



# Financial System Inquiry

FOS Submission to Interim Report

August 2014



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## Executive Summary

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The Financial Ombudsman Service (FOS) would like to thank the Committee for the opportunity to make a submission to the Financial System Inquiry Interim Report.<sup>1</sup>

### Importance of trust

Trust is paramount to a dynamic financial sector that supports the improved economic wellbeing of all Australians. The fair treatment of customers is at the heart of building trust in financial services. Even when things go wrong, if customer redress is effective, research shows that consumer confidence prevails.

### Approach to consumer protection regulation

Consumers are best served when financial products and services are less complex, more transparent and easier to use. Consumer protection arrangements and external dispute resolution options should also promote less complex, simpler and transparent arrangements that are easy for consumers to understand and use.

### Recommendation 1

The current approach to consumer protection regulation should be reframed. Instead of focusing on separate functional activities, regulation should be more clearly based on the fair treatment of customers at all stages of what is an increasingly integrated product design, origination and distribution system. This approach will help ensure the financial system meets the needs of all users, including consumers and small businesses.

### Consumer outcomes

FOS supports the five consumer outcomes identified by the Inquiry in its interim report. We propose the following modifications to these outcomes (included in **bold**, below).

- 1. Consumers should have access to products and services that help them meet their individual financial needs. Consumers need to be able to make and receive payments, borrow, invest and manage risk. **Products should be appropriate for the needs of the specific categories of consumers to whom they are targeted.***
- 2. Consumers should have access to the information, advice and education **they can trust** necessary to make effective decisions about products and services that help them meet their financial needs. Informed consumers can better stimulate effective competition, driving system efficiency.*
- 3. Consumers should have confidence and trust in the financial system, **financial services providers and their employees, products and services** and be able to expect fair treatment. Effective regulation that minimises misconduct and promotes fair outcomes will drive confidence and trust in the financial system.*

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<sup>1</sup> 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.

- 4. Financial services and products should meet the purposes for which they are sold. Products and services should be accurately described, and perform as they are described, especially in the trade-off between risk and return.*
- 5. Consumers should have access to timely, low-cost and efficient dispute resolution and remedies when problems arise. Effective avenues for redress provide access to justice for consumers and promote confidence and trust in the system.*

## **Recommendation 2**

The Inquiry should include an additional consumer outcome with a specific focus on the importance of enhanced support arrangements for vulnerable consumers and those currently excluded from or on the margins of the formal financial services sector.

### **A limited default consumer protection scheme**

FOS considers the Inquiry should recommend that the regulatory gap in current consumer protection arrangements be fixed. This is not about imposing any new regulatory obligations. Rather, it is to ensure current legal obligations operate as they should and provide adequate compensation arrangements for all retail customers.

We have attached a report prepared by Grant Thornton<sup>2</sup> that provides, for illustrative purposes, some possible alternative funding arrangements for such a scheme (See Appendix 2).

Also, what can often get lost in this discussion is the impact that losses and unpaid compensation awards have on the lives of individual consumers and their families. At Appendix 1, we provide brief examples based on FOS published Determinations that remain unpaid.

## **Recommendation 3**

FOS supports the establishment of a default consumer protection scheme, funded by all relevant licensed entities in the financial product distribution process. The scheme would enable the establishment of a fund to ensure consumers are paid when awarded compensation in a FOS decision. The scheme would be structured as a legal entity that is separate and independent of FOS.

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<sup>2</sup> <http://www.grantthornton.com.au/>

## **Managed investments**

FOS's dispute experience has shown that the combination of conflicted remuneration and failed managed investment scheme businesses has resulted in significant consumer losses over a number of years.

### **Recommendation 4**

FOS considers that, along with steps to remove conflicted remuneration arrangements in the provision of advice, the changes proposed by CAMAC to the managed investments regime would help reduce the incidence of these consumer losses in future.

## **Financial advice**

FOS supports the views of the Inquiry on the impact of conflicted remuneration on the ability of consumers to access advice they need and can trust.

FOS also supports industry and regulatory initiatives to improve the competency, training and professional requirements for advisers, and the concept of a register of individual advisers. Similar registers implemented in the region can provide useful models.

While we acknowledge that this is a complex issue, FOS has reservations about whether renaming general advice as "sales" or "product information" is an adequate solution to the problems that arise from conflicted remuneration and the increasing structural integration of retail product issuer and distribution mechanisms.

## **Obligations for product design and distribution arrangements**

Consistent with a customer life cycle approach to consumer protection regulation, FOS supports product issuers having appropriate responsibilities for the suitability of their products and for the expertise, professionalism and conduct of those they engage to distribute those products to end customers on their behalf. These responsibilities could be achieved either by formal regulation or through a regulator-approved code of practice.

### **Recommendation 5**

We consider there is merit in requiring product issuers or manufacturers to be required to take reasonable steps to address the suitability of their products for their target customer segments.

### **Recommendation 6**

We also consider that product issuers should have appropriate responsibilities for the expertise, professionalism and conduct of the entities they engage to distribute their products to customers, and that those entities have adequate compensation arrangements in place.

## **Support vulnerable and disadvantaged consumers**

FOS supports continued efforts to ensure sustainably-funded community financial counselling, specialist legal services and legal aid organisations are available to assist vulnerable and disadvantaged financial consumers.

We support further collaborative initiatives between government, industry and community organisations to develop sustainable micro finance arrangements.

### **Recommendation 7**

Continued support is essential to enable the provision of assistance on financial service issues to vulnerable and disadvantaged consumers. In the absence of these community arrangements, we are concerned that entities will operate outside the regulatory net and that vulnerable consumers will be targeted by predatory business practices.

## **The Regulator**

We consider that ASIC, as the financial sector consumer protection regulator, should have the expertise, resources, capabilities and powers to enable early supervisory intervention in order to limit serious conduct problems. This would require a regulatory philosophy that combines an early intervention “supervisory” approach with a strong focus on enforcement when the law is breached.

### **Recommendation 8**

FOS also considers there would be benefits in ASIC being able to intervene at an early stage to address emerging problems rather than only being able to act once consumer losses have potentially occurred. The UK regulator 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). We recommend a similar power should be considered for ASIC.

## **Future developments in external dispute resolution (EDR)**

FOS welcomes the interim report’s recognition that it is important for consumers to have access to timely, low cost and efficient dispute resolution and remedies when problems arise, and that EDR arrangements in the financial sector are generally working well.

### **Recommendation 9**

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.

# Restoring trust in financial services

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## Introduction

FOS welcomes the interim report's focus on consumer trust and confidence in the financial system. This reflects the key theme of the FOS submission to the Inquiry, in which we recommended placing **sustainable consumer trust in financial services** at the heart of the Inquiry's considerations, as trust is the key principle underpinning a dynamic, innovative and competitive financial sector.<sup>3</sup>

In FOS's initial submission we highlighted international research which shows that trust in financial services continues to lag other industry sectors<sup>4</sup>.

We also welcome the Inquiry setting out, as key principles:

- the importance of the financial system serving the needs of end users, including consumers
- acknowledging that fairness is an important policy objective for the financial system, and
- setting out the role fairness plays in supporting the development and maintenance of trust in the financial sector.

## Refreshing the underpinnings of consumer protection regulation

FOS supports an approach to consumer protection regulation that takes account of evidence about how individuals make decisions when dealing with financial matters.

We welcome the Inquiry's acknowledgement of the limitations of the current disclosure-based approach.

The current approach to consumer regulation grew out of the Wallis Inquiry's analysis of trends in the financial system and its views that the regulatory structure should be based on the hierarchy of the "intensity of promises" in the financial sector. This approach led to the formation of the twin peaks regulatory structure with prudential regulation by APRA and conduct regulation by ASIC, the latter centred on a disclosure-based philosophy.

While somewhat of a generalisation, this led to distinct supervisory styles being adopted by the prudential and conduct regulators. The focus of the prudential regulator was more

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<sup>3</sup> The importance of trust as a key component of a competitive financial centre has been adopted in other regional jurisdictions. For example, the Managing Director of the Monetary Authority of Singapore said in a recent speech:

"Let me conclude. The global financial industry is undergoing great change. What kind of financial centre do we want to be? If I had to choose three words, I would say robust, trusted, and purposeful

- robust, in the sense of building resilience against shocks and managing risks prudently;
- trusted, in the sense of staying clean and imbibing a culture of fair dealing with all stakeholders; and
- purposeful, in the sense of generating real value, creating opportunities for people, and serving the economic needs of Singapore and the region.

**Singapore's Financial Centre in the New Landscape" - Keynote Address by Mr Ravi Menon, Managing Director, Monetary Authority of Singapore, at Investment Management Association of Singapore (IMAS) 14th Annual Conference on 13 March 2013**

<sup>4</sup> 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/>

about preventing problems emerging, while the focus of the market conduct regulator was on taking enforcement action once problems crystallised. Increasingly, these distinctions have become blurred as a result of developments following the global financial crisis.

The Wallis Report also highlighted the blurring among once distinct sectors in the finance system due to the impact of technology and broader market developments.

As the interim report notes, there have been significant changes in the financial sector since the Wallis Inquiry. These changes include the dramatic growth of the finance system and the considerable consolidation and integration across banking, insurance and wealth management. The interim report also highlights the limits of the Wallis Inquiry's disclosure-based approach to consumer protection regulation, given events and experiences since the Wallis Committee report.

A result of the Wallis Inquiry's analysis of regulation was the development of a consumer protection regime that treats customer advisers and agents, product issuers, platform providers, custodians and responsible entities as distinct activities which are each subject to separate functional and disclosure-based approaches to conduct regulation.

This functional approach had merit in enabling a move away from the previous institution-specific conduct regulation that treated similar products and activities differently across industry sectors.

However, given the consolidation and integration within the financial sector and the likely future impact of technology, the approach to consumer protection now needs to be shaped around a financial sector where product origination, risk management, intermediation and distribution to end users operate as an integrated value chain (in the case of consumers on a life cycle basis) rather than as separate industry sectors, products, entities or activities.

Increasingly, these links apply to both open and closed architecture distribution models via ownership by the banks and product issuers of the major distribution channels, or by service arrangements with platform or administration services that create networked linkages among multiple participants in the financial system.

This view of the financial system as an integrated origination and distribution network underpinned FOS's recommendations in our initial submission of:

- ensuring customer interests were put first **in all business stages**
- the creation of sustainable relationships of trust **through the whole intermediation process**, and
- **appropriate standards of care** across the financial system rather than just in parts of the process.

