



Providing digital financial product advice to retail clients

Financial Ombudsman Service Australia Submission

May 2016



Contents

Executive summary	3
1 Definition of digital advice	5
1.1 <i>Definition in RG 000.1</i>	5
1.2 <i>Human involvement</i>	5
1.3 <i>Dispute information</i>	5
2 Putting the client's needs first	6
3 General obligation to have a dispute resolution system	6
4 Organisational competence obligation	7
4.1 <i>Ensuring reviews are adequate</i>	7
4.2 <i>Transitional arrangement</i>	7
4.3 <i>Changes to algorithms</i>	7
5 Adequate risk management systems	8
5.1 <i>Systemic issues</i>	8
5.2 <i>Managed discretionary account services</i>	8
6 Reviewing digital advice	8
7 Remediation arrangements	8
8 Adequate compensation arrangements	9
Appendix - About FOS	10

Executive summary

The Financial Ombudsman Service (FOS) Australia¹ is an ASIC-approved independent external dispute resolution (EDR) scheme that covers disputes across the financial sector.²

In addition to our role in dispute resolution, we have responsibilities to identify and resolve systemic issues and obligations to make certain reports to ASIC. We also provide code monitoring and compliance services for four industry codes of practice.

We welcome the opportunity to respond to ASIC's Consultation Paper 254 *Regulating digital financial product advice* and provide feedback on the proposed guidelines attached to the paper (RG 000).

We acknowledge that RG 000 is designed to give guidance on matters that may be unique to a digital advice scenario and that traditional AFS licence obligations related to financial product advice will also apply to digital advice providers.

We support innovation and initiatives to help consumers to access sources of quality, cost-effective financial advice. We believe digital advice businesses, whether established or start up, should be well positioned to build effective cultures that ensure fair service, fair conduct and fair treatment of consumers. We agree that regulatory guidance for digital advice is required to facilitate these outcomes and agree generally with the approach taken in RG 000.

Key points in this submission³ include:

Definition of digital advice

Clarity about the meaning of digital advice and the types of services that may be caught by this definition will be important.

We suggest that RG 000 emphasises that:

- digital advice is defined broadly, and
- providing digital advice would still require significant human interaction, engagement, oversight and accountability.

Putting the client's needs first

We suggest that RG 000 requires digital advice providers to put the client's needs first in all stages of business design including promotion of services, advisory services offerings and processes, irrespective of whether the advice provided is personal or general advice under the law. This includes communications and disclosure obligations. We also comment on clients' needs in particular areas.

¹ Information about FOS is set out in full on our website at www.fos.org.au. The Appendix summarises key points.

² FOS is approved by ASIC under its Regulatory Guide 139 *Approval and Oversight of External Dispute Resolution Schemes*, which is available under 'Regulatory Resources' on www.asic.gov.au.

³ This submission does not necessarily represent the views of the Board of FOS. It draws on the experience of FOS and its predecessor schemes.

Organisational competence obligation

The quality of the advisory services provided by digital advice providers must be consistent with that expected from traditional AFS licensees to ensure consumer and stakeholder trust and confidence.

We suggest that RG 000 requires that reviews and audit of digital advice be central aspects of the required risk management framework and that these reviews be conducted by people who meet the current training and competence standards for financial advisers. We anticipate that these reviews will not be undertaken solely by a responsible manager in a larger digital advice provider.

We also raise a question about how the proposed transitional arrangement for responsible managers is intended to apply.

Adequate risk management systems

We suggest that further guidance be included in the 'Adequate risk management systems' section of RG 000 to address:

- the risk of systemic issues and
- risks for businesses providing managed discretionary account services.

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Remediation arrangements

We suggest that RG 000 highlights obligations in respect to remediation.

Adequate compensation arrangements

We note that the growth of digital advice in Australia may increase the need to establish a compensation scheme of last resort.

If FOS can provide further input or assistance, please contact us.

1 Definition of digital advice

1.1 Definition in RG 000.1

We support the approach taken in Consultation Paper 254 that the law is 'technology neutral'. We acknowledge this and support this approach in regulation. The definition of digital advice in RG 000.1 appears to reflect this approach.

We believe it is important to ensure that there is no gap in consumer protection permitting some digital advice to be treated as a mere contractual relationship without the safeguards provided to consumers of other financial product advice. To alert digital advice providers to their responsibilities, we consider RG 000 should emphasise that digital advice is defined broadly. If ASIC intends to interpret the definition widely, we suggest that RG 000 explains that.

