



Investment & Financial Services Association Ltd

## **IFSA Submission FOS Proposed Terms of Reference**

Dated: 20 April 2009

## INTRODUCTION

IFSA members strongly support the operation of external dispute resolution (**EDR**) to provide a quick and relatively inexpensive determination of client disputes, particularly for clients who do not have the means to readily access the legal system. However, the determination of substantial claims and consideration of matters such as indirect and consequential losses are matters appropriately left to the courts. It is disappointing that a number of significant issues identified by IFSA members in response to the earlier consultation Draft Terms of Reference appear to have been dismissed without any explanation or discussion.

The consultation process undertaken by FOS to date has not been satisfactory and there does not appear to have been a serious attempt to properly consult with Members.

IFSA members in conjunction with other Industry Bodies had previously committed to the development of an industry funded EDR at no cost to consumers that provided for the quick and effective resolution of relatively small claims. As part of that scheme members contractually agreed to be bound by the determination of any dispute and to forgo any right of appeal. It is noted that the proposed FOS monetary thresholds far exceed small claims limits of Australian courts and tribunals. While IFSA members support the speedy resolution of a majority of disputes within reasonable monetary limits, they do not support surrendering the right to judicial determination of issues and disputes in relation to significant claims.

As drafted, the thrust of the Terms of Reference appears to be designed to give FOS all the trappings of a court without the responsibilities or review mechanisms. The wide discretions provided to FOS (sections 1.2(a), 4.2(a), 5.2, 6.3, 7.4, 8.4(c)) appear to shield FOS from any objective accountability to its members in the administration of its responsibility or the exercise of its discretions.

## ISSUES OF PARTICULAR CONCERN TO IFSA

### Monetary thresholds

FOS is an amalgamation of separate, previously-existing external dispute resolution schemes. Each of those schemes dealt with a limited range of financial products having specific characteristics, and the determination of a dispute required application of particular understanding of that industry sector, the legal requirements applying to the Financial Services Provider (**FSP**) and financial products purchased by the consumer. The existing monetary threshold applying to disputes involving ILIS FSPs reflect majority retail investor coverage within that sector. The monetary threshold reflects the fundamental jurisdictional basis on which FOS can entertain a dispute concerning a particular class of financial product.

The proposed increase in the FOS thresholds to a uniform \$300,000 has been proposed on the basis of convenience for FOS and without any regard to fundamental differences in financial products or the markets in which they operate. The proposed increase is arbitrary and lacks any apparent data basis or proper assessment of the impact of the changes or cost/benefit analysis<sup>1</sup>.

It is also contrary to the position recommended by the Productivity Commission in its *Review of Australia's Consumer Policy Framework*. In particular, we note recommendation 9.1 which calls for "further enhancing financial ADR services through timely and coordinated revision of ceilings

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<sup>1</sup> IFSA Submission to FICS dated 18 September 2007.

on the value of transactions subject to ADR, with ceilings differentiated according to the relative risks of consumer detriment for the relevant classes of products.”

While we understand that the uniform increase in the threshold to \$300,000 is designed to anticipate a proposed ASIC threshold under a Regulatory Guide, such a requirement is not law and if it were to be prescribed in the relevant Act or regulations it would require a regulatory impact assessment to be undertaken.

The proposed threshold will, in the ILIS context, amount to a doubling of the current threshold in some instances. The view of IFSA members is that EDR thresholds should not be increased above the CPI unless the increase is justified on the basis of relevant data and proper assessment of the impact on members. Additionally, operation of the threshold from 1 January 2012 assumes that professional indemnity insurance will be available at a reasonable cost to all FOS members. Advice from IFSA members is that the current insurance market is hardening, and indications are that it will become very difficult for members outside of the large conglomerated financial groups to obtain adequate insurance coverage at a reasonable cost - if at all - within existing parameters, let alone a doubling of the threshold for non-life investment products. The consequence of this will be a reduction in the availability of financial advice by FSPs to those consumers most in need of advice. This outcome runs counter the very reasons for which the original Financial Industry Complaints Scheme was established.

To date, FICS members have not sought to distinguish between clients who are retail investors and those who are not. The EDR was designed to cover the majority of claims made, although not all claims. The compromise position accepted by members has been that the EDR should be available to clients of ILIS members where disputed claims fall below specified monetary thresholds covering a majority of claims for specific types of financial products or services.

