



Financial System Inquiry Financial Ombudsman Service Submission

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1 Executive summary

We believe the Committee should place ***sustainable consumer trust in financial services*** at the heart of its considerations as trust is the key principle underpinning a dynamic, innovative and competitive financial sector.

While a robust financial services industry requires strong systems for support, it is important to remain aware of the human side to finance – that there are real people with real issues who are affected by the systems put in place.

We strongly support sustainably funded community-based financial counselling and specialist legal centres, especially for individuals who are vulnerable and/or disadvantaged. We also advocate the introduction of adequate compensation measures to ensure consumers receive the compensation to which they are entitled, when all other remedies failed.

FOS will continue to adapt to and evolve with any changes in the financial services industry, and play its role in supporting consumer trust by providing an impartial, fair and efficient dispute resolution process.

FOS recommends:

The Committee's recommendations should be designed to encourage and support consumer trust and confidence in the financial system, the financial services providers and individuals they deal with and the products and services they use.¹ In our view, the Committee should ensure its recommendations clearly support:

- financial services providers putting the interests of their customers first at all stages of their business from the design of products, marketing and distribution, to managing customers' savings, the provision of risk protection, and how they deal with their customers when things go wrong
- the creation of sustainable relationships that encourage consumers' confidence and trust in financial services throughout the whole intermediation process
- appropriate high standards of care by all of those who manage the savings of others, or who advise on credit, financial investment and risk products and services
- special attention to measures that assist vulnerable consumers and those currently excluded from the formal financial services sector
- regulation, competition policy and remuneration structures that create the appropriate incentive structures for the creation of relationships of trust, and
- strong sanctions and effective EDR mechanisms where such trust relationships are breached.

¹ This discussion draws on the valuable analysis of the importance of trust by Professor John Kay in his report- The Kay Review of UK Equity Markets and Long Term Decision Making, Final Report, July 2012

It is important for the Committee to take into account (in its review and findings) not only mainstream financial services consumers but also the more vulnerable and disadvantaged consumers as well as those excluded from active participation in the formal financial services sector. These groups tend not to be front and centre in wide-ranging inquiries given the focus on broader themes and trends in the financial sector.

The current process for resolving financial services disputes – which is based on a cooperative, non-adversarial, industry-based approach – should be maintained.

Industry codes governing the financial industry sector, play a vital role in supporting consumer trust, and should be supported.

Adequately funded community financial counselling and specialist community legal services play a critical role in promoting practical financial literacy among their clients, and help prevent future problems. Support for sustainable community financial counselling and legal services will also help mitigate against the emergence of a claims management industry in Australia. We urge the government and financial sector to work together to develop a sustainable funding basis for the provision of these financial counselling and related services.

The Committee should review whether it would be appropriate, in the context of Australian law and regulation, for ASIC to have the powers to put in place a consumer redress scheme and appoint a skilled person review in appropriate circumstances.

We encourage the Committee to consider a limited last resort compensation scheme for consumers, as professional indemnity insurance is not an adequate compensation mechanism for consumers where companies have gone into administration or are insolvent.

2 Introduction

The Financial Ombudsman Service (FOS) would like to thank the Committee for the opportunity to make a submission to the Financial Systems Inquiry.²

We acknowledge that the Committee will consider a broad range of issues during the Inquiry. Given FOS's specific role in the financial system, we have limited our submission to providing observations on:

- the role of effective external dispute resolution within the broader framework of supporting consumer trust and promoting a dynamic financial sector
- the importance of sustainable community financial counselling and legal services in the financial services sector
- the role that industry codes can play in helping to build consumer trust and in promoting good industry practice, and
- gaps in consumer redress and regulation.

2.1 FOS's role in the financial sector

At the heart of what FOS deals with is the loss of trust by consumers in financial services. We see our role largely as helping restore that trust.

FOS's mission is to fulfil an important community role by providing an independent dispute resolution service in which people can place their confidence and trust.

FOS's perspective is informed by its unique position in the financial services sector as a non-government industry and consumer supported external dispute resolution (EDR) scheme funded by the financial sector industry. Approved by the Australian Securities and Investments Commission (ASIC), FOS's jurisdiction covers the majority of financial services providers across all sectors of the financial system.

Central to the development of EDR in the financial sector has been a shared commitment over the last 25 years from the major participants – consumer organisations, financial services providers, government and the regulators – to effective mechanisms for non-court based consumer EDR.³

The formal components of this commitment are the FOS Terms of Reference – which outline the types of disputes we can consider, and acts as a contract between us and our members – and the formal regulatory accountability arrangements established by ASIC.

The FOS Terms of Reference highlight our co-operative and merit-based approach to dispute resolution.⁴ As an EDR scheme, we strive to share our experience with all our

² This submission has been prepared by the office of FOS 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.

³ Australia and New Zealand Ombudsman Association (ANZOA), *Submission into access to justice Inquiry, Productivity Commission* http://www.anzoa.com.au/ANZOA-submission_Productivity-Commission_Access-to-Justice-Inquiry_December2013.pdf & *Setting the scene: Industry-based customer dispute resolution schemes* (speech delivered by Colin Neave and John Pinnock, NADRAC conference 2003) http://www.anzoa.com.au/ANZOA-presentation_Setting-the-scene-Industry-based-customer-dispute-resolution-schemes_NADRAC-September2003.pdf

⁴ The principles underpinning our operations and processes for dealing with disputes are stated in the FOS Terms of Reference (Paragraph 1.2). In dealing with Disputes, FOS:

- a) must do what in its opinion is appropriate with a view to resolving Disputes in a cooperative, efficient, timely and fair manner
- b) shall proceed with the minimum formality and technicality, and

stakeholders to help reduce the number of disputes that arise in the future. This collaborative approach is one of the strengths of the current arrangements for EDR which have evolved over the last 25 years in Australia.

