FINANCIAL PLANNING
ASSOCIATION of AUSTRALIA

31 January 2017

EDR Review Secretariat
Financial System Division
Markets Group
The Treasury
Langton Crescent
PARKES ACT 2600

Phone: +61 2 6263 2111

Email: EDRreview@treasury.gov.au

Re. Interim Report — Review of the financial system external dispute resolution and complaints framework

Dear Sir/Madam,

We welcome the opportunity to comment on the Panel's Interim Report. We support the goal of enhancing the dispute resolution framework available to consumers of financial services. For example, we support reducing consumer confusion about their dispute resolution options; and improving governance of EDR schemes.

However, we would discourage an overly prescriptive regulatory approach, especially in relation to the monetary limits and compensations caps of EDR schemes.

If you have any queries or comments, please do not hesitate to contact me at policy@fpa.com.au or on 02 9220 4500.

Yours sincerely

Dimitri Diamantes CFP®
Policy Manager
Financial Planning Association of Australia[1]

[1] The Financial Planning Association (FPA) has more than 12,000 members and affiliates of whom 10,000 are practising financial planners and 5,600 CFP professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:

- Our first "policy pillar" is to act in the public interest at all times.
- In 2009 we announced a remuneration policy banning all commissions and conflicted remuneration on investments and superannuation for our members – years ahead of FOFA.
- We have an independent conduct review panel, Chaired by Mark Vincent, dealing with investigations and complaints against our members for breaches of our professional rules.
- The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules that explain and underpin professional financial planning practices. This is being exported to 24 member countries and the 150,000 CFP practitioners that make up the FPSB globally.
- We have built a curriculum with 17 Australian Universities for degrees in financial planning. As at the 1st July 2013 all new members of the FPA will be required to hold, as a minimum, an approved undergraduate degree.
- CFP certification is the pre-eminent certification in financial planning globally. The educational requirements and standards to attain CFP standing are equal to other professional bodies, eg CPA Australia.
- We are recognised as a professional body by the Tax Practitioners Board.

REVIEW OF THE FINANCIAL SYSTEM EXTERNAL DISPUTE RESOLUTION FRAMEWORK

FPA submission to:
Treasury

31 January 2017

INTRODUCTION

The FPA supports the goal of providing enhancing the dispute resolution framework available to consumers of financial services. However, we believe that the best way to achieve this goal is a modest regulatory approach that improves the governance of EDR schemes and allows schemes the flexibility to make commercially sustainable decisions.

For example, we support reducing consumer confusion about their dispute resolution options; and improving governance of EDR schemes. However, we would discourage an overly prescriptive regulatory approach, especially in relation to the monetary limits and compensations caps of EDR schemes.

Draft recommendations

1. *A new industry ombudsman scheme for financial, credit and investment disputes*

There should be a single industry ombudsman scheme for financial, credit and investment disputes (other than superannuation disputes) to replace FOS and CIO.

We appreciate that moving to a single scheme has the potential to improve the quality of the EDR framework as assessed against the accepted criteria. While we are concerned about the potential adverse impact of having only one scheme to choose, we accept that reducing the number of schemes will reduce confusion for consumers.

If the proposal is proceeded with, there is an especially strong need to ensure that governance arrangements reflect the interests of all constituencies affect by the scheme, including third parties to disputes. For example, for disputes involving financial planners, the individual planner is not a party to the dispute unless they are also a financial services provider. This exposes financial planners to risks (including reputational risk) from dispute resolution, that are outside their direct influence. In turn, financial planners are incentivised to be more risk averse in dealing with their clients than would otherwise be optimal. Therefore consistent with how FOS has structured their Board we recommend that the new single ombudsman should appoint financial planners (and other practitioners in their professional capacity) as representatives on the board of the EDR scheme.

