



FOS response to request for information by the
Royal Commission into Misconduct in the Banking,
Superannuation and Financial Services Industry

2 February 2018



Contents

Overview	3
Systemic issues and serious misconduct	5
Remediation programs	6
Our systemic issues process	6
Overview of our systemic issues investigations	7
Outcomes of systemic issues investigations	9
Overview of our serious misconduct investigations	10
Unpaid determinations	10
Effects of systemic and serious misconduct issues	11
Conduct and practices of financial services providers	12
Our dispute resolution experience	14
FOS statistics	15
Credit disputes	15
General insurance disputes	17
Life insurance disputes	18
Investments and advice disputes	19
Payment systems disputes	20
Deposit-taking disputes	20
Code compliance and monitoring	21
Significant code breaches	21
Own motion inquiries	22
Conduct, practices and redress mechanisms	23
Culture, governance and other factors	23
Approach by boards and senior management of FSPs	24
Market structures and competition	25
Regulatory framework and fair treatment	26
Effective mechanisms for redress available to consumers of financial services	28

Overview

- 1 The Financial Ombudsman Service (FOS)¹ appreciates the invitation to respond to the request from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. This response addresses the three questions set out in the letter from the Commissioner to FOS dated 20 December 2017.
- 2 FOS is an ASIC-approved external dispute resolution (EDR) scheme that handles disputes across the financial sector. FOS was formed in 2008 from the merger of three predecessor schemes organised largely along industry sector lines.² On 1 January 2009, a further two schemes joined FOS.³
- 3 Our service is free to consumers and is funded through a combination of levies and case fees paid by participant financial services providers (FSPs). Our operations are governed by our terms of reference (TOR).⁴ FOS and its predecessor schemes have more than 20 years' experience in providing dispute resolution services in the financial services sector. FOS provides services to resolve disputes between member FSPs and consumers, including certain small businesses.
- 4 FOS handles about 83% of disputes received by the three EDR schemes (FOS, the Credit and Investments Ombudsman (CIO) and the Superannuation Complaints Tribunal)⁵ in the financial sector. Of the two ASIC-approved EDR schemes (FOS and the CIO), FOS handles about 87% of all disputes received. As well as its role in dispute resolution, FOS has formal obligations to identify and resolve systemic issues and make certain reports to ASIC.
- 5 Under current Government reforms, and subject to the passage of legislation, FOS and the other two financial sector dispute resolution schemes will be replaced by a single dispute resolution scheme for the financial sector to be called the Australian Financial Complaints Authority (AFCA). This reform arose from the review of the financial system external dispute resolution and complaints framework (Ramsay Review) whose Panel's recommendations⁶ were accepted by the Government. The legislation to establish AFCA has been passed by the Senate and is awaiting passage in the House of Representatives.
- 6 FOS has been working closely with the Government-established AFCA transition team, led by Dr Malcolm Edey, to facilitate a smooth implementation of the new single scheme in the interests of consumers and industry.

¹ This response has been prepared by the Office of the Chief Ombudsman and does not necessarily represent the views of the individual Board members of FOS. It draws on experience of FOS and its predecessor schemes in the resolution of disputes about financial services.

² Banking and Financial Services Ombudsman Service, Insurance Ombudsman Service and the Financial Industry Complaints Service.

³ Credit Union Dispute Resolution Centre and Insurance Brokers Disputes Ltd.

⁴ <http://fos.org.au/about-us/terms-of-reference/>

⁵ Percentages calculated based on 39,479 disputes received by FOS (annual review 2016-17, page 60), 5,892 disputes received by CIO (annual report on operations 2016-17, page 2) and 2,138 disputes received by SCT (2016-17 annual report, page 24).

⁶ [Final Report](#) - Review of the financial system external dispute resolution and complaints framework, April 2017.

- 7 Details of the current structure of dispute resolution in the financial sector, FOS's role and operations within those arrangements and the proposed reforms to establish a single scheme are set out in the final report of the Ramsay Review.⁷
- 8 Separately from our EDR role, FOS provides secretariat services to Code Compliance and Monitoring Committees for five financial industry codes of practice. While FOS reports high level information in its annual reviews on Code compliance and monitoring, detailed information is available directly through the relevant Code Compliance Committees and their annual reports. See page 21 for further information.

Dispute insights

- 9 FOS, like other EDR schemes, is not the 'primary' resolver of consumer complaints in the financial services industry. This is the role of FSPs dealing directly with their customers. FOS dispute data can help identify activities that may be considered to be falling below community standards and expectations. However, FOS data represents only a small percentage of the total number of disputes handled by FSPs. Further, a dispute lodged with FOS does not automatically mean that FOS will find the FSP has failed to meet its standards of conduct.
- 10 In this response, we have used our data and experience to explain some of the issues we have seen in our disputes and definite systemic issues investigations to identify conduct that may fall below community standards and expectations. However, given the limited time and the Commission's required page limit, we have kept our observations brief and at a high level. We can provide more specific information relating to particular aspects of this response if required by the Commission.

Effects

- 11 The Commission has sought details of effects of any identified misconduct, or of conduct, practices, behaviours or business activities since 1 January 2008 that have fallen below community standards and expectations. This has proved a challenging request to respond to in any quantifiable or comprehensive manner. FOS finds it difficult to quantify the effects that certain types of conduct and practices have had on consumers or groups of consumers because this is not something we capture as part of our dispute resolution activities. The effects also differ depending on the type of dispute and consumer involved. We have made some high level observations where we are able to do so.
- 12 We are acutely aware that there is an individual story behind every dispute we deal with. In many cases, it is a story not just of financial loss but also of the human toll of stress, anxiety and ill health, which has flow-on effects beyond the people involved in disputes to the community more generally. And while the effects of the issues we see vary, we do not underestimate the impact these have on people's lives, particularly on the lives of those who are vulnerable and/or disadvantaged.

⁷ [Final Report](#) - Review of the financial system external dispute resolution and complaints framework, April 2017.

Systemic issues and serious misconduct

Question 1

What kinds of misconduct by financial services entities since 1 January 2008 has the body identified as possible systemic issues or serious misconduct (within the meaning explained in ASIC regulatory Guide 139)? What was the nature, prevalence and effect of each of those kinds of misconduct?

- 13 FOS is required by ASIC's Regulatory Guide 139 (RG139) to identify, resolve and report on systemic issues and to notify ASIC of cases of serious misconduct.

Responsibilities of the scheme⁸

RG 139.127 It is the responsibility of a scheme to:

- (a) identify systemic issues and cases of serious misconduct that arise from the consideration of consumer complaints and disputes;*
- (b) refer these matters to the relevant scheme member or members for response and action; and*
- (c) report information about the systemic issue or serious misconduct to us, in accordance with these guidelines.*

- 14 ASIC's RG139 states that systemic issues relate to issues that have implications beyond the immediate actions and rights of the parties to the complaint or dispute. Under the FOS TOR⁹, a systemic issue is defined as an issue that will have an effect on people beyond the parties to a dispute.
- 15 Identifying systemic issues gives FOS the chance to help FSPs fix the issues, raise industry standards and resolve issues with their customers, including obtaining fair compensation. This helps to prevent disputes from occurring.
- 16 A systemic issue can arise for a variety of reasons and can impact on a handful or a much larger number of customers, some of whom may not even realise they have been affected.
- 17 Typically, many issues we identify arise from a finding in an individual dispute. Consumer detriment may have arisen from a system or process error made by an FSP that impacted other customers in similar circumstances. We treat this as a systemic issue and work with the relevant FSP to identify the number of customers affected, the impact on them, what redress is appropriate and what changes are required to ensure the problem does not recur.

⁸ ASIC [Regulatory Guide 139: Approval and oversight of external complaints resolution schemes](#)

⁹ [FOS Terms of Reference Section D](#), paragraph 11.2

Remediation programs

- 18 FOS has also dealt with a number of disputes that are part of major remediation programs arising from regulatory action by ASIC or, in a few cases, have been initiated by FSPs.¹⁰ Where this happens, ASIC or the FSP have determined that there is a widespread failure to comply with relevant regulatory obligations or standards, impacting a significant number of customers. As part of the remediation program, the relevant FSP undertakes to review and remediate affected customers, including providing compensation where appropriate.
- 19 Under these remediation programs, if a customer is unhappy with the outcome proposed by the FSP, they generally retain a right to have the matter determined by FOS. We have supported efforts to strengthen remediation arrangements and mechanisms to ensure that remediation arrangements align with standards for Internal Dispute Resolution (IDR) and EDR, including early engagement with EDR schemes and adopting an approach consistent with them.¹¹ Further details of remediation activities by FSPs are available from ASIC public releases.

Our systemic issues process

- 20 The following outlines our approach in identifying, resolving and reporting systemic issues.

Identification of a possible systemic issue

In the course of handling disputes, our staff consider whether a dispute raises any issues that could affect a wider group of people. Systemic issues can be identified by staff at any stage of the FOS dispute resolution process.