FOS only becomes involved in disputes when a consumer feels that the promise made by their financial services provider about a product or service has not been kept and they are unable to resolve their complaint directly with their financial services provider.

Therefore, at the heart of what FOS deals with is the loss of trust by consumers in financial services. We see our role largely as helping restore that trust, and in doing so we:

- act as an impartial and independent third party in resolving disputes between consumers and their financial services provider
- share our experience to help prevent future disputes
- identify systemic issues and work with financial services providers to address the effect they have beyond the consumer who brought the dispute to FOS, and
- play a role in the way financial services providers serve their customers.

2.2 Trust is the cornerstone of financial services

Trust and confidence are considered to be at the core of what consumers look for when dealing with financial services providers and their products and services.

Recent research on Global Consumer Banking⁵ identified that trust is key to creating customer advocates and important to the overall banking relationship. Institutional stability, customer experience, level of fees and rates were identified as important factors for consumer trust in financial services.

The research also reported that financial stability (60%), the way people are treated (56%) and the way an organisation solves problems (38%) are important elements to building that trust. The results suggest that there *is an astounding upside if customers are very satisfied with their problem resolution versus a downward spiral in trust and the relationship if dissatisfied.*⁶

The overall findings showed that while confidence in the banking industry is on the rise, banks must earn the highest levels of trust in order to retain customers and win more business.⁷ We consider similar findings are likely to apply across other financial services sectors.

As the financial services sector continues to recover after the Global Financial Crisis (GFC), the importance of trust – or lack thereof – remains front and center. The annual global Edelman Trust Barometer study for 2014,⁸ shows financial services as the least trusted

c) shall be as transparent as possible, whilst also acting in accordance with its confidentiality and privacy obligations.

⁵ EY Global Consumer Banking Survey 2014: *Winning through customer experience*
[http://www.ey.com/Publication/vwLUAssets/EY - Global Consumer Banking Survey 2014/\\$FILE/EY-Global-Consumer-Banking-Survey-2014.pdf](http://www.ey.com/Publication/vwLUAssets/EY_-_Global_Consumer_Banking_Survey_2014/$FILE/EY-Global-Consumer-Banking-Survey-2014.pdf)

⁶ See footnote 5

⁷ See footnote 5

⁸ Edelman Trust Barometer: Annual global study 2014 (financial services): <http://www.edelman.com/insights/intellectual-property/2014-edelman-trust-barometer/trust-in-business/trust-in-financial-services/>

industry globally in a group of 13 industries. Technology is the most trusted industry (79%) and financial services the least trusted (50%). This is consistent with the results of the previous year. Australian financial services are ranked around the middle of the countries involved in the Edelman study.⁹

While indicators of trust in financial services have improved since the GFC, these results are both surprising and concerning given trust and confidence are considered to be at the core of what consumers look for when dealing with financial services providers and their products and services.¹⁰

We acknowledge that the overwhelming majority of consumer complaints about financial services are resolved directly between consumers and their financial services providers, without FOS getting involved. However, since the establishment of FOS in 2008, the number of disputes received by FOS has increased dramatically. This increase is also an indicator of the potential erosion of consumer trust and confidence in financial services.

Recommendation 1:

The Committee's recommendations should be designed to encourage and support consumer trust and confidence in the financial system, the financial services providers and individuals they deal with and the products and services they use.¹¹ In our view, the Committee should ensure its recommendations clearly support:

- financial services providers putting the interests of their customers first at all stages of their business from the design of products, marketing and distribution, to managing customers' savings, the provision of risk protection, and how they deal with their customers when things go wrong
- the creation of sustainable relationships that encourage consumers' confidence and trust in financial services throughout the whole intermediation process
- appropriate high standards of care by all of those who manage the savings of others, or who advise on credit, financial investment and risk products and services
- special attention to measures that assist vulnerable consumers and those currently excluded from the formal financial services sector
- regulation, competition policy and remuneration structures that create the appropriate incentive structures for the creation of relationships of trust, and
- strong sanctions and effective EDR mechanisms where such trust relationships are breached.

⁹ Edelman Trust Barometer: Annual global study 2014: Australian Results:

http://www.edelman.com.au/pdf/Edelman_Trust_Deck.pdf?v=2

¹⁰ EY Global Consumer Banking Survey 2014: *Winning through customer experience*

[http://www.ey.com/Publication/vwLUAssets/EY_-_Global_Consumer_Banking_Survey_2014/\\$FILE/EY-Global-Consumer-Banking-Survey-2014.pdf](http://www.ey.com/Publication/vwLUAssets/EY_-_Global_Consumer_Banking_Survey_2014/$FILE/EY-Global-Consumer-Banking-Survey-2014.pdf)

¹¹ This discussion draws on the valuable analysis of the importance of trust by Professor John Kay in his report- The Kay Review of UK Equity Markets and Long Term Decision Making, Final Report, July 2012

2.3 Vulnerable and excluded consumers deserve particular focus

Recommendation 2:

It is important for the Committee to take into account (in its review and findings) not only mainstream financial services consumers but also the more vulnerable and disadvantaged consumers as well as those excluded from active participation in the formal financial services sector. These groups tend not to be front and centre in wide-ranging inquiries given the focus on broader themes and trends in the financial sector.

