



InsuranceLegalUpdate

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Proposed changes to the Financial Ombudsman Service (FOS) terms of reference

Background

FOS is one of the three external dispute resolution (EDR) schemes approved by ASIC under Chapter 7 of the Corporations Act 2001 (Cth) (the Corporations Act) and provides EDR services for up to 80% of Australian banking, insurance and investment disputes.

It commenced on 1 July 2008 merging the:

- Banking and Financial Services Ombudsman Limited (BFSO);
- Financial Industry Complaints Service Limited (FICS); and
- Insurance Ombudsman Service Limited (IOS),

and from 1 January 2009:

- Insurance Brokers Disputes Limited (IBDL); and
- Credit Union Dispute Resolution Centre Pty Limited (CUDRC).

FOS currently operates the rules and procedures of the merged schemes and is proposing to implement a single set of FOS Terms of Reference (TOR) for all members by 1 January 2010.

Based on an Issues Paper and consultation on exposure drafts of the proposed single TOR, the FOS Board settled a version of the TOR on 30 May 2009 for submission to ASIC for approval under Regulatory Guide 139 (revised version of RG 139 issued 18 May 2009).

This paper summarises some of the key features of the proposed TOR and certain issues that arise for Financial Service Provider members (FSPs).

General overview of FOS

The purpose of FOS is to act as an independent forum to resolve disputes between applicants and FSPs in a cooperative, efficient, timely and fair manner, with a minimum of formality and technicality. A dispute is an expression of dissatisfaction with a FSP.

It is free of charge for applicants but the costs of the service will be met by the FSP (subject to certain limitations).

The TOR sets out who is eligible to lodge a dispute (essentially individuals and small businesses), the types of disputes that FOS can consider (e.g. claims in excess of \$500,000 are not covered), how FOS resolves disputes (by negotiation, conciliation, mediation and ultimately determination), the types of remedies that FOS can provide (these are very broad but award caps apply) and other related matters.

The TOR are binding upon FSPs but not the consumer unless they agree.

Operational Guidelines are yet to be provided (expected to commence in late July 2009 after consultation with members) which are to assist with the understanding of the TOR and to provide further detail as to how FOS will resolve disputes. Concern has been expressed that too much is being left to be covered in the Guidelines.

Eligibility of applicants (see TOR paragraph 4.1)

Eligibility of applicants is limited to an individual (whether a trustee, legal personal representative or otherwise), a defined Small Business as well as a partnership, corporate trustee of a self managed superannuation fund or a family trust, club or incorporated association and body corporate of a strata title or company title building which is wholly occupied for residential or Small Business purposes. Where the above entities carry on a business it must be a Small Business.

A "Small Business" is defined as a business that, at the time of the act or omission by the FSP that gave rise to the dispute, if the business is or includes the manufacture of goods - it had less than 100 employees; or otherwise - it had less than 20 employees.

Types of disputes that can be considered by FOS (see TOR paragraph 4.2)

A dispute must meet the jurisdictional test i.e. it must arise from a contract or obligation arising under Australian law.

It must also arise from or relate to one of the following:

- the provision of a Financial Service by the FSP to the applicant.

The definition of "Financial Service" in the TOR is much broader than the same definition in the *Corporations Act* and covers disputes with persons who are provided with products and services not covered by the Act.

It is defined to mean "a product or service that is financial in nature including a product or service which is or is in connection with..." "certain matters such as a loan or any other kind of credit transaction, a deposit, an insurance contract, a financial investment, a facility under which a person seeks to manage financial risk, non cash payment facilities, leasing and hire purchase arrangements, or financial or investment advice. It also includes a custodial service;

- the provision by the applicant of a guarantee or security for, or repayment of, financial accommodation provided by the FSP to an eligible applicant;
- an entitlement or benefit under a Life Insurance Contract by a person who is specified or referred to in the Life Insurance Contract, whether by name or otherwise, as a person to whom the insurance cover extends or to whom money becomes payable under the Life Insurance Contract;

A Life Insurance Contract is defined very broadly to include any product or service offered by a life insurance company;

- an entitlement or benefit under a General Insurance Policy (as defined in the Insurance Contracts Act 1984 (Cth) (Insurance Contracts Act)) by a person who is specified or referred to in the policy contract, whether by name, class of persons or otherwise, as a person to whom the policy extends.