Referral of the issue to the FSP

Once a possible systemic issue is identified, we provide details of the issue to the relevant FSP, ask for further information and invite the FSP to respond formally.

Assessment of whether it is a definite systemic issue

We assess the FSP's response and form a view as to whether the issue is appropriately dealt with as systemic. Our systemic issues team works with the relevant FOS Ombudsman to carry out investigations. If we decide there is a systemic issue, we manage its resolution with the FSP. If we decide that an issue is not systemic, the matter is concluded. If new information becomes available, we may reconsider the issue.

Resolution of issue through collaboration with the FSP

We work with the FSP to resolve the systemic issue. This requires the FSP, where appropriate, to:

- identify all affected customers

¹⁰ [FOS annual review 2016-17, page 93](#)

¹¹ [FOS Submission to ASIC's Consultation Paper 247, Review and remediation programs](#), March 2016

- compensate the affected customers fairly for any financial loss, or take other appropriate remedial action
- implement a strategy to prevent the problem recurring.

To this extent, the handling of systemic issues provides one mechanism by which FOS facilitates the provision of redress to consumers for misconduct. This mechanism has the advantage that consumers affected by the issue can be identified and appropriately compensated in a timely and cost-efficient manner.

Reporting the issue to ASIC

We provide quarterly reports to ASIC on the number of possible and definite systemic issues we have identified, and the nature, progress and resolution of definite systemic issues, as required by ASIC's RG139. FSPs are not named in these reports. We identify an FSP in a report to ASIC only if the FSP has not dealt with a definite systemic issue to the satisfaction of the relevant Ombudsman, is a case of serious misconduct, or ASIC has issued FOS with a notice under the ASIC Act requesting FSP details.

Overview of our systemic issues investigations

- 21 In our annual reviews, we provide details of the numbers of possible and confirmed systemic issues for that financial year and a short commentary on the types of issues identified and consumer outcomes achieved from our systemic investigations. The following provides high level information relating to definite systemic issues FOS has investigated.
- 22 Since 1 January 2008, FOS has identified approximately 1,120 possible systemic issues.¹² Of these, 463¹³ were considered to be definitely systemic, involving 171 FSPs. Of the 171 FSPs with systemic issues identified and resolved in the past 10 years, more than three-quarters (78%) had one or two systemic issues, 10% had three or four systemic issues and 12% had five or more systemic issues.
- 23 We categorise systemic issues by product line and systemic issue type.¹⁴ Credit issues were the major product line for identified and resolved systemic issues. Main issues included policies for dealing with customers in financial difficulty, errors in credit listings, improper collection activity, processing errors and compliance with the National Credit Code.
- 24 General insurance was the next major category, with systemic issues relating to interpretation of policies, inadequate claims handling processes, incorrect claim denials, cancellation of policies and failure or inadequate disclosure.
- 25 In the category of investments and advice, the main issue related to the conduct of employees and authorised representatives.

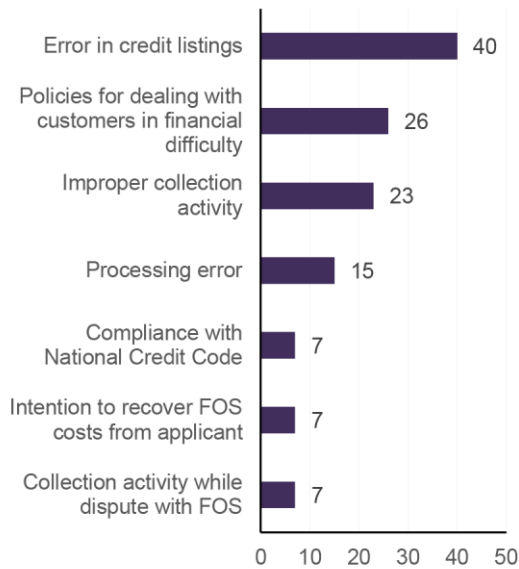
¹² Before 1 January 2010, FOS operated under the predecessor schemes' terms of reference, processes, case management systems and reporting regime. After 1 January 2010, a consistent systemic issues process, case management system and reporting regime applied. As such, there are limitations to the availability of data before 1 January 2010.

¹³ 21 definite systemic issues are currently open and under investigation.

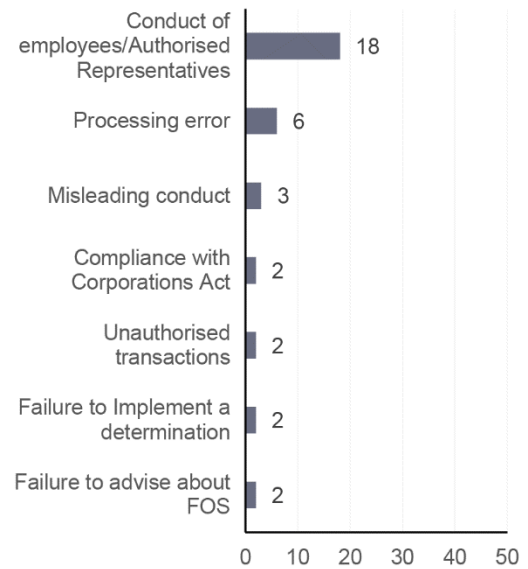
¹⁴ We have identified 138 types of systemic issues since 2008.

26 The following graphs provide details of the main types of definite systemic issues FOS has identified, by product line and systemic issue type.

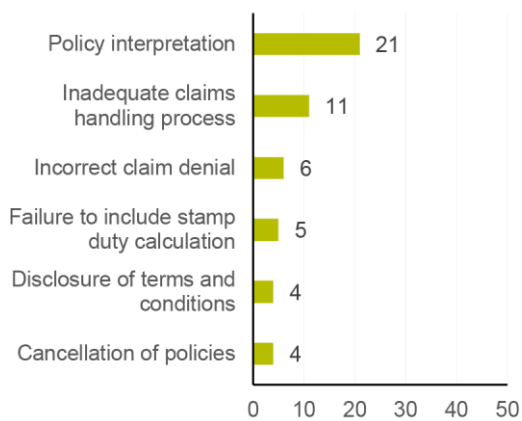
Credit



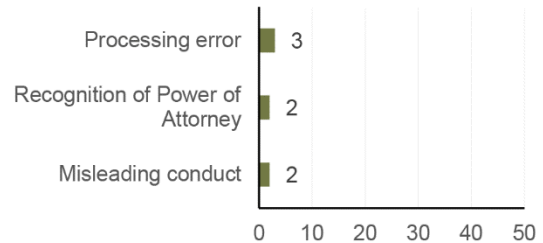
Investments and advice



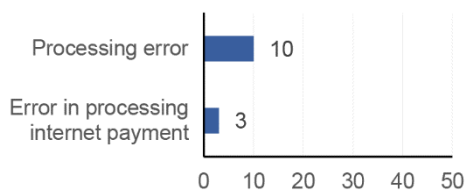
General insurance



Deposit taking



Payment systems



Life insurance

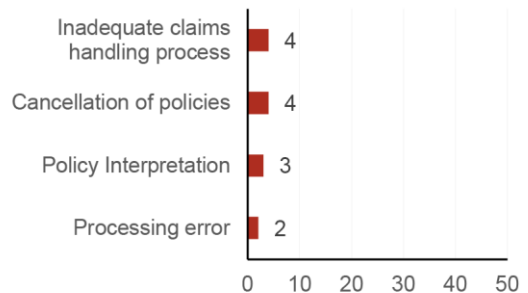


Table 1- Systemic issues identified and resolved by product line¹⁵

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	Total
Credit	10	12	14	8	19	27	32	29	33	27	27	238
General insurance	-	-	-	9	7	8	8	8	12	24	10	86
Investments and advice	-	-	-	-	-	7	4	5	8	10	15	49
Payment systems	1	4	9	2	1	-	1	2	9	7	3	39
Deposit taking	2	6	6	1	1	3	1	3	5	3	-	31
Life insurance	-	-	-	-	2	3	-	1	5	2	7	20
Grand total	13	22	29	20	30	48	46	48	72	73	62	463

27 The following table below shows the top five FSP categories¹⁶ for the 463 definite systemic issues we have identified since 2008.

Table 2- Systemic issues identified and resolved by member category

Category	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	Total
Bank ¹⁷	13	17	26	9	10	25	18	20	33	24	19	214
General insurer ¹⁸	-	-	-	8	5	5	6	7	11	20	9	71
Credit provider ¹⁹	-	2	2	2	6	5	13	11	10	10	5	66
Financial advisor/planner ²⁰	-	1	-	-	-	2	-	4	2	3	11	23
Life insurer ²¹	-	-	-	-	2	2	2	1	5	3	6	21
Total	13	20	28	19	23	39	39	43	61	60	50	395

28 The FSPs in the above table account for 85% of all identified and resolved systemic issues, and 79% of all disputes accepted at FOS.²² This shows that the number of systemic issues identified and resolved by FSP category in the past 10 years is consistent with the number of disputes accepted at FOS for those FSPs.