## Recommendation 1

The current approach to consumer protection regulation should be reframed. Instead of focusing on separate functional activities, regulation should be more clearly based on the fair treatment of customers at all stages of what is an increasingly integrated product design, origination and distribution system. This approach will help ensure the financial system meets the needs of all users, including consumers and small businesses.

## Support for Proposed Consumer Outcomes

In FOS's initial submission we proposed the Inquiry's recommendations should encourage and support consumer trust and confidence in the financial system, the financial services providers (FSPs) and individuals they deal with, and the products and services they use.<sup>5</sup>

Accordingly, we support the five consumer outcomes identified by the Inquiry in its interim report, and propose strengthening the outcomes further (indicated in **bold** below):

- 1. Consumers should have access to products and services that help them meet their individual financial needs. Consumers need to be able to make and receive payments, borrow, invest and manage risk. **Products should be appropriate for the needs of the specific categories of consumers to whom they are targeted.***
- 2. Consumers should have access to the information, advice and education they can trust necessary to make effective decisions about products and services that help them meet their financial needs. Informed consumers can better stimulate effective competition, driving system efficiency.*
- 3. Consumers should have confidence and trust in the financial system, **financial services providers and their employees, products and services** and be able to expect fair treatment. Effective regulation that minimises misconduct and promotes fair outcomes will drive confidence and trust in the financial system.*
- 4. Financial services and products should meet the purposes for which they are sold. Products and services should be accurately described, and perform as they are described, especially in the trade-off between risk and return.*
- 5. Consumers should have access to timely, low-cost and efficient dispute resolution and remedies when problems arise. Effective avenues for redress provide access to justice for consumers and promote confidence and trust in the system.*

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<sup>5</sup> FOS Submission to the FSI Inquiry- April 2014: <http://www.fos.org.au/custom/files/docs/fos-submission-to-fsi-inquiry.pdf>

## **Recommendation 2**

The Inquiry should include an additional consumer outcome with a specific focus on the importance of enhanced support arrangements for vulnerable consumers and those currently excluded from or on the margins of the formal financial services sector.

### **Unpaid FOS Determinations: a limited default consumer protection scheme**

The current Corporations law requires licensed entities to have compensation arrangements in place to ensure any awards of compensation to customers are able to be paid for breaches of the law. Despite this clear obligation, FOS continues to see customers who have been awarded compensation not being paid.<sup>6</sup>

There is general industry and regulatory agreement that while professional indemnity insurance is important, it is not designed to function as a consumer compensation mechanism.

FOS considers the Inquiry should recommend that this regulatory gap in current consumer protection arrangements be fixed. This is not about imposing any new regulatory obligations. Rather, it is to ensure that current legal obligations operate as they should and provide adequate compensation arrangements for all retail customers.

There have been a number of recent reviews on the appropriate solution to this issue and as the interim report noted, there were mixed views on the need for a compensation scheme.

However, FOS considers that while circumstances have changed since the issue was last reviewed, there appear to be no viable alternative proposals that directly address the problem of unpaid Determinations and consumer losses. Consumers must have confidence that when things go wrong, they will be compensated when there is a decision made in their favour.

What can often get lost in this discussion is the impact that losses and unpaid compensation awards have on the lives of individual consumers and their families. To illustrate this, we provide brief examples based on FOS published Determinations that remain unpaid (see Appendix 1).

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<sup>6</sup> Since 1 January 2010:

- 22 financial services providers (FSPs) have been unwilling or unable to comply with 105 FOS determinations made in favour of consumers.
- As at 30 June 2014, the value of the outstanding amounts awarded by these determinations is \$10,157,401.23 plus interest (interest accrues at approximately 5% per annum).
- Four unpaid determinations relate to disputes that are now the subject of legal proceedings commenced by FOS.

This issue affects approximately 150 individuals whose claims FOS upheld but who have not been paid the compensation awarded to them. 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, unpaid determinations represent 29.33 per cent of all determinations issued in the Investments, Life Insurance and Superannuation (ILIS) area, and relate to disputes in the financial planning and advisory sector. This is despite the small number of FSPs involved.

We consider it to be in the interests of all financial system participants to find a solution to the issue of unpaid FOS Determinations that helps rebuild consumer trust in financial services.

We are confident such a scheme 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 or as part of any ASIC levy funding arrangement.

The aim would be to establish the basic fund over three years, with any subsequent fee or levy being reduced based on claim experience during that period. We have attached a report prepared by Grant Thornton that provides, for illustrative purposes, some possible alternative funding arrangements for such a scheme (See Appendix 2).

Implementing this type of default scheme would not prevent the development of other industry or professional body arrangements. If such arrangements are put in place and eliminate any risk of unpaid Determinations to consumers, this can be factored into the funding arrangements of the default scheme.

We have presented some illustrative costing of the scheme to show how such a fund could be established and phased in at relatively low cost. The detailed governance, operational and other implementation issues would need to be developed in consultation with government, ASIC and relevant stakeholders.

### **Recommendation 3**

FOS supports the establishment of a default consumer protection scheme funded by all relevant licensed entities in the financial product distribution process. The scheme would enable the establishment of a fund to ensure consumers are paid when awarded compensation in a FOS decision. The scheme would be structured as a legal entity that is separate and independent of FOS.

### **Managed investments regime**

FOS's dispute experience has shown that the combination of conflicted remuneration and failed managed investment scheme businesses has resulted in significant consumer losses over a number of years.

### **Recommendation 4**

FOS considers that, along with the steps to remove conflicted remuneration arrangements in the provision of advice, the changes proposed by CAMAC to the managed investments regime would help reduce the incidence of these consumer losses in future.<sup>7</sup>

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<sup>7</sup> One of the contributors to the CASAC (now CAMAC) report Dr Pamela Hanrahan has proposed the regulatory regime should: "[ ] limit the kinds of managed investment schemes that may be registered under the Corporations Act to schemes that are taxed as unit trusts under the Tax Act. This will allow for the continued

## Financial advice

FOS supports the views of the Inquiry on the impact of conflicted remuneration on the ability of consumers to access advice they need and can trust.

FOS also supports industry and regulatory initiatives to improve the competency, training and professional requirements for advisers, and the concept of a register of individual advisers. Similar registers implemented in the region can provide a model.<sup>8</sup>

While we acknowledge that this is a complex issue, FOS has reservations about whether renaming general advice as “sales” or “product information” is an adequate solution to the problems that arise from conflicted remuneration and increasing structural integration of retail product issuer and distribution mechanisms.

These reservations include:

- Whether consumers would be able to clearly distinguish between sales, product information and general advice
- Whether, with the level of customer information available to FSPs through sophisticated data mining and analytics capabilities, it will be increasingly difficult to distinguish whether product advice is based on an analysis of the particular circumstances of a customer, or is truly generic. Given trends in customer analytics, this distinction will continue to blur
- The potential for this re-badging to facilitate the re-emergence of a commission-driven sales culture of the type that existed in the tied agent arrangements in insurance and financial advice prior to changes in regulation in the mid-1990s, as part of the first tranche of “good advice” reforms. This would run counter to the reforms being introduced in countries in the region such as Singapore and Hong Kong, and would not support a clear focus on ensuring customer interests are put first by financial services providers, and
- The need to take note of other jurisdictions where, in retaining the term “sales”, the requirements for the intermediary to assess suitability for and act in the best interests of its customers continue to apply as “sales practice rules”.

The introduction of any such distinction would require careful review of whether it was necessary to introduce further requirements that certain types of complex products can only be sold to retail customers on an “advised only” basis. This would introduce a new set of complexities into the regulatory framework for consumers to navigate.

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operation of property trusts and managed funds but eliminate weak legal structures, like contract-based agribusiness schemes, from the market. For registered schemes such as mortgage funds, link the ability to offer redemption facilities properly to the liquidity of the underlying investments to avoid the GFC-era “frozen funds” problem. <http://www.smh.com.au/business/eight-ways-to-improve-our-financial-services-rules->

<sup>8</sup> The Monetary Authority of Singapore (MAS) Register of Representatives is a public record of individuals who conduct regulated activities under the Securities and Futures Act (Cap. 289) [“SFA”] and provide financial advisory services under the Financial Advisers Act (Cap. 110) [“FAA”].

## Obligations for product design and distribution arrangements

Consistent with a customer life cycle approach to consumer protection regulation, FOS supports product issuers having responsibility for the suitability of their products and for ensuring the appropriate expertise, professionalism and conduct of those they engage to distribute those products to end customers on their behalf. This responsibility could be achieved either by formal regulation or through a regulator-approved code of practice.

In FOS's initial submission we highlighted the important role that industry codes can play in helping build consumer trust in financial services. We also noted that codes have traditionally paid less attention to industry standards for product design or to ensuring the financial products are "fit for purpose". In FOS's initial submission we referred to the principles of product design applied by the Monetary Authority of Singapore<sup>9</sup> and the UK Financial Conduct Authority<sup>10</sup> and to principles relating to product approval for retail structured products<sup>11</sup> from the Australian Financial Markets Association.

As product issuers play a key role in product distribution, we consider they should also have appropriate responsibilities for ensuring anyone involved in the distribution meets the relevant training and compliance requirements and has adequate compensation arrangements in place to meet any awards made by an EDR scheme.<sup>12</sup> The last point is particularly important from a FOS perspective.

### Recommendation 5

We consider there is merit in requiring product issuers or manufacturers to be required to take reasonable steps to address the suitability of their products for their target customer segments.

### Recommendation 6

We also consider that product issuers should have appropriate responsibilities for the expertise, professionalism and conduct of the entities they engage to distribute their products to customers, and that those entities have adequate compensation arrangements in place.

## Support for vulnerable consumers

FOS notes the ongoing funding support for financial counselling provided in the recent Federal Budget.

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<sup>9</sup> 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](http://www.mas.gov.sg/~media/resource/legislation_guidelines/fin_advisers/fin_advisers_act/guidelines/Guidelines%20on%20Fair%20Dealing.ashx)

<sup>10</sup> 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>

<sup>11</sup> 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>

<sup>12</sup> The Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD), UK FSA, July 2007

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. This is an important component of the broader financial sector infrastructure, as these organisations provide important support and advice to vulnerable consumers and those on the margins of the financial sector.

As set out in FOS's initial submission, we are also concerned that in the absence of such community based services, we will see the emergence of a claims management industry of the type that has emerged in the UK.<sup>13</sup>

We support further collaborative initiatives between government, industry and community organisations to develop sustainable micro finance arrangements.