3 Our dispute resolution experience

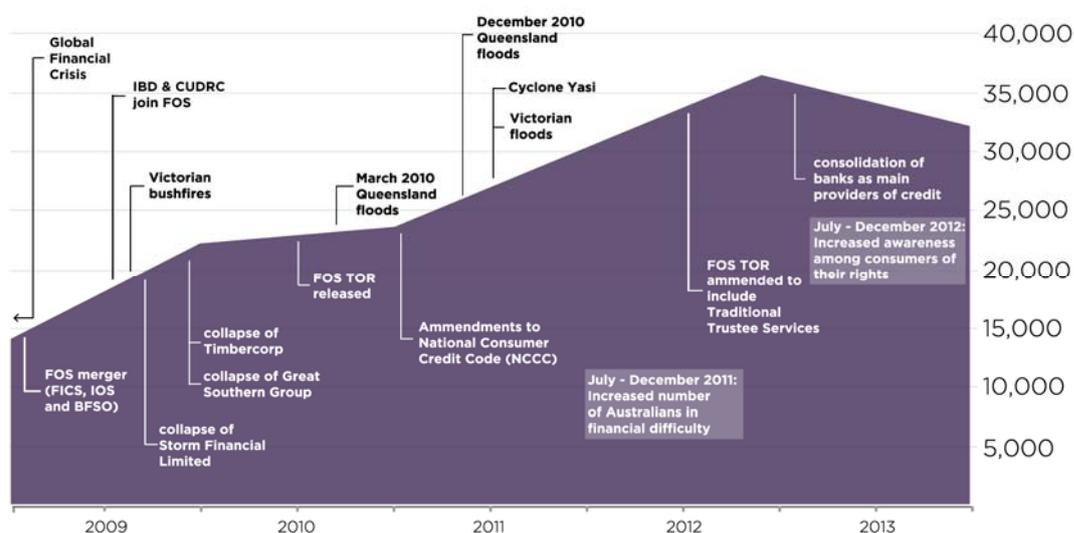
Behind our dispute statistics lie the personal stories of consumers living with the very personal impact of their dispute.

3.1 Rapid increase in dispute numbers from 2008

Since FOS was established in 2008, as a result of the merger of the predecessor sector-based schemes, there has been a dramatic increase in the number of disputes received.

This increase came as a result of a combination of factors: the fallout from the GFC of 2008; the expansion of our jurisdiction under the new national credit reforms and the impact of natural disasters (particularly the floods in Queensland and elsewhere).

Volumes of disputes received



The rapid increase in dispute numbers over the last five years has unfortunately resulted in delays and a backlog of disputes at FOS. This was highlighted in the recent independent review of FOS and our current focus is to significantly reduce this backlog by the end of December 2014 and improve our dispute process to reduce the time taken to resolve new disputes without compromising quality. We have set out the steps we are taking to do so in our 2013-2014 Business Plan and in response to the Independent Review.¹²

3.2 Increase in financial hardship disputes

During this period we also saw a rapid increase in financial hardship disputes received due to new obligations in the national credit regime.¹³ Financial hardship disputes represent 21% of all disputes accepted by FOS (in 2012-2013 just over 5,100 financial hardship disputes were received). See Appendix 2 for further statistical information. The majority of these disputes relate to consumer credit facilities – home loans, credit cards and personal loans.

¹² Cameronralph Navigator Report 2013 : Independent Review of FOS & FOS Board Response: <http://www.fos.org.au/about-us/independent-reviews> and FOS Business Plan 2012-2013: <http://www.fos.org.au/publications/business-plan/>

¹³ National Credit Code in Schedule 1 of the *National Consumer Credit Protection Act 2009*.

There is also often a strong link between financial exclusion and financial stress or hardship. Recent research indicates that there may be around 17% of the adult Australian population who are either fully excluded or severely excluded from financial services.¹⁴

3.3 Recent flattening in dispute numbers

Despite the rapid increase in disputes received by FOS over the last five years, we have welcomed a flattening of disputes numbers in 2012-2013 across all sectors. This is the result of:

- the resolution of the spike in investment disputes arising from the fallout of the GFC
- the efforts and investment many major financial services providers have made in improving their systems and processes for internal complaints resolution and claims management processes
- initiatives by the Australian Banking Association and major banks to improve their approach to financial hardship matters¹⁵
- legislative changes to the flood coverage offered by insurance policies
- initiatives by the Insurance Council of Australia and insurance companies to improve claim handling for natural disasters,¹⁶ and
- efforts within other sectors to enhance their professional codes and standards of conduct for their members.

A hallmark of each of these efforts has been the collaborative approach of the relevant industry bodies and financial services providers working with relevant consumer organisations, policy makers and other stakeholders, with a clear focus on improving customer outcomes.

3.4 The financial system affects lives

What can often get lost in this discussion is the very real impact the financial sector can have on the lives of individual consumers in Australia.

Much of the discussion around the financial sector can become focused on the details of market structures, funding, new products and regulation from the perspective of the various intermediaries and institutions involved in the financial sector. Discussion of EDR can also focus on aggregate numbers and types of disputes.

What can often get lost in this discussion is the very real impact the financial sector can have on the lives of individual consumers in Australia.

FOS becomes involved when things have gone wrong, and we are well aware that behind our dispute statistics lie the personal stories of consumers living with the personal impact of their dispute on themselves, their families and often their communities.

¹⁴ The Centre for Social Impact for National Australia Bank, May 2012- *Measuring Financial Exclusion in Australia*, http://cr.nab.com.au/docs/nab_fin_exclusion_report_final_2012_web-2_1.pdf

(Financial exclusion is defined as where individuals lack access to appropriate and affordable financial services and products such as a transaction account, general insurance and a moderate amount of credit)

¹⁵ See www.fos.org.au – 2012-2013 Annual Review, page78: Industry bodies have also worked closely with their members. The Australian Banker's Association (ABA) released their financial hardship industry guide in 2013, and a revised Code of Banking Practice which includes a greater focus on banks working with their customers to overcome financial difficulty.

