

September 2014

Senator David Fawcett  
Parliamentary Joint Committee on Corporations and Financial Services  
PO Box 6100  
Parliament House  
Canberra ACT 2600

\_\_\_\_\_ **by email** \_\_\_\_\_

Dear Senator,

**Re: Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry**

The Financial Ombudsman Service (FOS) would like to thank the Committee for the opportunity to make a submission to the above mentioned inquiry<sup>1</sup>.

Sustainable consumer trust in financial services is critical for a dynamic, innovative and competitive financial sector and is reliant on high standards of professionalism and care by those who manage the savings of others, or who advise on credit, financial investment and risk products and services. Efforts to lift the professional, ethical and education standards in the financial services industry are therefore welcomed by FOS.

These efforts will be essential to achieve the five consumer outcomes recently highlighted in the Financial System Inquiry's interim report<sup>2</sup>:

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 designed to meet the needs of consumers.
2. Consumers should have access to the information, advice and education 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 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.

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<sup>1</sup> This submission 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.

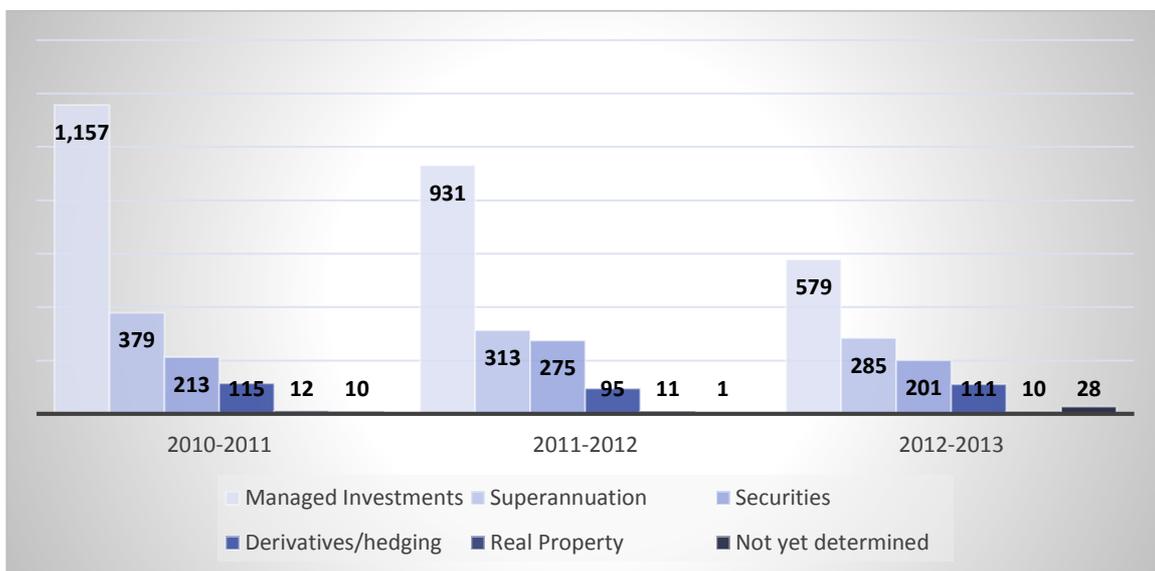
<sup>2</sup> FOS has recommended in its submission to the FSI interim report that these outcomes be further strengthened <http://fos.org.au/custom/files/docs/fos-submission-to-fsi-interim-report-august-2014.pdf> (pp.3,9)

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.

### Our dispute resolution experience

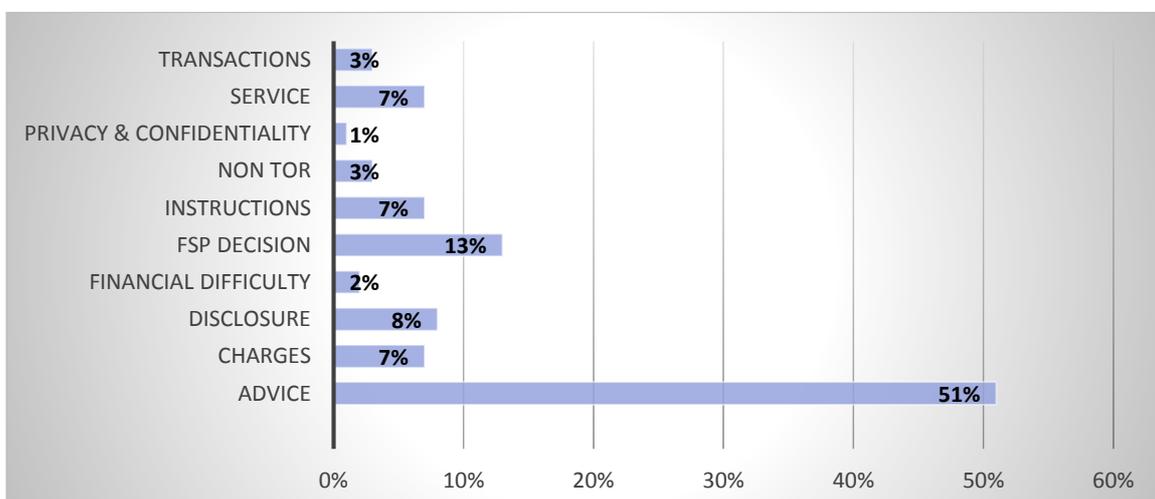
In 2012-2013<sup>3</sup>, FOS accepted 24,100 disputes which had not been resolved to the consumer's satisfaction by their financial services provider. Of these, 1,214 related to disputes about investments. Managed investments continue to be the most complained about investment product (48%) followed by disputes about superannuation (23%).