We recommend that principles-based legislation be introduced, requiring that the EDR constitution or rules require financial professionals (in that capacity), industry and consumers to all be represented on the board. For example, in our view, to meet the legislative requirement an EDR scheme should require itself to appoint representatives of professional associations that represent members and consumers. This is particularly important in light of the number of EDR schemes being reduced to one.

We note FOS has appointed a CFP® to their board, although would further note this does not appear to be a requirement. To ensure compliance with our proposed governance framework, ASIC should have oversight of the scheme, including relevant powers of direction.

2. *Consumer monetary limits and compensation caps*

The new industry ombudsman scheme for financial, credit and investment disputes should provide consumers with monetary limits and compensation caps that are higher than the current arrangements, and that are subject to regular indexation.

Should a single ombudsman scheme be established, then it would be prudent for the monetary limits and compensation caps to be reviewed. We would be concerned if government dictated these limits. Given the commercial implications, we would recommend an approach where industry, consumer and practitioner representatives are required, under the new scheme's constitution or rules, to be appointed to the board, and the board decides on appropriate limits after consulting with members. Consultation and review of limits and caps should be conducted at least annually.

We would encourage compensation caps to be set so that in the vast majority of cases the compensation amount is less than the cap. Similarly, we would encourage indexation rates that maintain this coverage. Determining ideal monetary limits and compensation caps requires a clear determination of which groups of consumers (e.g. those unlikely to have the resources to protect their own interests) are intended to be protected and whether the limits appropriately target those groups. Limits should be based on how well they target the selected groups.

3. *Small business monetary limits and compensation caps*

The new industry ombudsman scheme for financial, credit and investment disputes should provide small business with monetary limits and compensation caps that are higher than the current arrangements, and that are subject to regular indexation.

As already discussed, we are wary of imposing monetary limits and compensation caps on schemes given the commercial effects, including the flow-on effects to practitioners such as financial planners who are subject to an increasingly costly regulatory burden.

Our preferred approach is that industry, consumer and practitioner representatives be required, under the EDR scheme's constitution or rules, to be appointed to the board, and the board collectively decides appropriate limits after consulting with members. Consultation and review of limits and caps should be conducted at least annually.

Having said that, we would encourage schemes to set limits and caps such that the vast majority of small businesses are covered (if feasible). In practice, this may mean a higher limit/cap for small businesses than other consumers.

4. *A new industry ombudsman scheme for superannuation disputes*

SCT should transition into an industry ombudsman scheme for superannuation disputes.

We support the SCT transitioning to an industry ombudsman scheme due largely to the enhanced flexibility and consequential benefits under the Panel's assessment criteria. However, we caution against overly prescriptive regulation, especially as to monetary limits and compensation caps, which has the potential to hamper flexibility due to the pressure to manage costs to members of the schemes.

We recommend that the new superannuation scheme work closely with the new single ombudsman replacing FOS and the CIO to benefit from each other's strengths. For example, the superannuation scheme replacing the SCT is likely to have relative strength in decision-making and the setting of precedent, whereas the new single ombudsman replacing FOS and the CIO is likely to have relative strength in mediation of complaints and facilitation of settlement.

While we appreciate that one of the strengths of the EDR framework is a departure from legalism, we believe that collaboration between organisations with historically different approaches to the trade-off between speed and rigour, will help each scheme achieve a better balance (for affected parties) between speed of resolution and rigour of decisions.

5. *A superannuation code of practice*

The superannuation industry should develop a superannuation code of practice.

We strongly support the superannuation industry developing a code of practice covering, for example, the competence and ethical standards of individuals and organisations involved in the industry. This has the potential to bring an orderliness to the industry that everyone could reasonably agree to given community expectations about financial product providers.

A superannuation code would cover superannuation funds and those who represent them, such as administrators, trustees, benefit claims teams and industry associations. However, we do not support such a code applying to financial planners, as a higher standard of conduct is expected of professionals than other service providers. In our view, professional associations are the best forum

for the articulation of professional standards. This is because of the concentration of knowledge of the members professional lives and a focus on a single discipline without distraction.

