



Financial System Inquiry

FOS Submission to Final Report

March 2015



CONTENTS

1.	<i>Overview</i>	3
2.	<i>Unpaid FOS Determinations</i>	5
2.1	<i>Background</i>	5
2.2	<i>Impact and extent of issue</i>	6
2.3	<i>Fixing the Issue</i>	7
3.	<i>External dispute resolution (EDR) arrangements</i>	7
3.1	<i>A framework for general customer remediation programs</i>	7
3.2	<i>Complexity in EDR in Financial Services</i>	9
4.	<i>Funding of community financial counselling and other services</i>	11
	<i>Appendix 1- About FOS</i>	12

1. Overview

The Financial Ombudsman Service Australia (FOS) welcomes the focus in the Final Report of the FSI Inquiry on promoting trust and confidence and the importance of treating participants fairly as key characteristics of a well-functioning financial system.

In this submission FOS¹ responds to the Final Report of the Financial System Inquiry (Inquiry) by addressing the following issues:

- unpaid FOS Determinations & external dispute resolution (EDR) arrangements
- an industry wide framework for general remediation programs
- reducing complexity in EDR in financial services, and
- funding for community financial counselling and similar 'social infrastructure' services.

As previously raised in our submissions to the Inquiry, one of the key issues that FOS considers should be addressed is the clear gap in the consumer protection framework and the problem of unpaid compensation. While unpaid compensation was included as an issue in the Interim FSI Report, it was not addressed in the Inquiry's Final Report.

FOS believes this is the missing piece in the current package of regulatory reforms under discussion to improve the confidence and trust in the financial advice sector.

FOS recommends the establishment of a limited compensation scheme of last resort and in the absence of the industry working together to establish such a scheme, the government implement such a scheme. One option would be to include funding for a last resort compensation scheme in a levy funding scheme for ASIC should the government adopt this approach to future ASIC funding.

In our first submission to the Inquiry, FOS discussed the current gap in the regulatory framework for dealing with general customer remediation schemes. In light of recent developments involving remediation programs by some major financial services providers (FSPs), FOS has given further consideration to what an appropriate framework for general remediation programs might involve.

FOS considers such a framework to be important in ensuring a consistent, transparent and efficient approach to similar matters across customers and FSPs, and should be based on the well-established and accepted framework and existing infrastructure that FOS provides for EDR in the financial sector.

¹ This submission has been prepared by the Office of the Chief Ombudsman and does not necessarily represent the views of the Board of FOS. It draws on the experience of FOS and its predecessors in the resolution of disputes about financial services.

FOS recommends that ASIC establish industry-wide principles and operating guidelines for the implementation of major remediation programs by FSPs, including interaction with independent dispute resolution arrangements. These should build on and be consistent with the current standards set for internal and EDR for FSPs set out by ASIC in its Regulatory Guides.

FOS is willing to work with ASIC, major industry bodies, individual FSPs and other stakeholders to develop specific arrangements for general customer remediation programs for the financial sector.

In its submission to the Inquiry's Interim Report, FOS recommended that any future developments in EDR arrangements should be based on the principle of reducing complexity for consumers in accessing timely, low cost and efficient dispute resolution in the financial sector for all financial sector disputes.

FOS considers it would be timely for ASIC to review the current approval framework for EDR schemes in the Corporations law with a clear focus on:

- reducing complexity for consumers in accessing timely, low cost and efficient dispute resolution in the financial sector for all financial sector disputes
- facilitating Australia's participation in regional and other cross-border arrangements
- taking into account the likely impact of digital disruption on industry boundaries and entry of new style participants, and
- enhancing cross industry co-operation across finance, telecommunications and other sectors for resolution of disputes relating to privacy, hardship and small business jurisdictions.

Finally, FOS has previously emphasised the value of community financial counselling, legal aid and specialist legal centres and the key role they play in the financial sector. They raise the standard of practical financial literacy, help consumers to avoid financial problems and, where problems do arise, help consumers to pursue and resolve disputes.

FOS continues to strongly support government, industry and community sector collaboration to develop a sustainable funding model for community financial counselling, legal aid and specialist legal centres. These organisations form an important component of the broader financial sector infrastructure, by providing crucial support and advice to vulnerable and disadvantaged consumers and those on the margins of the financial sector, including in relation to advice about debt.

