

This is the submission of the Financial Ombudsman Service Limited (“FOS”) in response to the consultation paper *Review of not-for-profit governance arrangements*, released by Treasury on 8 December 2011 (“the Consultation Paper”).

The submission has been prepared by the office of FOS and does not necessarily represent the views of the Board of FOS. It should be read in conjunction with the submission by FOS in February 2011 (“the February Submission”) to the consultation paper *Scoping Study for a national not-for-profit regulator*.

## Updates to the February Submission

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FOS understands that the intention of the ACNC is to:

1. Ensure the financial responsibility of charities and not-for-profit companies who are in receipt of public monies;
2. Ensure high standards of corporate governance for these entities;
3. Ensure transparency of operations of these entities through reporting obligations; and
4. Provide a forum in which people adversely affected by the actions of charities and not-for-profit companies can have their dispute resolved.

FOS supports the motivations for the proposed reforms as set out at paragraph 13 of the Final Report. As a community service organisation operating as an approved external dispute resolution (“EDR”) scheme for financial services, FOS is committed to meeting the highest standards of accessibility, accountability and governance.

A key difference from most NFPs is that while FOS is a community service organisation incorporated as a company limited by guarantee, the service we provide to the community is as an independent external dispute resolution scheme as an integral part of the financial services regulatory regime for financial services licenses under the *Corporations Act 2001* (“the Corporations Act”).

- FOS provides an ASIC-approved EDR scheme to Australian Financial Services (“AFS”) Licensees and other financial services providers. The Corporations Act requires all holders of an AFS license, and the *National Consumer Credit Protection Act 2009* (“the NCCP Act”) requires Credit Licensees (and their Authorised Credit Representatives), to belong to such a scheme.

- The terms of approval are set by ASIC and include what must be covered in our Terms of Reference (“TOR”), the governance document that establishes what disputes we can deal with as an EDR scheme. Combined with our Constitution, the TOR details our governance and reporting obligations on the activities we undertake and we report to ASIC on a quarterly basis.
- FOS is wholly funded via a levy and cases fees paid by its members for the services we provide. In accordance with the terms of our approval from ASIC, our services are free to consumers.

One of the key principles underlying the reform proposals set out in final report is principle 13.4:

13.4. the regulation of service provision should remain with existing entities;

We support this principle in the design of the new regime and expect that under this principle, ASIC would continue to regulate FOS for the reasons set out above.

However, some of the proposed reforms, if applied to FOS would appear to conflict with this principle and the requirements for ASIC approval contained in ASIC Regulatory Guide 139. These include that the FOS governance structure, TOR and reporting obligations are all key preconditions for approval by ASIC as an EDR scheme for the purposes of the financial services regime.

Another key requirement is that decisions made by FOS are independent and not subject to appeal by our members. We consider it important that mechanisms be put in place in the proposals that would enable these aspects, which go to the core of FOS’ role as an ASIC-approved EDR scheme, be preserved.

In the context of the above, FOS is concerned that there may be some unintended consequences for FOS under the current proposals.

The power for the ACNC to intervene in disputes in which a not-for-profit entity is a party could have unintended impact for FOS. FOS is required under the conditions of ASIC approval to be the final decision maker on disputes that are brought to it. This is at the core of our role as an independent EDR scheme. FOS would be concerned if the dispute resolution mechanism created a de-facto ‘appeals’ process for unsuccessful parties to a FOS dispute to take their dissatisfaction about the decision in that specific dispute to the ACNC, but understands that the wording in the Explanatory Memorandum is necessarily at a high-level and the specifics of the scope of this mechanism are yet to be settled.

Our understanding of the purpose of the proposed appeals mechanism under the new regime is to provide a cost-effective mechanism to deal with concerns that an entity is acting outside its primary purpose. In FOS, this requirement is already met as we are subject to ongoing review by ASIC and under the conditions of approval a

formal independent periodic review is held to ensure that we are meeting the approval conditions under ASIC RG139.

FOS anticipates that the intention of the proposed dispute resolution mechanism will be to mirror the current arrangements regarding complaints about corporate activities that may be made to ASIC about alleged misconduct or illegal activity concerning:

- how company directors and officers manage their companies;
- incorrect or late release of company information to the market;
- raising money from the public;
- a company continuing to trade while unable to pay its debts;
- how company administrators, liquidators or auditors perform their duties;
- misleading or deceptive conduct to do with borrowing money; and
- a takeover or company restructure.