6. *Ensuring schemes are accountable to their users*

Both new schemes should be required to meet the standards developed and set by ASIC. At a minimum, ASIC's regulatory guidance should require the schemes to:

- **ensure they have sufficient funding and flexible processes to allow them to deal with unforeseen events in the system, such as an increase in complaints following a financial crisis or natural disaster;**
- **provide an appropriate level of financial transparency to ensure they remain accountable to users and the wider public;**
- **be subject to more frequent, periodic independent reviews and provide detailed responses in relation to recommendations of independent reviews, including updates on the implementation of actions taken in response to the reviews and a detailed explanation when a recommendation of an independent review is not accepted by the scheme; and**
- **establish an independent assessor to review the handling of complaints by the scheme but not to review the outcome of individual disputes.**

In addition, ASIC's regulatory guidance should require the new scheme for financial, credit and investment disputes to regularly review and update its monetary limits and compensation caps so that they remain relevant and fit-for-purpose over time.

We are comfortable with the recommended approach as it would:

- enhance transparency and accountability (for example, independent reviews), which is especially important given the lack of competitive pressures to reconcile providers, consumers and third-parties interests; and
- provide oversight to ensure the scheme does what any reasonable and rational actor would do (for example, having sufficient funding and flexible processes to allow them to deal with unforeseen events in the system)

7. *Increased ASIC oversight of industry ombudsman schemes*

ASIC's oversight powers in relation to industry ombudsman schemes should be enhanced by providing ASIC with more specific powers to allow it to compel performance where the schemes do not comply with EDR benchmarks.

As discussed above, we are wary of giving schemes powers well beyond the status quo. This is because they undermine the bargain between consumer and provider. However, we would be comfortable with ASIC having suitable powers to enforce the regulatory approach outlined in draft recommendation 6.

Similarly, we are comfortable with ASIC having powers to enforce appropriate governance arrangements. This is because we believe that, given financial service providers must be members of a scheme and that the member involved in a matter is bound by the determination if the complainant accepts it, there is a strong case for ensuring that the schemes represent the interests of their various constituencies. This case is strengthened if existing schemes are consolidated into a single scheme.

8. *Internal dispute resolution*

Financial firms should be required to publish information and report to ASIC on their IDR activity and the outcomes consumers receive in relation to IDR complaints. ASIC should have the power to determine the content and format of IDR reporting.

We support this recommendation. It is crucial that consumers have access to information to make informed purchase decisions. It can be very costly (or impractical) for an individual consumer to compile this information on their own. Government mandated collection and dissemination of such information can provide an efficient way of facilitating informed decision-making.

For the same reasons, EDR schemes should also be required to provide information on their activity and outcomes, with ASIC having the power to determine the content and format of the reporting. For ease of comparison, we'd recommend the content and format of EDR and IDR reports be the substantially the same.

9. *Schemes to monitor*

IDR Schemes should register and track the progress of complaints referred back to IDR.

We support this recommendation on the basis that such information should be made available to consumers to help them make informed purchasing decisions.

10. *Debt management firms*

Debt management firms should be required to be a member of an industry ombudsman scheme. One mechanism to ensure access to EDR is a requirement for debt management firms to be licensed.

We would support requiring debt management firms to be members of an industry ombudsman scheme. As such firms have the potential to cause loss to consumers, we can't see any good reason for excluding them from requirements to be a member of an EDR; or, where relevant, the credit licensing regime (for example, competence and training requirements).

Panel observation

The Panel is of the view that there is considerable merit in introducing an industry-funded compensation scheme of last resort

Though the FPA understands the reasons for the Panel and other stakeholders wanting to introduce a last resort compensation scheme, we do not support the introduction of such a scheme. We recommend that further analysis or inquiry is conducted as to why there are unpaid determinations, before bolting on a costly scheme that does not actually resolve the underlying reasons as to why there are unpaid determinations.