2. Unpaid FOS Determinations

The Inquiry's Interim Report examined uncompensated loss arising from unpaid FOS determinations and acknowledged that it is a pressing issue given the limitations of professional indemnity insurance as a compensation mechanism². However, the Inquiry did not address or propose any solution to this problem in its Final Report.

We consider this clear gap in the consumer protection framework should be addressed so that consumers can have confidence that if things go wrong, they will be compensated when a decision is made by FOS in their favour. In our view, it is in the interests of all financial system participants to find a solution to the problem of unpaid compensation, to help rebuild consumer trust in financial services.

The costs of establishing the limited compensation scheme of last resort proposed by FOS on a phased in basis would be relatively low if spread across financial advisers and managed investment schemes. The illustrative costings prepared for FOS are set out in FOS's second FSI submission³.

FOS recommends the establishment of a limited compensation scheme of last resort and in the absence of the industry working together to establish such a scheme, the government implement such a scheme.

We believe this is the missing piece in the current package of regulatory reforms under discussion to improve the confidence and trust in the financial advice sector.

2.1 Background

The *Corporations Act 2001* requires licensees to have arrangements in place to ensure they can pay any awards of compensation to retail clients for breaches of Chapter 7 of the Act⁴. Despite this clear requirement, FOS continues to see cases where these awards of compensation under FOS Determinations are not paid.

To date, FSPs have used professional indemnity insurance policies to meet the requirement for compensation arrangements. It is widely acknowledged that professional indemnity insurance is important, but is not designed to function as a consumer compensation mechanism.

FOS has made Determinations against financial advisers with professional indemnity insurance, requiring them to compensate consumers for losses. In some cases, the compensation remains unpaid. Factors explaining why professional indemnity insurance cover may not result in consumers receiving compensation awarded under a FOS Determination are:

- the total funds available under an adviser's insurance may not cover all of the compensation that FOS awards against that adviser
- an adviser's insurance may not cover the conduct for which FOS awards compensation against that adviser, and

² http://fsi.gov.au/files/2014/07/FSI_Report_Final_Reduced20140715.pdf: Section 6 Consumer loss and compensation page 3-83

³ FOS submission to the FSI Interim Report August 2014 (Appendix 2), which can be accessed at this [link](#).

⁴ Section 912b of the *Corporations Act 2001*.

- the amount of compensation that FOS awards against an adviser may be below the excess under their insurance policy.

Our second submission to the Inquiry⁵ included case studies based on disputes in which compensation awarded by FOS was not paid. These are cases where existing compensation mechanisms failed and individual consumers remain uncompensated.

2.2 Impact and extent of issue

Our statistics on unpaid FOS Determinations for the period from 1 January 2010 to 31 December 2014 are as follows:

- 26 FSPs have been unwilling or unable to comply with 120 Determinations made in favour of consumers
- the value of the outstanding amounts awarded by these Determinations was \$12,686,956.69 plus interest (which accrues at about 5% per annum) as at 31 December 2014
- adjusting for interest and inflation, the present day value of these uncompensated losses is about \$15,000,000, and
- these represent 30.07% of the total value awarded by our Investments, Life Insurance and Superannuation decision makers and 25.85% of the total number of binding decisions made in this space.

This issue affects approximately 174 individuals whose claims FOS upheld, but who have not been paid the compensation awarded to them. These figures only reflect disputes that have proceeded to a binding determination.

Only a very small percentage of all FOS members are involved, and these figures represent only a small proportion of all the awards we issue across all our jurisdictions in banking, insurance, life insurance and investments. However, 69% of non-compliance relate to disputes in the financial planning and advisory sector.

Since 30 September 2014, the value of unpaid Determinations has increased by nearly 4%. This increase was caused by the liquidation of a single financial advisory firm which could not pay compensation totalling almost \$1.8 million, awarded in six Determinations.⁶

Lastly, disputes involving FSPs that experience an insolvency event during the course of EDR are often discontinued on the basis that the insolvency process is a more appropriate forum. As there is no decision on the merits made by FOS, the full impact and extent of unpaid compensation for these types of matters is unknown. We do however, expect that the issue is far more significant than what we are able to quantify.