¹⁶ General Insurance Code of Practice 2012, Insurance Council of Australia:

<http://www.codeofpractice.com.au/Portals/0/Code%20of%20Practice%202012%20-%20FINAL%20.pdf>

In the lead up to the GFC, these stories painted a picture of inappropriate leverage; individuals sold complex products they did not really understand by financial services providers they trusted; products that were not necessarily fit for purpose; people losing much of their savings which they had put away in anticipation of a comfortable retirement; and the devastating impact of different definitions of insurance cover for losses arising from natural disasters.

And, despite the long economic boom we have experienced in Australia, there were and still are many people who are vulnerable to shifts in their life circumstances – shifts that can suddenly cause financial hardship and an inability to meet obligations entered into with financial services providers in better times.

We deal with applicants seeking to come to terms with what has happened to their lives. Some are resigned, some are angry and many are confused. Often the most distressing cases we deal with involve people who feel guilty or embarrassed that they have let themselves enter into financial arrangements they really did not fully understand – even when they are not at fault or had placed their trust in the financial services provider or relied on guidance and advice from a trusted intermediary.

The overwhelming majority of consumer complaints are resolved directly between consumers and their financial services providers without FOS getting involved. It is also important to note that lodging a dispute with FOS does not mean that we necessarily decide the dispute in the consumer's favour. FOS provides an impartial resolution process – despite the emotions often involved, our role is to review and make our decisions based on the facts and merits of the specific disputes.

4 Effective dispute resolution

FOS's jurisdiction is based on the application of a merits-based approach to resolving disputes.

The current regulatory arrangement for consumer EDR in the financial sector has two key elements:

- an obligation on financial services providers to have in place internal dispute mechanisms, and
- access by consumers to an independent EDR scheme if they are unable to resolve the matter directly with their financial services provider.

4.1 Internal Dispute Resolution

Trust is multi-faceted and is most frequently associated with the stability of the institution and the customer experience, with "the way I am treated" being of great importance followed closely by...problem resolution.¹⁷

Internal Dispute Resolution (IDR) arrangements provide the cornerstone for effective consumer redress mechanisms in the financial sector. The vast majority of consumer issues are resolved by financial services providers directly with their customers, and research shows the way in which financial services providers deal with problems when they occur is key to gaining consumer trust and confidence.

In recent years, many financial services providers have recognised that dealing effectively with customer concerns is not only the right thing to do but also makes good business sense. Their increased commitment and investment in systems and processes to deal with consumer complaints has led to both improved customer satisfaction and retention. Effective IDR is therefore an important element to restoring consumer trust in financial services.

4.2 External Dispute Resolution

The second element of current regulatory arrangements is consumer access to an ASIC-approved independent and impartial dispute resolution scheme when they are unable to resolve their complaint directly with their financial services provider.

Industry-based dispute resolution schemes emerged in Australia to provide the community with a cheaper, quicker and less formal alternative to the courts to resolve certain disputes in the financial sector. Without such schemes, the only option available to consumers would be to seek external dispute resolution through the courts, which is not a practical option for many consumers in Australia.

While decisions made by industry-based EDR schemes (where accepted by the consumer) are binding on financial services providers, they are not binding on consumers, who are able to take their dispute to court if they do not accept the outcome.

FOS does, however, have mechanisms to engage with stakeholders on the approach we take to particular types of disputes. We encourage internal discussions at industry and

¹⁷ EY Global Consumer Banking Survey 2014, *Winning through customer experience*: [http://www.ey.com/Publication/vwLUAssets/EY_-_Global_Consumer_Banking_Survey_2014/\\$FILE/EY-Global-Consumer-Banking-Survey-2014.pdf](http://www.ey.com/Publication/vwLUAssets/EY_-_Global_Consumer_Banking_Survey_2014/$FILE/EY-Global-Consumer-Banking-Survey-2014.pdf)

consumer meetings. We have recently put in place a formal review mechanism to complement these discussions.¹⁸

In Australia, industry-based EDR schemes provide services free to consumers to resolve disputes.¹⁹ FOS also:

- helps financial services providers resolve disputes with consumers directly
- shares and discusses information about issues that commonly give rise to disputes, with a view to preventing or reducing future disputes
- highlights and addresses systemic issues, and
- contributes to policy development and law reform.

4.3 Merits based jurisdiction

FOS's jurisdiction is based on the application of a merits-based approach to resolving disputes. We decide each individual case on its merits based on the specific facts and circumstances involved. Our jurisdiction reflects our role as an EDR scheme for individual consumer disputes in the financial sector.

When deciding a dispute and determining whether a remedy should be provided, FOS will do what in its opinion is fair in all the circumstances, having regard to each of the following:

- legal principles
- applicable industry codes or guidance as to practice
- good industry practice, and
- previous relevant decisions of FOS or a Predecessor Scheme (although FOS will not be bound by these).²⁰

The courts in Australia and overseas and in jurisdictions such as the UK, have strongly endorsed a merits-based approach for EDR schemes.²¹

This is illustrated in the way the Financial Ombudsman Service in the UK describes its approach to resolving disputes, which is “to ask questions, listen to both sides of the story, and decide each case on its individual facts and merits – not on how cleverly or persuasively either side argues their case”.²²

Over the years, some lawyers and participants in the financial sector have called for a more legalistic and adversarial approach to EDR. However, we do not consider this is consistent with the broad principles that apply to EDR in Australia and in other jurisdictions.