If the wording of this section of the Bill was effectively to transfer the existing ASIC dispute resolution mechanism to the ACNC, this would resolve the concerns of FOS.

Another solution to these concerns could be to exclude FOS from the proposed regime. However, FOS is currently a recipient of tax concessions relating to its business as a not-for-profit entity engaged in activities for community service purposes. FOS is currently exempt from Income Tax and receives concessions in respect of Fringe Benefit Tax. As FOS is prohibited from charging consumers for its services as a requirement of its approval from ASIC, these exemptions are necessary to enable FOS to keep the fees, levies and charges imposed upon the financial services providers who are its members at the lowest feasible level whilst still maintaining the required high level of service provision.

In the event that exclusion from the not-for-profit reforms would result in the loss of these tax concessions, the impact would be adverse, not just to FOS, but also to the financial services sector and consumers.

FOS has been advised that the ATO will remain responsible for the determination of the entitlement to receive tax concessions, so it appears that the role of the ACNC will simply be to assess if FOS is a NFP or not and notify the ATO accordingly. If this is the case, this may alleviate FOS' concerns.

## **Comments on the Consultation Paper**

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### **Context**

The Consultation Paper states:

The intent of the governance review is to centralise and simplify the existing arrangements in order to reduce red tape and minimise compliance burdens for the sector.

Given this intention, this submission will focus on the impact of the proposed reforms on FOS, interpreting those reforms in a way that meets this intention.

As noted above, the operations of FOS are intertwined with the current regulatory responsibilities of ASIC and the financial services sector. As a consequence, FOS is unlikely to be able to centralise its operations with a single regulator under the proposed regime.

## **Governance**

The FOS approach to corporate governance is set out in the *Financial Ombudsman Service 2010-2011 Annual Review*, available at [www.fos.org.au](http://www.fos.org.au). FOS seeks, as far as is appropriate, to meet the benchmark standards of an ASX-listed company, and where it is not appropriate to do so, has explained why it has departed from the ASX recommendations. We are also subject to the governance requirements set out in ASIC Regulatory Guide 139 as a condition of approval as an approved EDR scheme for purposes of the Corporations Act.

## **Pressures faced by the NFP sector**

FOS does not employ volunteers and as such the pressures mentioned in the Consultation Paper at paragraphs 48 and 54 do not apply. The Board of FOS, comprised of four representatives of consumer interests, four representatives of industry interests and an independent Chair. Directors are paid an annual director's fee in accordance with the FOS Constitution and are offered training and ongoing refresher courses to augment their existing knowledge. The Board conducts regular performance reviews of its committees and individual directors and all FOS directors are fully conversant with their responsibilities under the Corporations Act.

FOS operates on a 'user-pays' financial model which is adjusted to meet the inflow of disputes that it handles. It charges industry directly and receives no funding (outside of the tax concessions) from state or federal government.

The finances of FOS are overseen by the FOS Board and its dedicated Finance & Risk Management Committee, the charter for which is modelled on a for-profit audit committee, as envisaged by the *ASX Corporate Governance Principles and Recommendations with 2010 Amendments*.

These governance mechanisms, along with the annual financial audit and the tri-annual independent audit of operations, ensure that there is a high standard of accountability and transparency in place.

## **Existing arrangements**

As noted at 5.1 of the Consultation Paper, FOS, as a company limited by guarantee, is subject to similar governance requirements as for-profit entities. Given the nature of FOS operations as an ASIC approved EDR scheme, we consider there are

sufficient safeguards under current arrangements to sufficiently safeguard stakeholder interests.

## **Discussion**

### **Section 6.1**

Much of the initial discussion in this section of the Consultation Paper focuses on the need for additional standards for NFPs who do not have a traditional director-shareholder/member relationship (see paragraph 89). FOS is subject to the Directors and Officers obligations in the Corporations Act and considers that these provide sufficient safeguards. In light of this, FOS has no comment to make in response to any of the specific questions under Section 6.1.