The FPA believes that enhancements to the existing arrangements with professional indemnity (PI) insurance should be reviewed and considered, especially in response to the unpaid determinations, before jumping to the establishment of a last resort scheme. In particular, we recommend investigating how competition in the PI insurance market could be enhanced to improve cost and quality. For example, as discussed in our first-round submission to the Panel (p. 15):

> There is an argument that professional standards legislation at the Commonwealth level, that limits a professional's civil liability in return for improved risk management at the practice level

and improved standards of conduct, may make the PI insurance market more competitive. This might drive improvements in the quality and price of PI cover, and, in turn, reduce uncompensated consumer losses at the EDR level.

Further, there is a case for modest product regulation requiring product providers to identify the target market for their product, and ensure the product is suitable for that market. This could be justified on the basis that most financial products have a degree of complexity and there is an expectation in the community that product providers will provide a basic level of assistance to consumers deciding whether the product is suitable for them. If this approach were adopted and enforced well, the argument for a CSLS would be weakened.

In addition, the FPA is concerned about the following:

- scope of scheme — there appears to be no consensus as to coverage; for example, would the scheme:
    - cover products, managed investment schemes, credit providers, stockbrokers as well as financial planners?
    - only apply prospectively or also applies to events that happen before its introduction?
- funding — there are concerns that small business are particularly vulnerable at the moment if they suffer any cost increases. This may lead to small business financial planning firms exiting the market, which in turn affects competition.

Given the current difficulties and the existence of an arguably better alternative, there is a high risk that a sub-standard scheme will result if the Panel pushes its proposal.

Information requests

Should the national consumer credit protection law be extended to small businesses?

In principle, we support the national consumer credit protection law being extended to small businesses. This is because we agree that the general conduct obligation (for example, in relation to competence and training), responsible lending (for example, ascertaining and verifying a client's financial situation) and disclosure give the market an orderliness that, at least at the level of principle, it would be reasonable for everyone to agree to. The argument for these protections is strong where the consumer is in a weak position due to the information-related costs or the costs of pursuing their own interests through the judicial system.

Our concern in practice is that, depending on how small business is defined, the concept may capture businesses that would be more likely to be able to protect their own interests in a cost-effective way. We would prefer that a more nuanced approach be taken to defining the boundaries of the application of the national consumer credit protection law.

For example, the credit provider might be required to make an assessment of the financial capability of the particular consumer based on the following factors:

- the size of the business;
- the education and experience of the directors and leadership; and
- the size of the loan taken together with any other lending of the business.

We acknowledge that this approach introduces uncertainty. To manage the compliance burden, default provisions based on size, value or number or employees could be used. However, beyond the defaults, the more nuanced assessment would have to be applied.

Should schemes be provided with additional powers and, if so, what additional powers should be provided? How should any change in powers be implemented?

The schemes provide a commercial solution to disputes, namely the settlement of claims given the prospect of judicial determination. We are wary of giving schemes powers well beyond the status quo. This is because doing so would undermine the bargain between consumer and provider.

Nevertheless, we would encourage schemes to develop, in consultation with members, their own codes of conduct to facilitate dispute resolution. In particular, we would encourage schemes to develop rules to compel documents from members; and require mandatory discovery and the open exchange of information. We would support Government providing legislative backing for these such self-regulation, provided reciprocal obligations (based by legislation) are imposed on consumers.

We are not against penalties, which can be an effective way of encouraging better behaviour. However, we would strongly discourage schemes from having the power to impose penalties (and would strongly object to such powers being given legislative backing). Penalties reduce the member's property or opportunities beyond what would be required to compensate the consumer. Such a power properly belongs only to bodies with procedures and decision-making that ensures decisions are of judicial quality.

Does EDR scheme membership by credit representatives provide an additional or necessary layer of consumer protection that is not already met through the credit licensee's membership?

EDR scheme membership by credit representatives does provide an extra protection to what's already met through the credit licensee's membership. By way of example, if the licensee fails to maintain its cover, the representative's insurer may respond to a claim. However, we question whether the extra protection is worth the extra cost.