In an environment as dynamic as the financial sector, the current merits-based jurisdiction is also an important factor, allowing EDR to keep pace with industry developments and to resolve individual disputes on their individual merits in a collaborative manner rather than applying a more legalistic and adversarial approach.

¹⁸ To be shortly included in the FOS Operational Guidelines- <http://www.fos.org.au/about-us/terms-of-reference/>

¹⁹ The principles adopted in Australia for establishing EDR schemes are consistent with the G20 High Level Principles on Financial Consumer Protection, which emphasise the need for jurisdictions to ensure that consumers have access to adequate complaints handling and EDR mechanisms that are accessible, affordable, independent, fair, accountable, timely and efficient.

²⁰ Clause 8.2, FOS Terms of Reference- <http://www.fos.org.au/about-us/terms-of-reference/>

²¹ *Wealthcare Financial Planning Pty Ltd v Financial Industry Complaints Service Ltd & Ors* [2009] Vsc 7 & *Moor & Edgecomb Limited v FOS and Simon Lodge* [2008] EWCA Civ 642.

²² Financial Ombudsman Service UK, *Frequently Asked Questions*: <http://www.financial-ombudsman.org.uk/faq/index.htm>

4.4 Accountability framework

As an ASIC-approved EDR scheme, FOS is required to meet the robust accountability and other conditions set out by ASIC in its Regulatory Guide 139. (See details further details in Appendix 1).

FOS must be accessible to consumers by providing a dispute resolution service (even when legal proceedings have commenced) at no cost to the consumer, and must actively promote its services so consumers are aware of its existence.

These various approval conditions ensure that FOS:

- operates independent of industry
- acts impartially and fairly in its decision-making
- is governed by a Board of Directors (comprised of equal numbers of consumer and industry directors and an independent Chair)
- reports regularly to its stakeholders and publicly on its performance
- reports systemic issues and serious misconduct to ASIC, and
- undertakes periodic independent reviews.

These measures provide a robust accountability framework for FOS dispute resolution and the services we provide to consumers of Australian financial services.

Recommendation 3:

The current process for resolving financial services disputes – which is based on a cooperative, non-adversarial, industry-based approach – should be maintained.

5 Evolution of external dispute resolution

Both financial services providers and EDR are expected to innovate and transform themselves for the future.

The history of EDR in Australia is one of adaption and evolution in response to changes in the financial sector.

5.1 Dispute resolution evolves with a changing financial system



In the financial sector, EDR was developed following deregulation of the financial system, after the Campbell Committee Inquiry, and the emergence of an active consumer movement in Australia. The current regulatory arrangements for EDR followed the implementation of the current twin peak regulatory structure recommended by the Wallis Inquiry.

The diagram above shows that in a dynamic financial sector, it is inevitable that EDR needs to evolve and adapt. Customer expectations, technological capabilities, regulatory requirements, demographics and economics all create the imperative for change. Both financial services providers and EDR schemes will need to continually innovate and transform themselves for the future.

The current EDR model – being a compact between major stakeholders, and taking a cooperative, non-adversarial approach with a robust accountability framework – means that FOS is well placed to evolve and adapt to changes in the financial sector.

6 Industry codes of practice

Industry codes can play an important role in enhancing the relationship of trust between consumers and financial service providers.

6.1 The role of industry codes

A code of practice sets standards of good industry practice for financial service providers to follow when dealing with people who are, or who may become, individual or business customers. FOS provides support arrangements for a number of codes in the financial sector, with a separate business unit supporting the work of independent code compliance committees²³ whose role is to monitor compliance with these standards.

The committees are comprised of an independent chair, a consumer representative and an industry representative. In our experience this composition facilitates transparency and accountability in the code monitoring and governance frameworks.

Each of the contractual arrangements with the committees is the subject of a separate funding and service level agreement with the relevant industry body or code committee.

The codes involved are:

- the Code of Banking Practice
- the Customer Owned Banking Code of Practice
- the General Insurance Code of Practice, and
- the Insurance Broker's Code of Practice.

Each code subscriber has made a commitment to:

- work to improve the standards of practice and service in their industry
- promote informed decisions about their services, and
- act fairly and reasonably in delivering those services.

6.2 Industry codes can help build consumer trust

Industry codes can play an important role in enhancing the relationship of trust between consumers and financial service providers. They are means by which industry bodies and their members can complement formal law and regulation in areas relating to service issues for consumers, standards of professional conduct, practice standards and ethical behaviour. They are also useful for addressing new and emerging issues, such as for electronic transactions.²⁴

Most industry codes are “technology neutral”. Accordingly, codes can respond to changing business models within the financial sector, including the transition from face to face interaction with customers towards digitalised services.

²³ FOS Annual Review 2012-2013- <http://www.fos.org.au/publications/annual-review/>

²⁴ epayments Code 2012- regulates electronic payments, including ATM, EFTPOS and credit card transactions, online payments, internet and mobile banking, and BPAY.

Industry codes can potentially play an important role in the initial product design stage and within the whole lifecycle of a financial product. Codes have traditionally paid less attention to industry standards for product design or ensuring the financial products are “fit for purpose”.

In a number of other jurisdictions the relevant regulator has articulated high level principles on product design. The Monetary Authority of Singapore²⁵ and the UK Financial Conduct Authority²⁶ both have principles for fair dealing with consumers that clearly set out the responsibilities of the Board and senior management of the financial services provider in ensuring that “trust” and a culture of fair dealing is embedded at all stages of the life cycle of a financial product and service, including in the initial product design stage. The Australian Financial Markets Association has also published a set of principles relating to product approval for retail structured products.²⁷

Recommendation 4:

Industry codes governing the financial industry sector, play a vital role in supporting consumer trust, and should be supported.

