

## Introduction

This is the submission by the Financial Ombudsman Service (“FOS”) in response to Consultation Paper 188 *Managed Investments: Constitutions – Updates to RG 134* released by ASIC in September 2012.

This submission has been prepared by the office of FOS and 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.

## Information about FOS

FOS commenced operations on 1 July 2008. It is an independent dispute resolution scheme that was formed through the consolidation of three schemes:

- the Banking and Financial Services Ombudsman (“BFSO”);
- the Financial Industry Complaints Service (“FICS”); and
- the Insurance Ombudsman Service (“IOS”).

On 1 January 2009, two other schemes joined FOS, namely:

- the Credit Union Dispute Resolution Centre (“CUDRC”); and
- Insurance Brokers Disputes Ltd (“IBD”).

FOS is an external dispute resolution (“EDR”) scheme approved by ASIC. Membership of FOS is open to any financial services provider carrying on business in Australia including providers not required to join a dispute resolution scheme approved by ASIC. Replacing the schemes previously operated by BFSO, FICS, IOS, CUDRC and IBD, FOS provides free, fair and accessible dispute resolution for consumers unable to resolve disputes with financial services providers that are members of FOS.

Members of BFSO, FICS, IOS, CUDRC and IBD are now members of FOS. The members of those schemes included:

- BFSO – credit providers, mortgage brokers, payment system operators, Australian banks and their related corporations, Australian subsidiaries of foreign banks and foreign banks with Australian operations;
- FICS – life insurance companies, fund managers, friendly societies, stockbrokers, financial planners, pooled superannuation trusts, timeshare operators and other Australian financial services providers;
- IOS – general insurance companies, re-insurers, underwriting agents and related entities of member companies;

- CUDRC – credit unions and building societies;
- IBD – insurance brokers, underwriting agents and other insurance intermediaries.

FOS provides services to resolve disputes between member financial services providers and consumers, including certain small businesses, about financial services such as:

- banking;
- credit;
- loans;
- general insurance;
- life insurance;
- financial planning;
- investments;
- stock broking;
- managed funds; and
- pooled superannuation trusts.

As well as its functions in relation to dispute resolution, FOS has responsibilities to identify and resolve systemic issues and obligations to make certain reports to ASIC. FOS also monitors compliance with a number of industry codes of practice.

FOS is a not for profit organisation that provides services free to consumers. FOS is funded by its members, which are financial services providers. A significant proportion of our funding is from case fees, and the fees paid by a financial services provider reflect the number of disputes in which it is involved and the stages to which they progress.

FOS is governed by a board with an independent chair and:

- four “industry directors” appointed based on their expertise in and knowledge of the financial services industry, independence and capacity and willingness to consult with the industry; and
- four “consumer directors” appointed based on their expertise in consumer affairs, knowledge of issues pertaining to the industry, independence and capacity and willingness to consult with consumer organisations.

## **Submission**

### **Section E – Complaints**

#### **Question E3Q3**

Paragraph 74 of Regulatory Guide 165 (“RG 165”) specifies requirements in (a) to (c). They are requirements to adopt a stated definition of “complaint”, to satisfy certain complaint handling principles and to have a system for informing complainants about the availability and accessibility of the relevant EDR scheme. As a licensee a responsible entity (“RE”) is obliged to comply with these requirements. We understand ASIC’s policy intent is that a constitution should

reflect this obligation by either stating the RE will comply with the ASIC approved dispute arrangements or “addressing” the criteria in RG 165.74(a) to (c).

We agree with the approach outlined in proposal E2, in which an RE includes a constitutional provision stating that it will comply with ASIC approved dispute resolution requirements for complaints by retail clients. If the alternative to proposal E2 described in E3Q3 is allowed, it should be made clear that complaints handling procedures for retail clients **must comply** with the requirements in RG 165.74(a) to (c). The current wording of the alternative proposal that the RE “address” these criteria in its constitution may not be sufficient to ensure such compliance by the RE as a licensee with its obligations. We consider this should be clarified.