As stated in the earlier IFSA submission on the FOS Consultation Paper for developing the proposed Terms of Reference, and in view of the proposed \$300,000 threshold, IFSA members may review the industry compromise to date, that the industry funded scheme should be available to all clients (wholesale and retail) where disputed claims fall below specified monetary thresholds for specific types of financial products or services. Again, it should be noted that a number of IFSA members favour limiting the ILIS Terms of Reference to ‘retail clients’ as defined in the Corporations Act. This would be consistent with the requirements of the Corporations Act, but will limit current access to FOS.

The IFSA position to the proposed \$300,000 threshold, in relation for the ILIS Division, is that:

- (a) The monetary thresholds should not be increased from current levels above the CPI unless the increase is justified on the basis of relevant data and proper assessment of the impact on members.
- (b) Increase in the threshold should be conditional to the availability of professional indemnity at a reasonable cost to all FOS members; and
- (c) If monetary thresholds are increased substantially (as proposed), a new requirement should be included in the Terms of Reference providing that a FOS member is entitled to refuse a matter being considered by FOS where the member can establish that its client is not a retail client within the meaning of the Corporations Act 2001.

## **OTHER MATTERS**

### **Section 1.2 – Principles that underpin FOS operations and processes**

Principles under which FOS should operate must set an objective standard. It is not appropriate within the context of procedural requirements for the rules of engagement to provide FOS with an absolute power that is not reviewable, to determine what should be required under the rules.

Additionally, an important principle which underpins an effective EDR process is that the service is delivered to all parties concerned in a cost effective manner.

**It is recommended that:** delete clause 1.2(a) and replace with the following clause:

“a) must do what is appropriate to resolve disputes in a cooperative, efficient, cost effective, timely and fair manner:“

## **SECTION B – JURISDICTION OF FOS**

### **Clause 4 – Eligibility to lodge a Dispute with FOS**

Clause 4.2(a) - The discretion for FOS to determine if a dispute has a “sufficient connection” with Australia is too vague. As matters of jurisdiction are fundamental to a dispute being considered by FOS, the requirement must be clear on its face. If an Applicant cannot establish that they have either a legal or beneficial interest they have no standing at law. It is NOT ACCEPTABLE that a *Guideline* be used to explain what in FOS’s view constitutes a sufficient connection.

**It is recommended that:** Clause 4.2(a) be amended to expressly limit FOS jurisdiction to disputes involving a possible breach of an Australian financial services law.

Clause 4.2(b)(v) - Disputes heard by FOS should not involve parties that are not otherwise a party to the contractual relationship between the AFSL holder and their client. Matters of special interest would be more appropriately considered and dealt with by the courts.

**It is recommended that:** Clause 4.2(b)(v) be amended by deleting “or other special interest”.

Clause 4.2(c) - Clause 3.9(c) of the Constitution specifically states that a member immediately ceases to be a FOS Member if they become insolvent. If a FOS member is in liquidation, the matter is more appropriately dealt with by the courts.

**It is recommended that:** Clause 4.2(c) be amended to make clear that FOS cannot entertain a dispute where the FSP has become insolvent.

## **Clause 5      Discretion to exclude Disputes**

It is noted that Clause 5.1 sets out the types of Disputes which are mandatorily excluded from FOS's jurisdiction. The TOR should clearly set out the limits of FOS and the types of complaints FOS can or cannot consider. Many of the matters identified in 5.2 as matters which 'may' be excluded from FOS's jurisdiction should be incorporated in Clause 5.1 as specific exclusions.

Clause 5.2(c) - While we note the recommendation by the Productivity Commission in its *Review of Australia's Consumer Policy Framework* that ADR services could be enhanced through "allowing a consumer with a claim exceeding any given ceiling to waive the excess and have their claim met up to the limit", that recommendation was made in the context of much smaller claims than will be considered by FOS.

Any proposal to allow claims to be heard by FOS where they exceed the monetary threshold in recognition that any award could be made only up to the amount of that threshold, would only be acceptable to IFSA members if:

- (a) Both parties to the dispute – member and client - agreed to the matter being heard by FOS (reflected in proposed clause 4.4); and
- (b) The Applicant is required, prior to FOS hearing the matter, to waive any right to further legal action in relation to the claim regardless of whether the client is successful or not at FOS. A formally binding agreement eg deed of release or deed of agreement should be required.