⁵ The case studies are in Appendix 1 of the second submission, which can be accessed through this [link](#).

⁶ FOS provides regular updates on unpaid Determinations in its quarterly publication, *The Circular*, which can be accessed through this [link](#).

2.3 Fixing the issue

In its submission to the Inquiry in August 2014, ASIC supported consideration of a limited last resort statutory compensation scheme “to address the relatively high levels of uncompensated loss in the financial advice sector”. ASIC contemplated the introduction of a compensation scheme that would:

- be narrow in scope, only responding to retail claims regarding financial adviser licensees where their professional indemnity insurance does not pay a valid claim, and
- only provide compensation where all other options are exhausted.

FOS is confident that such a limited compensation scheme of last resort can be designed to address moral hazard and other concerns of industry participants, at low cost. The scheme could be funded by a special fee on industry participants under the legislation or regulations establishing the scheme or as part of any ASIC levy funding arrangement. We consider that the scheme should be funded by means of fees or levies imposed by government.

FOS recommends the establishment of a limited compensation scheme of last resort and in the absence of the industry working together to establish such a scheme, the government implement such a scheme. One option would be to include funding for a last resort compensation scheme in a levy funding scheme for ASIC should the government adopt this approach to future ASIC funding.

3. External dispute resolution (EDR) arrangements

The Inquiry did not suggest any changes to EDR arrangements. The Inquiry’s Final Report explained this is because alternative dispute resolution arrangements are “generally working well”. That Report states:

“The Inquiry recognises the importance of continuing to have an adequate consumer dispute resolution system.”

FOS welcomes the Inquiry’s recognition of the important role access by consumers to EDR plays in the financial sector.

While current arrangements have served the community well, we consider there are some further initiatives required to ensure that EDR arrangements continue to meet consumers’ needs into the future. These matters are:

- the role FOS can play as part of an industry-wide framework for general remediation and redress schemes, and
- reducing the current complexity of EDR in the financial sector.

3.1 A framework for general customer remediation programs

In our first submission to the Inquiry⁷, FOS discussed a current gap in the regulatory framework for dealing with general customer remediation schemes.

⁷ See page 21 of the first submission by FOS, which can be accessed through this [link](#).

In light of recent developments involving remediation programs by some major FSPs, FOS has been giving further consideration to what an appropriate framework for general remediation programs might involve.

FOS considers such a framework to be important in ensuring a consistent, transparent and efficient approach to similar matters across customers and FSPs. It should be based on the well-established and accepted framework and existing infrastructure that FOS provides for External Dispute Resolution in the financial sector. We consider this is important as part of broader efforts to restore confidence and trust in the financial services industry.

While not questioning the commitment or efforts of FSPs to do the right thing by their customers, FOS is concerned that the current customer remediation programs by individual FSPs will not necessarily be seen by the broader community as sufficient to rebuild confidence and trust in financial services. We consider a broader industry-wide framework and approach is required to do so.

We are also concerned that:

- the current diverse arrangements, use of different approaches, persons and panels to oversee each of the individual FSP reviews, however eminent and experienced, raises legitimate issues of consistency and transparency across the sector as a whole, and
- under the current remediation programs each individual FSP has developed complex, multi-tiered review and other processes in an effort to provide a degree of comfort on independence. This has the potential to add complexity, cost and extended timeframes for the internal dispute resolution (IDR) by these firms.

We consider these issues can best be addressed transparently and cost effectively by leveraging on the current EDR infrastructure developed over the last 20 years, where FOS provides independent and impartial dispute resolution across the financial sector. One of the strengths of EDR arrangements is the way in which they have been able to adapt and innovate in response to a changing external environment.

FOS considers it would be useful for ASIC to establish industry-wide principles and operating guidelines for the implementation of major remediation programs by FSPs, including the independent dispute resolution arrangements. These should build on and be consistent with the current standards set for IDR and EDR for FSPs set out by ASIC in its Regulatory Guides.