### **Recommendation 7**

Continued support is essential to enable the provision of assistance on financial service issues to vulnerable and disadvantaged consumers. In the absence of these community arrangements, we are concerned that entities will operate outside the regulatory net and that vulnerable consumers will be targeted by predatory business practices.

### **Regulatory approach**

We consider ASIC, as the financial sector consumer protection regulator, should have the expertise, resources, capabilities and powers to enable early supervisory intervention designed to limit serious conduct problems. This requires a regulatory philosophy that combines an early intervention "supervisory" approach with a strong focus on enforcement when the law is breached.

To achieve this, ASIC must have the full range of regulatory tools to deal with culture, governance and risk management issues on a whole-of-entity basis and across the complete chain of origination and distribution – regardless of the particular entities and channels by which this occurs.<sup>14</sup>

FOS considers there would be benefits in ASIC being able to intervene at an early stage to address emerging problems rather than only being able to act once consumer losses have potentially occurred. 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).<sup>15</sup> This is useful when there are concerns about potentially emerging issues that may result in consumer losses and where the regulator's staffing resources are limited.

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<sup>13</sup> In 2013-2014, FOS saw a 59% increase in the number of applicants using a dispute resolution agent.

<sup>14</sup> The UK FCA Report - *Tackling serious failings in firms: A response to the Special Measures proposal of the Parliamentary Committee on Banking Standards*, <http://www.fca.org.uk/static/article-type/news/tackling-serious-failings-in-firms.pdf>

<sup>15</sup> Financial Conduct Authority (UK): *Financial Services & Markets Act 2000* (as amended by the Financial Services Act 2012), s166

### **Recommendation 8**

FOS also considers there would be benefits in ASIC being able to intervene at an early stage to address emerging problems rather than only being able to act once consumer losses have potentially occurred. The UK regulator 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). We recommend a similar power should be considered for ASIC

### **Future developments in external dispute resolution**

FOS welcomes the interim report's recognition that it is important for consumers to have access to timely, low cost and efficient dispute resolution and remedies when problems arise, and that EDR arrangements in the financial sector are generally working well.

FOS considers future developments in EDR should focus on greater awareness, simplicity, ease of use and consistency of standards and processes for resolving disputes with financial service providers across the whole of the financial sector. This would lead to improved consumer outcomes, and is consistent with the important goal of reducing complexity in the financial system.

The major structural change in EDR arrangements over the last 10 years was the amalgamation of the previous sector-based schemes to create FOS in 2008. This can be viewed in large part as a response to the blurring of lines between what had previously been distinct sectors set out in the Wallis report.

There are currently three distinct financial sector schemes in the financial sector: FOS, the Superannuation Complaints Tribunal (SCT) and the Credit Ombudsman Service Limited (COSL). These schemes were initially based on distinct industry sectors and/or clear-cut jurisdictional differences. However, in some cases these distinctions are increasingly confusing for consumers and others, and will continue to be so. FOS is the largest of the current schemes in terms of size and coverage.

In the case of FOS and COSL, there are potential membership overlaps and, while the jurisdiction and legal bases of FOS and the SCT remain largely distinct, both FOS and the SCT deal with similar financial sector participants.

There are a number of developments in consumer expectations, the finance sector and in access to justice that have important implications for EDR in the financial sector. For example:

- consumers increasingly require simple, easy access to dispute resolution mechanisms across the whole of the finance sector system, including the product issuer, intermediation and distribution system
- increasing recognition of the important role industry Ombudsmen can play as part of broader access to justice arrangements in the Australian community

- regional and global integration of the Australian financial sector, including the important role access to EDR will play as part of cross-border recognition and passport arrangements for retail products
- developments in the region where a single integrated financial services dispute resolution scheme is the emerging model
- the impact of new technology on consumer expectations of access to EDR, and
- the pace of convergence between the financial sector and the information and telecommunication sectors.

We consider these trends are likely to create further consumer demands to improve and simplify consumer redress in the financial sector. This means there will be a need for:

- greater awareness of – and less confusion for – consumers about what a financial sector Ombudsman does, and how to easily access the service
- consistent standards and processes that are easy for consumers to navigate
- the ability to deal with disputes arising from the sale and administration of the full range of financial products, including cross-border arrangements, and
- consolidation of member-funded investment in technologies to facilitate enhanced consumer, FSP and EDR scheme interaction across mobile platforms and social media networks – investments that are currently replicated in each of the three schemes.

There are also opportunities for further innovation and experimentation in EDR as part of broader developments in improving access to justice arrangements. For example, there could be opportunities for hybrid EDR models that combine elements of a tribunal-like structure for more complex financial sector disputes, or where potentially multiple disputes against one FSP are involved, while still retaining the less formal EDR arrangements that deal quickly and simply with the bulk of consumer disputes that occur in the financial sector. However, it would be important to ensure that any such developments retain the current key attributes and benefits of industry-based ombudsman schemes, such as FOS, of being accessible and easy for consumers to use.

In recent years, reforms to some civil court jurisdictions<sup>16</sup> have introduced formal obligations for parties to a civil dispute to narrow the issues and settle by agreement wherever possible. This includes the ability of the court to refer a civil proceeding or any part of it to Alternative Dispute Resolution. There may be opportunities in future to explore the role the Financial Ombudsman Service might play in such arrangements for relevant civil disputes with the consent of the parties<sup>17</sup>

FOS does not consider there is merit in arguments for competition in consumer protection arrangements, whether of regulators, codes, or EDR schemes. The issues relating to competition in EDR fail to take account of the regional and global nature of financial services and are not consistent with the concerns from the key consumer

<sup>16</sup> For example, Civil Procedure Act 2010 (Vic) (“CPA”) and Civil Disputes Resolution Act 2011 (C’th) (“CDRA”)

<sup>17</sup> CPA s66

organisations in their initial submissions to the FSI<sup>18</sup>. This is also consistent with Australian and New Zealand Ombudsman Association's current views on competition among Ombudsman offices<sup>19</sup>.

Moreover, competition in EDR was addressed by ASIC in its 2000 report into self-regulation,<sup>20</sup> and dismissed at that time as not productive. While written by ASIC in a report in 2000, we consider these comments remain relevant today.

### **Recommendation 9**

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.

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<sup>18</sup> [http://fsi.gov.au/files/2014/04/Consumer\\_Action\\_Law\\_Centre.pdf](http://fsi.gov.au/files/2014/04/Consumer_Action_Law_Centre.pdf)

<sup>19</sup> ANZOA's Policy Statement on Competition among Ombudsman Offices: [http://www.anzoa.com.au/ANZOA\\_Policy-Statement\\_Competition-among-Ombudsman-offices\\_Sept2011.pdf](http://www.anzoa.com.au/ANZOA_Policy-Statement_Competition-among-Ombudsman-offices_Sept2011.pdf)

<sup>20</sup> Australian Securities and Investments Commission: *Submission to the inquiry on industry self-regulation*. January 2000. pp 26-27. <http://archive.treasury.gov.au/documents/1132/PDF/037.pdf>

## Appendix 1- Case Studies: Unpaid FOS Determinations

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### Case Study 1: Family loses \$721,000 in investment schemes

A married couple with four dependent children and a single income lost more than \$721,000 as a result of inappropriate personal financial advice, an Ombudsman has determined.

The husband, Mr A was the sole income earner and Mrs A was the primary carer of their children.

The couple followed their adviser's recommendation to invest in 100% geared equities products and agribusiness projects. These projects failed because the entities responsible for running the schemes are now insolvent.

Their adviser was a representative of a financial services provider (FSP), which is now in liquidation.

Mr and Mrs A lodged seven claims for compensation to FOS for inappropriate financial advice in relation to separate Statements of Advice and investments made between 2005 and 2009.

As part of the investment advice:

- equity in Mr and Mrs A's home was used as a buffer account to meet cash flow shortfalls, and
- all dividends, distributions and tax savings were used to supplement funding of the investment borrowings.

Negative cash flows as a result of loan repayments had to be funded from Mr and Mrs A's buffer account, and they had to redeem some of their investments early, incurring further financial penalties.

The Ombudsman determined that the FSP breached its duty of care and obligations to Mr and Mrs A because it did not assess their capacity to meet their loan obligations in the event of the investments underperforming, and did not have an appropriate plan in place to meet such a contingency.

"The FSP, when giving personal advice (to Mr and Mrs A) about their investments, was required to have a reasonable basis for making the recommendation. This required an assessment of their objectives, financial situation and needs. It also was required to act efficiently, honestly and fairly in doing this," the Ombudsman said.

"It is clear the long-term success of the recommended strategies was the continued good performance of the recommended investments to fund the investment loans.

"An adviser acting reasonably and prudently when making recommendations was required to factor in the potential for investments to underperform and consider the stresses this would place on their client's budget. It is clear this did not occur."

The Determination was for a payment of \$636,397 for compensation for investment losses and a refund of \$84,990 for adviser fees. The compensation was not paid because the FSP went into liquidation.

## **Case Study 2: Consumer loses \$500,000 in shipping scheme**

A consumer, who was permanently disabled and unable to work, lost \$500,000 in an investment scheme as a result of advice determined by the Ombudsman to be inappropriate.

The consumer, Mr H, received compensation for his disability of approximately \$1.5 million in 2009. Mr H had two children and shared the care of them equally with his recently divorced former wife. Mr H's plan was to assure his finances for years to come, given his incapacity to return to work.

Before receiving his compensation payout, Mr H contacted a financial services provider (FSP) to set up a self-managed super fund (SMSF) and a separate trust fund. A qualified accountant with the FSP and related companies, Mr B, later introduced Mr H to an investment opportunity described as a parallel import scheme.

The scheme was in operation since 2004 and funding was from individual investors and the capital reserves of the scheme manager. The FSP provided documentation to Mr H stating that shipping cycles were typically three months and had historically generated returns of 15% per cycle.

In May and June 2009, Mr H deposited \$250,000 into each of the SMSF and Trust cash management accounts, and between May and August 2009, the FSP made 21 withdrawals from these accounts for investment in the scheme.

In June 2010, Mr B emailed Mr H to tell him that one of the buyers of parallel imported products had been placed into administration. Neither the SMSF nor Trust has received any return of invested funds or profits.

The Ombudsman found that the FSP's advice showed a complete disregard for Mr H's personal circumstances (of which Mr B was aware).