Outcomes of systemic issues investigations

29 Outcomes from our systemic issues investigations include, among others, monetary refunds, removal or amendment of incorrect credit listings, improvements to processes and procedures, better communications and disclosure to customers, improved staff training, rectification of system errors and declined claims reconsidered.

¹⁵ 21 definite systemic issues are currently open and under investigation.

¹⁶ This is the primary business category, as advised by FSPs to FOS in their annual assessment.

¹⁷ This category includes 26 banks

¹⁸ This category includes 30 general insurers

¹⁹ This category includes 32 credit providers

²⁰ This category includes 21 financial advisors/planners

²¹ This category includes 10 life insurers

²² This is based on the number of disputes accepted in 2016-17

- 30 As noted above, not all systemic issues result in monetary outcomes. Over the past 10 years over a million customers²³ have received some form of corrective action. In one matter, the outcome was a refund totaling \$37 million paid to some 350,000 customers.²⁴
- 31 In some cases the work we have done on a systemic issue will also inform ASIC's regulatory action and the steps taken by the FSP itself.
- 32 Given the numbers of matters involved, we have limited this response to providing a high level summary of the numbers and type of definite systemic issues we have dealt with since 1 January 2008. The Commission can find further information on FOS's systemic issues handling and outcomes in FOS's annual reviews.²⁵ We are also available to provide further detailed information should the Commission require it.

Overview of our serious misconduct investigations

- 33 Serious misconduct is defined in ASIC's RG139 as conduct that may be fraudulent or grossly negligent or may involve wilful breaches of applicable laws or obligations.
- 34 The following table provides details of identified serious misconduct issues categorised by product line.²⁶ Eight in ten (81%) of all serious misconduct issues relate to investments and failures to pay a FOS determination. Financial advisors/planners account for more than one-third (39%) of serious misconduct issues we have identified since early 2012.²⁷

Table 3- Serious misconduct Issues identified by product line

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	Total
Investments and advice ²⁸	-	-	2	4	8	10	5	8	5	42
Credit	1	-	-	1	2	3	-	1	-	8
Deposit taking	-	-	-	-	-	2	-	-	-	2
Total	1	-	2	5	10	15	5	9	5	52

* FOS did not commence reporting failures to pay FOS determinations as serious misconduct until early 2012. Our records of unpaid determinations date back to 1 January 2010.

Unpaid determinations

- 35 FOS has issued a number of determinations which, despite having found the FSP liable for losses suffered by the consumer, have not resulted in the awarded compensation being paid to the consumer.²⁹ Generally, this has happened when the FSP has gone into liquidation or administration. This is primarily an issue in our investments and advice jurisdiction.

²³ These are customers that have been affected in definite systemic issue cases.

²⁴ In some cases, the issues identified from FOS disputes may have already been remediated by the FSP or been subject to ASIC's involvement. In this particular case, 358,717 accounts were affected, see FOS annual review 2016-17, page 116.

²⁵ FOS's annual reviews since 2008 can be found at <http://fos.org.au/publications/annual-review/>

²⁶ Before 1 January 2010, FOS operated under the predecessor schemes' terms of reference, processes, systems and reporting. After 1 January 2010, a consistent process for identifying serious misconduct issues applied. As such, there are limitations to the availability of the data before 1 January 2010.

²⁷ *ibid*

²⁸ Investments and advice disputes include financial advice, managed funds, stockbroking and trading in derivatives, options and cryptocurrency.

²⁹ As at 31 December 2017, 40 FSPs were unwilling or unable to comply with 157 FOS determinations, affecting 223 consumers. As a result, in excess of \$14 million has not been returned to affected consumers, excluding interest.

- 36 While the issue involves only a minority of our members who provide financial advice, the level of unpaid determinations at the end of December 2017 was almost one-quarter (24%) of all determinations made in our investments and advice jurisdiction. Financial advisors/planners were involved in more than half (55%) of all of these unpaid determinations, followed by operators of managed investments schemes (13%) and credit providers (10%).

Effects of systemic and serious misconduct issues

- 37 The effects of systemic issues on consumers can vary from issue to issue and are difficult to quantify. They are broad-ranging issues that affect consumers who may be unaware of the issue. In the most common systemic issues we see, effects include:
- Financial hardship – people are not able to access timely and effective assistance from FSPs when in financial hardship. This can prolong a consumer’s hardship and impair their ability to improve their situation. It can also exacerbate mental health issues and family violence.
 - Breaches of lending obligations – consumers enter into loans they are unable to afford or repay. This can affect their ability to purchase a home or result in their home being repossessed. These issues affect families and small businesses, and can have broader economic implications.
 - Policy interpretation or cancellations – issues relating to the interpretation of insurance policies and denial of claims can result in consumers not receiving payments to which they are entitled. Cancellation of policies can result in consumers not having the necessary cover at the time of needing it. These practices can put undue pressure on consumers, families and small businesses and in some circumstances can contribute to financial hardship.
 - Provision of advice – inappropriate financial advice can result in consumers investing in unsuitable products and suffering losses for which they were unprepared or financially unable to support. This can impact their financial wellbeing and plans for retirement.
 - Unpaid determinations – Since 1 January 2010, outstanding failures to pay FOS determinations have resulted in excess of \$14 million dollars not returned to affected consumers.³⁰ These have had and continue to have significant impacts on people’s lives.
 - Incorrect credit listings – consumers and business have had their ability to borrow impacted with an incorrect credit listing on their file.

³⁰ As at 31 December 2017, 40 FSPs were unwilling or unable to comply with 157 FOS determinations, affecting 223 consumers. As a result, in excess of \$14 million has not been returned to affected consumers, excluding interest.

Conduct and practices of financial services providers

Question 2

What kind of conduct, practices, behaviours or business activities by financial services entities occurring since 1 January 2008 has the body identified which it considers have fallen below community standards or expectations? What was the nature, prevalence and effect of each of those kinds of conduct?

- 38 Unlike the first question relating to information about systemic issues and serious misconduct, which are defined terms in ASIC RG139, the concept of 'appropriate community standards and expectations' is less well defined and an area where opinions may differ.
- 39 This is a challenging question to respond to given:
- the volume of disputes FOS deals with every year across all sectors³¹
 - the diversity of financial service providers
 - changes in industry practice, regulatory framework and the broader economic and social environment.
- 40 While our primary role is to resolve individual disputes, we also consider it important to share our experience to prevent disputes occurring in the first place. We do so in a variety of ways, such as:
- publishing our determinations on our website
 - making submissions to relevant inquiries
 - holding industry and consumer forums
 - providing detailed dispute data in our annual review and our comparative tables
 - publishing FOS approach documents and case studies.
- 41 This allows us to share our views based on our dispute resolution experience. In doing so, we aim to improve practices and standards of FSPs to prevent disputes arising.
- 42 We have consistently stated in public submissions that in our view a key underpinning of consumer trust in financial services is a focus on fairness in consumer outcomes. This was our key message in our first submission to the Financial System Inquiry (Murray Inquiry) in 2014³², our submissions on the Draft Life Insurance Code Practice³³ and in response to the Ramsay Review of the financial system external dispute resolution and complaints framework.³⁴

³¹ Since 2007-08, FOS has received almost 300,000 disputes and accepted more than 200,000. All disputes received by FOS are registered. Accepted disputes are those which were previously registered and sent to an FSP but not resolved at the registration stage of our dispute process.

³² [FOS submissions to the Financial System Inquiry – April 2014](#)

³³ [FOS submission to the Life Insurance Code of Practice - Second Consultation Draft- September 2016](#)

³⁴ [FOS submission to the Review of the financial system external dispute resolution framework October 2016](#)

- 43 This is not surprising given our role and jurisdiction to make decisions on financial services disputes based on our opinion of what is fair in all the circumstances, having regard to:³⁵
- legal principles
 - applicable industry codes or guidance as to practice
 - good industry practice
 - previous relevant decisions of FOS or a predecessor scheme (although FOS will not be bound by these).
- 44 We consider the concept of community standards and expectations on FSPs should be based on the fair treatment of consumers, including delivering on the promises FSPs make to their customers. In our view, fair treatment should be at the heart of FSPs' dealings with their customers at all stages – from product design, distribution and claims handling to consumer problems when they arise. We consider FSPs should apply higher standards of care for customers who may be vulnerable or otherwise disadvantaged.³⁶
- 45 The interim report of the Murray Inquiry endorsed the view that fair treatment of consumers was the key to restoring community trust in financial services. The Inquiry considered that fundamental to fair treatment is the concept that financial products and services should perform in the way that consumers expect or are led to believe.³⁷ In its final report, the FSI Inquiry reiterated that in assisting consumers to bear responsibility for their financial decisions, it was important that consumers receive fair treatment from FSPs.³⁸
- 46 The Inquiry also found that the then regulatory framework was not sufficient to deliver fair treatment to consumers and made recommendations to strengthen that framework to promote consumer trust in financial services and fair treatment of consumers.³⁹ We acknowledge that a number of its recommendations are being progressed as part of current policy and law reform initiatives.
- 47 The courts have also commented on the societal norms expected of those engaged in commerce in Australia.⁴⁰ The court decision held that: “Section 51AC of the TPA operated at the relevant time to prohibit conduct in trade or commerce that was, in all the circumstances, unconscionable. It reinforced a recognised societal expectation that, even in the competitive world of business, people acting in trade or commerce must be dealt with honestly, fairly and without deception or unfair pressure.” Similarly, the duty of utmost good faith outlined in the *Insurance Contracts Act 1984* has been considered by courts to encompass notions of fairness, reasonableness and community standards of decency and fair dealing.⁴¹

³⁵ [FOS TOR paragraph 8.2, Dispute Resolution Criteria](#)

³⁶ [FOS submissions to the Financial System Inquiry, April 2014](#)

³⁷ [FSI Interim Report, July 2014](#)

³⁸ [FSI Final Report, December 2014](#)

³⁹ [FSI Interim Report, July 2014](#)

⁴⁰ *Colin R Price Pty Ltd v Four Oaks Pty Ltd* (2017) 349 ALR 100; [2017] FCAFC 75 at [57].