²⁵ Monetary Authority of Singapore (Financial Advisers Act- CAP 110)- *Guidelines on fair dealing: board and senior management responsibilities for delivering fair dealing outcomes to customers*: http://www.mas.gov.sg/~media/resource/legislation_guidelines/fin_advisers/fin_advisers_act/guidelines/Guidelines%20on%20Fair%20Dealing.ashx

²⁶ UK Financial Conduct Authority: *The six TCF outcomes: Treating Customers Fairly*: <http://www.fca.org.uk/firms/being-regulated/meeting-your-obligations/fair-treatment-of-customers>

²⁷ Australian Financial Markets Association October 2012-*Principles relating to product approval: retail structured financial products*: <http://www.afma.com.au/afmawr/assets/main/lib90032/product%20approval%20principles.pdf>

7 Access for vulnerable and disadvantaged consumers

Without community-based financial counselling and specialist community legal services, many consumers would have no help with financial problems that are impacting on their lives and wellbeing.

As a key principle of EDR, FOS should be accessible to all consumers of financial products in Australia. Such access is easier for those in our community who are financially literate, are connected to services and information through the internet, and have the knowledge and resources to seek external dispute resolution if they have a problem with their financial services provider. We are aware, however, that vulnerable and disadvantaged consumers often have difficulties seeking assistance from an EDR scheme.

We are committed to making FOS services available to all consumers, particularly those who may be vulnerable and disadvantaged. We work with a range of community organisations that assist FOS in the resolution of disputes by advising customers about appropriate resolution techniques and engaging with FOS in various ways. We believe that their contribution has been invaluable in ensuring consumers have appropriate representation and assistance at both IDR and EDR levels.

7.1 Community-based financial counselling and legal centres

Community-based free financial counselling and specialist community legal services²⁸ are an important part of the social infrastructure of our financial sector. Financial counsellors and specialist community legal services connect vulnerable and disadvantaged members of the community to EDR schemes such as FOS, and to other important services where needed. Community-based financial counselling services also support practical financial literacy for the individuals they assist by help with budgeting, dealing with credit issues and other practical financial matters.

Without the support provided by community-based financial counselling and specialist community legal services, many consumers would have little or no opportunity for their dispute with a financial services provider to be considered and resolved.

However, we are seeing a gap in the availability of financial counselling services to consumers, and this is confirmed by consumers who tell us about long delays in obtaining assistance from these services. These delays and accessibility issues lead to the exacerbation of the concerns that brought the consumers to FOS in the first place, and negatively impact both their personal and financial circumstances.

A recent submission by Financial Counselling Australia²⁹, the peak body for the financial counselling sector, highlights the special role its members play in supporting consumers in need of financial support. For FOS, the ongoing availability and support of community based financial counsellors and legal services is a key aspect of the infrastructure underpinning financial sector dispute resolution.

²⁸ We also note a number of publicly funded state legal aid organisations that provide similar services. We have included these organisations in the *specialist community legal services* description.

²⁹ Financial Counselling Australia, Pre-Budget Submission, January 2014:

<http://www.financialcounselingaustralia.org.au/getattachment/Corporate/News/Pre-Budget-Submission-Calls-for-Ongoing-Funding-fo/FCA-Pre-Budget-Submission-2014.pdf>

A cost-benefit analysis of financial counselling services funded by the Wyatt Trust in South Australia, has found that every \$1 invested provides a \$5 return.³⁰

The analysis did not include other benefits which are more difficult to quantify, such as improvements in financial literacy, stabilised housing or avoidance of legal action. In other words, the \$1:\$5 cost benefit is likely to be an understated and conservative measure of the benefit of financial counselling.³¹

7.2 Joint initiatives to assist vulnerable and disadvantaged consumers

Financial counsellors and specialist community legal services have played an important role in working with the financial services industry to pilot practicable approaches for dealing with consumers experiencing long-term financial difficulty, where it is clear that the consumer's circumstances will not improve. Consumers who fall into this profile are commonly long-term recipients of Centrelink payments who do not have assets.

An example of this collaboration is the work being done by Financial Counselling Australia with the major banks to establish a debt repayment service in Australia.³² A service of this nature will provide consumers with an option that does not presently exist.

Financial counsellors also add value by sharing their experiences of dealing with consumers experiencing financial difficulty. In September 2013, Financial Counselling Australia conducted a comparative hardship workshop which brought together hardship practitioners within the telecommunications industry, financial services, energy and water sectors, as well as government, regulators and EDR schemes. The workshop shared approaches for hardship across the industries and identified six key principles to be explored in more depth across the industries.

Financial Counselling Australia has also collaborated across the financial services industry to assist with the development of:

- mental Health Guidelines to help industry better deal with people suffering mental health issues
- guidelines for dealing with customers in financial hardship
- an information sheet about basic bank accounts for disadvantaged customers
- a single Statement of Financial Position and Privacy Authority to aid the more efficient delivery of services to customers experiencing financial difficulty

7.3 The risk of a commercial claims management industry

In the absence of community-based financial counsellors and specialist community legal services, there is a risk that a commercial 'claims management industry' will develop. This has occurred on large scale in the UK, arising from disputes about the mis-selling of payment protection insurance policies. UK FOS has indicated that 57% of all payment protection insurance disputes they received in 2013 were lodged on behalf of consumers by claims management companies.³³

