

31 March 2017

The Manager
Financial Services Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: ProductRegulation@treasury.gov.au

Dear Manager

Design and distribution obligations and product intervention power - Proposals Paper December 2016

The Financial Ombudsman Service (FOS) Australia¹ is an ASIC-approved independent external dispute resolution (EDR) scheme that covers disputes across the financial sector.²

We welcome the opportunity to provide feedback³ in response to the Proposals Paper *Design and distribution obligations and product intervention power* released by the Treasury in December 2016 (Proposals Paper).

FOS has consistently supported reforms to ensure consumers are treated fairly in all facets of product design, sales and marketing, service, conduct, claims handling, complaints and remediation⁴ and accordingly broadly supports the approach outlined in the Proposals Paper.

This letter provides feedback on particular matters addressed in the Proposals Paper that are relevant to consumer redress and dispute resolution. We look forward to providing further feedback when the proposals progress to draft legislation.

¹ Information about FOS is set out in full on our website at www.fos.org.au.

² FOS is approved by ASIC under its [Regulatory Guide 139](#) *Approval and Oversight of External Dispute Resolution Schemes* (Regulatory Guide 139).

³ This feedback 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 experience of FOS and its predecessors in the resolution of disputes about financial services

⁴ See our submissions to the Financial System Inquiry [April 2014](#) and [August 2014](#).

In the meantime, if FOS can provide further input or assistance on the specific issues addressed below, please contact our Policy & Liaison Adviser, Carolyn Bruns at cbruns@fos.org.au or on (03) 9613 7389.

1. Design and distribution obligations

The *Corporations Act 2001* (Corporations Act) requires licensees to have arrangements in place to ensure they can pay awards of compensation to retail clients for breaches of Chapter 7 of the Act.⁵ Despite this clear requirement, FOS continues to see cases where awards of compensation against licensees under FOS determinations are not paid. Our electronic publication, *The FOS Circular*, provides regular updates on the extent of this problem.⁶

FOS has been a strong advocate for the establishment of a compensation scheme of last resort (see section 3.3 below) to provide redress to consumers who have been denied access to justice because they have not received compensation awarded to them, due to a firm's lack of resources.

Whether or not a compensation scheme of last resort is established, it is essential in our view to reinforce the requirements in the Corporations Act for licensees to have adequate complaints handling and compensation arrangements. For this reason, we suggest the obligations on issuers discussed in section 3.2 of the Proposals Paper should require an issuer to assess a distributor's capacity to deal with complaints through to payment of any appropriate compensation for losses, and not select that distributor if their capacity is inadequate. This could be done, for example, by adding to the list of factors in 'Detailed Proposal 2' on page 21 of the Proposals Paper an item such as:

'the capacity of the distributor to handle complaints appropriately, including their ability to compensate consumers for losses'.

Consultation question 13 suggests that an issuer could be required to have regard to factors including 'the risks associated with a distribution channel and steps to mitigate those risks' when determining whether a distributor is appropriate for a product. We note that a distribution channel with inadequate compensation arrangements may present the risk that consumers may not be able to recover any financial losses they sustain.

2. Product intervention power

An intervention made using the power described in Chapter 4 of the Proposals Paper could result in a large number of consumers seeking redress through EDR. Before such an intervention, we consider that certain matters would need to be addressed in a consultation between ASIC and the relevant EDR scheme.

⁵ See s912B of the Corporations Act.

⁶ [The FOS Circular](#), published on our website.

We suggest therefore that the proposed legislation provides for consultation between ASIC and an EDR scheme before certain interventions are made, namely:

- an intervention that could result in a large number of consumers seeking redress through EDR or
- an intervention requiring an unlicensed financial firm⁷ to join an EDR scheme (if such an intervention could be made).

Addressing key matters as early as possible would help to ensure, for example, that consumers do not develop unrealistic expectations in regard to redress. It would also help the EDR scheme to plan for any large influx of disputes which could give rise to changes in processes or staffing and/or amendment to its Terms of Reference.

Examples of points that an early consultation may need to address are:

- whether disputes would fall within the jurisdiction of the EDR scheme
- whether the scheme could award full compensation for losses and
- whether a remediation program meeting the requirements of ASIC's Regulatory Guide 256⁸ should be established and, if so, how the program should be coordinated with EDR.