"Mr B failed to consider Mr H's attitude to risk and this approach demonstrated a total lack of diversification," the Ombudsman said. "It was an extremely high risk strategy for someone whom Mr B knew would never again be in gainful employment. I am not satisfied that the written general advice warnings were sufficient to put Mr H on notice that the scheme might not be a suitable investment for him."

The Determination also said that Mr B failed to properly set out his advice (in a Statement of Advice).

The Ombudsman determined that the FSP should compensate Mr H by paying \$150,000 to each of the SMSF and the Trust (the maximum permitted amount per claim under the FOS Terms of Reference at that time) plus interest on these amounts at 5% per annum compounded annually from July 2009 until the date of each payment.

To date the FOS Determination has not been complied with and Mr H has not been compensated for his losses.

### **Case Study 3: Retirees lose \$378,000 in loans**

A retired couple lost more than \$378,000 as a result of financial advice for which there was no reasonable basis, according to the Ombudsman's Determination.

The couple, Mr and Mrs M, were aged in their early 70's when they engaged the financial services provider (FSP) in 2004.

They had sold their home and an investment property, bought land to build a new home and were renting in the meantime.

In June 2007, following the advice of the FSP's authorised representative, Ms D, they entered into the following borrowings secured against their home:

- \$71,000 to pay for house improvements (personal borrowings)
- \$300,000 to invest in income-producing growth assets (investment loan)
- \$100,000 to be used as a cash buffer

They also followed Ms D's advice to borrow \$200,000 via a margin loan to fund further investments (with the investments used as security).

Mr and Mrs M said they did not understand anything about financial markets, did not recall any discussions with Ms D about their attitude to risk, and trusted her advice.

The investment loan was a five-year interest-only loan that was due for repayment in June 2012. Mr and Mrs M were unable to repay this loan, which has become the subject of recovery action.

The FOS decision noted that Ms D's advice failed to clearly set out the overall investment strategy, the purpose of the recommendations and their associated risks. It said there was a strong focus from Ms D to repay the personal borrowings, even though this was a 30-year loan.

"In contrast, there is no mention of how those loans with significantly lesser terms, particularly the investment loan, are to be repaid," the decision stated.

It also said there was also a lack of explanation as to why the margin loan was required and the risks associated with margin lending generally.

The Ombudsman found that there was inadequate risk disclosure, that the FSP's breaches of duty had caused Mr and Mrs M's loss and that the FSP must compensate them.

The Determination calculated that their total loss was \$378,725 after considering investment losses, non-investment uses of the buffer loan and adviser fees. However, under the FOS terms of Reference, the maximum amount that can be awarded is \$280,000 (plus interest).

To date, Mr and Mrs M have not yet been paid the amount awarded in the Ombudsman's Determination.

# Financial Ombudsman Service Limited

## Report on the assessment of funding options for a Default Consumer Protection Scheme

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### **The Financial Ombudsman's Service Ltd Default Consumer Protection Scheme**

August 2014

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25 August 2014

Dear Jenny

### **Development of the Default Consumer Protection Scheme**

We have pleasure in enclosing a copy of our report regarding your request for the specification for the provision of modelling services for a last resort compensation scheme.

Our report presents two models utilising a sliding scale fee funding model for the generation and maintenance of an appropriate level of funds for the payment of unpaid determinations issued by the Financial Ombudsman Service. In the creation of these models, we reviewed the material of previous reviews (including the recent Richard St John report), previous proposals and commentary of a scheme of last resort and considerations from consultation with the financial and insurance sector.

### **Contacts**

If there are any matters upon which you require clarification or further information please contact Scott Hartley on +61 3 8663 6143 or Andrew Webster on +61 3 8663 6213.

Yours faithfully

Grant Thornton Australia Limited



Scott Hartley

Managing Partner – Operational Advisory

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# Glossary

<b>ABS</b>	Australian Bureau of Statistics
<b>AFSL</b>	Australian Financial Services License
<b>APRA</b>	Australian Prudential Regulation Authority
<b>ASIC</b>	Australian Securities and Investments Commission
<b>EDR</b>	External Dispute Resolution
<b>FOS</b>	Financial Ombudsman Service Limited
<b>FSI</b>	Financial System Inquiry
<b>FSR</b>	Financial Services Reform Act
<b>FSP</b>	Financial Services Provider
<b>GFC</b>	Global Financial Crisis
<b>ILIS</b>	Investments, Life Insurance & Superannuation
<b>MIS</b>	Managed Investment Scheme
<b>PI Insurance</b>	Professional Indemnity Insurance
<b>RBA</b>	Reserve Bank of Australia

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# Section 1 Overview

**01. Overview**

02. Recommendation

03. Appendices

# Background Information – Unpaid Determinations

## Unpaid Determinations

- Since 2010, 22 financial services providers (FSPs) have been unwilling or unable to comply with 105 FOS determinations made in favour of consumers.<sup>1</sup>
- This equates to 0.3% of the 4,900 financial licensee members or 0.14% of the estimated 15,000 financial advisers/planners in Australia.
- The value of the outstanding amounts awarded under these determinations exceeds \$10.143 million with interest accruing annually.<sup>2</sup>
- Data received from the Financial Ombudsman Service illustrates that all except one of these determinations were in the investment area and involved financial advisers.
- Where a client of an Australian Financial Service Licensed (AFSL) practice has been awarded compensation through the external dispute resolution process, if the entity become insolvent or is placed into administration, it is plausible that the client will not receive any compensation.
- *Caveat: these figures were sourced from the FOS Circular June 2014 and it is anticipated that these figures will have changed since this document is submitted to the Inquiry. With the establishment of the Default Consumer Protection Scheme, these figures will decrease.*

## Impact on the financial sector

- The unpaid determinations of an external dispute resolution process influence directly and indirectly on the Australian financial markets.
- The impact includes:
  - A decrease in consumer confidence of the financial market,
  - A decrease in confidence of the government and the financial market regulators,
  - A decrease in the confidence that a level playing field for all participants exists (retail or wholesale),
  - The decrease in confidence could lead to the withdrawal of funds and investments from the Australian financial markets,
  - A decrease in consumer confidence and increase in uncertainty may lead to a decrease in capital injection and foreign investment,
  - Decreased consumer confidence may lead to the increased use of offshore financial entities and structures.

### Notes

1. Unpaid Determinations – FOS Circular June 2014

2. *ibid*

# Background Information – Scope of the Scheme

## Scope of the Scheme

The Default Consumer Protection Scheme will focus on the following market segments:

1. Financial Adviser/Planners
2. Managed Investment Schemes

With only one exception, all unpaid determinations were classified as financial advice related. This includes the failure to disclose material information, inappropriate risk profiling, failing to take into account an individual's circumstances and desired outcome from an investment strategy or product.

Australia experienced the collapse of several Managed Investment Schemes post Global Financial Crisis. It was reported in December 2012 that an estimated \$4 billion of consumer investment was lost in agricultural Managed Investment Schemes that entered into administration, liquidation or court proceedings.<sup>1</sup>

The Default Consumer Protection Scheme is focused on non-APRA regulated entities including:

- AFS license holders
  - Licensed Financial Adviser/Planner
  - Registered Managed Investment Scheme

The development of the Default Consumer Protection Scheme is supplemented with additional recommendations to the Financial Systems Inquiry including a robust design of mandatory professional accreditation and registration of financial advisers/planners including a requirement of on-going professional development akin to the medical, legal and pharmaceutical industries. Recommendations are also made regarding minimum coverage and policy inclusions of Professional Indemnity Insurance.

## Exclusions from the Scheme

APRA regulated entities including:

- Authorised Deposit-taking Institutions
- General Insurance
- Superannuation
- Life Insurance and Friendly Societies

1. These entities are excluded due to the higher level prudential requirements an entity is required to meet under APRA regulatory regime.
2. The APRA regulated entities possess adequate compensation schemes for consumers – these include the National Guarantee Fund, the Financial Claims Scheme, and the Australian Stock Exchange Supplemental Compensation Fund.
3. The scheme is not designed as an avenue for consumers to seek compensation for investment or product performance.

## Notes

1. <http://www.abc.net.au/site-archive/rural/content/2012/s3659281.htm>

# Overview of the Financial Market

## The Australian Financial Market

The Reserve Bank of Australia and Australian Bureau of Statistics reported the Total of Managed Funds (consolidated) at \$2.3 trillion for the March quarter 2014.<sup>1</sup> This includes Asset Allocation of Domestic Managed fund institutions (consolidated) of \$1.8 trillion, an increase of \$186 million over 12 months, or \$1.13 billion over ten year (2004:2014)

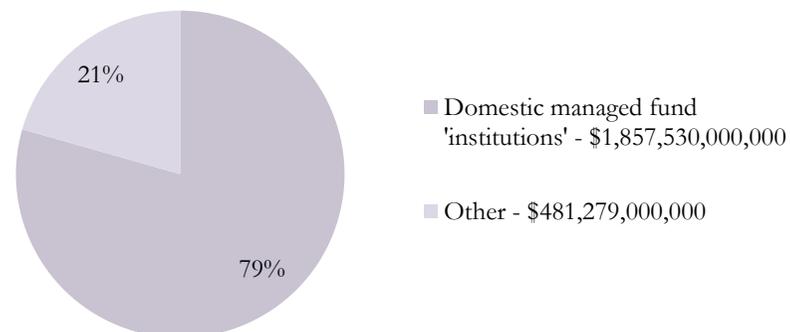
The official cash rate remained unchanged at 2.5 per cent at the August 2014 Reserve Bank of Australia (RBA) meeting; this was influenced by the RBA citing an accommodative financial market which is supported by emerging capital inflow from market economies.<sup>3</sup>

The RBA cites a very low probability to a rise in global interest rates or other adverse events over the forward period.<sup>4</sup>

With Australian interest rates at their lowest in 40 years, an expected increase in household disposable income in conjunction with higher average weekly earnings (2.4% increase from May 2013 to May 2014),<sup>5</sup> the appetite for investment by retail consumers is anticipated to increase.

