Interministerial Credit Committee (CICR) – operating within the Ministry of Economy and Finance – with the Resolution issued on 29 July 2008 imposed the criteria for carrying out dispute resolution procedures and entrusted their organization and functioning to the Bank of Italy
- In order to implement the CICR Resolution, the Bank of Italy adopted the provisions governing the ABF dispute resolution system as a whole

## ABF: composition

- The disputes received by the ABF are submitted to a decision-making body divided into seven territorial panels in Bari, Bologna, Milan, Naples, Palermo, Rome and Turin
- The composition of the panels ensures that the interests of all parties involved are represented, since each panel is composed of five members:
  - the chair (appointed for 5 years) and two members are selected by the Bank of Italy
  - one member represents financial intermediaries
  - one member represents customers (consumers and non-consumers)
- Members are appointed for a three-years terms, removable only once

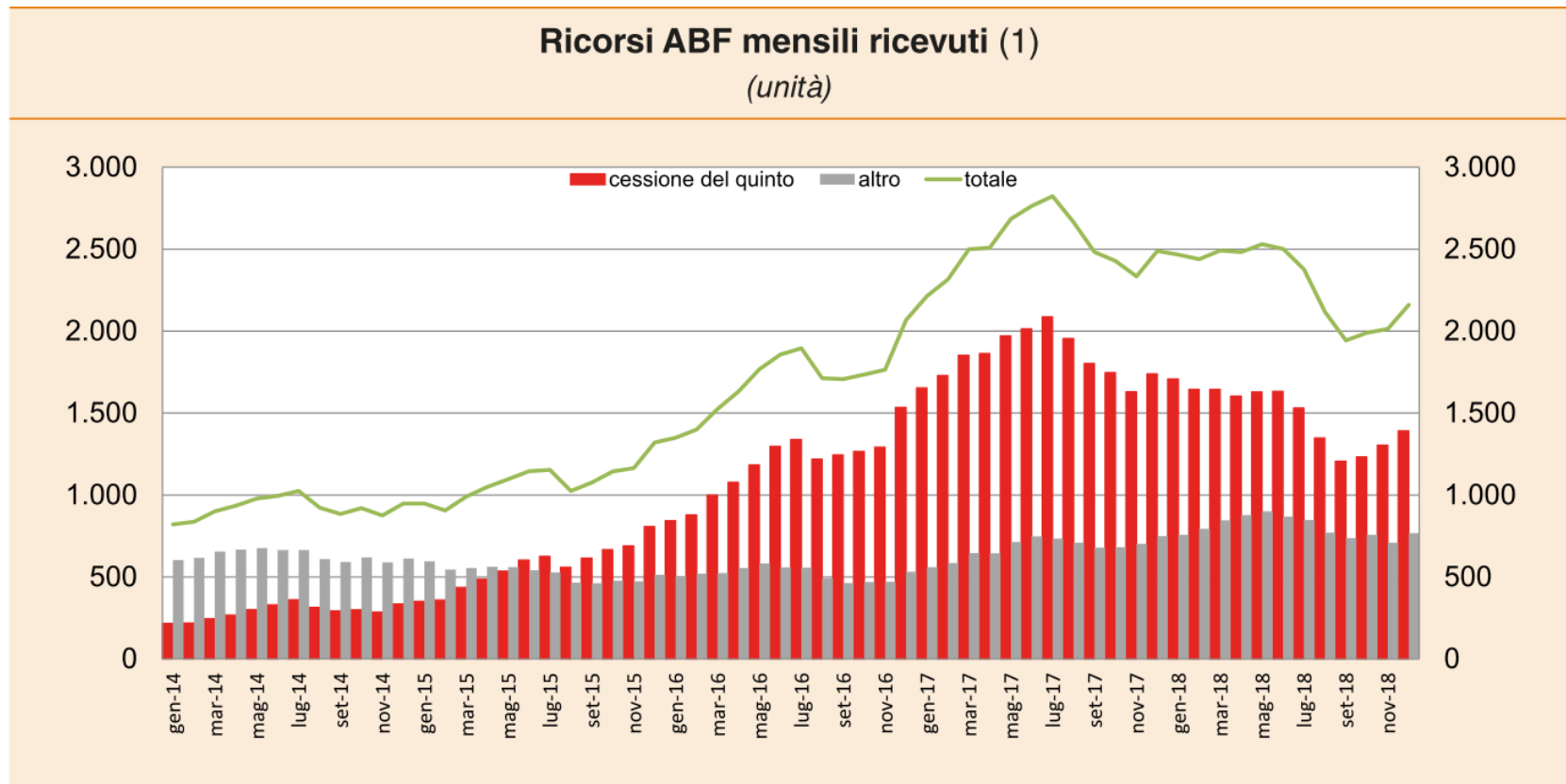
## ABF: Bank of Italy's support

- The activity of each panel is (heavily) supported by the technical secretariats, composed of Bank of Italy employees
- The seven technical secretariats carry out the following activities:
  - receive and analyze complaints and check that the documentation is complete, correct and respects the deadlines
  - receive the documentation submitted by the intermediary in response to the complaint and, if necessary, ask the parties to provide further information
  - handle all communications with the parties concerning their complaints

## ABF: recent activity

- Concluding the presentation of the 2015 report, the general director of Bank of Italy said that the objective of the ABF was to deal with 20,000 complaints per year in 2018
- In 2017 they were already 30,644
- 77% of cases were broadly favorable to customers (47% with a favorable decision, 30% with an ending of the litigation)
- In terms of defending customers' rights, this can be considered a great success
- However, the reason is the explosion of complaints on a very specific issue: the reimbursement of fixed and variable costs in the case of anticipated extension of loans secured by a pledge of salary

