

Submission to the Second Round of the FSI

26/8/2014

My name is Paul Williams. I am an individual consumer.

In 2009, I made a submission to the ASIC inquiry that approved the FOS Terms of Reference. My submission helped secure an increase in the income protection insurance caps by 25% from \$6000 a month to \$7,500 a month. (This is recorded in ASIC report 182 starting at paragraph 99). The FOS board's stated preference was for this cap to remain at \$6000 a month until January 2015. However, on 1 January 2015 further indexation will take it to around \$8300.

I wish to make a submission relating to the following parts of the FSI Terms of Reference:

- 1) 2.1: balancing competition, innovation, efficiency, stability and consumer protection
- 2) 2.5: the role, objectives, funding and performance of financial regulators
- 3) 3.5 corporate governance structures across the financial system and how they affect stakeholder interests

1. 2.1:balancing competition, innovation, efficiency, stability and consumer protection

The limits of effective disclosure

I support the view that even effective disclosure, does not provide adequate consumer protection when the consumer has inadequate financial literacy or when the PDS causes "information fatigue".

There remains an asymmetry of power and knowledge between the Financial Service Provider and consumers.

I note that the committee's chair told the Sydney Public Forum that the majority of clients struggle with the concept of compound interest.

Options for the Classification of clients

The senate economic reference committee report into the performance of ASIC, considered the matters relating to retail/wholesale and sophisticated clients to be an unresolved issue.

The options appear to be to adequately index the “old “ transition points, or grade clients by a new system .

i) Adequately Index current Retail/Wholesale/ Sophisticated transition points.

There has been no increase in the retail client limit of \$500,000 since it was introduced in the Corporations Act in 2002.

However, the neglected indexation of this retail client limit amount extends back a further decade to 1991.

In the 2010, the Treasury Department issued an options paper on Retail and Wholesale clients and acknowledged at footnote 3 that *“The \$500,000 threshold was effectively a carryover from the same figure adopted as the point of exclusion of prospectus requirements in 1991.”*

The Treasury department option paper highlighted the dwindling value of the retail client limit by stating, *“The level of \$500,000 is a level now within reach of an increasing number of Australians, given that in June 2010 the median value of a house in Australia was \$558,540.”*

Results of Indexation (see Appendix 1 and 2)

Indexing \$500,000 by Male Total Average (MTAWE) weekly income growth since 2002 increases it to \$818,300 in today’s dollars.

Wage growth since 1991 increases \$500,000 to \$1,198,552 in today’s dollars.

CPI since 1991 increases \$500,000 to \$898,981.

Indexing the sophisticated client transition point of \$250,000 by MTAWE from 2002 to November 2013 results in \$409,150.

Similarly, the \$2.5million asset limit becomes \$4.09m.

ii). A Novel method of classifying clients: The “TRAFFIC LIGHT” Grading System

I submit that all clients be automatically assumed to be “Retail clients with inadequate financial literacy” and that these “default retail client” can only be sold products from pre-approved simple “plain vanilla” products.

Using this system, all consumers of unproven ability are “green light client” and can only be sold products that have been given the “green light”. This would protect those who are financially illiterate but suddenly wealthy such as those who inherit or remove lump sums from their super.

It must be a conscious decision by the consumer to be “opt out” of being a “green light client” and become either an “amber light wholesale client ” or a “red light Sophisticated client”.

There is much room for discussion on the definition of “wholesale and sophisticated” clients and “amber and red” products but there should be ready agreement on the “green light products and green light customers”.

Until the customer and the FSP prove otherwise, the consumer remains a “green light customer” who can only be sold “green light products”.

2. FSI Terms of Reference 2.5 the role, objectives, funding and performance of financial regulators

There appears to be an inherent conflict of interests between the consumer objectives of ASIC and the market objectives of ASIC.

In 2009, Jeremy Cooper, deputy chairman of ASIC, overlooked the interests of consumers when he gave FSP’s relief from three years of indexation on the limits at FICS (FOS predecessor scheme) that was enshrined in the FICS ToR and due to be applied in 2010. This would have resulted in the FOS lump sum rising from the current \$280,000 to around \$305,000 in 2010.

“25 So, in recognition that PI insurance is a real concern for stakeholders, we have delayed increasing the minimum compensation limits until 2012. We think this should give plenty of time for financial services businesses, EDR schemes and the PI insurance market to adjust to these changes. (An ASIC Update at the FOS Annual Conference: Jeremy Cooper, ASIC Deputy Chairman, June 2009 Page 4)

Ideally, the consumer protection division should be taken out of ASIC.

The establishment of a separate “Consumer Protection Office” would give consumers confidence that their interests are under ongoing observation, especially when other checks and balances in the system are being reduced. The separation from ASIC would allow significantly more ministerial input into the consumer function.