This covers section 48-type beneficiaries;

- a legal or beneficial interest arising out of:
 - a financial investment (such as life insurance, a security or an interest in a managed investment scheme or a superannuation fund); or
 - a facility under which a person seeks to manage financial risk (e.g discretionary mutual fund or extended warranty) or to avoid or limit the financial consequences of fluctuations in, or in the value of, an asset, receipts or costs (such as a derivatives contract);
- a claim under another person's motor vehicle insurance policy for property damage to an Uninsured Motor Vehicle caused by a driver of the insured motor vehicle – but only where a valid claim has been lodged by the owner of the insured motor vehicle and any relevant excess has been paid unless the claim is being made pursuant to section 51 of the Insurance Contracts Act; or

- where the FSP is a mutual – the provision of a Financial Service by a third party through the agency of the mutual to a customer of the mutual; and
- if the FSP is a member at the time that the applicant lodged the dispute with FOS (even if not a member at the time of the events giving rise to the dispute). This may give rise to some professional indemnity issues for members.

Even if all of the above criteria are met, the dispute must still otherwise be within the jurisdiction of FOS under the TOR and meet all other TOR requirements.

General insurance product limitation (See TOR paragraph 4.3)

A special general insurance limitation applies that is similar to the current insurers' TOR.

FOS may only consider a dispute in relation to a General Insurance Policy that is one of the following defined types:

- Retail General Insurance Policy;
- Residential Strata Title Insurance Product;
- Small Business Insurance Product;
- Medical Indemnity Insurance Product.

The main concern is that the definition of "Small Business Insurance Product" has a different meaning depending on whether the dispute is with an insurance broker or not.

For insurance broker disputes any General Insurance Policy covered by the Corporations Act is caught.

For other types of disputes the definition broadens the scope of the current insurer TOR (e.g. it removes the "claims dispute" and "non claims dispute" distinction and the Small Business definition is broader).

This distinction, and the fact that an insurance broker is not defined, is likely to cause confusion and argument.

Consideration of other disputes by agreement (see TOR paragraph 4.4)

FOS may also consider a dispute where all parties and FOS agree.

Disputes outside the scope of FOS (see TOR paragraph 5.1)

Even if the above criteria are met, FOS may not consider a dispute in certain specified circumstances, such as where the dispute has been dealt with by a court. New exceptions have been introduced to take account of the changed TOR. For example, because of the breadth of the type of disputes allowed and concerns expressed about privacy disputes, the TOR include a limited exception to deal with this issue. FOS has also restricted disputes to those where the value of the applicant's claim does not exceed \$500,000 and excluded disputes where the applicant is part of a group of related bodies corporate and that group has in excess of 20 employees (or 100 employees in the case of a manufacturing group).

Discretion to exclude disputes (See TOR paragraph 5.2)

FOS may also at its discretion refuse to consider, or continue to consider, a dispute if FOS considers this course of action appropriate. A number of examples are provided that will be familiar (e.g. frivolous or vexatious) and others added to take account of the new breadth of the TOR (e.g. there is a more appropriate place to deal with the dispute, such as the Privacy Commissioner).

Where FOS believes the TOR do not apply to a dispute, or exercises a discretion to decline involvement, the applicant can ask for a review but there is no equivalent right in the TOR for a FSP.

Transition disputes

For disputes lodged with FOS or transferred to FOS by a predecessor scheme before 1/1/2010:

- If FOS had not closed the matter by 1/1/2010, the TOR that applied at the time the dispute was originally lodged will apply;
- If FOS had closed the matter by 1/1/2010 and FOS decides it is appropriate to reopen the dispute, the TOR previously applied will apply.

For disputes lodged with FOS between 1/1/2010 and 31/12/2011 specified limits apply to the claim as specified in Schedule 1 of the TOR (see further below).

The aim was to match existing limits to avoid issues with professional indemnity insurance limits

applicable to EDR scheme decisions but this does not appear to have been achieved in all cases.

For disputes lodged with FOS on or after 1/1/2012 the new TOR apply.

Members will need to carefully consider whether cover under their professional indemnity policies (past and present) will be sufficient having regard to these transition arrangements and the new definitions used in the TOR. Circumstances notified under past policies with terms inconsistent with the new award limits can cause problems.