What should be the monetary limits and compensation caps for the new scheme? Should they be different for small business disputes? What principles should guide the levels at which the monetary limits and compensation caps are set? What indexation arrangements should apply to ensure the monetary limits and compensation caps remain fit-for-purpose?

Monetary limits should be set by the scheme's board, on an annual basis, after consultation with members. The amount of the limits is largely a commercial. As discussed above, our preferred approach is that industry, consumer and practitioner representatives are required, under the EDR scheme's constitution or rules, to be appointed to the board, and the board collectively decides appropriate limits after consulting with members. Consultation and review of limits and caps should be conducted at least annually.

However, we would encourage the scheme to set its monetary limits such that the vast majority of consumers and small businesses have access to the scheme, especially those who are unlikely to have the resources or time to wait for a determination by the legal system. Further, we would encourage the scheme to index monetary limits to ensure that the vast majority of consumers and businesses continue to have access to the scheme.

We would encourage compensation caps to be set so that in the vast majority of cases the compensation amount is less than the cap (if feasible). Similarly, we would encourage indexation rates that maintain this coverage (if feasible).

Our suggested approach would also apply to the small business monetary limit and compensation cap. However, as discussed above, it is possible that it will be commercially appropriate for the limit/cap for small businesses to be higher than for other consumers.

On what matters should ASIC have the power to give directions? For example, should ASIC be able to give directions in relation to governance and funding arrangements and monetary limits?

We believe that, given financial service providers must be members of a scheme and that the member involved in a matter is bound by the determination if the complainant accepts it, there is a strong case for ensuring that the schemes represent the interests of their various constituencies. This case is strengthened if existing schemes are consolidated into a single scheme.

Further, given the potential costs to third parties to a dispute, there is a strong case for ensuring their interests are represented. For example, for disputes involving financial planners, the individual planner is not a party to the dispute unless they are also a financial services provider. This exposes individual financial planners to risks (including reputation risk) from dispute resolution, that are outside their direct influence. In turn, financial planners are incentivised to be more risk averse in managing their relationship with the client than would otherwise be optimal. In turn, we believe it is appropriate to appoint financial planners (and other practitioners in their professional capacity) as representatives on the board of the EDR scheme.

As discussed, we recommend that principles-based legislation be introduced, requiring that the EDR constitution or rules require financial professionals (in that capacity), industry and consumers to all be represented on the board. For example, in our view, to meet the legislative requirement an EDR scheme should require itself to appoint representatives of professional associations that represent members and consumers. This is particularly important in light of the number of EDR schemes being reduced to one.

We note FOS has appointed a CFP® to their board, although would further note this does not appear to be a requirement. To ensure compliance with legislation or the scheme's own rules, ASIC should have oversight of the scheme, including relevant powers of direction.

We think that funding arrangements should largely be commercial issues. However, as already mentioned, we would encourage the scheme to set monetary limits and compensation caps so that, in the vast majority of cases, the limits would have no practical impact on access or compensation.

If monetary limits and caps can be set and enforced by government, there will be flow-on effects for scheme members and others. For example, financial services licensees may need to pay higher premiums for professional indemnity insurance, which may flow-on to advice businesses in the form of higher fees charged by licensees. Especially in a time when advice businesses are being hit with increased regulatory costs (for example, ASIC industry levy) and there is downward pressure on revenue (for example, due to the Life Insurance Framework), we would caution against distorting the market further.

What IDR metrics should financial firms be required to report on? Should ASIC publish details of non-compliance or poor performance IDR, including identifying financial firms?

We recommend the following metrics:

- time to resolution (range, median and average)
- how satisfied (or dissatisfied) complaints are with the process and outcome
- compensation for product/service category (range, median and average)

As discussed, we'd recommend that for ease of comparison, the content and format of EDR and IDR reports be the substantially the same.