Any such principles and guidelines should include the following to support the credibility of the FSP's remediation program in meeting the tests of independence, impartiality, transparency and efficiency:

- a robust process for ensuring all reasonable steps are taken to contact all potentially affected customers using clear and effective communication methods
- an efficient single process for internal review, consistent with normal IDR processes and timeframes once a customer has been contacted and requested a review of their matter. Multiple layering of internal review and IDR process should be avoided
- independent review and decision provided by FOS after a single step internal review process has been completed by the FSP

- waiver of any technical time, monetary or other limits that might constrain our jurisdiction for dealing with the disputes, including for customers who may have previously entered into confidential settlements
- identification of any potentially affected clients in financial distress for early review and assistance, and
- either providing support for, or covering the costs for, clients to get advice and assistance in reviewing and putting their case in a dispute to FOS.

FOS would be able to structure a bespoke arrangement for external review of disputes not able to be settled through the FSPs IDR process in accordance with the principles set out above. Any such arrangement would be consistent with FOS's current independent and impartial role in resolving disputes and leverages off existing processes for dealing with significant events. FOS arrangements could also be structured to meet the scope or internal process assurance arrangements that might be required by ASIC in specific circumstances.

We consider the more active involvement of FOS to provide independent and external review would help address current community concerns about perceptions of independence of any FSP internal review. This would also be consistent with FOS's role in providing an independent EDR service in which the community can have confidence and trust. Further, it would provide a process that would shorten the timeframes to address consumer disputes and deliver timelier consumer outcomes.

FOS is willing to work with ASIC, major industry bodies, individual FSPs and other stakeholders to develop specific arrangements for general customer remediation programs for the financial sector.

3.2 Complexity in EDR in Financial Services

In FOS's second submission it set out some possible future trends potentially impacting on EDR in Australia. Among other issues, we highlighted that there are currently three schemes providing dispute resolution services in relation to financial services - FOS, the Credit and Investments Ombudsman⁸ and the Superannuation Complaints Tribunal. There is a degree of overlap between the schemes with the following implications:

- FSPs can choose whether to join FOS or the Credit and Investments Ombudsman, and
- FOS and the Superannuation Complaints Tribunal deal with similar financial sector participants.

The overlap between schemes increases complexity for consumers and consumer organisations. This issue was discussed in detail in our second submission to the Inquiry, where we recommended:

“Any future developments in external dispute resolution arrangements should be based on the principle of reducing complexity for consumers in accessing timely, low cost and efficient dispute resolution in the financial sector for all financial sector disputes.”

⁸ The former name of this scheme was the Credit Ombudsman Service Limited. Our second submission to the Inquiry referred to the scheme by its former name.

The differences between EDR schemes operating in the financial sector were also highlighted in submissions by Consumer Organisations to the Inquiry. One submission in particular noted that competition among EDR schemes in the one industry sector did not operate in the interests of consumers or efficient market outcomes.

In addition, the existence of multiple EDR schemes with overlapping industry coverage creates scope for potential forum shopping by FSPs and raises some other difficulties. Over time this could lead to:

- pressure on consistent standards and approach to fairness of dispute outcomes
- potential for different approaches to similar types of disputes emerging
- a reduced role for EDR schemes in addressing systemic and emerging issues across the whole financial sector
- limited engagement with industry participants in promoting good industry practice, and
- more complex regional cross-border arrangements where these may involve access to EDR, for example, the current regional funds passport initiative.

The current framework for ASIC approval of EDR schemes⁹ was put in place in the late 1990s. This framework reflected the landscape of multiple industry sector schemes operating at that time. The regime was designed to build on the pre-existing structure of multiple sector based industry schemes at the time by establishing clear standards, approval and accountability processes for those schemes as part of the move to require membership of an ASIC-approved EDR scheme as a condition of licensing.

While there was some overlap between the various schemes, the distinct sectoral coverage of schemes limited to a large extent the potential for forum shopping between the various schemes. The issue of access to EDR as part of regional cross-border fund management and passport and other arrangements was also not an issue at that time.

EDR arrangements will also need to take into account new developments in cross industry dispute jurisdictions such as privacy and the proposed operation of the Ombudsman for Small Business and Family Enterprise, the implications of the digital disruption for convergence between telecommunications, financial services and other sectors as set out in the FSI Report.

These trends highlight the importance of looking for opportunities for streamlined dispute arrangements within each sector to facilitate co-operation across sectors and cross-sectoral jurisdictions. Each of the current national jurisdictions has a different legal basis, history and role. However, it is notable that financial services has multiple dispute schemes compared to telecommunications and privacy jurisdictions which operate as single national schemes.