## Managed Funds

### Total Managed Funds (consolidated)



Total Managed Funds (consolidated)  
\$2.338 trillion

#### Notes

1. Australian Bureau of Statistics <http://www.abs.gov.au/ausstats/abs@.nsf/mf/5655.0>
2. Ibid
3. Reserve Bank of Australia <http://www.rba.gov.au/media-releases/2014/mr-14-12.html>
4. Ibid
5. Australian Bureau of Statistics <http://www.abs.gov.au/AUSSTATS/abs@.nsf/ProductsbyTopic/7F76D15354BB25D5CA2575BC001D5866?OpenDocument>

# Previous Proposals - Evaluation

## Details of previous proposals

In 2001, the Minister of Finance sought advice from the now Companies and Markets Advisory Committee (CAMAC) on a consumer compensation regime. After consultation, CAMAC proposed the scheme would:

- Be operated by an independent body
- Apply to retail clients of licensees
- Compensate retail clients of licensees who are insolvent or are unable to pay
- Use the same eligibility criteria as applied in disputes with solvent licensees
- Be subject to compensation caps and time limits in making claims
- Be funded by levies on licensees dealing with investments on behalf of retail clients
- Include transitional arrangements to deal with funds already held by NGF and the Sydney Futures Exchange.<sup>1</sup>

While the scheme received support, the government of the day concluded that the use of Professional Indemnity Insurance (PI Insurance) offered an appropriate level of protection for consumers in relation to the cost of business.

ASIC and the Richard St John Review noted the limitations of PI Insurance for consumer protection. ASIC Regulatory Guide 126 (RG 126) states that it is the responsibility of the entity to determine what is 'adequate' coverage for the entity including whether the licensee has the financial resources to make the insurance work in practice.<sup>2</sup> Consequently, as PI Insurance is a requirement of RG 126, what is deemed 'adequate' by the licensee does not always meet the market's expectations as affordability and the need for compliance is prioritised over protection from litigation and claims.

PI Insurance policy exclusions can include non-approved products, agricultural schemes, hedge funds, fraud and misconduct by the licensee or their representative, discretionary investments and failure to comply. Data and anecdotal evidence from FOS concludes that these exclusions are commonly the catalysts for complaints made and the subsequent determinations.

As the market regulator, ASIC state in RG 126 that 'the reliance on PI Insurance is not without limitation as aggregate funds available under the policy have at times been insufficient to meet all awards; conduct which gave rise to the compensation awarded was not covered by the policy; or the amount of the award was below that of the applicable excess under the policy'. The Guide further states that PI Insurance 'is not designed to protect consumers directly and is not a guarantee that compensation will be paid' and that 'currently available insurance is unlikely to provide a source of funds where a licensee has become insolvent before the claim was brought'.<sup>3</sup> This is in contrast to the St John review when he deemed that a compensation scheme was not necessary for the market albeit, there is a general agreement from ASIC and St John that the reliance on PI Insurance is not designed to compensate consumers and that gaps do exist in this regime.

## Exposed Limitations

1. The market and ASIC have confirmed that a gap exists with the reliance on PI Insurance as the consumer protection tool
2. Continued exclusions in PI Insurance policies
3. The onus on the entity to ensure adequate insurance can be inconsistent with the actual and realised risk
4. A decreasing participation from Australian Insurers that offer PI Insurance

### Notes

1. St John, Richard. 2012. Compensation arrangements for consumers of financial services
2. ASIC Regulatory Guide 126 – Compensation and insurance arrangements for AFS licensees
3. Ibid

# Whole of Sector Approach

## Recommended Amendments to the Regulatory Regime

One of the stated areas of focus for the FSI is consumer protection. The Default Consumer Protection Scheme will be strengthened with additional amendments to professional accreditation, ongoing professional development and the establishment of minimum standards of professional indemnity insurance. It is understood that industry are widely supportive of these measures.

### Default Consumer Protection Scheme

The cost of the Default Consumer Protection Scheme once established, can be influenced by the market.

If the market, via self-regulation increases their compliance and standards, the ongoing funding mechanisms will be minimal (due to a decrease in compensation payments) while remaining in place to offer consumer protection and increase consumer confidence.

### Professional Indemnity Insurance

- Collaborate with the insurance sector to revise the exclusions and limitations of PI Insurance.
- Establish requirements for run-off policies for the specified period of the life cycle of a MIS or for a set period of years for a financial adviser/planner.
- Explore implementing limitation of the selling of policies for entities under administration or liquidation as this removes the policy and consumer protection mechanism.
- Pre-payment or a requirement of evidence of the ability to meet insurance premiums of the forward estimates
- The establishment of a minimum level of cover (based on a percentage of assets under management) for professional indemnity insurance and managed investment schemes
- Ensuring that the coverage is fit for purpose

### Professional Accreditation

- Compulsory registration of all financial advisers/planners (removing the focus on the licensee.)
- Mandatory registration with an accredited professional association.
  - Financial Planning Association of Australia; or
  - Association of Financial Advisers.
- Basic requirements for registration including but not limited:
  - Minimum qualification held;
  - Currency of qualification;
  - Professional Indemnity Insurance.

### Professional Development

- Implementing a sector wide professional accreditation program akin to the medical or legal professions.
- Each member is required to complete a pre-determined value of professional development (i.e. 12 credit points).
- These can include;
  - Seminars,
  - Domestic conferences,
  - International conferences,
  - Industry workshops,
  - Information sessions conducted by ASIC, the Tax Office, APRA.

# The Default Consumer Protection Scheme & the Market

## Influence of the Financial System Inquiry

The Financial Systems Inquiry will establish the direction for the future of Australia's financial system and provide a blueprint for the coming decade.

The Committee stated in a public consultation forum that the review will focus on three main areas:

1. the stability of the financial market
2. consumer protection
3. the superannuation sector including fees <sup>1</sup>

The Chair of the Committee Mr. David Murray AO acknowledged that some actions and behaviours by financial advisers/planners were below industry expectations.<sup>2</sup> The 2014 Inquiry presents an opportunity for reform and the strengthening of consumer protection.

The principles underpinning the proposed Default Consumer Protection Scheme are extrapolated from previous models of the compensation scheme of last resort. This model, although acknowledged as important did not receive the support for implementation due to arguments from industry that the 'good should not pay for the bad' and large compliant entities should not have to pay for the smaller entities failing. The Default Consumer Protection Scheme specifically targets the market segments where unpaid determinations lie; financial advisers/planners and managed investment schemes.

This new approach incorporates previous submissions. We acknowledge the concerns of the wider industry and the architecture is specifically directed towards the area of unpaid determinations. The design of the scheme is underpinned by the principle that an agreement exists as the PI Insurance does not provide 100 per cent assurance and consumer protection. Moreover, that the gap that currently exists is eroding consumer confidence.

The strategy of the Default Consumer Protection Scheme, in conjunction with the recommendations for a more robust registration and accreditation process for financial advisers/planner will increase consumer protection across the financial system. To ensure maximum efficacy, the Scheme is designed to increase compliance within the market. It is intended that stronger requirements around financial advisers/planners and products will see a reduction in the call for any compensation funds.

## Notes

1. Mr David Murray AO. Chair of the Financial Systems Inquiry. Public Forum into the Financial Systems Inquiry – Melbourne held 14 August State Library.
2. Ibid

# The Default Consumer Protection Scheme & the Market cont'd

## Address concerns of moral hazard

Discussions noted that FOS wishes to ensure the levy is targeted to where the unpaid determinations have arisen i.e. financial advisers/planners and Managed Investment Schemes.

A fixed fee amount each year will ensure that each financial adviser/planner and MIS will pay an equal share rather than if the levy were based on the size of their revenue or asset base as this would single out large entities who will be required to fund the majority of the scheme. The fees have been determined to align with the associated costs across the market.

Any subsequent trigger levy (see funding options for detailed explanation) can be collected from the market segment where the determinations arose, meaning those who caused the determination are accountable for their actions.

It is anticipated that the implementation of the Default Consumer Protection Scheme will lead to increased accountability and more responsible practices when implemented in conjunction with the three pillars of the whole of market approach (as detailed above).

## Financial Incentives

The developers of managed investment schemes may receive incentives for the implementation of an increased, robust product design and internal market surveillance mechanisms.

The use of commissions in the sale and distributions of products including managed investment schemes necessitates further exploration. In terms of creating an incentive for the market, there are options to explore a potential decrease in operations costs (i.e. ASIC fees, FOS membership expenses) for entities that exceed their compliance obligations.

The models below would rely on legislation (establishment) and regulation (administration). Should additional funds be required in the scheme to account for an event or major failure, increased levies could be raised via a disallowable instrument mechanism. These would be issues for ASIC and Treasury.

## Manufacturers of MIS

Over the past few years, the Australian market has observed the collapse of several large managed investment schemes, as cited above, approximately \$4 billion of funds were lost in failed agricultural schemes.

Ensuring the product manufacturers hold a level of accountability and responsibility over the life of the product is integral for the efficacy not only of the product, but also reflect consumer and market confidence. A concentrated approach during the design and marketing phase may assist in ensure the viability and sustainability of future scheme. *(Please note this is not limited to agricultural schemes)*. Consultations identified that product construction, including the use of hedge funds, warrants further exploration with potential for limitations and increase reporting requirements. While the adviser is required to understand the products in making a recommendation, anecdotal evidence suggests that the primary construction of a product requires increased regulation from ASIC.

## Selection of product distribution

Implementing a regime that supports manufacturers to complete a defined level of due diligence on the advisers/planners that they use to distribute their product should assist reducing consumer disputes.

It is anticipated that a product manufacturer would only seek the distribution of their product from licensed and accredited advisers; this regime would equally benefit the manufacturers by increasing confidence in their product from the marketplace. An increased focus on distribution including becoming an approved product (APL) would increase confidence amongst insurers and AFSL holders. Products that were offered without restriction or a level of due diligence on the market should receive additional surveillance from ASIC.