### **Section 6.2**

Paragraph 119 draws a distinction between receipt of public monies and receipt of tax concessions, whilst the remainder of section 6.2 focuses on the obligations of entities that are in receipt of public monies. FOS does not finance itself in this way. Accordingly, we consider the position of an entity such as FOS should be distinguished from entities that are in receipt of public monies in the regime. A definition of 'public monies' in the legislation may be useful

FOS currently complies with the Tier 1 financial reporting requirements as we consider transparency is important to inform stakeholders what the fees, charges and levies are being spent on. Again, the obligations on companies limited by guarantee are similar as those on for-profit entities and as such FOS does not propose to comment on the specific questions asked at Section 6.2.

### **Section 6.3**

FOS maintains adequate insurance cover as part of its risk management practices and as such has no comment to make in respect of the specific questions asked at Section 6.3.

#### **Section 6.3.1**

FOS falls within the definition of a large company limited by guarantee and has appropriate internal review mechanisms in place for entities of this type.

### **Section 6.4**

FOS has a Constitution and Terms of Reference which, along with the membership application form, comprise the contract between FOS and each of its members.<sup>1</sup> These meet the requirements set out by ASIC for approval of FOS as an approved EDR scheme under the Corporations Act in its Regulatory Guide 139. As noted in the Consultation Paper, companies limited by guarantee are subject to the requirements of the Corporations Act and these apply to FOS.

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<sup>1</sup> *Financial Industry Complaints Service v Deakin Financial Services Pty Ltd* [2006] FCA 1805

In respect of the governing rules for charities or NFPs, FOS suggests that the approach taken by ASIC in respect of the approval of EDR schemes would be appropriate – i.e. in order to comply, the EDR scheme constitution and terms of reference must be ‘approved’, but there is no mandated approach to obtain approval, rather a principle-based approach to the types of factors that would influence approval.

### **Section 6.5**

FOS is subject to the Corporations Act requirements regarding interactions with its members. FOS undertakes significant stakeholder communication and engagement over and above these statutory obligations.

### **Summary**

In respect of question 30, we consider that the current regime whereby FOS meets Corporations Act standards as a company limited by guarantee, complies with the reporting standards of a listed company and where our services to the community can only be provided pursuant to our status as an ASIC-approved EDR scheme provides appropriate safeguards for stakeholders.

FOS does not receive public donations and we do not consider that proposed regime would enhance the protection to stakeholders in our case, but may add a layer of complexity and in some cases some duplication. Accordingly, we consider that it may be more appropriate for the focus to primarily be upon charities and other entities receiving public donations. This seems to be in line with the international comparisons listed in the appendix, where bodies similar to the ACNC have focussed their attention to charities and not the wider NFP sector.

In respect of question 33, as the EDR scheme that FOS operates is subject to approval, reporting and other obligations under the current ASIC-administered regime for approved EDR schemes, we consider any additional regulatory regime unnecessary to provide appropriate safeguards for stakeholders.

### **Options**

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FOS, as well as other non-statutory industry-based Ombudsman schemes, faces potential impacts on its operations that do not appear to have been considered by the proposals to date.

One option is to exclude FOS from the operation of the new regime on the basis that the current ASIC-administered EDR regime provides adequate safeguards for stakeholders. The ATO would continue to assess and regulate the status of FOS as a not-for-profit entity engaged in activities for community service purposes, and the tax concessions currently granted to FOS would continue. This would remove duplication and ensure there were no unintended consequences.

If FOS were to be included in the new regime, we consider it is essential that the issues identified above be addressed. We consider this would inevitably involve a system of continued dual regulation by the ACNC and ASIC. Under this option, corporate and financial reporting will be made to the ACNC, but approvals, reporting and oversight as an approved EDR for the financial services industry will remain with ASIC. Compliance by FOS with the requirements of RG139 and any additional requirements from ASIC will could be deemed by the ACNC to fulfil any initial and ongoing governance and registration requirements for tax status assessment purposes.

## **Conclusion**

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While FOS supports the motivations for the proposed reforms, we reiterate the need for careful wording of the scope of the dispute resolution mechanism and the need for consistency with the principle of continued oversight from ASIC without creating duplication or unintended consequences.

We would be happy to discuss practical solutions to ensure no unintended consequences for FOS under the proposed regime.