⁴¹ *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* [2007] HCA 36; *Nell, Greg* “Utmost Good Faith in Insurance Contracts: *CGU Insurance Ltd v AMP Financial Planning*” [2007] NSW Bar Assoc News 47

Our dispute resolution experience

- 48 One indicator in determining whether actions by FSPs may not be meeting “appropriate community expectations or standards” is when we see an increasing trend in particular types of disputes. While not definitive, dispute trends can be an indicator that FSPs are not meeting the expectations of their customers, in terms of the products and/or services they provide. Accordingly, FOS dispute data can help identify activities that may be considered as falling below “community standards and expectations”. In forming our views, among other things, we take into account the types of conduct we consider do not meet good industry practice or the standards set out in relevant industry codes or guides to practice.
- 49 An FSP’s IDR process and approach to dealing with customer complaints can also be an area of where “appropriate community expectations and standards” are not being met.
- 50 As noted earlier, however, FOS data represents only a small percentage of the total number of complaints handled by FSPs. Most disputes are resolved directly between FSPs and their customers. Even when a dispute is handled by FOS, most matters are resolved at the early stages of our process by agreement between the consumer and the FSP. The lodging of disputes with FOS does not automatically mean that FOS will decide there has been any failure of standards of conduct by the FSP.
- 51 It is also difficult for FOS to quantify the effects of particular types of FSP conduct and practices that may be considered as falling below community standards and expectations, because it will differ for each consumer and dispute.
- 52 Set out below are high level trends we have seen by product line in our dispute data since 1 January 2008. These have informed our decisions, guidance materials and stakeholder engagement when providing our views to industry and consumers. Further, they have informed the views we have set out in our submissions to various public inquiries. Accordingly, they identify where we consider conduct needs to improve to meet relevant regulatory, good industry and industry codes or practice standards.
- 53 While not necessarily expressed in those terms in FOS documents, this also means that in our view the types of conduct identified fall below community expectations and standards based on the considerations we apply under our TOR when making a decision on what, in our opinion, is fair in all the circumstances in a specific dispute.
- 54 A number of the issues identified have resulted in reforms to industry practice, regulation or industry codes (for example, dealing with customers in financial hardship, Future of Financial Advice, ePayments Code, the establishment of the Financial Adviser Standards and Ethics Authority and Code of Ethics). In other cases, reform is ongoing (ABA’s Better Banking Reform Program, review of the Code of Banking Practice and General Insurance Code of Practice, second stage of development of the new Life Insurance Code of Practice and reforms to enhance ASIC’s regulatory powers in a range of areas).

FOS statistics⁴²

55 Over the past 10 years, FOS and its predecessor schemes have received almost 300,000 disputes and accepted more than 200,000 disputes.⁴³

Table 4- Disputes received by product line⁴⁴

Product Line	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Credit	4,944	8,634	10,112	14,537	18,485	16,358	16,544	16,458	16,491	18,525
Insurance	4,798	6,413	7,964	<i>General insurance and Life insurance now reported separately - see below</i>						
General insurance	<i>Reported together as Insurance (above)</i>			8,781	10,423	9,468	8,643	8,867	10,588	13,200
Life insurance				1,193	1,139	1,268	1,420	1,485	1,365	1,307
Investments and advice	916	1,572	1,999	2,235	1,923	1,462	1,430	1,666	1,517	1,681
Deposit taking	1,590	1,548	1,390	2,244	2,174	2,086	2,310	2,721	3,102	4,309
Payment systems	1,365	1,982	2,022	2,422	2,508	2,457	2,348	2,754	2,894	3,342
Traditional trustee services	<i>Jurisdiction to deal with traditional trustee services disputes commenced in 2011-12</i>				20	26	29	31	34	26
Products outside TOR	477	928	135	464	566	324	500	455	197	173
Not yet determined ⁴⁵	269	1,315	1,331	5	19	88	54	53	249	687
Total	14,359	22,392	24,953	31,881	37,257	33,537	33,278	34,490	36,437	43,250

Credit disputes

56 Most credit disputes accepted by FOS relate to consumer credit products, such as home loans, credit cards and personal loans. In the past 10 years, the most prevalent types of consumer credit disputes have been financial difficulty disputes and disputes regarding FSP decisions.

Application of break costs

57 In 2008-09, the biggest single cause in credit disputes about the decisions of FSPs was the application of break costs to fixed rate and business loans at a time when consumers sought to exit their fixed rate loans by switching to a variable product offered by their FSP or by refinancing to another financial institution.⁴⁶

⁴² Before 1 January 2010, FOS operated under the predecessor schemes' terms of reference, processes, systems and reporting. After 1 January 2010, a consistent data capture system and reporting applied.

⁴³ All disputes received by FOS are registered. Accepted disputes are those which were previously registered and sent to an FSP but not resolved at the registration stage of our dispute process. FOS annual reviews can be found at this [link](#).

⁴⁴ Disputes received by FOS may involve more than one product or issue. The distinct count of total disputes received will be less than those disputes received by product.

⁴⁵ 'Not yet determined' includes disputes that were not classified at the time the annual review was published.

⁴⁶ [FOS annual review 2008-09](#), page 32

- 58 In terms of failing to meet community standards and expectations at the time, the disputes we look at revealed, among other things, a lack of understanding by frontline staff of the manner in which the break costs were calculated. It also demonstrated inadequate disclosure by FSPs to their customers.⁴⁷ The effect was that consumers were locked into loans and unable to improve their financial position by moving to a lower interest rate loan.⁴⁸
- 59 FOS subsequently developed and published guidance material on its approach to break costs.⁴⁹ Issues relating to the application of break costs were later addressed through regulatory reform.⁵⁰

Responsible lending disputes

- 60 Over the years we have seen increases in disputes about responsible lending (previously identified as maladministration in lending). In 2012-13, the number of disputes we accepted about responsible lending had more than doubled.⁵¹ Responsible lending continues to be one of the key issues in disputes about FSP decisions.
- 61 Over the years, FOS has discussed responsible lending issues in submissions⁵² and approach documents.⁵³ The areas we highlighted as not meeting regulatory, good industry or community standards at the time, included the range of common errors made by FSPs when assessing a consumer's ability to repay a loan.⁵⁴ This includes FSPs relying on information they shouldn't have, or failing to consider relevant aspects of the consumer's financial position. This resulted in consumers being placed in loans they could not afford, causing financial difficulty, including in some cases loss of the family home.
- 62 FOS has over the years released guidance on the approach we take in assessing an FSP's compliance with its responsible lending obligations. The introduction of the *National Consumer Credit Protection Act 2009* (NCCP Act) and the National Credit Code in July 2010 (NCC Code) have been key regulatory reforms.

Financial difficulty disputes

- 63 As a result of jurisdictional changes made to FOS following the introduction of the NCCP Act and the NCC Code, as well as deteriorating economic conditions due to the impact of the Global Financial Crisis, the number of accepted financial difficulty disputes reached its highest level in 2011-12.⁵⁵ Financial difficulty disputes occur when consumers unexpectedly cannot meet their repayment obligations. This can be as a result of a range of personal circumstances such as illness or an accident, separation, bereavement, medical expenses, business downturn, job loss or other factors.