# The Default Consumer Protection Scheme - Requirements

Size of the fund	Administration of the fund
<p>Through initial discussions with FOS, it was determined that there are approximately \$10.15 million of unpaid determinations by Financial Service Providers that need to be paid to consumers as compensation.</p> <p>Our objective is to ensure that the fund is self-managing. Based on the proposed options, the fund will continue to grow through ongoing contributions from financial advisers/planners and Managed Investment Schemes as well as interest earned on the reserve balance based on a modest interest rate (i.e. 3%). The annual increase in funds aims to cover the estimated administration costs, an estimated amount of determinations to be paid and will allow for a sufficient reserve balance that will provide an adequate level of security in the event of unforeseen situations.</p> <p>Both proposed levies will involve three stages; building the fund, sustaining management of the fund and a trigger to raise additional funds. A strong and growing fund balance will provide greater confidence to consumers that they are more than likely to receive adequate compensation in the event of their Australian Financial Services Licensee becoming insolvent or to bridge the gaps of PI Insurance.</p> <p>We utilised a reverse engineering process to determine the size of the fund for all funding options. There are approximately 15,000 financial advisers/planners and approximately 4,152 MIS operating in Australia. Instead of previous models that used the AFS license holders, to ensure equity across the market, we used the total population of advisers versus AFSL holders (15,000:5000) as this will keep the estimated levy low.</p>	<p><b>Establishment Costs</b> Establishment costs are estimated to be \$300,000 which would consist of legal fees, recruitment fees and costs associated with creating a communications strategy and materials for the industry.</p> <p><b>Administration Costs</b> The costs of the ongoing administration of the fund were estimated to be between \$750,000-\$800,000 per annum. This would include approximate staff expenses of \$250,000 p.a. as it is believed 1.75 FTEs would be required to deal with the day-to-day management of the fund. Administration, legal and compliance activities would account for approximately \$100,000. The Scheme would require a board or oversight committee/commission to ensure the distribution of funds (these are estimated around \$200,000-\$300,000). The Financial Ombudsman Service have stated that they could host the scheme within their Melbourne office, there are expenses related to floor space, ICT hosting and support services (for example human resources). The scheme would be structured as a legal entity that is separate and independent of FOS.</p>

# The Default Consumer Protection Scheme – overview of funding models

## Fund Option 1A

- Raise \$22.43 million in year zero
- Pay the full amount of unpaid determinations of \$10.15 million
- High upfront cost to MIS and Financial Advisers/Planners
- Lower declining ongoing contributions for year one and onwards compared to *Option 1B*
- Target fund balance of \$12 million
- Larger cash reserve than *Option 1B*
- Trigger threshold to be set at \$5 million

## Fund Option 1B

- Raise \$10.84 million in year zero
- A proportion of the \$10.15 million unpaid determinations will be paid each year
- Lower upfront costs to MIS and Financial Advisers/Planners
- Marginally higher ongoing costs for year one and onwards compared to *Option 1A*
- Target fund balance of \$6 million
- Smaller cash reserve than *Option 1A*
- Trigger threshold to be set at \$2 million

## Fund Option 2

- Raise \$17 million in year zero
- Pay the full amount of unpaid determinations of \$10.15 million
- Levy rate based on a percentage of Total Consolidated Assets of Managed Funds
- Rate will need to be adjusted each year
- Higher cost for entities with a large asset base
- Target fund balance of \$6 million
- Smaller cash reserve than *Option 1A*

# The Default Consumer Protection Scheme Details of Option 1A

## Metrics

The proposed levy of Option 1A will commence with a upfront levy payment of \$250 from financial advisers/planners and \$4,500 from Managed Investment Schemes. This will provide the scheme with an amount of \$22.43 million to establish the fund based on the estimate of 15,000 licensee holders and 4,152 MIS. From the \$22.43 million, \$10.15 million will be used to pay the unpaid determinations, \$300,000 of establishment costs and \$750,000 of annual administration costs. This will leave approximately \$11.23 million in the fund’s reserve.

For the following years, a reduced levy amount will be collected in order to build a minimum target of \$12 million p.a. By year three, the ongoing contributions are minimal, at \$20 for financial advisers/planners and \$720 for MIS.

The balance of the fund will factor in a decrease of the approximate annual value of determination payments (\$2,537,500 – see calculations on page 18), a reduction of \$750,000 for administration costs (page 13) and an increase from revenue earned from interest (estimated at 3% p.a.). Based on a \$12 million balance, interest earned will be around \$360,000p.a. which will offset against some of the administration costs.

The fund reserve balance being maintained at a target level of \$12 million is largely sufficient to cover any unforeseen circumstances without having to implement the trigger levy contribution if the funds were insufficient (e.g. if funds fell below \$5 million).

	Year 0		Year 1		Year 2		Year 3 and onwards	
	Financial Adviser/ Planner	MIS	Financial Adviser/ Planner	MIS	Financial Adviser/ Planner	MIS	Financial Adviser/ Planner	MIS
Proposed Levy	\$ 250	\$ 4,500	\$ 30	\$ 775	\$ 25	\$ 750	\$ 20	\$ 720
Total per industry	\$ 3,750,000	\$ 18,684,000	\$ 450,000	\$ 3,217,800	\$ 375,000	\$ 3,114,000	\$ 300,000	\$ 2,989,440
<b>Total funds raised p.a</b>	<b>\$ 22,434,000</b>	<b>\$ 3,667,800</b>	<b>\$ 3,489,000</b>	<b>\$ 3,289,440</b>				
<i>Less: Payments of Unpaid Determination</i>	\$ 10,150,000	\$ 2,537,500	\$ 2,537,500	\$ 2,537,500				
<i>Less: Establishment Costs</i>	\$ 300,000	n/a	n/a	n/a				
<i>Less: Administration Costs</i>	\$ 750,000	\$ 750,000	\$ 750,000	\$ 750,000				
Remaining Balance of Fund	\$ 11,234,000	\$ 11,614,300	\$ 12,164,229	\$ 12,531,096				
Approximate 3% Interest on Balance	n/a	\$ 348,429.00	\$ 364,926.87	\$ 375,933				
Approximate Balance of Fund at Year End	\$ 11,234,000	\$ 11,962,729	\$ 12,529,156	\$ 12,907,029				

### Option 1 A

#### Advantages

- Large cash reserve at the end of the first year of establishment
- Larger cash reserve will decrease the likelihood of an increased levy amount in later years triggered by an insufficient fund balance
- Larger cash reserve produces a higher interest income earned which offsets substantial amount of administration costs
- The upfront payment can be considered as part of the cost of obtaining an AFSL License
- The ongoing contributions made to the fund are considered to be minimal amounts to the two market segments

#### Disadvantages

- High upfront payment involved

# The Default Consumer Protection Scheme Details of Option 1B

## Metrics

Option 1B considered incurring the cost of historical unpaid determination payments over 3 years rather than upfront causing a proportion of the \$10.15 million to be paid each year.

The proposed levy Option 1B will commence with a upfront levy payment of \$100 from financial advisers/planners and \$2,250 from Managed Investment Schemes, roughly 50% less than Option 1A.

This will provide the FOS with \$10.84 million to establish the fund based on the estimate of 15,000 financial advisers/planners and 4,152 MIS. From the \$10.84 million, \$5.07 million will be used to pay a proportion of the unpaid determinations, \$300,000 of establishment costs and \$500,000 of administration costs. This will leave approximately \$3.68 million in the fund's reserve.

For the following years, a reduced levy amount will be collected in order to maintain a minimum target of \$6 million p.a. The balance of the fund will factor in:

- A decrease of a proportion of the remainder of the historical unpaid determination amount (see page 18 for breakdown of assumptions)
- A decrease of the approximate annual value of determination payments (\$2,537,500 – see calculations on page 18)
- A decrease of \$750,000 of administration costs (page 13)
- An increase from revenue earned from interest (estimated at 3% p.a).

The fund reserve balance being maintained at a target level of \$6 million is reasonable to cover any unforeseen circumstances. A threshold amount of \$2 million should be set hence if the balance falls below the amount a higher levy amount will be triggered to increase funds back to the \$6 million target.

	Year 0		Year 1		Year 2		Year 3 and onwards	
	Financial Adviser/ Planner	MIS						
Proposed Levy	\$ 100	\$ 2,250	\$ 50	\$ 1,700	\$ 35	\$ 1,100	\$ 20	\$ 720
Total per industry	\$ 1,500,000	\$ 9,342,000	\$ 750,000	\$ 7,058,400	\$ 525,000	\$ 4,567,200	\$ 300,000	\$ 2,989,440
<b>Total funds raised p.a</b>	<b>\$ 10,842,000</b>	<b>\$ 10,842,000</b>	<b>\$ 7,808,400</b>	<b>\$ 7,808,400</b>	<b>\$ 5,092,200</b>	<b>\$ 5,092,200</b>	<b>\$ 3,289,440</b>	<b>\$ 3,289,440</b>
<i>Less: Payments of Historic Unpaid Determination</i>		\$ 5,075,000		\$ 3,383,333		\$ 1,691,667		n/a
<i>Less: Payments of Current Unpaid Determination</i>		n/a		\$ 2,537,500		\$ 2,537,500		\$ 2,537,500
<i>Less: Establishment Costs</i>		\$ 300,000		n/a		n/a		n/a
<i>Less: Administration Costs</i>		\$ 750,000		\$ 750,000		\$ 750,000		\$ 750,000
<b>Remaining Balance of Fund</b>	<b>\$ 4,717,000</b>	<b>\$ 4,717,000</b>	<b>\$ 5,854,567</b>	<b>\$ 5,854,567</b>	<b>\$ 6,143,237</b>	<b>\$ 6,143,237</b>	<b>\$ 6,329,474</b>	<b>\$ 6,329,474</b>
<b>Approximate 3% Interest on Balance</b>	<b>n/a</b>	<b>n/a</b>	<b>\$ 175,637.00</b>	<b>\$ 175,637.00</b>	<b>\$ 184,297.11</b>	<b>\$ 184,297.11</b>	<b>\$ 189,884.22</b>	<b>\$ 189,884.22</b>
<b>Approximate Balance of Fund at Year End</b>	<b>\$ 3,679,000</b>	<b>\$ 3,679,000</b>	<b>\$ 6,030,204</b>	<b>\$ 6,030,204</b>	<b>\$ 6,327,534</b>	<b>\$ 6,327,534</b>	<b>\$ 6,519,358</b>	<b>\$ 6,519,358</b>

### Option 1B

#### Advantages

- Lower upfront payment than Option 1A
- The upfront payment can be considered as part of the cost of obtaining an AFSL License
- The ongoing contributions made to the fund are considered to be minimal amounts to the two market segments

#### Disadvantages

- Smaller cash reserve than Option 1A
- Increased likelihood of an increased levy being set off by trigger
- Less interest earned on cash reserve than Option 1A
- Marginally higher ongoing contributions from the two market segments

# The Default Consumer Protection Scheme Funding Model – Option 1A&1B

## Build

To build the required funds, an upfront levy fee will be collected from MIS and financial advisers/planners. Possible collection methods of the fee include:

- Attaching the levy to ASIC fees; or
- Attaching the levy to FOS membership fees collecting the levy on behalf of ASIC

The proposal reflects a larger levy amount placed on MIS as the MIS industry have a greater ability to pay. Furthermore it was noted that FOS has also taken into consideration that there are more financial advisers/planners (15,000) compared to MIS (4,152) meaning that a lower fee to the majority of those required to pay the levy will result in a lower level of complaints.