If the proposed product intervention power allows ASIC to impose requirements on an unlicensed financial firm, including a requirement to join an EDR scheme, special measures may be required to ensure dispute resolution can operate effectively. If such an intervention could be made, we consider that the special measures would need to be discussed in an early consultation between ASIC and the EDR scheme.

FOS has in place systems to ensure that financial firms engage in dispute resolution effectively and these systems rely, ultimately, on the licensing regime. In very simple terms, licensees may risk losing their licences if they do not meet their obligations in dispute resolution. Our systems are also supported by regulatory guidance that applies only to licensees. If a member of FOS is unlicensed, separate arrangements will be needed to ensure the member engages in dispute resolution effectively.

3. Consumer redress

3.1 Redress through EDR

Section 5.2 of the Proposals Paper discusses redress that could be available to consumers who suffer loss due to a breach of the design or distribution

⁷ The term 'unlicensed financial firm' is used to describe a financial services provider that does not hold an Australian financial services licence under s913B of the Corporations Act or an Australian credit licence under s35 of the *National Consumer Credit Protection Act 2009*.

⁸ See ASIC's [Regulatory Guide 256](#) *Client review and remediation conducted by advice licensees* (Regulatory Guide 256).

obligations or a requirement imposed in an intervention, including redress through an EDR scheme such as FOS. We consider that these consumers should have access to effective internal dispute resolution procedures and, where necessary, EDR.

At present, there are limits on the remedies FOS can award for individual disputes and the work we can do with financial services providers to ensure consumers receive compensation for losses attributable to systemic issues. These matters are governed by our Terms of Reference, which comply with requirements imposed through ASIC's Regulatory Guide 139.

As the Proposals Paper acknowledges, a review of the EDR and complaints framework is being conducted at present to ensure the framework effectively meets the needs of users of the financial system (Ramsay Review). Redress available to consumers is one of many issues being examined in the review. As the interim report of the Ramsay Review stated:

‘Consumers should be able to expect that financial products will perform in the way they are led to believe **and, where they do not, have access to effective redress.**’

FOS strongly supports the Ramsay Review's work in recommending enhancements to improve access for consumers to effective dispute resolution and compensation and we have made submissions to the review to support its work.⁹ For example, our response to the interim report provided detailed analysis that shows current claims limits and compensation caps for consumers and small businesses are outdated and need to be significantly increased.

3.2 Existing avenues of redress

Section 5.2 of the Proposals Paper outlines avenues of redress available to consumers at present, which include EDR.

One consumer redress mechanism available at present, but not mentioned in section 5.2, is remediation (see our comments in section 2 above). From time to time financial services providers need to establish remediation programs to compensate consumers who suffer loss due to misconduct or other compliance failure. ASIC recently developed regulatory guidance to ensure remediation programs provide a consistent, transparent and efficient approach to similar matters across consumers and financial services providers. This guidance is set out in ASIC's Regulatory Guide 256, issued on 15 September 2016, and applies to remediation initiated on or after that date.¹⁰

3.3 Access to a compensation scheme

As mentioned in section 1 above, for many years FOS has been advocating the establishment of a compensation scheme of last resort so consumers have confidence that if things go wrong, they will be compensated when a decision is

⁹ See our submissions to the Ramsay Review in [October 2016](#) and [February 2017](#).

¹⁰ See ASIC's [Regulatory Guide 256](#).

made by EDR in their favour. The Financial System Inquiry's interim report examined uncompensated loss arising from unpaid FOS determinations and acknowledged it was a pressing issue given the limitation of professional indemnity insurance as a compensation mechanism.

More recently, the Ramsay Review was established to look into the financial system's EDR and complaints framework. The Ramsay Review's interim report stated that the panel is 'of the view that there is considerable merit in introducing an industry-funded compensation scheme of last resort.'¹¹

Further, in February the Minister for Revenue and Financial Services amended the Ramsay Review's terms of reference to include¹²:

- the making of recommendations (rather than mere observations) on the establishment, merits and potential design of a compensation scheme of last resort and
- consideration of the merits and issues involved in providing access to redress for past disputes.

FOS, in responding to the Ramsay Review's consideration of these expanded terms of reference, will continue to advocate for a compensation scheme of last resort as the missing element in recent reform efforts.

Yours faithfully



Shane Tregillis
Chief Ombudsman
Financial Ombudsman Service Australia

¹¹ See page 168 of the [interim report of the Ramsay Review](#), December 2016.

¹² Amendment to Terms of Reference of Ramsay Review, 3 February 2017