### **Questions E3Q4 to E3Q7**

E3Q4 to E3Q7 deal with the issue of whether internal dispute resolution (“IDR”) procedures of REs for retail and wholesale clients should be consistent or different. Unless EDR arrangements are changed radically, there must be a significant difference between the two IDR procedures in our view. This is because the wholesale client procedures cannot have the same link with EDR as the retail client procedures. ASIC will be aware of this. It may nevertheless be helpful for us to highlight some important considerations.

#### Current position

Current EDR arrangements reflect the requirement under section 912A<sup>1</sup> for licensees to have in place membership of an ASIC approved EDR scheme that covers complaints by retail clients. Regulatory Guide 139 (“RG 139”) reflects section 912A, for example, in its requirement that an EDR scheme be able to consider complaints involving amounts up to \$500,000, which is set by reference to the value of the retail client test under section 761G.

Complaints by wholesale clients may fall outside the jurisdiction of an EDR scheme set up in accordance with all present requirements. Our Terms of Reference specify our jurisdiction in a way that meets the requirements of RG 139. The Terms of Reference state, for example, that:

- we cannot consider a dispute in which the value of the applicant’s claim exceeds \$500,000; and
- we may refuse to consider a dispute in which the applicant is not a retail client as defined in the Corporations Act.

Our jurisdiction does not cover some categories of disputes that may arise in relation to managed investment schemes. For example, we cannot consider disputes about:

- the level of a fee or charge (unless the disputes fall within specified exceptions which cover certain disputes concerning –
  - non-disclosure, misrepresentation or incorrect application of a fee or charge or

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<sup>1</sup> This and all later references to sections of legislation are to sections of the *Corporations Act 2001*.

- a financial services provider's breach of a legal obligation or duty); or
- the management of a fund or scheme as a whole.

For disputes within our jurisdiction, there is a single set of dispute resolution processes that apply whether or not the applicant is a retail client. In other words, our processes for disputes involving wholesale clients are the same as our processes for disputes involving retail clients. However, the merits of a dispute are decided having regard to the legal rights and obligations of the parties, which are affected by whether the applicant is a retail client.

### Future position

If managed investment schemes are in future required to have more extensive EDR coverage for disputes with wholesale clients, some measure would be needed to alter the application of section 912A to those schemes. In addition, RG 139 and the jurisdictions of EDR schemes would need significant changes to provide for the extension. Any changes of this type would need to be designed to fit in with, and not disrupt, arrangements already in place for the purposes of section 912A.

If more extensive EDR coverage is not required, the IDR procedures of REs for wholesale clients will not have the same link with EDR as equivalent procedures for retail clients. The wholesale client procedures will need to take into account that EDR may only be available in some cases.

### **Question E3Q7**

E3Q7 asks about practical issues. We believe that there are risks of confusion and error where an RE has two IDR procedures. Examples of these risks are:

- an RE might give a retail client information about the complaint procedures for wholesale clients;
- a wholesale client might seek to use the procedure for retail clients.

We suggest that steps be taken to reduce these risks, to strengthen IDR. Factors that make IDR less effective and efficient may increase the demands on EDR. Examples of steps that could be considered are:

- providing guidance on how to classify clients as retail or wholesale (to help REs ensure that they handle complaints correctly); and
- requiring training to ensure that RE staff who handle complaints fully understand differences between IDR procedures for wholesale and retail clients.

### **Section H – Withdrawal rights of members**

We endorse proposal H3. It is consistent with our understanding and an approach we take to compensation in certain cases where a dispute against an RE is upheld.

For example, in some disputes where an RE of a scheme engaged in misleading or deceptive conduct that induced the applicant to invest in the scheme, we have

required the RE to acquire the applicant's units at a price which would place the applicant in the position they would have been in had they not invested in the scheme.

We have considered this arrangement to constitute a transfer of an interest to the RE rather than a withdrawal from the scheme. Accordingly, we did not consider it to be a breach of section 601KA or 601KB. We note, however, that if the scheme constitution prevented the RE from acquiring or holding an investment in the scheme, such an arrangement would be precluded. In those circumstances, or if this approach was otherwise inappropriate in the circumstances of the case, we would need to consider alternative forms of redress.