⁴⁷ [FOS submission in response to ASIC's Consultation Paper 135 - Mortgage early exit fees August 2010](#)

⁴⁸ [FOS Circular Issue 4](#), December 2010

⁴⁹ [FOS Bulletin 60](#) - Breaking a Fixed Rate Loan - our approach to break costs and [FOS Circular 1](#) - Actuarial confirmation of approach to break costs

⁵⁰ <http://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rq-220-early-termination-fees-for-residential-loans-unconscionable-fees-and-unfair-contract-terms/>

⁵¹ [FOS annual review 2012-13](#), page 61

⁵² [FOS submission to the inquiry into impairment of loans](#) - September 2015, [FOS submission to the Independent Review of the Code of Banking Practice](#), September 2016

⁵³ [FOS Bulletin 45](#) March 2005, [FOS Bulletin 60](#) December 2008, [FOS Circular Issue 5](#) March 2011, [FOS Circular Issue 12](#)- Disputes about Low Doc Loans, [FOS Approach documents in responsible lending disputes](#) (responsible lending series), [FOS Circular Issue 15](#) - Maladministration and low doc loans

⁵⁴ [FOS Circular Issue 5](#), March 2011

⁵⁵ [FOS annual review 2011-12](#)

- 64 In the past five years, the number of financial difficulty disputes accepted has steadily decreased.⁵⁶ The reduction is a result of improved FSP practices, the release of industry guides⁵⁷ and revised Codes of Practice and an improvement in economic conditions, including low interest rates.
- 65 Some of the financial difficulty disputes we have looked at over the years revealed that certain FSPs were failing to meet relevant regulatory, good industry or community standards in this area by not providing customers in financial difficulty with assistance promptly and failing to consider long-term solutions or providing consumers with unrealistic repayment plans.⁵⁸ Over the years, FOS has raised these issues in submissions⁵⁹, and published guidance materials about the approach we take in assessing an FSP's compliance with its obligations when dealing with customers in financial hardship.⁶⁰

General insurance disputes

- 66 Most general insurance disputes accepted at FOS are in relation to domestic insurance, including home building, contents and motor vehicle insurance. Decisions of FSPs are the main issue represented in these disputes and involve denial of claims under a policy, or an FSP's decision to offer less money to settle a claim than a consumer was expecting.

Natural disasters

- 67 Periods with the highest number of accepted domestic insurance disputes were linked to the occurrence of natural disasters, particularly during 2010 and 2011. The main issue in these disputes was confusion over the extent of cover due to the various definitions of flood/storm.
- 68 FOS found that in some instances, certain FSPs failed to communicate early and effectively with consumers. A key community expectation during these events, is that insurance companies will communicate with those affected promptly and handle claims under the insurance policy by customers in distress in a prompt and efficient manner. We note that in some circumstances the communication was adversely affected by the dislocation caused by the event and delays in determining liability, in particular, where the policy did not provide flood cover.
- 69 In our experience, those FSPs who contacted potential claimants or kept consumers informed about the progress of their claim on a regular basis, were able to resolve issues more efficiently. FOS also observed delays by certain FSPs in exchanging information and in particular hydrologists' reports, or requiring multiple reports before making a decision on a claim. This resulted in an increase in the number of consumer disputes relating to natural disasters, and reports of stress and hardship on affected consumers.

⁵⁶ In 2016-17, financial difficulty disputes accepted had decreased to 2,742. [FOS annual review 2016-17](#), page 99

⁵⁷ The Australian Banker's Association (ABA) released their financial hardship industry guide in 2013, and a revised Code of Banking Practice which includes a greater focus on banks working with their customers to overcome financial difficulty.

⁵⁸ [FOS annual review 2014-15](#), case study page 91

⁵⁹ [FOS submission to the Inquiry by Senate Economics References Committee into developments in the banking sector arising from the GFC](#)- May 2012

⁶⁰ [FOS Circular Issue 7](#)- Financial Difficulty- what is good practice page 4, [FOS approach documents on financial difficulty disputes](#) (financial difficulty series)

- 70 FOS has addressed these issues in various submissions⁶¹ and provided guidance in various publications.⁶² The Federal Government's introduction in June 2012 of a standard definition of flood and subsequent changes to general insurance policies has significantly reduced consumer confusion, and subsequently disputes in relation to this issue.⁶³
- 71 In the past two years, the number of general insurance disputes accepted by FOS has increased due to industry-specific issues including higher claim numbers and organisational changes. All these issues may have had an impact on FSPs' ability to meet community standards and expectations of the quality and effectiveness of their IDR systems and processes.⁶⁴ In a particular case, FOS identified a possible systemic issue from a number of general insurance disputes that raised concerns about the quality and timeliness of an FSP's response to FOS via a law firm engaged by the FSP to conduct its IDR and EDR processes. FOS took the view that providing IDR correspondence to consumers on legal letterhead could influence or dissuade consumers from pursuing a dispute.⁶⁵
- 72 More recently, FOS highlighted how FSPs are dealing with mental health issues and potential discrimination issues arising from the terms of their policies.⁶⁶ In a particular dispute, the FSP denied liability for the claim relying on a general exclusion for claims arising from or in any way related to depression, anxiety, stress, mental or nervous conditions (a blanket exclusion).⁶⁷
- 73 The FOS Panel that decided this dispute found the general exclusion relating to mental illness in the FSP's policy discriminated against the applicant because it sought to treat a person who developed a mental illness during the period of insurance differently from how it treated a person without a mental illness.⁶⁸
- 74 FOS welcomes the current review into the General Insurance Code of Practice in light of current community standards and expectations, and in particular proposals to strengthen standards relating to vulnerable consumers, guidance on best practice mental health principles, guidance on recognising and responding to instances of family violence and stronger financial hardship standards.

Life insurance disputes

- 75 Most life insurance disputes received at FOS relate to claims involving income stream products, such as income protection. The number of life insurance disputes has decreased over the past few years. A decision to deny a consumer's claim is the most common issue we see in life insurance disputes.
- 76 It is our experience that life insurance disputes generally arise as a result of the application and interpretation of policy definitions where the definition is overly restrictive, ambiguous or outdated. We have found that certain definitions have not kept pace with current clinical, medical or diagnostic tools. Typically these matters also involve instances where community expectations about what a policy covers differs from the

⁶¹ [FOS Submission to Inquiry into Operation of Insurance Industry during Disaster Events](#)- Aug 2011, [FOS submission to the Natural Disaster Insurance Review](#)- July 2011

⁶² [FOS Circular Issue 7](#)- Flood Edition, [FOS Circular Issue 8](#)- Flood Determinations

⁶³ [FOS Circular Issue 14](#) - Queensland Floods - lessons learnt

⁶⁴ [FOS media release, 5 October 2017](#)

⁶⁵ [FOS annual review 2014-15](#), case study, *direct involvement of law firm could send the wrong message*, page 98

⁶⁶ [FOS Circular Issue 29](#)- Key Determination - *Mental illness exclusion discriminated against the applicant*. April 2017

⁶⁷ *ibid*

⁶⁸ *ibid*

highly technical definitions in policies and narrow interpretation applied by the insurer in assessing the claim.

- 77 FOS has welcomed recent life insurance reforms, including efforts to improve remuneration structures and remove conflicted advice in the sector. FOS also welcomed the recent introduction of the Life Insurance Code Practice, including the introduction of standardised medical definitions that are better intended to keep up to date with community expectations and diagnostic practice.⁶⁹

Investments and advice disputes

- 78 Investments and advice disputes accepted by FOS involve financial advisory services, managed investments funds, stockbroking, trading in derivatives, options and cryptocurrency and managed investments schemes, such as timeshare, horseracing syndicates and agricultural schemes.
- 79 The first six months of 2008 saw a significant change in the investment landscape as a result of the impact of the Global Financial crisis. The suitability of investments in Westpoint disputes was a major issue that year. These disputes were dealt with by the FOS predecessor scheme, the Financial Industry Complaints Service (FICS). The FICS Panel determining those disputes found that in a number of instances, financial advisors did not understand the true nature of the risk of the investment and failed to carry out adequate research in order to make a proper assessment of the risk. Some advisors were found to have relied on dated research material in recommending the rollover or extension of investments rather than ascertaining the investment risk at the time.⁷⁰
- 80 In 2008-09, the highest increase in disputes was in investments and advice, with a 68% increase in disputes. This was the year of large managed fund collapses including Storm Financial, Great Southern and Timbercorp. The number of investment disputes was also affected by a number of managed investment mortgage funds suspending distributions and redemptions due to market volatility and liquidity issues.⁷¹
- 81 Currently, the proportion of investments and advice disputes is around 5% of all disputes accepted at FOS.⁷² Most of these relate to managed investments. The most common issues are provision of inappropriate financial advice and failure to follow customer instructions.
- 82 In some of the disputes we investigated, we found that certain risk profiling practices and procedures did not appropriately address the client's attitude to risk or capacity for loss. In some cases, the FSP failed to properly understand the product it was recommending and as a result, did not adequately explain the features and risks associated with the product. We considered these practices did not meet regulatory, good industry or community standards at the time. This placed consumers in products that did not meet their needs and caused them to suffer losses for which they were unprepared or financially unable to support.