**It is recommended that:**

- (1) Clause 5.2(c) be amended by including the words "Subject to clause 5.2(ca)"; and
- (2) Clause 5.2(ca) be included to provide:

FOS may consider a dispute that exceeds the maximum monetary threshold only where:

- (a) Both Member and Applicant agree to the matter being heard by FOS; and
- (b) the Applicant signs a deed of release accepting the FOS determination as final.

Clause 5.2(e) - Consistent with Rule 16 of the ILIS TOR, clause 5.2(e) should allow the dismissal of a Dispute as frivolous or vexatious. Either or both parties should be permitted to make written submissions and a decision made by the Ombudsman having regard to the written submissions of the parties.

**It is recommended that:** clause 5.2(e) be amended by including the words "having regard to the written submission of the Member and the Applicant" at the end of that clause.

Clause 5.2(g) - A determination by FOS is final and binding for the Member. It is not appropriate that the Member be subject to double jeopardy.

**It is recommended that:** Clause 5.2(g) be deleted and included in clause 5.1.

Clause 5.2(h) provides that if after lodging a Dispute with FOS, the Applicant commences legal proceedings against the financial services provider (FSP) on matters that are related to the Dispute, FOS *'may refuse to consider, or continue to consider'* that Dispute. If a matter is before a Court or other Tribunal then it is entirely inappropriate for FOS to consider the matter.

If the Applicant elects to take a matter to a Court or Tribunal, then they have done exactly that - made an election as to which forum they elect to have their dispute determined. Allowing FOS to consider matters before a Court or Tribunal amounts to no more than 'forum shopping'; is a considerable waste of Members' and FOS's resources; allows FOS to be used as a 'dry run' by Applicants; and may result in inconsistent findings being made by different bodies.

**It is recommended that:** the types of matters raised in Clause 5.2(f) and (h) should be specifically excluded from FOS's jurisdiction under Clause 5.1.

## **Clause 6 - Dispute Resolution Process**

### Clause 6.1 – Lodging of disputes

In the ILIS context it is not acceptable for disputes to be accepted by FOS if not detailed in writing. A Member is entitled to receive formal argument and reasons before it is asked to submit its defence to FOS on an issue.

Additionally, given concerns previously raised with FOS/FICS about assistance being provided to Applicants, FOS is not a consumer advocacy body and runs the risk of again losing the confidence of ILIS member as to its impartiality. In this regard it is noted that FOS is permitted to assist the Applicant with the process, that is explaining the steps required for the lodgement of a claim and the process to determination of the claim, not the actual formulation or preparation of the claim.

**It is recommended that** clause 6.1 be amended to expressly provide for ILIS disputes to be made in writing to FOS and satisfy the requirements of clause 5.1 before FOS can take action to consider the complaint.

Clause 6.3 - Opportunity for internal dispute resolution. The FOS process must follow the completion of the IDR process. It is not the role of FOS to regulate its members.

As currently drafted FOS can take up an issue per (b) within 45 days of the applicant first requesting the FSP to remedy a situation, even where the IDR has not seen the complaint.

**It is recommended that** clause 6.3 be amended to provide that :

Where an Applicant lodges a Dispute with FOS:

- a) before complaining to the Financial Services Provider, FOS must refer the Applicant to the Financial Services provider and give the Applicant the contact details of the Financial Services provider;
- b) after 45 days of lodging a complaint with the Financial Services Provider and before the receipt of the IDR response of the Financial Services Provider, FOS may, subject to clause 6.4, hear the complaint.

## **Clause 7 - Dispute resolution methods and related matters**

### Clause 7.3 - Other obligations of the parties to a dispute

This proposal is cast too broadly and does not fit well within the context of resolving Disputes in an efficient and timely manner. The use of the words '*FOS may require a party to a Dispute to do anything else...*' are not helpful and only create uncertainty.

FOS should be primarily limited to the information provided to it for the purpose of determining a dispute. While it may request information and could possibly draw a negative inference if that information is not provided, it should not be able to require the provision of information. In the ILIS context, IFSA members do not consider it appropriate for FOS to require an FSP to investigate a matter further or appoint an independent expert.

To require a Member to obtain an independent expert report will do no more than add significant expense to the process and effectively require the Member to present the Applicant's case when the onus ought be on the Applicant to present their case. This proposed requirement may be a legacy of merging what may work in one scheme, and simply expecting it to fit smoothly into other schemes eg. in some general insurance disputes where an assessor or specialist engineer may be asked to report on damage. However, in life insurance matters we typically deal in medical issues and the like, where the condition may have manifested some years prior. Appointing a further consultant years after the event is often of questionable value - this is often admitted by the consultant themselves - and will be at further cost to the insurer, on top of the already substantial Panel fees incurred in having a matter determined at FOS.

