

5 December 2014

Senator Sam Dastyari  
Chair  
Senate Economics References Committee  
Parliament House  
CANBERRA ACT 2600

By email: [economics.sen@aph.gov.au](mailto:economics.sen@aph.gov.au)

Dear Senator Dastyari

**Senate Economics References Committee  
Inquiry into scrutiny of financial advice**

Thank you for inviting the Financial Ombudsman Service (FOS) to make a submission to the inquiry into the scrutiny of financial advice.

The mission of FOS is to fulfil an important community role by providing an independent dispute resolution service in which people can place their confidence and trust. This involves understanding all sides of a dispute and resolving it fairly and efficiently.

We have provided input on matters within this inquiry's Terms of Reference in our recent submissions to other inquiries.<sup>1</sup> In these submissions we have emphasised the importance of promoting sustainable consumer trust in financial services as trust is the key principle underpinning a dynamic, competitive and innovative financial sector.

This submission<sup>2</sup> concentrates on compensation mechanisms, which are the subject of item (c) of the inquiry's Terms of Reference. Consumer loss and compensation is a pressing issue, as acknowledged by the Financial System Inquiry in Chapter 6 of its interim report. The final report of the Financial System Inquiry is due to be released shortly. Accordingly, we are not aware at the time of preparing this submission what, if anything, the final report of the Financial System Inquiry will recommend in response to the issues identified in its interim report relating to consumer loss and unpaid FOS Determinations.

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<sup>1</sup> See our two submissions to the Financial System Inquiry, <http://www.fos.org.au/custom/files/docs/fos-submission-to-fsi-inquiry.pdf> and <http://www.fos.org.au/custom/files/docs/fos-submission-to-fsi-interim-report-august-2014.pdf> and our submission to the Parliamentary inquiry into proposals to lift the professional, ethical and education standards in the financial services industry, <http://www.fos.org.au/custom/files/docs/fos-submission-to-the-inquiry-into-proposals-to-lift-the-professional-ethical-and-education-standards-in-the-financial-services-industry.pdf>

<sup>2</sup> This submission has been prepared by the office of the Chief Ombudsman 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.



## **Issue of unpaid compensation**

The *Corporations Act 2001* requires licensees to have arrangements in place to ensure they can pay any awards of compensation to retail clients for breaches of Chapter 7 of the Act. Despite this clear requirement, FOS continues to see cases where these awards of compensation under FOS Determinations are not paid.

To date, licensees have used professional indemnity insurance policies to meet the requirement for compensation arrangements. It is widely acknowledged that professional indemnity insurance is important, but is not designed to function as a consumer compensation mechanism.

FOS has made Determinations against financial advisers with professional indemnity insurance, requiring them to compensate consumers for losses. In some cases, the compensation remains unpaid. Factors explaining why PI insurance cover may not result in consumers receiving compensation awarded under a FOS determination are:

- The total funds available under an adviser's insurance may not cover all of the compensation that FOS awards against that adviser
- An adviser's insurance may not cover the conduct for which FOS awards compensation against that adviser, and
- The amount of compensation that FOS awards against an adviser may be below the excess under their insurance policy.

## **Impact and extent of issue**

Our second submission to the Financial System Inquiry<sup>3</sup> includes case studies based on disputes in which compensation awarded by FOS was not paid. These are cases where existing compensation mechanisms have failed and individual consumers have suffered greatly due to the failure.

Since 1 January 2010 and as at 30 September 2014:

- 25 financial services providers had been unwilling or unable to comply with 114 Determinations made by FOS in favour of consumers. Of the 25 financial services providers, 10 were in liquidation, 1 was under administration and 9 had their Financial Services Licence or Credit Licence ceased and are no longer trading
- The value of the outstanding amounts awarded by the 114 Determinations was \$12,578,987.23 plus interest. Interest accrues at approximately 5% per annum, and
- Four unpaid Determinations related to disputes that are now the subject of legal proceedings commenced by FOS.

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<sup>3</sup> <http://www.fos.org.au/custom/files/docs/fos-submission-to-fsi-interim-report-august-2014.pdf>

This issue affects approximately 165 individuals whose claims FOS upheld but who have not been paid the compensation awarded to them. Only a very small percentage of all FOS members are involved, and these figures represent only a small proportion of all the awards we issue across all our jurisdictions in banking, insurance, life insurance and investments. However, unpaid Determinations represent 26.89% of all Determinations issued in our Investments, Life Insurance and Superannuation area, and 68% of these relate to disputes in the financial planning and advisory sector.

### **Our Recommendation**

We consider that this gap in consumer protection should be addressed. Consumers must have confidence that if things go wrong, they will be compensated when a decision is made in their favour. In our view, it is in the interests of all financial system participants to find a solution to the problem of unpaid compensation, to help rebuild consumer trust in financial services.

Our second submission to the Financial System Inquiry supports the establishment of a default compensation scheme funded by all relevant licensed entities in the financial product distribution process. That submission addresses funding in some detail and includes a report by Grant Thornton on possible funding arrangements. Governance, operational and other implementation issues would need to be developed in consultation with government, ASIC and relevant stakeholders.

We are confident that a compensation scheme can be designed to address moral hazard and other concerns of industry participants, at low cost. The scheme could be funded by a special fee on industry participants under the legislation or regulations establishing the scheme or as part of any ASIC levy funding arrangement. We consider that the scheme should be funded by means of fees or levies imposed by Government.

If you have any questions about this submission or would like further information, please contact our Policy Manager, Carolyn Bruns

Yours sincerely

**Shane Tregillis**  
**Chief Ombudsman**