FOS considers it would be timely for ASIC to review the current approval framework for EDR schemes in the Corporations law with a clear focus on:

- reducing complexity for consumers in accessing timely, low cost and efficient dispute resolution in the financial sector for all financial sector disputes
- facilitating Australia's participation in regional and other cross-border arrangements

⁹ ASIC's Regulatory Guide 139- Approval and oversight of external dispute resolution schemes

- taking into account the likely impact of digital disruption on industry boundaries and entry of new style participants, and
- enhancing cross industry co-operation across finance, telecommunications and other sectors for resolution of disputes relating to privacy, hardship and small business jurisdictions.

This could form the basis for recommendations to Treasury and government on changes required to the current approval regime for EDR under the Corporations law that was put in place in the 1990s, to ensure it remains relevant in the current environment.

4. Funding of community financial counselling and similar “social infrastructure” services

Our first submission¹⁰ to the Inquiry explained that community financial counselling, legal aid and specialist legal centres play a very valuable role in the financial sector. They raise the standard of practical financial literacy, help consumers to avoid financial problems and, where problems do arise, help consumers to pursue and resolve disputes. We referred to the importance of these institutions to the ‘social infrastructure’ of our financial sector.

We believe that without these services, many vulnerable and disadvantaged consumers could not take complaints to FSPs or escalate complaints to EDR. If consumers cannot obtain assistance free of charge, they may turn to commercial claims management businesses. This may prompt the emergence of a claims management industry in Australia, bringing the issues associated with this industry in the United Kingdom.

We have become aware of gaps in the availability of financial counselling services and consumers have indicated that they have encountered long delays when accessing these services. When financial counselling is not available, or only available after long delays, consumers’ financial problems are exacerbated and their personal wellbeing suffers.

FOS continues to strongly support government, industry and community sector collaboration to develop a sustainable funding model for community financial counselling, legal aid and specialist legal centres. These organisations form an important component in the broader financial sector infrastructure by providing crucial support and advice to vulnerable and disadvantaged consumers and those on the margins of the financial sector, including in relation to advice about debt.

We note that in the UK, the debt counselling provided under the auspices of their Money Advice Service is funded by FCA regulated firms by means of the debt advice levy under the general levy arrangements in place for financial regulation in that jurisdiction¹¹.

¹⁰ FOS’s first submission (April 2014) to the FSI Inquiry at this [link](#).

¹¹ Further information about the Money Advice Service at this [link](#).

Appendix 1- About FOS

FOS was formed in 2008 from the merger of three predecessor schemes organised largely along industry sector lines. The original participants were:

- the Banking and Financial Services Ombudsman
- the Financial Industry Complaints Service, and
- the Insurance Ombudsman Service.

On 1 January 2009, two other schemes joined FOS, namely:

- the Credit Union Dispute Resolution Centre, and
- Insurance Brokers Disputes Ltd.

FOS is an ASIC-approved independent EDR scheme that covers disputes across the financial sector. Our service is free to consumers and is funded through a combination of levies and case fees paid by our members, which are FSPs.

Our operations are governed by our Terms of Reference that form a contract with our members. The Terms of Reference are available on our website.¹²

FOS and its predecessor schemes have over 20 years' experience in providing dispute resolution services in the financial services sector. FOS provides services to resolve disputes between member FSPs and consumers, including certain small businesses, about financial services such as:

- banking
- credit
- loans
- general insurance
- life insurance
- financial planning
- investments
- stock broking
- managed funds, and
- pooled superannuation trusts.

As well as its functions in relation to dispute resolution, FOS has responsibilities to identify and resolve systemic issues and obligations to make certain reports to ASIC. FOS also monitors compliance with a number of industry codes of practice

FOS is governed by a board with an independent chair and:

- four 'industry directors' appointed based on their expertise in and knowledge of the financial services industry, independence and capacity and willingness to consult with the industry, and
- four 'consumer directors' appointed based on their expertise in consumer affairs, knowledge of issues pertaining to the industry, independence and capacity and willingness to consult with consumer organisations.

¹² See www.fos.org.au -Terms of Reference, under 'About Us'.