**It is recommended that** clause 7.3(a)(ii) be deleted.

## **Clause 8 Rules of Evidence**

### Clause 8.3 (b) Specialist input (see comments on clause 7.3)

Having to pay for an independent expert is a significant concern for IFSA members. We note that this may be targeted more for general insurance – eg for loss adjusters – but formal guidelines are required around this.

We note that current FOS Terms of Reference for ILIS provide (at 30.4 and 30.5) that FOS can commission expert advice, and may order that the costs be met by the member, but the default position is that FOS bears the costs.

Our concern with this provision is that:

- (a) it can put real commercial pressure on the member to settle just because of cost of expert report, and
- (b) it could lead to FOS delegating decision-making that should really be the province of FOS.

Clause 8.4(c) Provision of information to the parties

Where information is provided to FOS for the purpose of considering a dispute, that information must be made available to all parties to the dispute. To do otherwise would be a denial of natural justice.

**It is recommended that** the words “unless FOS determines that special circumstances apply” should be deleted from clause 8.4(c).

Clause 8.5 – Process for deciding disputes

Clause 8.5(c) – IFSA members consider that where a FOS Recommendation is not accepted and FOS proceeds to a Determination, the matter should be considered by a FOS Panel.

**It is recommended that** the words “either an Ombudsman or by a FOS panel (as the Chief Ombudsman or his or her delegate decides is appropriate)” be deleted and be replaced with the words “a FOS Panel”.

Clause 8.8 – Applicant acceptance of Recommendation or Determination

IFSA members agree that where a Recommendation or Determination is accepted by an Applicant, the Applicant must provide the FSP with a binding release in relation to the matters pertaining to the Dispute. However, it is not appropriate for FOS to be able to consider matters in excess of the compensation cap unless the recommendations at clause 5.2(c) above are accepted.

As proposed, the approach runs the significant risk that if the Applicant receives a favourable outcome, they will either not accept the outcome (a waste of considerable resources for both the Member and FOS) or be placed in a position where they are forced to compromise their potential rights to significant benefits because of the compensation caps. Accordingly, complaints in excess of the compensation caps should not be considered by FOS unless both parties agree that FOS may consider the Dispute.

**It is recommended that** the words “If the amount claimed is in excess of the amount of the award, the release must be for the full amount claimed. The release shall be effective from the date on which the Financial Services Provider fulfils its obligations under the Recommendation or Determination.” be deleted and proposed 5.2(ca) applied.

Clause 8.9 – Consequences of an Applicant refusing to accept a Recommendation or Determination

IFSA members are concerned with capacity of double dipping. If a matter is not accepted within 30 days of the Recommendation or Determination, the matter should be closed and final. That is the matter should not be able to be reopened by the Applicant or FOS. Any further consideration of the matter is a matter for determination by the courts.

**It is recommended that** the wording of clause 8.9 expressly provide that “If a matter is not accepted within 30 days of the Recommendation or Determination, the matter should be closed and final. That is the matter should not be able to be reopened by the Applicant or FOS. Any further consideration of the matter is for determination by the courts.”

**Clause 9 Remedies**

It is the position of IFSA members that the jurisdiction of FOS should not be extended to cover matters that come within the jurisdiction of specialist bodies or tribunals. Given the fact that Members of FOS do not have any right of independent review of a Determination, it is inappropriate for FOS to have powers superior to those of the courts.

Clause 9.1(h) Types of remedies

The jurisdiction of FOS in the ILIS context should not be extended to deal with privacy issues. This is a matter better dealt with by a specialist tribunal or the court.

**It is recommended that** clause 9.1(h) be deleted

Clause 9.2(a) – Compensation for financial loss or damage

IFSA members oppose the proposed FOS jurisdiction to award damages for consequential loss. The determination of such loss often involves complicated questions of causation, remoteness, reliance and mitigation. Claims for damages of this nature are more properly dealt with by a court where parties have an opportunity to obtain a range of expert reports and to cross-examine witnesses.

**It is recommended that** the words “whether direct or consequential” be deleted from clause 9.2(a) and the words “excluding consequential loss” be inserted in place thereof.

Clause 9.2(b)(i) Non-economic loss – Generally

FOS should not have jurisdiction to award damages for non-economic loss. The wording in this paragraph is poorly constructed. The use of the words ‘time taken to resolve the situation’ would ordinarily be compensated by the discretionary award of interest in accordance with Clause 9.4. Potentially an Applicant would be able to ‘double dip’ based on this wording.