#### Investment Disputes Accepted at FOS 2012-13



The main issue involved in managed investments disputes was advice (51%), followed by disputes relating to decisions by financial services providers (13%), and disclosure (8%).

#### Managed Investments Disputes Accepted at FOS 2012-13 (Issues)



<sup>3</sup> FOS Annual Review 2012-2013- <http://www.fos.org.au/publications/annual-review/>

### *What the disputes were about*

The majority of managed investment disputes involved a financial adviser/planner (62%) or a managed investment scheme operator/fund manager (27%).

In these disputes, consumers complained that the advice they had been given was inappropriate and did not properly accord with their financial position, goals and tolerance to risk.

In our experience, disputes relating to the standard of advice arise when an adviser does not have sufficient understanding of the financial product they are recommending. This results in advisers failing to adequately explain the features and risks associated with a product and choosing unsuitable products for clients.

Knowledge of product features and risks is particularly important when dealing with complex products. In our view, product specific training is essential to achieve the necessary level of competency to advise clients whether to invest in these products.

We have also dealt with disputes in relation to clients being provided with advice that was not suitable to their circumstances; asset allocation made on generic basis and not tied to risk profiling outcomes; failure to prepare, implement and review a client's strategy. The case study below provides an example of inappropriate advice.

#### **Case Study- Inappropriate advice**

Mr and Mrs A sought financial advice in 2008 from an authorised representative of the financial services provider. They were looking to reduce their debt and create wealth, both personally and as trustees for their self-managed superannuation fund (SMSF). Mr and Mrs A had two young children and mortgages on their home and an investment property totalling more than \$1 million.

The authorised representative provided verbal advice and then asked them to fill in an application form for a series of agribusiness investments in both their personal names and their SMSF, and a leveraged Australian equities fund for the SMSF. Only after they had taken these steps did the authorised representative provide Statements of Advice.

After the investments were made, Mr and Mrs A's personal portfolio comprised 56% direct property and 44% agribusiness, and their SMSF had 79% in the leveraged equities fund and 21% in agribusiness.

Mr and Mrs A's combined salaries fell after the first year, and they began struggling to make the required repayments. Eventually, they had to sell their investment property.

In 2013-2014, they brought a complaint to FOS against the authorised representative's FSP.

FOS found that:

- the risks associated with the investment advice were not adequately disclosed
- the applicants could not afford the investments given their debt levels and other financial commitments
- their investment goals and objectives could not be achieved, and
- the investment portfolio was not diversified.

FOS recommended that Mr and Mrs A's losses from the investments be reimbursed. These losses, after tax benefits, were calculated at \$206,000 (personal) and \$162,000 (SMSF).

The recommendation was accepted by both parties.

Any efforts to lift professional, ethical and education standards will improve competency in relation to understanding of client circumstances, needs and objectives, developing suitable strategies, recommending and explaining the strategy and recommending and explaining the features and risks of suitable products.

### **The responsibilities of product issuers**

As product issuers play a key role in product distribution, we consider they too should have appropriate responsibilities for ensuring anyone involved in the distribution of products meets the relevant training and compliance requirements.

### **Professional regulation of standards of practice**

Strong governance arrangements for the regulation of professional standards across the financial services industry are crucial to sustain consumer trust in advisers, products and services. Equally, ongoing consumer confidence relies on strong sanctions and effective external dispute resolution mechanisms operating when trust relationships have been breached.

We also support the concept of a register of individual advisers. Similar registers have been implemented in the Asia region and can provide a model<sup>4</sup>.

### **The role and importance of codes of practice**

A code of practice sets standards of good industry practice for financial service providers to follow when dealing with people who are, or who may become, individual or business customers. FOS provides support arrangements for a number of codes in the financial sector, with a separate business unit supporting the work of independent code compliance committees<sup>5</sup> whose role is to monitor compliance with these standards.

The codes involved are:

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

The 617 current subscribers to these codes have made a commitment to:

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

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<sup>4</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"].

<sup>5</sup> FOS Annual Review 2012-2013- <http://www.fos.org.au/publications/annual-review/>

When deciding a dispute and determining whether a remedy should be provided, FOS will do what is in its opinion fair in all the circumstances<sup>6</sup>, having regard to not only legal principles but also applicable industry codes or guidance as to practice<sup>7</sup>.

The consistent application of professional standards for financial services advisers will rely on a sound regulatory framework and wide subscription to relevant codes of practice that are endorsed by Industry Associations. In FOS's view, regulation and code compliance while foundational to improved professionalism in the sector, must be supplemented by building the competency of advisers in ethical reasoning and conduct.

Initiatives to strengthen the professional standards across the sector are welcomed by FOS as the ultimate beneficiaries will be Australian consumers of financial products and services.

Yours sincerely

A handwritten signature in black ink that reads "Jenny Peachey". The signature is written in a cursive, flowing style.

**Jenny Peachey** | Executive General Manager  
Strategy and Business Operations

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<sup>6</sup> Clause 8.2, FOS Terms of Reference- <http://www.fos.org.au/about-us/terms-of-reference/>

<sup>7</sup> An example being the Financial Planning Association's Code of Professional Practice