## ABF: number of complaints





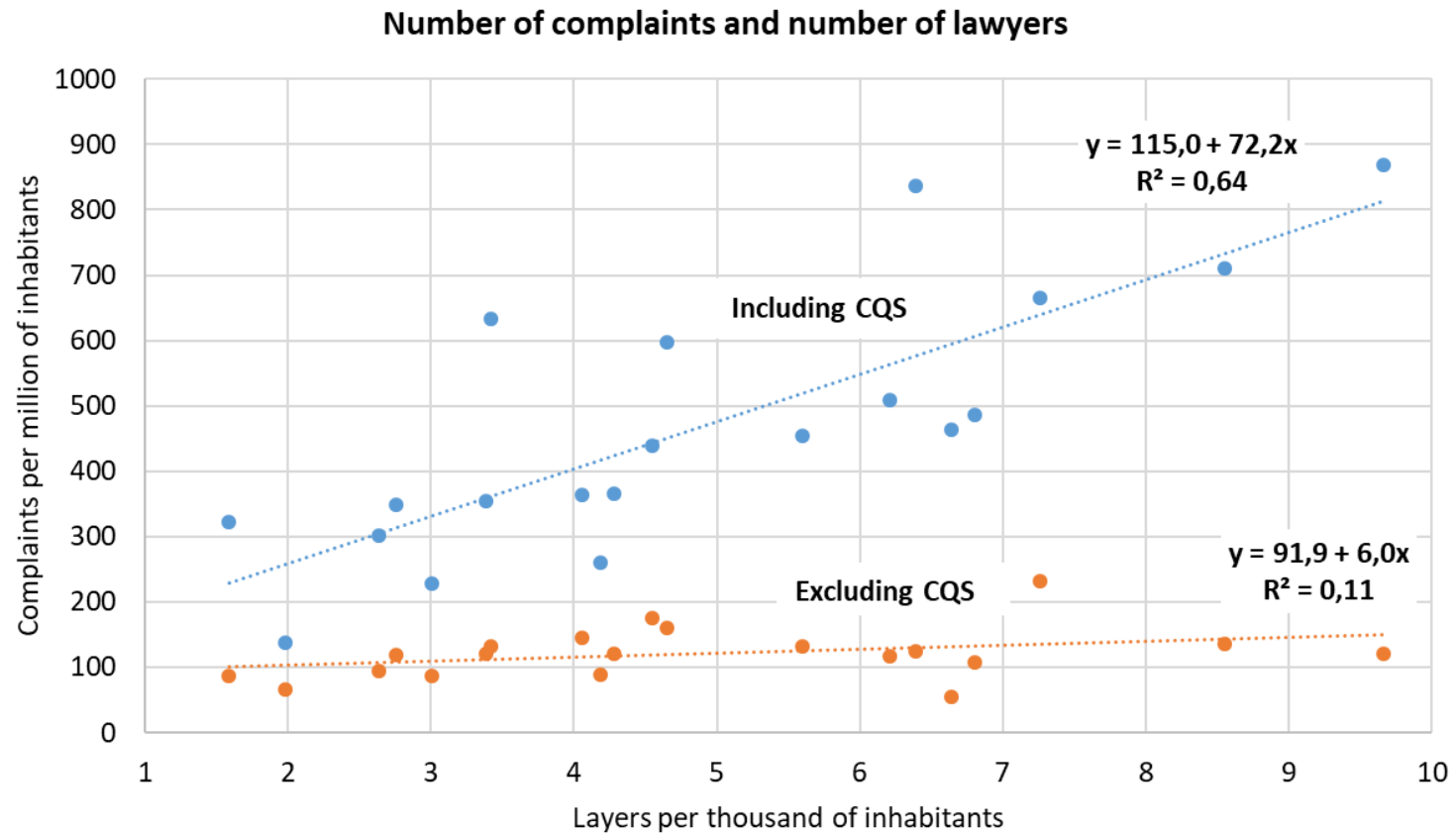
## The surge in complaints: a positive view

- One possible interpretation of this result is positive:
  - intermediaries applied opaque and often penalizing conditions for customers, which in turn was possible due to the lack of clarity of the rules
  - in a context of insufficient regulatory clarity, intermediaries may have assessed that it was possible to exploit information asymmetries to achieve higher profits
- The parallel evolution of financial practices and their regulation is a known and essential fact, as Charles Goodhart has largely motivated
- Ex-post, this profit prospect has probably proved to be fallacious, since intermediaries now return part of the revenues obtained following the application of conditions that are not transparent

## The surge in complaints: a more sceptical interpretation

- An alternative interpretation is less positive
- The possibility to obtain justice relatively quickly and at low costs has created a market driven by the offer of remunerated professional assistance
- A model driven by the offer of professional assistance services may create distorted incentives, because those who provide professional assistance do not have the same objective as the applicant
- For instance, and we have examples in this regard, it has less incentives to resolve the problem directly with the bank
- In fact, very often the requests of the applicants' representatives are exaggerated compared to what is recognized by ABF

# Lawyers and complaints on loans secured by salary



## Effectiveness and alternative routes

- I started my talk discussing the role of ADRs in increasing the efficiency of the judicial system
- I am not sure that devoting such a large share of the effort of ABF in dealing with standardized complaints is efficient
- I am more inclined to think that a class action would be a better way of addressing problems such as those described above

## Post scriptum: the role of an economist in an ADR

- What is my contribution at ABF?
- I have a better expertise in treating some technical issues, e.g., the derivation of a yield curve, which provides an important, but very specific contribution
- But I think that my major contribution is in the gray areas of the decision-making process, what Oliver Hart would perhaps define the space of incomplete contracts
- Here I try to drive the discussion to what will be effects of our decisions, more than on what is the correct interpretation of the law on the matter
- I believe that this contributes to ADRs' (quasi-)regulatory function