⁶⁹ [FOS submission to the Inquiry into the Life Insurance Industry](#), November 2016 and [Submission to the Draft Life Insurance Code of Practice](#), September 2016, [FOS submission to the Inquiry into Consumer Protection in Banking, Insurance and Financial Sector](#), March 2017

⁷⁰ [FICS Review](#)- 1 January 2008-30 June 2008, page 7

⁷¹ [FOS annual review 2008-09](#)

⁷² [FOS annual review 2016-17](#), investments and advice disputes

- 83 FOS has over the years raised legal, regulatory and cultural issues relating to the provision of financial advice in various submissions⁷³ and released guidance material to help reduce the number of investments and advice disputes.⁷⁴ We note the recent Future of Financial Advice (FOFA) and other reforms designed to address a number of these issues.

Payment systems disputes

- 84 The number of payment system disputes has consistently increased over the years. These mostly relate to electronic banking, ATM transactions and merchant facilities. Incorrect payments and unauthorised transactions are the most common issues we see. The increase is indicative of FSPs moving into an electronic world for banking transactions. The introduction of the ePayments Code in 2013 saw a new regime established for recovering mistaken internet payments.
- 85 The mistaken internet payments changes came about because of problems people were having in recovering their money when they sent a payment to a wrong account by mistake. The ePayments Code is due for review and could be further improved, but it has reduced the number of people unable to recover their funds.

Deposit-taking disputes

- 86 The number of deposit-taking disputes has steadily increased since 2011-12, with accepted disputes fluctuating in those years. Most accepted deposit-taking disputes are about current accounts, such as personal and business transaction accounts. The disputes are mainly about transactions, in particular unauthorised transactions that customers claim are made on their accounts.

⁷³ [FOS submission to Inquiry into Future of Financial Advice legislation](#), January 2012, [Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry](#), September 2014, [FOS submission to the Inquiry into Scrutiny of Financial Advice](#), December 2014, and FOS submission to [Lifting of The Professional, Ethical and Education Standards in the Financial Services Industry](#), May 2015

⁷⁴ [FOS Circular Issue 6](#), Risk profiling in financial advice disputes, Winter 2011, [FOS Circular Issue 7](#), Financial Advice and Planning, Loss Calculation, Spring 2011, the [FOS Approach to loss calculation in financial advice](#), [FOS approach to adequacy of statements of advice](#), [top 10 tips for getting financial advice right](#), [FOS approach to misleading conduct](#)

Code compliance and monitoring

- 87 As well as its role in dispute resolution and with systemic issues, FOS has a Code team that provides secretariat services and support to five Code compliance committees that independently monitor compliance with industry codes of practice in the financial services sector.⁷⁵
- 88 While FOS provides high level reporting on code compliance and monitoring in its annual reviews, each compliance committee publishes its own annual reports including details of code breaches, investigations and the results of its targeted monitoring activities.
- 89 For more information relating to code compliance and monitoring, please refer to the relevant annual reports of the various committees⁷⁶ or contact the General Manager of the Code team at info@codecompliance.org.au.
- 90 The following information provides an overview of Code compliance and monitoring reported in FOS annual reviews since July 2012.⁷⁷
- 91 Code compliance committees undertake annual compliance reporting programs for each code. Code subscribers self-report code breaches that they have identified through internal compliance monitoring activities. Since July 2012,⁷⁸ subscribers covering four⁷⁹ codes have self-reported more than 65,000 code breaches.
- 92 Each committee is also empowered to investigate individual allegations of non-compliance with a code. Committees may become aware of these matters through allegations made directly by individual or small business customers or their representatives, or through referrals from FOS's dispute resolution work.
- 93 Code compliance committees provide a more detailed breakdown of breaches self-reported by subscribers or identified as a result of investigations in their respective annual reports.

Significant code breaches

- 94 A 'significant' breach of code obligations is usually a breach that involves a number of customers who have been impacted by the conduct or activity and who have suffered loss. This term is defined and treated differently for each code of practice. Significant breaches generally require more extensive remedial action to be undertaken under the code than individual self-reported breaches.
- 95 Between 2012 and 2017, 160 significant breaches were self-reported by subscribers to the Banking, Customer Owned Banking and Insurance Broking code compliance committees. Table 5 provides the number of significant code breaches by industry sector.

⁷⁵ [Code of Banking Practice](#), [General Insurance Code of Practice](#), [Insurance Brokers Code of Practice](#), [Customer Owned Banking Code of Practice](#) and [Life Insurance Code of Practice](#).

⁷⁶ [Code compliance committee annual reports and publications 2014-17](#)

⁷⁷ FOS began to report high level information on code compliance and monitoring activities in its annual reviews in 2012-13. <http://fos.org.au/publications/annual-review/>. Information relating to activities prior to this time, was published and can be provided separately by each of the Code Committees or as a joint submission.

⁷⁸ Breach data was also collected and published by the individual Committees prior to July 2012.

⁷⁹ This information applies to four codes because the Life Insurance Code compliance committee only became operational in 2017.

Table 5- Significant code breaches by industry sector

Sector	2012-13	2013-14	2014-15	2015-16	2016-17	Total
Banking	10	12	8	16	21	67
Customer Owned Banking	-	16	6	5	11	38
Insurance Broking	-	5	5	11	34	55
Total	10	33	19	32	66	160

- 96 Subscribers to the General Insurance Code of Practice are obliged to self-report significant breaches directly to the Committee within a shorter timeframe and the Committee is empowered to investigate significant breaches when they are identified. In addition, the Committee may identify significant breaches through its own monitoring and investigation.
- 97 More than 30 significant breaches were reported and investigated by the General Insurance Committee since 2012⁸⁰.

Own motion inquiries

- 98 Where the Code compliance committees identify a particular area of compliance risk, through its investigations or from breaches self-reported by code subscribers, the Code team may conduct an own motion inquiry. These inquiries take an in-depth look at specific areas of concern using methodologies such as questionnaires, onsite visits to code subscribers, engagement with consumer advocates or mystery shopping exercises.
- 99 Between July 2012 and June 2017, the Code team finalised 12 own motion inquiries. These included, for example, the operation of general insurance claims handling standards during the 2010-11 Queensland floods⁸¹, the investigation of general insurance claims and outsourced services,⁸² how effectively banks⁸³ and customer owned banks⁸⁴ have provided assistance to customers experiencing financial difficulty and the provision of credit by banks⁸⁵. For further detail on the outcomes of the Code compliance committees' own motion inquiries, see individual Code committee reports.

⁸⁰ The Committee also investigated self-reported significant breaches before 2012 and the outcomes of these matters were reported in the Committee's annual reports.

⁸¹ A copy of the Committee's Queensland floods report is available on request.

⁸² [GICGC Own Motion Inquiry on Investigation of Claims and Outsourced Services](#), May 2017.

⁸³ [CCMC Financial Difficulty own motion inquiry](#), November 2015.

⁸⁴ [COBCCC Financial Difficulty own motion inquiry](#), December 2014.

⁸⁵ [CCMC Provision of Credit own motion inquiry](#), January 2017.

Conduct, practices and redress mechanisms

Question 3

For each of the kinds of conduct, practice, behaviour or activity identified in response to questions one or two:

- a) Does the body attribute the identified kind of conduct, practice, behaviour or activity to broader cultural or governance practices in the relevant industry or sector or the relevant industry? If so, describe those cultural or governance practices.
- b) Does the body consider that the identified kind of conduct, practice, behaviour or activity results from other practices (including risk management, recruitment or remuneration practices)? If so, describe those practices.
- c) To what extent, and in what respects, does the body consider that there are effective mechanisms for redress available to consumers of financial services who suffer detriment as a result of the identified kinds of conduct?

Culture, governance and other factors

- 100 We consider that the key cultural, governance and other factors behind the failures to meet community standards and expectations in each of the areas we have identified in questions 1 and 2 fundamentally relate to a failure on the part of FSPs to put the fair treatment of consumers at the heart of their business models, strategies, operations and practices.
- 101 While the concept of the customer centred firm has been talked about for some time in the financial services industry, the reality has not always lived up to the rhetoric.
- 102 Mr Ian McPhee, in his latest report on the ABA's Better Banking Package, comments that:
- "[t]he longer-term goal inherent in the various industry initiatives, and statements made in support of the initiatives by industry leaders, is the importance of embedding the central focus on customers in the way business is done within the culture of each bank. This needs to be viewed as an enduring goal for each bank, and supported by strategies responsive to the times and reinforced by those in key leadership roles on an ongoing basis."*⁸⁶
- 103 This recognition is welcome, but it is long overdue and indicates that efforts in this area remain very much a work in progress.

⁸⁶ [Independent governance expert report: Australian banking industry package of initiatives, Report 7 18 January 2018](#)

104 Other stakeholders are better placed to comment and analyse in more detail the underlying causes as to why this might be the case for particular FSPs or sectors. However, we point to the following key areas as contributing factors:

1. an insufficient focus by boards and senior management of financial services providers on truly putting their customers' interests first as central to their business models
2. market structures where competition does not always lead markets to be self-correcting, resulting in "persistent" poor outcomes for consumers
3. a regulatory framework not fully fit for purpose in delivering fair treatment of consumers.⁸⁷

Approach by boards and senior management of FSPs

105 The GFC highlighted in many jurisdictions the continuing fallout from failures of governance, risk management and conduct of FSPs with significant impact on investors, consumers, the economy and the broader community. These have been well documented in the many post-GFC reviews by government inquiries, international and domestic standard setters, academics and commentators of what went wrong in the financial system in the lead up to the GFC.