1.2 Human involvement

Although digital advice is defined as a category of advice provided 'without the direct involvement of a human adviser', we think it is important to acknowledge that digital advice services will require human interaction and engagement in several ways. This starts with the organisational and technical competencies of the responsible managers of the licensee and extends to the responsibilities and accountabilities of those who enter data into the algorithms, review the digital advice, operate help desks or call centres, provide the services to Australian consumers and handle complaints and remediation when something goes wrong.

The ethical culture and leadership of the organisations will be set by these individuals and their responsibilities and accountabilities will need to be consistent with those required of traditional AFS licensees.

We suggest that RG 000 includes a statement acknowledging these relationships.

We note that RG 000 does not discuss obligations related to the implementation and review of financial advice once given. We think it is important that Australian consumers clearly understand the nature and extent of the advisory services they will receive from digital advice providers. To achieve this objective, how these services are promoted will become a very important regulatory issue.

1.3 Dispute information

To date, FOS has not recorded whether disputes that we have handled relate to digital advice. There has not been any generally accepted definition of digital advice (or alternative terms such as 'robo advice') to use to classify disputes in this way. As a result, we do not have statistics on disputes about digital advice to provide in this submission.

In the year from 1 July 2014 to 30 June 2015, FOS accepted 1,332 investment disputes. Further information about those disputes is provided in our 2014-15 Annual

Review.⁴ Our experience with many of these disputes has informed our observations in this submission.

2 Putting the client's needs first

In the current landscape, the clear trend is to increase the quality of financial advisory services and the competence and professionalism of those who provide these services. The focus is on conduct in the best interests of the consumer. These objectives are also relevant in the provision of digital advisory services, we consider it is particularly important to ensure the client's needs are put first when designing all aspects of a digital advice business.

We support statements in RG 000.13 that digital advice providers should take a user-focused approach and put the client's needs first when designing their communications and disclosure. We suggest digital advice providers adopt this approach to whole of business operations, irrespective of the advice model they adopt.

Based on our dispute resolution experience, we anticipate that an area of particular risk in digital advice will be ensuring clients understand the exact nature of the advisory services they will receive. This needs to be a primary focus at all stages of business design, including:

- establishing client relationships
- providing electronic disclosure documents
- when clients provide information electronically
- providing advice and
- handling complaints.

As drafted, RG 000 focusses on digital advice provided at a point in time. To understand the full extent of the services to be provided, clients would need to know whether there are arrangements to review digital advice at regular intervals and, if so, what the arrangements are.

3 General obligation to have a dispute resolution system

One of the general obligations of AFS licensees referred to in RG 000.52 is the obligation under paragraph 912A(1)(g) of the Corporations Act to have an internal and external dispute resolution system. Complaints about digital advice may raise issues not raised in complaints about other forms of advice. It may be helpful for RG 000 to prompt digital advice licensees to consider these issues when designing or reviewing internal dispute resolution frameworks and links to EDR, in addition to the use of remediation programs.

⁴ See 2014-15 [Annual Review](#) on pages 74 to 79.

4 Organisational competence obligation

4.1 Ensuring reviews are adequate

RG 000 sets training and competence standards for a responsible manager (in RG 000.49) and requires a human adviser to review digital advice (in RG 000.101). RG 000.60 states that a digital advice licensee must ‘have at least one person who has the appropriate skills and experience to thoroughly review the quality of digital advice provided’.

We agree that responsible managers, who will be ethical leaders within the digital advice providers and have responsibility for key matters such as organisational culture, should meet the organisational and advisory competence standards expected of financial advisers, both current and future.

To ensure reviews of digital advice meet quality standards, we suggest RG 000 requires that these reviews be conducted by people who meet the current training and competence standards for financial advisers. A transition period for compliance with this requirement could be allowed (to fit in with the transitional arrangement discussed below).

RG 000 acknowledges that the size of a digital advice business affects the measures it needs to satisfy regulatory obligations. We anticipate that, to meet all of the objectives for reviewing advice and other processes such as ‘filtering’, a large digital advice business may need several authorised representatives who meet the required training and competence standards to undertake these functions.

4.2 Transitional arrangement

At present, a licensee could operate even if it does not have a responsible manager who meets the existing training and competence standards for financial advisers. ASIC proposes to require a digital advice licensee to have at least one responsible manager who meets the existing standards and to allow a 6 month transition period for compliance with this requirement. B1Q4 in Consultation Paper 254 contemplates allowing a longer transition period.