Time limits (see TOR paragraph 6.2)

FOS will not consider a dispute unless the dispute is lodged with FOS:

- within six years of the date when the applicant first became aware (or should reasonably have become aware) that they suffered a loss; and
- where, prior to lodging the dispute with FOS, the applicant received an IDR Response in relation to the dispute from the FSP – within two years of the date of that IDR Response.

Test cases (see TOR paragraph 10)

If a FSP wishes a dispute to be treated as a test case it can do so by following the procedures set out in the TOR but must make undertakings regarding certain matters such as the payment of the applicant's costs and disbursements (if not otherwise agreed, on a solicitor and own client basis).

Dispute resolution methods and related matters (see TOR Section C)

The process starts when an applicant, or member with the applicant's consent, lodges a dispute with FOS.

Assuming the eligibility criteria referred to above are met the process essentially works as follows:

Where a dispute is lodged:

- before the applicant has complained to the FSP; or
- within 45 days of the applicant first requesting the FSP to remedy the matter but before receipt of the FSP's IDR Response,

FOS must notify the FSP of the dispute and give the FSP 45 days or, the balance of the 45 day period respectively, to provide an IDR Response.

A longer period can be given if special circumstances exist.

FOS can however circumvent the IDR process and commence investigating or otherwise progressing the dispute immediately if FOS considers the matter urgent.

A dispute is resolved by negotiation, conciliation or mediation (this results in a recommendation) or the determination process.

FOS has wide powers and can require a party to:

- provide to, or procure for, FOS any information that FOS considers necessary subject to certain exclusions (e.g. where to provide information would

breach a duty of confidentiality to a third party, breach a Court order or prejudice a current investigation by the police or other law enforcement agency, or the information does not or no longer exists);

- do anything else that FOS considers may assist FOS' consideration of the dispute (e.g. interviews, appointment of an expert to report to FOS).

A failure to comply without reasonable excuse by an applicant can allow FOS to stop the process. A failure by either party allows FOS to draw an adverse inference from the failure, and continue.

FOS is expressed to operate on a "without prejudice" basis so information obtained through FOS may not be used in any subsequent court proceedings unless required by an appropriate court process.

FOS is not bound by any legal rule of evidence and subject to this, when deciding a dispute and appropriate remedy, FOS will do what in its opinion is fair in all the circumstances, having regard to each of the following:

- legal principles;
- applicable industry codes or guidance as to practice;
- good industry practice; and
- previous relevant decisions of FOS or a Predecessor Scheme (although FOS will not be bound by these).

Industry has expressed concern with the failure to specifically acknowledge the need to consider concepts such as contributory negligence and proportionate liability.

Whether the concept of "legal principles" will be sufficient remains to be seen.

FOS may consult with industry and consumer advisors and obtain expert advice (e.g. legal) as it thinks appropriate. It can require the FSP to pay for the expert's costs subject to certain qualifications (e.g. they must be reasonable having regard to the complexity of the dispute) and unless exceptional circumstances apply, a FSP would not have to pay more than \$3,000 per dispute.

The parties get a reasonable opportunity to make submissions and FOS then makes a written recommendation which, if accepted by the parties within 30 days of receipt, ends the dispute. However, if FOS considers it would be appropriate in the circumstances the dispute can go straight to a determination.

If the parties do not agree, FOS will proceed to make a written determination by either an Ombudsman or by a FOS Panel (as the Chief Ombudsman (essentially the manager of FOS elected by the FOS Board) or his or her delegate decides is appropriate).

Panels are made up of an ombudsman, a consumer representative, a medical representative (applicable only to medical indemnity disputes) or an industry representative.

Before a determination is made, the parties will be given a reasonable opportunity to make submissions, and provide any further information,

in response to the recommendation issued before the determination process began.

Before making a determination, FOS must provide the parties with access to the documentation, information and material upon which FOS proposes to rely in making it, subject to certain exclusions.

Despite the "without prejudice" protection, this process will be a useful intelligence tool.

A party can refuse to consent to this but must do so expressly and FOS is not entitled to use such information to reach a decision adverse to the party to whom the information is denied, unless FOS determines special circumstances apply.

A determination is binding upon the FSP if the applicant accepts it within 30 days of receiving the determination. It is not binding on the applicant.