106 The initial focus was on system stability and prudential issues such as capital, leverage and financial risk management. However, more recently this has turned to issues of broader reputation, trust, culture and conduct focused on how FSPs treat their customers.

107 In his latest report Mr Ian McPhee echoes the findings of the Group of 30 (G30) in its July 2015 Report on Banking Conduct and Culture⁸⁸. The G30 Report highlighted the impact of reputational damage, loss of public trust and financial cost, in terms of fines, litigation and regulatory action, and more broadly the costs to society as a whole.

108 The G30 Report found that there was a need to *restore the primacy of serving customers to help them achieve their financial goals and to service the communities and economies in which they operate*. Further, doing so needs to be core to firms' business models and to the sustainability of the institution. This requires a concerted whole of institution approach that goes beyond compliance with the law to an adherence of standards and value principles as a matter of judgement. Similar observations apply across others parts of the financial sector.

109 In Australia various Parliamentary Inquiries of the financial services industry have documented conduct issues and failures across a range of sectors and institutions.⁸⁹ Whatever the complex mix of factors involved, the result has been that the interests of consumers have not always been the central focus and core to FSPs' business models.

110 In response to questions 1 and 2 above, we set out some examples of conduct that in our view failed to meet community standards and expectations.

⁸⁷ This factor is further dealt with below under the heading *Regulatory framework and fair treatment*

⁸⁸ [Banking conduct and culture, a call for sustained and comprehensive reform, G30 \(Group of Thirty\)](#)

⁸⁹ [Inquiry Into Competition within the Australian Banking Sector](#); [Inquiry into the Operation of the Insurance Industry during Disaster Events](#); [Inquiry into Future of Financial Advice Legislation](#); [Inquiry into the Post-GFC Banking Sector](#); [Financial System Inquiry](#); [Inquiry into Proposals to Lift the Professional, Ethical and Education Standards in the Financial Services Industry](#); [Inquiry into Scrutiny of Financial Advice and Inquiry into Impairment of Loans](#).

111 Relevant to the role of boards and senior management in having a clear focus on the fair treatment of consumers, examples include:

- sales commissions and conflicts of interest were key factors in consumers not getting appropriate advice, being sold inappropriate products and accessing high risk market trading activities
- a focus on cost reduction had adverse impact on the quality of IDR systems and processes
- in a small number of cases, the business activities of FSPs were based on predatory sales models that target vulnerable consumers with products and services that are of high cost and limited real value⁹⁰
- highly technical approaches to policy definitions or payment of claims potentially driven by a focus on short term cost containment measures.

Market structures and competition

112 In addition to key cultural, governance and other factors within individual FSPs, market competition has not always resulted in correction of persistent poor outcomes for consumers.

113 A combination of the real world behaviour of consumers (inertia, challenges in dealing with product complexity, behavioural biases and often low levels of financial literacy) and market structures mean that markets have not always self-corrected to address persistent poor outcomes for consumers.

114 The recent studies by the UK Financial Conduct Authority (UK FCA) into general insurance and protection (add-ons and renewal pricing) and asset management⁹¹ provide examples in another jurisdiction where the particular characteristics of those markets have not always operated in the best interests of consumers.

115 This can also be seen in ASIC's recent investigation of add-on insurance in the motor vehicle market⁹², where market pressures have not been effective to eliminate a product sold to consumers of little or no real value.

116 In response to questions 1 and 2 above, we provide some examples of where market competition was not of itself sufficient to eliminate products or services with poor consumer outcomes. These include:

- credit card terms and conditions that were unfair for consumers continued to be marketed for considerable periods
- policy definitions in some life insurance policies did not keep pace with current clinical definitions
- sales of inappropriately complex products to certain consumer sectors continue to occur.

⁹⁰ This relates to a small number of disputes we received about a particular credit provider. This credit provider later went into liquidation leaving consumers with unpaid compensation.

⁹¹ [UK FCA competition report 2013-16](#) and [UK FCA final report into asset management sector](#) 28.06.2017

⁹² <http://www.asic.gov.au/about-asic/media-centre/articles-and-responses/add-on-insurance-and-flex-commission-practices/>

117 The Productivity Commission is currently reviewing competition in the financial system with the view to improving, among other matters, consumer outcomes. This review is due to be completed in July 2018 with an interim report due shortly. This work may shed further light on some of these underlying competition and market structure issues.⁹³

Regulatory framework and fair treatment

118 As we noted in our response to question 2 above, the Murray Inquiry found that the regulatory framework was not sufficient to deliver fair treatment to consumers.⁹⁴ In its Report, the Inquiry made a number of recommendations for enhancements including product and distribution intervention powers for the regulator, enhanced professional standards for advisers, increased and more stable funding for the regulator, higher penalties and a review of the current managed investments regime. It also recommended that there be an explicit requirement to consider competition included in ASIC's mandate.⁹⁵ The Government is currently progressing these initiatives in its current reform program.

119 While implicit in its recommendations, what we consider missing from the Murray Inquiry Report was the articulation of a clear philosophy of conduct regulation to replace the point of sale and product based disclosure regime that emerged post the Wallis Committee reforms.

120 The current approach to consumer protection regulation in the financial sector needs to be reframed. Instead of focusing on separate functional activities, conduct regulation should be more clearly based on the fair treatment of consumers at all stages of what is an increasingly integrated product design, origination and distribution system. This would help ensure the financial system better meets the needs of all users, including consumers and small businesses.

121 While there are series of individual reforms underway, these reforms do not include putting in place a common regulatory or legal requirement for fair treatment of consumers across financial activities and sectors taking into account community standards and expectations.

122 The current regulatory regime has a patchwork of obligations that seek to express in various ways the outcome of "fair treatment" depending on the specific regulated activity or entity.⁹⁶ For example, the unfair contract provisions apply to some financial sector activities but not others. The national unfair contract terms (UCT) laws generally apply to contracts for financial services under the ASIC Act 2001. There is also limited application to small business lending, but this could be extended. However, the UCT laws do not apply to life insurance and general insurance contracts.⁹⁷

⁹³ [Productivity Review of the competition in the Australian Financial System, July 2017](#), due to report in July 2018.

⁹⁴ [Financial System Inquiry- Final Report](#), Chapter 4

⁹⁵ [Financial System Inquiry- Final Report](#), Chapter 5, recommendation 30

⁹⁶ For example: statutory unconscionability provisions contained in s 21 of the Australian Consumer Law (ACL) and its State analogues, Subdivision C of the ASIC Act, and Part 9 of the Retail Leases Act 2003 (Vic) and other State and Territory analogues; unfair contract terms provisions contained in s 24 of the ACL and subdivision BA of the ASIC Act, s 76, 78 and 180A of the National Credit Code; statutory relief in respect of harsh, oppressive, unconscionable or unjust contracts in the Contracts Review Act (NSW); relief in respect of contracts or arrangements whereby a person performs work in any industry which are (for example) unfair, harsh or unconscionable, or against the public interest: s 106 of the Industrial Relations Act 1996 (NSW), s 11-17 of the Independent Contractors Act 2006 (Cth) (unfair contracts with independent contractors); reference might also be made to provisions of the Competition and Consumer (Industry Codes – Franchising) Regulations 2014 (Cth) which imposes a raft of conduct requirements including the obligation to act in good faith.