RG 000.51 is worded so as to give all holders of an AFS licence on RG 000’s issue date a six month transition period. It appears that this would go beyond allowing current digital advice business to continue without disruption and also provide a concession to a licensee as at the issue date that was not then operating a digital advice business. Such a licensee could move into digital advice after the issue date and take advantage of the transition period. We question whether the transitional arrangement is intended to apply in this broad way.

4.3 Changes to algorithms

We support the requirement that digital advice licensees should be able to control, monitor and reconstruct any changes to algorithms over a seven year timeframe.

We believe that this represents a key management tool to ensure algorithms are monitored and tested adequately. A licensee may need to rely on this capacity to assist in the identification and resolution of systemic issues that may arise from algorithms or systems error in the provision of advice.

5 Adequate risk management systems

5.1 Systemic issues

As digital advice uses algorithms, the risk of systemic issues related to systems or data entry error may be greater in a digital advice business than in businesses providing traditional financial product advice. The second dot point in RG 000.81 reflects this. We suggest that specific guidance on the need to address the risk of these types of systemic issues, be added to the 'Adequate risk management systems' section of RG 000.

5.2 Managed discretionary account services

RG 000.43 acknowledges the extra risk associated with providing managed discretionary account services. Our experience in dispute resolution suggests that the use of managed discretionary accounts is fraught with significant risk related to informed consent, acting outside client authority and failure to act in the client's best interests.

We consider that the compliance, governance and risk management systems of any business providing managed discretionary account services needs to be particularly robust. We suggest that the section headed 'Adequate risk management systems' in RG 000 highlights this point.

6 Reviewing digital advice

RG 000.105 states that immediate steps should be taken to rectify 'problems with an algorithm'. Given the focus elsewhere in RG 000 on errors **in an algorithm**, it is important for this statement to make clear that problems associated with an algorithm may not be in the algorithm itself and may affect other aspects of the digital advice licensee's business.

7 Remediation arrangements

RG 000.107 makes a brief statement about remediation and includes a note referring to the consultation conducted through ASIC's Consultation Paper 247. In our submission in response to Consultation Paper 247⁵, we provided detailed comments about how review and remediation programs should be designed and required to operate. We would support an expansion of the commentary in relation to obligations about remediation in the regular text in RG 000.

⁵ See [FOS submission](#) on review and remediation programs, made in March 2016.

To make the guidance on remediation arrangements sufficiently clear and prominent in RG 000, it may be necessary to present the guidance in a separate section. The current location of the reference to remediation may suggest that remediation is only required in limited circumstances, such as where a regular review indicates that advice is defective or where scaled advice is not in the best interests of clients.

8 Adequate compensation arrangements

RG 000.81 notes the potential for widespread loss resulting from digital advice. It also indicates that professional indemnity insurance may not cover such loss. For example, claims by multiple clients relating to one algorithm could, due to aggregation of claims clauses, be treated as a single claim by an insurer.

In recent submissions to inquiries and consultations, we have commented that professional indemnity insurance alone does not ensure that all consumers of financial services who suffer loss, receive the compensation to which they are entitled.⁶ To address this, FOS advocates the establishment of a compensation scheme of last resort.⁷

Digital advice has grown rapidly and is expected to keep growing. Consumers who may suffer loss from wrongdoing in the provision of these services should be able to access compensation. Professional indemnity insurance alone is unlikely to be a complete solution to ensure this objective is achieved. We consider that the growth of digital advice in Australia increases the need to establish a compensation scheme of last resort.

⁶ See, for example, [FOS submission](#) on lifting professional, ethical and education standards in the financial services industry, made in May 2015.

⁷ FOS released an [updated proposal](#) to establish a compensation scheme of last resort on 1 June 2015.

Appendix - About FOS

FOS is an ASIC-approved independent EDR scheme that covers disputes across the financial sector. Our service is free to consumers and is funded through a combination of levies and case fees paid by our members, which are financial services providers.

FOS was formed in 2008 from the merger of three predecessor schemes organised largely along industry sector lines. The original participants were:

- the Banking and Financial Services Ombudsman
- the Financial Industry Complaints Service, and
- the Insurance Ombudsman Service.

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

- the Credit Union Dispute Resolution Centre, and
- Insurance Brokers Disputes Ltd.

Our operations are governed by our Terms of Reference that form a contract with our members. The Terms of Reference are available on our website.

FOS and its predecessor schemes have over 20 years' experience in providing dispute resolution services in the financial services sector. 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 provides code monitoring, administration and secretariat services to committees that monitor financial services providers' compliance with these industry codes of practice:

- the Code of Banking Practice
- the Customer Owned Banking Code of Practice
- the General Insurance Code of Practice and
- the Insurance Brokers Code of Practice.

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.