An applicant accepting a recommendation or determination must provide the FSP with a binding release in respect of the matters resolved and for the full value of the claim the subject of the dispute, even if this exceeds the amount of the FOS remedy.

Types of remedies (see TOR paragraph 9)

FOS' remedy powers are very broad:

- it may decide that the FSP "undertake a course of action to resolve the dispute" including specified matters such as the payment of a sum of money, the forgiveness or variation of a debt

or the meeting of a claim under an insurance contract by, for example, repairing, reinstating or replacing items of property;

- it may decide that the FSP compensate the applicant for direct financial loss or damage; and
- it may award compensation to an applicant for consequential financial loss or damage or non-financial loss (subject to certain qualifications) up to \$3,000 per claim made in the dispute. No such award can be made for a dispute arising as a result of a claim on a General Insurance Policy that expressly excludes such liability.

An award cap applies to all of the above depending on the type of dispute which is summarised below.

FOS may also require the FSP to pay the following in addition to any award cap:

- legal or other professional costs or travel costs incurred by the applicant in the course of the dispute up to a limit of \$3,000 unless exceptional circumstances apply; and
- interest on a payment to be made by the FSP to the applicant calculated differently depending on the circumstances (e.g if the Insurance Contracts Act applies FOS will calculate interest in accordance with that Act).

Punitive, exemplary or aggravated damages may not be awarded.

Award caps

These differ according to the circumstances.

Disputes first lodged with FOS or with a predecessor scheme before 1/1/2010 are subject to the old terms and limits that applied at the time.

The following summarises the award limits for the other types of dispute:

Type of claim	New disputes with FOS between 1/1/2010 and 31/12/2011 (see TOR paragraph 3.2 and Schedule 1)	Dispute lodged on or after 1/1/2012 (see TOR paragraph 3.3 and Schedule 2) FOS has the power to adjust these periodically if it considers it appropriate. The limits will also be adjusted on 1/1/2015 and every three years thereafter.
Life Insurance Contract Claims - income stream risk or advice on contract. But – if claim is in excess of limit and total amount payable is calculable by reference to expiry date and/or age of insured and is less than “other” limit below the “other” limit applies.	\$6,000 per month	same
Third party claim on General Insurance Policy covering property loss or damage caused by or resulting from impact of motor vehicle	\$3,000	same
Managed investment, stock broking securities or derivative or financial planning (excluding advice re Life Insurance Contracts) claims	\$150,000	Now in other i.e. \$280,000
Claims relating to the provision only of insurance broking services	\$100,000	\$150,000
Other	\$280,000	same

Restrictions on FSPs regarding litigation and other matters (see TOR Section E)

Restrictions are imposed on FSPs regarding the instigation of legal proceedings against an applicant, the continuance of existing proceedings and debt recovery while FOS is dealing with the dispute.

Restrictions are also imposed regarding a dispute resolved in favour of the applicant, the terms of which are agreed to by the applicant and a FSP cannot instigate a defamation action against an applicant in respect of allegations made to FOS.

FOS Reporting Obligations (see TOR Section D)

FOS' reporting obligations are very broad. It may provide reports and recommendations and release information about a FSP to:

- any regulator such as ASIC, the Privacy Commissioner or a regulated securities exchange; or
- a disciplinary body with which FOS has a written agreement for the release of such information.

FOS *must*:

- identify systemic issues (i.e. an issue that will have an effect on other persons who would be eligible under the TOR) and refer these to the FSP for remedial action which the FSP must

report on and comply with to the satisfaction of FOS.

- report systemic issues to ASIC in accordance with its obligations under ASIC Regulatory Guide 139.
- report all serious misconduct (i.e. fraudulent, grossly negligent conduct or wilful breaches of applicable laws or obligations under the TOR) to ASIC.
- collect and record comprehensive information pertaining to its dispute resolution, including details of the relevant FSP involved.
- produce a report at least every twelve months for publication and provision to ASIC, the FSPs and the public. This report must be a comprehensive summary and analysis of the data collected. Of most concern to FSPs is the fact that it must include the statistical information about each FSP such as the number of disputes referred to FOS, the number closed and the outcome.

Change to Terms of Reference

The FOS Board may amend the TOR from time to time following consultation with ASIC, the Members and other stakeholders including key consumer, community and industry organisations.

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