⁹⁷ [FOS submission to the Scrutiny of Financial Advice Inquiry](#), April 2016

- 123 Concepts of “fair treatment” for other financial sector activities are expressed via obligations relating to responsible lending in national credit legislation, in best interests’ duty and related obligations in financial advice, in requirements for licensed intermediaries to act in a way that is “fair, honest and efficient”⁹⁸ and in various fiduciary like concepts for managed investment, broking and other financial sector activities.
- 124 This is in contrast with the UK financial services regime where there is a clear overriding obligation for fair treatment of customers across the range of financial sector activities. Principle 6 of the UK FCA rules states: ‘*A firm must pay due regard to the interests of its customers and treat them fairly*’.⁹⁹ In Singapore, a similar approach has been adopted by means of guidelines for fair dealing by boards and senior management.¹⁰⁰
- 125 We consider there is an opportunity for the Commission to recommend the establishment of a clear legal standard for the fair treatment of consumers across financial sector activities in a way that takes into account changing community standards and expectations. In addition, this obligation should continue even when the FSP has gone into liquidation.
- 126 A key advantage of doing so is that a broad general obligation is less about dealing with specific types of activities by different intermediaries and is directed at the whole of enterprise activities, including the role and accountabilities of boards and senior management.
- 127 Such an obligation would mean boards and senior management would be required to take appropriate steps to ensure their business models, strategies, accountability mechanisms and operations (including risk management, remuneration, and recruitment) put fair treatment of consumers at the core of their activities. This includes for example how major re-organisations or restructures are carried out, as in some cases these can result in poor consumer outcomes during what can often be an extended period of time. The approach proposed would enable the regulator to take effective regulatory action when boards and senior management fail to do so.
- 128 In addition to the absence of such a general obligation, structural issues in the sector and regulatory regime will continue to result in poor outcomes for consumers. As set out in our response to questions 1 and 2, there have been recurring problems and consumer losses due to the collapses of tax driven managed investment schemes. These highlight that more fundamental structural reforms may be required to address the weakness in the current regulatory regime. These issues are clearly analysed in the Corporations and Markets Advisory Committee (CAMAC) Report.¹⁰¹ We note that the Murray Inquiry supported the Government’s review of the CAMAC’s recommendations on managed investments schemes.¹⁰²
- 129 Finally, we note above that in some cases market competition has not been effective in delivering good outcomes for consumers or addressing persistent poor outcomes in some sectors. Unlike the UK regime, ASIC does not have a role in making sure markets

⁹⁸ s912A(1)(a) *Corporations Act 2001*

⁹⁹ Financial Conduct Authority, fair treatment of customers: <https://www.fca.org.uk/firms/fair-treatment-customers> See FCA Handbook Principle 2.1.1 <https://www.handbook.fca.org.uk/handbook/PRIN/2/1.html>

¹⁰⁰ Monetary Authority of Singapore (Financial Advisers Act- CAP 110)- Guidelines on fair dealing: board and senior management responsibilities for delivering fair dealing outcomes to customers: http://www.mas.gov.sg/~media/resource/legislation_guidelines/fin_advisers/fin_advisers_act/guidelines/Guidelines%20on%20Fair%20Dealing.ashx

¹⁰¹ *Corporations and Markets Advisory Committee (CAMAC) 2012, Managed investment schemes, CAMAC, Sydney*

¹⁰² *Financial System Inquiry- Final Report*, page 273

work effectively to promote competition in ways that support good consumer outcomes.¹⁰³ The Murray Inquiry recommended that such a role be considered for ASIC and we support this approach in our submission to that Inquiry.¹⁰⁴

Effective mechanisms for redress available to consumers of financial services

- 130 In question 3 (c) the Commission has asked for views about effective mechanisms for redress. We have set out in the earlier sections of our response the role that FOS currently plays as an alternative dispute resolution scheme covering about 83 per cent of all disputes by consumers and small businesses of the current three financial sector schemes. We have also set out our role in the current reforms by the government to establish a new single scheme for the financial sector with increased jurisdictional limits for both consumers and small business. We briefly comment on these issues below.
- 131 There have been a number of reviews over recent years that have looked at the effectiveness of redress mechanisms for consumers of financial services who suffer detriment as a result of FSP conduct and practices.¹⁰⁵ These include the reviews by Productivity Commission, the Murray Inquiry and various Parliamentary Committee Reviews.
- 132 Most recently, the current EDR and complaints framework was comprehensively reviewed by the Ramsay Review. While the Ramsay Review made a number of recommendations for enhancements, it concluded that:

*“... the existing industry ombudsman schemes are a cornerstone of the EDR framework and perform well against the Review’s core principles”.*¹⁰⁶

- 133 Importantly, consumer representatives in their submission to the Ramsay review, stated

*Our organisations have supported and represented thousands of consumers in disputes with banks and financial services providers over many years. We strongly believe that, in providing access to justice, the establishment of these schemes [FOS and CIO] has been one of the most significant advances in consumer protection of the past 20 years. Without industry ombudsman schemes, hundreds of thousands of people would have been left with no avenue for redress other than courts or, more likely (due to cost and other access barriers) would have been left with nowhere to turn.*¹⁰⁷

The current mechanisms for consumer redress can be enhanced

- 134 The Ramsay Review supported a number of enhancements to the current EDR and complaints framework, among them the consolidation of existing EDR schemes in the financial sector into a new single scheme and the expansion of the small business and consumer jurisdictional limits.¹⁰⁸
- 135 The Government has adopted the Ramsay Review’s recommendations for increased jurisdictional limits and compensation caps for consumers and small businesses. The

¹⁰³ [Financial System Inquiry- Final Report](https://www.fca.org.uk/publication/corporate/our-mission-2017.pdf#page=7), page 235; see also UK FCA: <https://www.fca.org.uk/publication/corporate/fca-approach-advancing-objectives-2015.pdf> and <https://www.fca.org.uk/about/promoting-competition>

¹⁰⁴ [Financial System Inquiry- Final Report](https://www.fca.org.uk/publication/corporate/our-mission-2017.pdf#page=7), page 235

¹⁰⁵ [Richard St John Review- compensation arrangements for consumer of financial services](#), [Financial System Inquiry](#), [Review of the financial system external dispute resolution framework](#).

¹⁰⁶ [Review of the financial system external dispute resolution and complaints framework](#), Interim Report 6 December 2016

¹⁰⁷ [Joint consumer submission to the Review into dispute resolution and complaints framework issues paper, 10 October 2016](#)

¹⁰⁸ [Review of the financial system external dispute resolution and complaints framework, Final Report April 2017](#)

new single scheme will have a consumer monetary limit of \$1 million and a compensation cap of \$500,000 which is a significant increase on existing limits. Moreover, for credit facility disputes, small businesses will be able to bring a claim where a small business credit facility is up to \$5 million and the single EDR body will be able to award compensation of up to \$1 million.

Compensation scheme of last resort

- 136 One of the gaps in the current redress mechanism for the financial sector is the lack of an effective mechanism to deal with the issue of unpaid EDR determinations.
- 137 The Ramsay Review was asked by Government to make recommendations on the establishment, merits and potential design of a compensation scheme of last resort (CSLR) and to consider the merits and issues involved in providing access to redress for past disputes.
- 138 In its final supplementary report¹⁰⁹ released in December 2017, the Ramsay Review recommended that a CSLR should be established and should be limited and carefully targeted at the areas of the financial sector with the greatest evidence of need. Further, it recommended that the CSLR should apply to unpaid EDR determinations, court judgements and tribunal awards which are made after the CSLR is established. The Ramsay Review also considered that there was a strong case for payment of legacy unpaid EDR determinations, which in the case of FOS stands at around \$14 million (excluding interest).
- 139 FOS has been a long standing proponent of a CSLR.¹¹⁰ The Ramsay Review clearly sets out the case for such a scheme and a proposed design. The CSLR recommended by the Ramsay Review in its report is narrower than the one proposed by FOS. However, we consider the analysis and proposals in its report provide a strong basis to build upon to quickly progress this important reform to address the gap in the current financial sector redress mechanisms.

Phoenix activity

- 140 A related issue is the impact of phoenix activity as a key reason why consumers are not being paid compensation that has been awarded to them. In addition to a CSLR, FOS supports enhancements to ASIC's powers to more effectively deal with various forms of phoenix activity.¹¹¹
- 141 Much of this activity additionally exposes gaps in the current effectiveness of the requirement for licensees to have adequate compensation arrangements in place. We would support initiatives to review the requirement for licensees to have adequate compensation arrangements and their heavy reliance on professional indemnity to meet this requirement.

¹⁰⁹ [Supplementary Final Report](#), review of the financial system external dispute resolution and complaints framework September 2017.

¹¹⁰ Summary of [FOS submissions](#) - Compensation Scheme of Last Resort.

¹¹¹ FOS has previously provided an example of phoenix activity in its [submission](#) to the Inquiry into Future of Financial Advice legislation.

Access for vulnerable and disadvantaged consumers

- 142 A key principle of EDR is that the scheme should be accessible to all consumers of financial products in Australia. Such access is easier for those in our community who are financially literate, are connected to services and information through the internet, and have the knowledge and resources to seek out external dispute resolution if they have a problem with their financial services provider. We are aware, however, that vulnerable and disadvantaged consumers often have difficulties knowing about and seeking assistance from an EDR scheme.
- 143 FOS works with a range of community organisations that assist FOS in the resolution of disputes by advising consumers about how best to resolve their problems. Financial counsellors and specialist community legal services help connect vulnerable and disadvantaged members of the community to EDR schemes such as FOS, and to other important support services where needed.
- 144 Without the support provided by community-based financial counselling and specialist community legal services, many consumers would have little or no opportunity for redress to help sort out their often complex and multi-faceted problems they face. We support initiatives to ensure sustainable funding for these organisations as an important element in ensuring consumers do have access to effective redress in the financial system when they suffer detriment.

Debt management firms

- 145 FOS, consumer groups and the Ramsay Review have identified the absence of debt management firms being required to be members of an EDR scheme as a gap in the current framework (for consumers of services these firms provide). The Ramsay Review recommended, and we agree, that debt management firms should be required to be members of the new single scheme to provide appropriate redress mechanisms for consumers of these services.