³⁰ Parvin Mahmoudi, Ann-Louise Hordacre and John Spoehr, The University of Adelaide, 2012: *Paying it forward, Cost benefit analysis of the Wyatt Trust Funded Financial Counselling Services*, http://www.adelaide.edu.au/wiser/docs/WISeR_wyatt-report2014.pdf

³¹ See footnote 30

³² The Debt Repayment Service will assist consumers in financial difficulty that have the ability to repay some portion of their debts, but not the entire debt. The service negotiates an affordable repayment arrangement, usually for a portion of the debt and with no interest. The consumer then makes one payment to the service each month and this is distributed on a pro rata basis to creditors: <http://www.financialcounsellingaustralia.org.au>

³³ Financial Ombudsman Service UK- Annual Review 2012/13: <http://www.financial-ombudsman.org.uk/publications/annual-reviews.htm>

Claims management companies charge consumers a fee for providing representation. In some cases fees can be significant. A report from the UK Citizen Advice Bureau has identified the scale of fees charged, aggressive cold calling and other misconduct as being of concern to consumers. The report calls for bans on unsolicited contacts and upfront fees, a crackdown on the lead generator feeds (feeding companies with consumer contact details) and a strengthening of consumer protection in this market against misuse of data and misleading contracts.³⁴

The EDR arrangements in Australia mean that we are able to provide a free service to consumers, and we base our dispute processes on a co-operative approach with our stakeholders. We consider that the development of a claims management industry in Australia of the type and scale now being seen in the United Kingdom could lead to more adversarial conduct from all parties. We do not consider this is consistent with the current approach to EDR in Australia.

Recommendation 5:

Adequately funded community financial counselling and specialist community legal services play a critical role in promoting practical financial literacy among their clients, and help prevent future problems. Support for sustainable community financial counselling and legal services will also help mitigate against the emergence of a claims management industry in Australia. We urge the government and financial sector to work together to develop a sustainable funding basis for the provision of these financial counselling and related services.

³⁴ Citizen Advice Bureau November 2012 UK: *The claims pests: Citizen Advice Bureau- evidence on PPI and claims-management companies*, http://www.citizensadvice.org.uk/the_claims_pests

8 Gaps in consumer redress and regulation

FOS wishes to ensure that when decisions of compensation in favour of consumers are made, these are able to be paid.

There is a potential weakness in the consumer redress mechanisms available to ASIC because the regulator does not currently have an explicit power to put in place a consumer redress scheme for a firm or sector when it identifies that consumers have potentially suffered a loss.

8.1 General Consumer Redress Schemes

FOS's role is primarily to resolve individual disputes based on a fair assessment of the individual facts, circumstances and merits of the case. Difficult issues can arise where there are large numbers of disputes arising from failings in a financial services provider or financial product (or service) which requires a substantial number of customers' claims of loss to be assessed. Currently, ASIC uses enforceable undertakings for this purpose and has done so successfully on a number of occasions.

In contrast, the UK regulator has an explicit power³⁵ to put in place a consumer redress scheme for particular financial services providers where:

- there may have been a widespread or regular failure by relevant firms to comply with requirements applicable to the carrying on by them of any activity
- consumers have suffered (or may suffer) loss or damage in respect of which, if they brought legal proceedings, a remedy or relief would be available in the proceedings, and
- it is desirable to make rules for the purpose of securing that redress is made to the consumers in respect of the failure (having regard to other ways in which consumers may obtain redress).

The UK regulator also has powers to appoint an external party to undertake an independent review of aspects of a firm's activities (which, for example, cause concern or require further analysis).³⁶ This is useful when there are concerns about potentially emerging issues that may result in consumer losses.

Recommendation 6:

The Committee should review whether it would be appropriate, in the context of Australian law and regulation, for ASIC to have the powers to put in place a consumer redress scheme and appoint a skilled person review in appropriate circumstances.

8.2 The impact of unpaid Determinations

FOS has issued a number of Determinations which, despite having found the financial services provider liable for the losses suffered by the customer, have not resulted in the awarded compensation being paid to the consumer. Generally, this has happened where the

³⁵ Financial Conduct Authority (UK): Financial Services Markets Act 2000 (as amended by the Financial Services Act 2012) s404

³⁶ Financial Conduct Authority (UK): *Financial Services & Markets Act 2000* (as amended by the Financial Services Act 2012), s166

financial services provider has gone into either liquidation or administration. This issue is emerging mainly in our investments jurisdiction.

While the issue involves only a minority of our members who provide financial advice, the level of unpaid Determinations as at 31 December 2013 is approximately 33% of all Determinations made in our investments jurisdiction.³⁷

Although this issue is currently affecting one financial sector in particular and involves only a minority of financial services providers who are members of FOS, we remain concerned that if it is left unaddressed there is a risk it may cause a loss of trust in FOS and EDR more generally.³⁸

8.3 The limitations of PI insurance

Our experience is that professional indemnity insurance is not an adequate compensation mechanism for consumers where companies have gone into administration or are insolvent.

Under the Corporations Act, ASIC licensees are required to have adequate compensation arrangements. This includes being able to cover EDR scheme compensation pay-outs. To date, professional indemnity insurance policies have been used to fulfil that requirement.

Some reasons why professional indemnity insurance does not operate as an adequate compensation mechanism for unpaid FOS determinations include:

- aggregate funds available under the policy may not be sufficient to meet all awards
- conduct giving rise to the awarded compensation may not be covered by the policy
- the amount of the award may be below the applicable excess under the policy.

We have previously recommended the introduction of a limited last resort compensation scheme for consumers.³⁹ While there have been varying opinions on the most appropriate compensation models, we remain an advocate for some form of limited last resort compensation scheme for consumers whose determinations are not able to be paid by the financial services provider.