Whilst we acknowledge that a new levy would increase the cost of business and its potential impact that it might have on small business and the consumer, the costs of contribution to the scheme are reasonable when compared to other regulatory costs, such as ASIC and FOS Membership fees.

### Option 1A

A proposed upfront levy cost of \$250 will be placed on financial advisers/planners whilst Managed Investment Schemes (MIS) will incur a levy of \$4,500.

### Option 1B

A proposed levy of \$100 will be placed on financial advisers/planners whilst Managed Investment Schemes (MIS) will be incurred with a levy of \$2,250.

	Year 0	
	Financial Adviser/ Planner	MIS
Proposed Levy	\$ 250	\$ 4,500
Total per industry	\$ 3,750,000	\$ 18,684,000
<b>Total funds raised p.a</b>		
	\$	22,434,000
<b>Less: Payments of Unpaid Determination</b>		
	\$	10,150,000
<b>Less: Establishment Costs</b>		
	\$	300,000
<b>Less: Administration Costs</b>		
	\$	750,000
<b>Remaining Balance of Fund</b>		
	\$	11,234,000
<b>Approximate 3% Interest on Balance</b>		
		n/a
<b>Approximate Balance of Fund at Year End</b>		
	\$	11,234,000

Option 1 A

	Year 0	
	Financial Adviser/ Planner	MIS
Proposed Levy	\$ 100	\$ 2,250
Total per industry	\$ 1,500,000	\$ 9,342,000
<b>Total funds raised p.a</b>		
	\$	10,842,000
<b>Less: Payments of Historic Unpaid Determination</b>		
	\$	5,075,000
<b>Less: Payments of Current Unpaid Determination</b>		
		n/a
<b>Less: Establishment Costs</b>		
	\$	300,000
<b>Less: Administration Costs</b>		
	\$	750,000
<b>Remaining Balance of Fund</b>		
	\$	4,717,000
<b>Approximate 3% Interest on Balance</b>		
		n/a
<b>Approximate Balance of Fund at Year End</b>		
	\$	3,679,000

Option 1B

### Calculation of proportional historical unpaid determination payments

- Unpaid determination - **\$10,150,000**
- Divide the amount into 6 portions ( $\$10,150,000/6$ ) = \$ 1,691,666.67
- In Year 0 – 3 portions, Year 1 – 2 portions, Year 2 – 1 portion
- Therefore Year 0 =  $\$1,691,666.67 \times 3 =$  **\$ 5,075,000.01**

# The Default Consumer Protection Scheme Funding Model – Option 1A&1B

## Sustain

To allow the fund to be self managing, the required injection of contributions is required to be offset the amount of annual determinations to be paid and administration costs which have been estimated at \$2,537,500 and \$750,000 respectively. The proposed ongoing contributions will cover those payment amounts. Based on discussions with FOS, these amounts will be considered minimal to their operating costs.

Furthermore, the fund will be continue to grow due to interest being earned on the remaining balance. Interest has been calculated at a modest 3% per annum. For a balance of \$12 million, \$360,000 in interest will be earned each year and for a balance of \$6 million; \$180,000 p.a. This balances against a sizeable amount of the administrative costs which were estimated to be \$750,000 per year.

## Option 1A

From the upfront payment in year zero of \$250 for financial advisers/planners and \$4,500 for MIS, the levy amount will drop considerably to \$30 and \$775 for the two segments in year one. By year three, levy amounts will be \$20 and \$720.

## Option 1B

Option 1B requires a higher ongoing contribution than Option 1A as the payment of historic unpaid determinations still require funding in years one and two. By year three all historic unpaid determinations will be paid.

From the upfront payment in year zero of \$100 for financial advisers/ planners and \$2,250 for MIS, the levy amount will drop to \$50 and \$1,700 for the two segments. By year three, levy amounts will be \$20 and \$720.

	Year 1		Year 2		Year 3 and onwards	
	Financial Adviser/ Planner	MIS	Financial Adviser/ Planner	MIS	Financial Adviser/ Planner	MIS
Proposed Levy	\$ 30	\$ 775	\$ 25	\$ 750	\$ 20	\$ 720
Total per industry	\$ 450,000	\$ 3,217,800	\$ 375,000	\$ 3,114,000	\$ 300,000	\$ 2,989,440
Total funds raised p.a	\$	3,667,800	\$	3,489,000	\$	3,289,440
Less: Payments of Unpaid Determination	\$	2,537,500	\$	2,537,500	\$	2,537,500
Less: Establishment Costs		n/a		n/a		n/a
Less: Administration Costs	\$	750,000	\$	750,000	\$	750,000
Remaining Balance of Fund	\$	11,614,300	\$	12,164,229	\$	12,531,096
Approximate 3% Interest on Balance	\$	348,429.00	\$	364,926.87	\$	375,933
Approximate Balance of Fund at Year End	\$	11,962,729	\$	12,529,156	\$	12,907,029

### Option 1A

	Year 1		Year 2		Year 3 and onwards	
	Financial Adviser/ Planner	MIS	Financial Adviser/ Planner	MIS	Financial Adviser/ Planner	MIS
Proposed Levy	\$ 50	\$ 1,700	\$ 35	\$ 1,100	\$ 20	\$ 720
Total per industry	\$ 750,000	\$ 7,058,400	\$ 525,000	\$ 4,567,200	\$ 300,000	\$ 2,989,440
Total funds raised p.a	\$	7,808,400	\$	5,092,200	\$	3,289,440
Less: Payments of Historic Unpaid Determination	\$	3,383,333	\$	1,691,667	\$	n/a
Less: Payments of Current Unpaid Determination	\$	2,537,500	\$	2,537,500	\$	2,537,500
Less: Establishment Costs		n/a		n/a		n/a
Less: Administration Costs	\$	750,000	\$	750,000	\$	750,000
Remaining Balance of Fund	\$	5,854,567	\$	6,143,237	\$	6,329,474
Approximate 3% Interest on Balance	\$	175,637.00	\$	184,297.11	\$	189,884.22
Approximate Balance of Fund at Year End	\$	6,030,204	\$	6,327,534	\$	6,519,358

### Option 1B

#### Calculation of estimated determination payments

- 105 unpaid determinations worth \$10,150,000 – average determination of **\$96,666.67**.
- Over 4 years there has been 105 unpaid determinations – average of **26.25** determinations per year
- Average annual determination payment  $\$96,666.67 \times 26.25 = \mathbf{\$2,537,500}$

#### Option 1B - Calculation of proportional historical unpaid determination payments

- Unpaid determination - **\$10,150,000**
- Divide the amount into 6 portions ( $\$10,150,000 / 6 = \$ 1,691,666.67$ )
- In Year 0 – 3 portions, Year 1 – 2 portions, Year 2 – 1 portion
- Year 1 =  $\$ 1,691,666.67 \times 2 = \mathbf{\$ 3,383,333.34}$
- Year 2 =  $\$ 1,691,666.67 \times 1 = \mathbf{\$ 1,691,666.67}$

# The Default Consumer Protection Scheme Funding Model – Option 1A&1B

## **Trigger**

The ongoing annual levy fees that have been proposed contribute an amount to the fund that is expected to offset the estimated payment of determinations of \$2,537,500 and the administration costs of \$750,000.

However, unforeseen events may cause the balance of the fund to fall relatively low (e.g. the event of a payment of determination being greater than expected due to a large financial adviser/planner or a MIS becoming insolvent).

Therefore the fund should set a threshold amount where if the balance of the fund falls below the threshold, a larger levy is collected for that particular year. This will raise sufficient funds to increase the fund back to its target balance.

It is proposed that any levy increase imposed due to the trigger will be incurred by the market sector which caused the greater than expected unpaid determination.

Legislation would be required with Regulation allowing for adjustments to the scheme contribution limits if required.

## **Proposed trigger thresholds**

Option 1A - \$5,000,000 (example of the legislative instrument for Option 1A is provided)

Option 1B - \$2,000,000

# The Default Consumer Protection Scheme Details of Option 2

## Metrics

A levy based on an entity’s assets under management was the second option considered. The levy will be calculated using a determined amount needed to be raised that is divided by the Total Consolidated Assets of Managed Funds<sub>1</sub>, which was \$2.33 trillion.

The amount needed to be raised was established to be \$17 million as this would result in a reserve fund balance at approximately \$6 million at the end of year zero after determinations, establishment and administration costs are paid.

The fixed percentage rate to be charged as a levy is calculated to be 0.00073% of all assets under management for an entity in the establishment year. Based on calculations, a reserve fund balance of \$5.97 million will be established.

In year one and onwards, the scheme should aim to raise at least \$3.3 million to cover the estimated annual amount of determinations of \$2,537,500 (for calculations see page 18), cover the estimated administration costs \$750,000 p.a. (page 13) and maintain the reserve balance at the \$6 million mark. To raise \$3.3 million, a levy of 0.000141% of Assets Under Management will need to be collected.

The levy percentage rate will need to be calculated every year based on the annual updated Total Consolidated Assets of Managed Funds<sub>1</sub> figure.

Examples of where this type of levy are currently in place are:

- Fire Services Property Levy – levy includes a variable cost calculated on the capital improved value of the property.
- Building Permit Levy (*Building Act 1993*) - requires 0.128 cents of every dollar of the cost of building work greater than \$100,000.
- Flood and Medicare Levy – both variable and based on taxable income.

