

13 July 2012

The General Manager
Retail Investor Division
The Treasury
Langton Crescent
PARKES ACT 2600

By Email: futureofadvice@treasury.gov.au

Dear Sir/Madam

**Response to the Report on Compensation Arrangements for Consumers of
Financial Services by Richard St John April 2012**

The Financial Ombudsman Service (FOS) is pleased to respond to the Report prepared by Mr Richard St John.

FOS was formed in 2008 from the merger of the three major financial services dispute resolution schemes, namely Banking & Financial Services Ombudsman, Financial Industry Complaints Service Ltd and Insurance Ombudsman Service Ltd. The merged group were subsequently joined by the Credit Union Dispute Resolution Centre and the Insurance Brokers Dispute Ltd.

FOS and its predecessor schemes have over 20 years experience in alternative dispute resolution and cover more than 80% of all disputes in the financial sector. Today FOS handles annually more than 30,000 disputes.

During the period of FOS's operations, FOS has issued determinations in which it found the financial service provider liable for the losses suffered by a consumer, but has become acutely aware that many of these awards are not subsequently paid to the consumer where the FSP in question has gone into liquidation or administration. For this reason, FOS has been a strong advocate for the establishment of a statutory last resort Financial Services Compensation Scheme.

FOS believes that the Richard St John Review itself has provided a compelling case describing the impact and human cost on consumers of firm failures. If a last resort compensation scheme were not to be introduced without delay, FOS considers this will be a lost opportunity for a major structural reform that has been under active consideration now for more than a decade.

FOS is also concerned that should the current trend for non payment of FOS awards continue at the same rate, or there were to be events causing significant losses to consumers in the near future, this may undermine the government's policy for effective EDR arrangements in the financial sector regulatory regime pursuant to Sections 912A (2) and 1017G (2) of the Corporations Act 2001(Cth) and as administered by ASIC under its regulatory guide 139.

In its submission, FOS deals with issues of funding and the wider benefits of a Scheme. It also provides more current data on continuing examples of consumer losses post 2009.

FOS also comments on the arrangements put forward by Richard St John as his proposed preferred alternatives to a compensation scheme of last resort. While some of these measures may be useful in their own right, to the extent they improve outcomes for consumers, FOS does not consider they are a viable alternative to establishing a last resort compensation scheme.

The Review has not compared the overall costs of the major alternatives proposed, namely professional indemnity insurance and an increase in regulatory capital to the overall costs of the proposed compensation scheme of last resort. A full comparison of costs would need to take into account the costs to industry of increased PI premiums and, possibly greater restrictions on its availability, significantly increased capital requirements, and resources required by the regulator to enable effective monitoring and enforcement of these requirements. Any such assessment of costs and benefits should also take into account the potential impact on competition as the level regulatory capital or PI cover needed to provide reasonable reassurance against firm failure could act as a barrier to new entrants.

These costs are likely to be substantially borne by the whole industry rather than only by those firms with the greatest likelihood of failure given the difficulties of an ex ante detailed calibration and assessment of the risks involved.

Even with the proposed enhanced regulatory measures the potential for losses to occur remains and these measures cannot substitute for a properly constructed last resort compensation scheme. In FOS's view, the proposed compensation scheme of last resort provides a cost effective solution narrowly targeted at the specific cause of the clearly identified consumer detriment – that is, consumers suffering losses because of non -payment of FOS or Court awards.

FOS also comments on the recommendations directed at EDR schemes generally. As these matters were not canvassed in any detail with FOS during the process of the Review, we have commented on the various observations in the Richard St John Review. In particular, FOS notes that the matters suggested for review are many of the fundamental principles which underpin EDR schemes in Australia and Internationally.

The Corporations Regulations 2001 require ASIC to take into account the "DIST Benchmarks" – *Benchmarks for industry-based customer dispute resolution schemes* released in 1997 by the Department of Industry, Science and Tourism. FOS considers the current requirements for financial sector EDR schemes as set out in ASIC regulatory guide RG 139 and based on the "DIST Benchmarks" continue to provide the basis for effective EDR arrangements. We consider there is no substantive evidence or basis in the report for revisiting these fundamental EDR principles.

However, FOS remains committed to engaging with all its stakeholders on how we can continue to improve the accessibility, efficiency and effectiveness of our dispute services within the framework set out by ASIC in Regulatory Guide 139 based on the DIST Benchmarks for EDR schemes. We currently do so through a variety of mechanisms and we are committed to enhancing our engagement with all our stakeholders in order to improve our dispute resolution services for consumers and the financial services industry.

FOS would appreciate the opportunity to meet with Treasury to discuss this submission.

Yours sincerely



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Financial Ombudsman Service

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The Treasury

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Commissioner
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