We are not aware of any case law where an Applicant has been awarded damages for non-economic loss for breach of contract in relation to a life insurance contract or for negligent professional advice. The position of the courts is that where the contract involves a standard transaction (such as a life insurance contract) damages for disappointment or injured feelings will

not be awarded. It is, therefore, inappropriate for FOS to have ability to award damages for non-economic loss in circumstances where courts would not recognise such entitlements.

Damages for non-economic loss are properly awarded in personal injury matters and these are not the subject of FOS's jurisdiction. It is noted that the BFSO has jurisdiction to make awards for non-economic loss under the applicable TORs. If damages for non-economic loss are to come within FOS's jurisdiction then the power should be limited to matters which currently fall under this area and not more broadly. There should also be a nominal cap, say \$2,000, imposed for BFSO matters only.

**It is recommended that** an ability for FOS to award damages for consequential loss not be extended to the ILIS jurisdiction and should be subject to a nominal cap in other jurisdictions where the power previously operated.

#### Clause 9.2(b)(ii) – Non-economic loss – Privacy

For the reasons stated above, privacy complaints should not fall within FOS's jurisdiction (see 5.2 above). In any event, the wording in the proposed clause 9.2(b)(ii) is not an accurate reflection of the wording used in section 52 of the Privacy Act 1988.

As per the recommended deletion of clause 9.1(h), FOS should not be able to consider privacy matters in the ILIS context. It follows that clause 9.2(b)(ii) should likewise have no application in an ILIS context.

#### Clause 9.3 – Applicant's costs in pursuing matter

The fact that the EDR is made available at no cost to clients of FOS members does not mean that the member should contribute to legal or other professional costs incurred by the client. Consistent with the view that an EDR forum should deal with disputes in a cost effective manner it is not appropriate for an FSP to be required to 'contribute to' the Applicant's legal or other professional costs.

Many lawyers are retained by their client's on a 'no-win no fee' basis and that their client's are often charged set fees for certain stages of work completed. Many lawyers also charge their client's a premium of up to 25% on top of these charges. In many cases, these costs are quite substantial. This proposal therefore has the potential to significantly increase the costs borne by the FSP in a system designed to be relatively simple and without dependence on the legal profession.

**It is recommended that** clause 9.3 be deleted.

#### Clause 9.4 – Interest

Interest is considered compensatory in nature. However, unless interest is capped the concept of a compensation cap becomes illusory given that interest can often be a substantial part of an

award. At the very least, a cap on interest should be imposed in the TOR. It is noted that the current cap under the ILIS TOR is \$50,000.00.

**It is recommended that** any interest awarded as part of a recommendation or determination be calculated to reflect the economic loss and in any event be subject to a maximum capped amount specified in the thresholds Schedule.

#### Clause 9.5 – Other types of damages

The wording should be amended to make it clear that FOS cannot make awards for consequential loss and non-economic loss. This is consistent with Rule 33.4 of the ILIS TOR.

**It is recommended that** clause 9.5 be amended by including in the list of exclusions the terms “consequential or non-economic loss”.

#### Clause 9.6 – Cap on maximum value of remedy

This Clause carries the same concerns as above clause 8.8 above as regards the addition of compensatory amounts on top of the amount specified in the applicable Schedule. This "cap" therefore gives little surety to the FSP when allowing a matter to go through for Determination, because the amount specified in the Schedule may well differ greatly from the total amount awarded.

As previously expressed many Members operating in the ILIS jurisdiction are likely to be relatively small businesses for which adequate insurance is difficult to obtain particularly because there are no avenues for independent appeal of a Determination. The arbitrary increase in the ILIS monetary thresholds is likely to adversely impact the industry to the detriment of both FSPs and consumers.

**It is recommended that** clause 9.6 be amended by deleting clause 9.6(b)(ii).

#### Clause 9.7 Review of monetary value of remedies

It is not appropriate that the Board of FOS be able to unilaterally increase limits in Schedule 2 without consulting. The statement in the commentary is noted however the description in clause 9.7(b) is not considered satisfactory.

**It is recommended that** clause 9.7(b) be replaced with the following:  
“In addition to these adjustments, the Board may consider, in consultation with Members, any change to monetary thresholds prescribed in Schedule 2. Any variation to amounts under this clause must be based on current data supporting the adjustment.”