### Notes

1. Total Consolidated Assets of Managed Funds  
<http://www.rba.gov.au/statistics/tables/index.html>

	Year 0	Year 1 and onwards
Amount of Funds To Be Raised	\$ 17,000,000.00	\$ 3,300,000
<i>Less: Payments of Unpaid Determination</i>	\$ 10,150,000	\$ 2,537,500
<i>Less: Establishment Costs</i>	\$ 300,000	n/a
<i>Less: Administration Costs</i>	\$ 750,000	\$ 750,000
Remaining Balance of Fund	\$ 5,800,000	\$ 5,986,500.00
Approximate 3% Interest on Balance	\$ 174,000.00	\$ 179,595.00
Approximate Balance of Fund at Year End	\$ 5,974,000.00	\$ 6,166,095.00

### Option 2

#### Calculations to raise funds required in Year 0

Funds to be raised	\$17 million
Total Consolidated Assets of Managed Funds	\$2.33 trillion
\$17 million / \$2.33 trillion = <b>0.00073</b> % of Assets Under Management	

#### Calculations to raise funds required in Year 1 to cover annual costs

Funds to be raised	\$3.3 million
Total Consolidated Assets of Managed Funds	\$2.33 trillion
\$3.3 million / \$2.33 trillion = <b>0.000141</b> % of Assets Under Management	

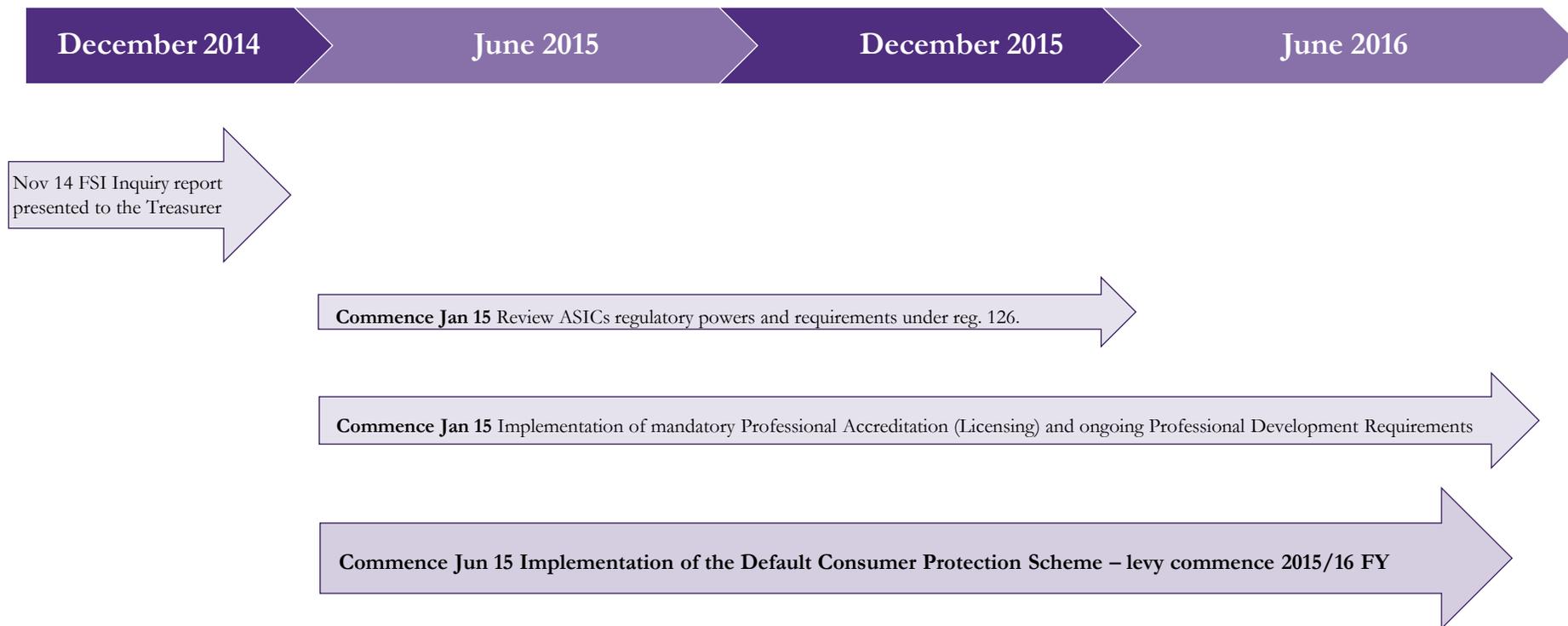
### Advantages

- Benefits the smaller entities

### Disadvantages

- Significantly larger cost to entities with a larger asset base which may be seen as unfair– ‘big/good paying for the small/bad’
- Encourages misstatement of assets
- Discourages investment in assets
- Varied annual cost – difficult for entities to plan for the expense

# Default Consumer Protection Scheme Implementation life-cycle



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## Section 2 Recommendation

01. Overview

02. Recommendation

03. Appendices

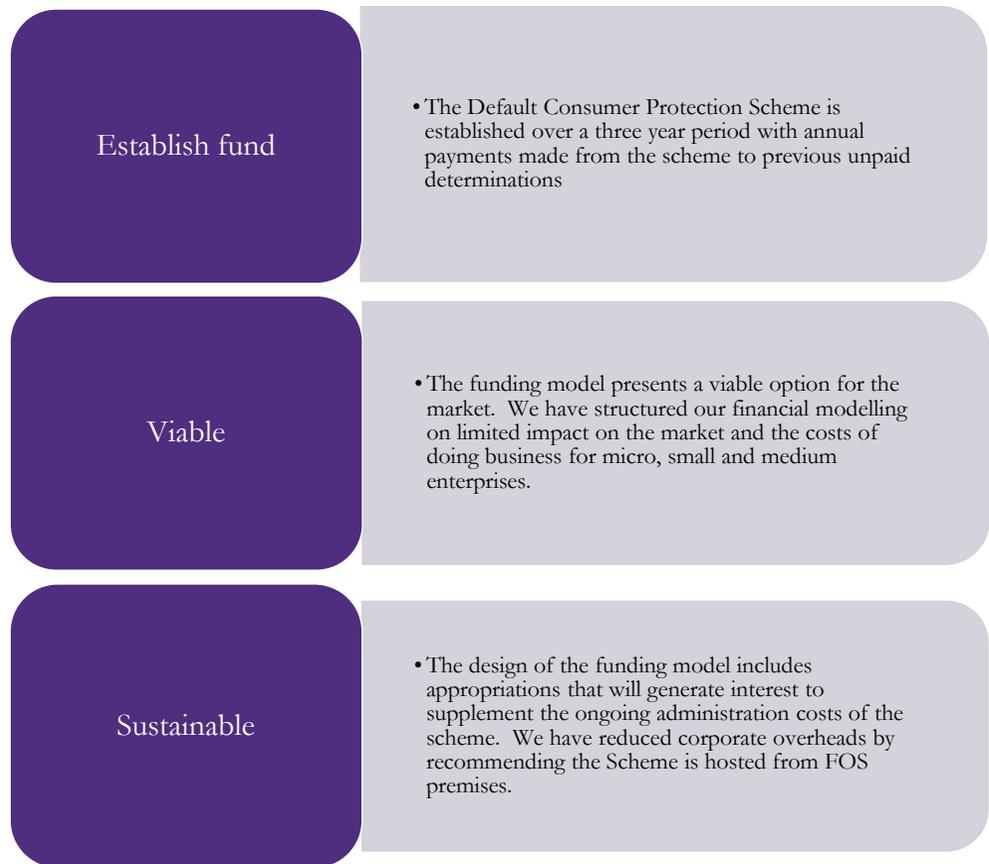
# Recommendation

## Summary

- We recommend the implementation of Option One B (1B). The levy funding is conducted in three tranches to establish the fund at the desired operational balance and the levy is priced to be agreeable from market participants

## Next Steps

- Selection of the preferred model for the Default Consumer Protection Scheme.
- Comprehensive modelling including;
  - The three phases of development
  - Financial modelling of the staged payment of unpaid determinations
  - Further advice on the structure of 'trigger' disallowable instrument



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## Section 3. Appendices

### A. Additional Funding Options

### Additional Calculations

Scenario B represents the revised levy amounts if an equal contribution was made by Financial Advisers/Planners and Managed Investment Schemes.

Note: Estimations for annual determinations to be paid etc. have remained unchanged from original scenarios.

#### Scenario B for Option 1A

- Based on the original scenario, the full amount of determinations were to be paid in year zero (\$10.15 million) and a target fund balance of \$12 million was to be established.
- Upfront payment of \$1,200 will be required from each Financial Adviser/Planner and MIS. Ongoing levy contributions of \$175 p.a. will cover the estimated costs per year.

	Year 0	Year 1	Year 2	Year 3 and onwards
	Financial Adviser/ Planner & MIS			
Proposed Levy	\$ 1,200	\$ 175	\$ 175	\$ 175
Total funds raised p.a	\$ 22,982,400	\$ 3,351,600	\$ 3,351,600	\$ 3,351,600
Less: Payments of Unpaid Determination	\$ 10,150,000	\$ 2,537,500	\$ 2,537,500	\$ 2,537,500
Less: Establishment Costs	\$ 300,000	n/a	n/a	n/a
Less: Administration Costs	\$ 750,000	\$ 750,000	\$ 750,000	\$ 750,000
Remaining Balance of Fund	\$ 11,782,400	\$ 11,846,500	\$ 12,265,995	\$ 12,698,075
Approximate 3% Interest on Balance	n/a	\$ 355,395.00	\$ 367,979.85	\$ 380,942
Approximate Balance of Fund at Year End	\$ 11,782,400	\$ 12,201,895	\$ 12,633,975	\$ 13,079,017

#### Option 1 A

##### Chartered Accountants

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#### Scenario B for Option 1B

- Based on the original scenario, a proportion of the \$10.15 million unpaid determinations are paid each year until year two and a target fund balance of \$6 million was to be established.
- Upfront payment of \$600 will be required from each Financial Adviser/Planner and MIS. Ongoing levy contributions are:
  - Year one \$375
  - Year two \$275
  - Year three and onwards \$175

	Year 0	Year 1	Year 2	Year 3 and onwards
	Financial Adviser/ Planner & MIS			
Proposed Levy	\$ 600	\$ 375	\$ 275	\$ 175
Total funds raised p.a	\$ 11,491,200	\$ 7,182,000	\$ 5,266,800	\$ 3,351,600
Less: Payments of Historic Unpaid	\$ 5,075,000	\$ 3,383,333	\$ 1,691,667	n/a
Less: Payments of Current Unpaid	n/a	\$ 2,537,500	\$ 2,537,500	\$ 2,537,500
Less: Establishment Costs	\$ 300,000	n/a	n/a	n/a
Less: Administration Costs	\$ 750,000	\$ 750,000	\$ 750,000	\$ 750,000
Remaining Balance of Fund	\$ 5,366,200	\$ 5,877,367	\$ 6,341,321	\$ 6,595,661
Approximate 3% Interest on Balance	n/a	\$ 176,321.00	\$ 190,239.63	\$ 197,869.82
Approximate Balance of Fund at Year End	\$ 5,366,200	\$ 6,053,688	\$ 6,531,561	\$ 6,793,530

#### Option 1B