We will continue to explore more appropriate mechanisms with ASIC, industry, consumers and policy-makers to ensure that when decisions of compensation in favour of consumers are made, these are able to be paid.

Recommendation 7:

We encourage the Committee to consider a limited last resort compensation scheme for consumers, as professional indemnity insurance is not an adequate compensation mechanism for consumers where companies have gone into administration or are insolvent.

April 2014

³⁷ 18 financial services providers haven't complied with Determinations made by FOS in favour of consumers (1 January 2010 to 1 January 2014). \$8,335,479.95 plus interest is owed to 99 applicants whose claims FOS upheld but have not been paid compensation.

³⁸ FOS special Circular, April 2014: <http://www.fos.org.au/the-circular-special-issue-april-2014/>

³⁹ FOS submission to the *Review of Compensation Arrangements for Consumers of Financial Services*- Richard St John 2010: http://fos.org.au/custom/files/docs/fos_response_to_richard_st_john_report_and_letter_july_2012.pdf

Appendix 1

About FOS

FOS was formed in 2008 from the merger of 3 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 financial services providers.

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.⁴⁰

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 financial services providers 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

⁴⁰ See www.fos.org.au -Terms of Reference, under "About Us".

- 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.

Benchmarks: ASIC Regulatory Guide 139

ASIC has set out the approval standards for schemes in its Regulatory Guide 139 (RG 139)⁴¹. These include standards on independence, accessibility, fairness, jurisdiction and requirements to report systemic issues to ASIC. The approval standards also set out governance requirements including commissioning a periodic independent review.

ACCESSIBILITY

The scheme makes itself readily available to customers 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.

⁴¹ Regulatory Guide 139 *Approval and oversight of external dispute resolution schemes* is available on www.asic.gov.au under “Regulatory Documents”.

Appendix 2- Statistics at a glance⁴²

DISPUTES

32,307

total disputes received

11% ✓ from the previous year

33,773

total disputes closed

71% resolved by agreement

9% resolved by FOS decision

21% discontinued or outside Terms of Reference

5,161 **191**

financial difficulty disputes accepted - down 22% from the previous year

investigations of alleged breaches of industry codes of practice, with 116 confirmed breaches

37

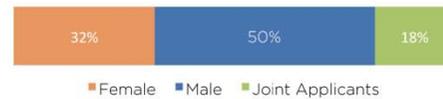
systemic issues resolved >13,600 customers compensated >\$2 million compensation

234,063

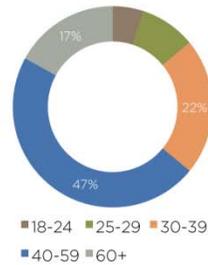
phone calls handled by our contact team, up 2% from the previous year

DEMOGRAPHICS

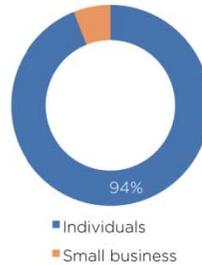
GENDER



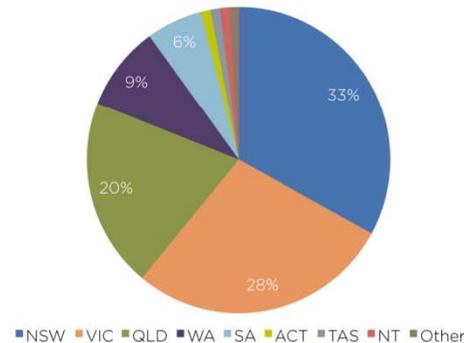
AGE



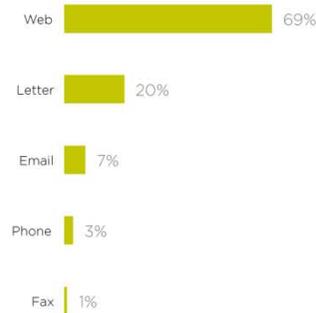
TYPE



LOCATION



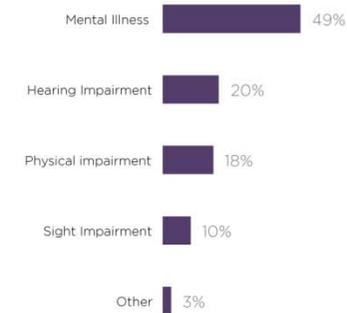
METHOD OF LODGEMENT



6% increase in the number of disputes lodged online from 2011-12 (12% increase from 2010-2011)

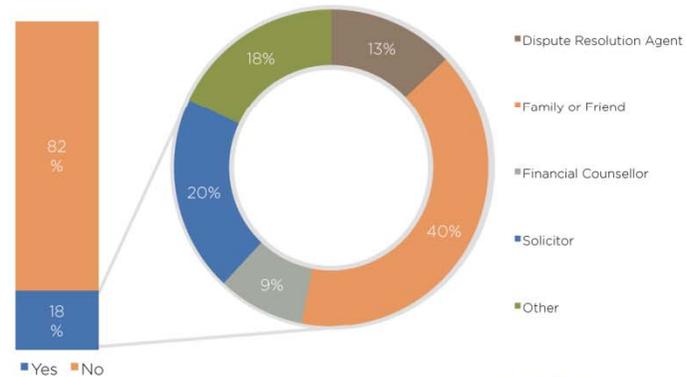
2012-2013

SPECIAL ASSISTANCE



19% increase in the number of consumers who requested special assistance from 2011-12. 49% of these related to mental illness, an increase of 23% from 2011-2012

REPRESENTATION



⁴² The above statistics are from the FOS Annual Review 2012-2013

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