The consumer protection division should supervise:

1. Systemic issue detection and the operation of enforceable undertakings.

- the systemic detection of persons causing consumer detriment,
- appoint the independent expert in the programs of remediation that occur under enforceable undertakings. The FSP should not be allowed to choose the Independent expert.

- desk audit a “statistically significant” number of the remediation files to ensure effectiveness and coverage of the enforceable undertaking.

2. Establish and supervise the new position of “Independent assessor of FOS” (the UK FOS has had an Independent assessor for around a decade)

- this new role would provide day-to-day ongoing responsive EDR on complaints about FOS service
- review FOS’s correction of the systemic issues it detects and remediates
- Supervise the outcomes from the existing Codes of Compliance and Monitoring (ie banking, general insurance) and establish new codes for life insurance and financial planning
- The UK FOS Independent Assessor can fine FOS around AUD\$300 for providing slow service and passes this money to the applicant. The Independent review found that TOS is too slow.
- To ensure transparency, any ongoing divergence of opinion between FOS and the Independent Assessor may be published in the Independent Assessor’s contribution to the FOS Annual Report.

3. Terms of Reference: 3.5 corporate governance structures across the financial system and how they affect stakeholder interests

Consumers appear to be detrimentally affected by a lack of transparency in the corporate governance of the FOS board.

The result that is that details surrounding the board appointment of ombudsmen and the Independent Reviewer of FOS are unobtainable.

The current ASIC chairman expressed his general support for transparency and has stated, “Sunshine is the best disinfectant”.

The Sydney Public Forum put emphasis on transparency in corporate governance, as did the Joint Consumer submission to the Independent review of FOS .

“2.2.Board transparency

12.2.1.

Stakeholder views

The Joint Consumer Submission seeks greater transparency as to the FOS Board’s activities and states that Board reports should be provided to consumer advocates and industry after each meeting. Also FOS’s consumer directors should report on FOS Board activities through the Consumers’ Federation of Australia(Independent Review of FOS, page 83”

However, the Independent Reviewer of FOS, CameronRalph, response was “As is the case for other companies, the Board’s proceedings are and should be confidential. This best promotes an open dialogue within the Boardroom, allows Management to be as frank as possible with the Board and permits more rigorous and probing scrutiny of Management.(page 84.)

The opinion of the Independent Reviewer of FOS appears out of step with the views expressed at the public forum and the Joint Consumer Submission. There is a unresolved need for transparency at FOS.

Appendix 1

There are three obvious ways to index the \$500,000 retail limit.

a) Indexation using Multiples of average incomes

The 2010 Treasury options paper stated, "2.3) *The threshold for product value was set at \$500,000, as compared to average total earnings for Australian full-time workers which were around \$29,300 in 1991.*"

In 1991, the \$500,000 threshold was 17.1 times the average annual income of \$29,300.

In November 2013, the average annual income was \$70,090 (MTAWE :male total average weekly earnings of \$1347.90 x 52 weeks), so the current \$500,000 retail limit is only 7.13 times the average annual income.

If we were to fully restore the retail client limit to its 1991 value it would be around **\$1,198,552** (17.1 x \$70,090).

b) Indexation by Male TAFE

The FOS ToR uses MTAWE for indexation.

The male MTAWE (ABS Cat. 6302, Table 10c, series A2734030W) was historically \$823.60 in May 2002, \$1069.10 in May 2008, and \$1347.90 in November 2013.

From May 2002 to November 2013, MTAWE rose 63.66 % (1347.90- 823.60 divided by 823.60) which indexes the current \$500,000 retail limit to \$818,300.

c) Indexation by CPI

The CPI index (ABS: Weighted average of Eight capital cities: Series A2325846C) in March 1991 58.9 and in June 2014 was 105.9.

The CPI has risen 79.8% since 1991.

Using CPI, the value of \$500,000 in 1991 has risen to \$898,981.

Appendix 2. Indexation of Sophisticated transition points.

The minimum income level at which a person can be certified as a wholesale client under section 761G (7) (c) (ii) is \$250,000 for two years. It appears this transition point has not been increased since at least 2002

The male Total Average Weekly Earnings (ABS Cat. 6302, Table 10C, series A2734030W) was historically \$823.6 in May 2002, and \$1347.90 in November 2013. Male AWOTE rose 63.66% ($1347.9 - 823.6$ divided by 823.6).

Indexing \$250,000 income amount by MTAWTE from 2002 to November 2013 results in \$409,150.

Similarly indexing \$2.5million asset amount by MTAWTE from 2002 to November 2013 results in \$4.09 million.