

NewsFlash

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Overview of the new Financial Ombudsman Service (FOS) Terms of Reference (TOR)

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

After a long period of consultation a new single set of TOR has been approved by ASIC and FOS.

The new TOR apply from 1 January 2010 to disputes lodged after that date and replace the separate TOR that previously applied to the different industry sectors.

Licensees that belong to FOS (called Financial Service Provider members (FSPs) in the TOR) need to ensure that their current arrangements take into account the new TOR which are different in many respects to the old TOR that applied to each industry sector.

This paper summarises some of the key features of the new TOR and certain issues that arise for 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 co-operative, efficient, timely and fair manner, with a minimum of formality and technicality. A dispute is simply an expression of dissatisfaction with a FSP.

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

The TOR set 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, recommendation 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 applicants unless they agree to be bound.

Operational Guidelines have been provided which assist with the interpretation of the TOR and provide further detail as to how FOS will resolve disputes. These Guidelines will be updated from time to time to address any issues with the new TOR as they arise.

Eligibility of applicants (see TOR paragraph 4.1)

Eligibility of applicants is limited to:

- individual(s) (including those acting as a trustee, legal personal representative or otherwise),
- a Small Business (whether a sole trader or constituted as a company, partnership, trust or otherwise),

- a body corporate of a strata title or company title building which is wholly occupied for residential or Small Business purposes,
- the policy holder of a group life or group general insurance policy where the dispute relates to the payment of benefits under that policy, and
- a partnership comprised of individuals, a corporate trustee of a self managed superannuation fund or a family trust and a club or incorporated association (if any of these is carrying on a business, the business 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, had less than 100 employees if the business is or includes the manufacture of goods, or otherwise, 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 policy, 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 Policy by a person who is specified or referred to in the policy, whether by name or otherwise, as a person to whom the insurance cover extends or to whom money becomes payable under the policy.

A Life Insurance Policy 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)) by a person who is specified or referred to in the policy contract, whether by name 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.

The FSP needs to have been 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) for FOS' jurisdiction to be invoked. This may give rise to some professional indemnity issues for FSPs.

Even if all of the above criteria are met, the dispute must still meet the other jurisdictional requirements

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 old General Insurance 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.

It is important to note that the definition of "Retail General Insurance Policy" and "Small Business Insurance Product" have different meanings depending on whether the dispute is with a General Insurance Broker or not.

A General Insurance Broker is defined as an FSP whose licence has a condition authorising them to assume or use the expression "insurance broker", "insurance broking" or "general insurance broker" in relation to general insurance products.

For disputes between any applicant (Small Business or not) and any FSP (General Insurance Broker or not), a "Retail General Insurance Policy" includes an insurance product specified in section 761G(5)(b) of the *Corporations Act* (ie retail client-type products).

For disputes between an applicant other than a Small Business and a General Insurance Broker, if the dispute pertains to a product that includes an insurance product specified in section 761G(5)(b) of the *Corporations Act*, the definition of a "Retail General Insurance Policy" also includes any other insurance cover provided by that product, with the exception of cover under a product that is not a financial product for the purposes of Part 7.1 Division 3 of the *Corporations Act*.

For disputes between a Small Business and a General Insurance Broker, a "Small Business Insurance Product" is limited to an insurance product specified in section 761G(5)(b) of the *Corporations Act* that is a financial product for the purposes of Part 7.1 Division 3 of that Act.

For disputes between a Small Business and an FSP other than a General Insurance Broker, a "Small Business Insurance Product" is a policy or part of a policy that provides insurance cover (whether or not the cover is limited or restricted in any way) in respect of specified types of insurance substantially the same as under the old FOS General Insurance TOR.

The new TOR do however broaden the scope of the previous insurer TOR (e.g. they remove the "claims dispute" and "non-claims dispute" distinction and the new "Small Business" definition is broader).

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

FOS may consider a dispute that would otherwise be excluded by the TOR 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. where

claims are frivolous or vexatious) and others added to take account of the new breadth of the TOR (e.g. where 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 consideration of it, the applicant can ask for a review. An FSP has no equivalent right.

Transition arrangements

For disputes lodged with FOS or transferred to FOS by a Predecessor Scheme before 1 January 2010:

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

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

It was intended that the new TOR would match existing limits to avoid issues with professional indemnity insurance limits applicable to EDR scheme decisions. This does not appear to have been achieved in all cases.

For disputes lodged with FOS on or after 1 January 2012 the new TOR apply. Award limits apply to such disputes as specified in Schedule 2 of the TOR (see further below).

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 before the earlier of the following time limits:

- 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.

It is important to note that "IDR Reponse" is a defined term and FSPs need to provide a response in compliance with this definition to be able to rely on the second limitation period.

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 institution of proceedings within six months of having notified FOS and 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 FSP 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.

FOS has a discretion to choose, in order to resolve the dispute, from one or more of negotiation, conciliation/mediation or recommendation. If, for example, negotiation is chosen and subsequently fails, conciliation/

mediation could be attempted or a recommendation could be made.

Negotiation involves a FOS officer, ordinarily a case manager, informally liaising between the parties one by one in an attempt to persuade them to reach agreement as to the outcome of the dispute.

Conciliation/mediation involves a meeting between the parties, usually by way of teleconference, led by a FOS officer who acts as conciliator/mediator.

In the recommendation process, the parties are given 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 (see below).

If the parties do not agree to the recommendation, FOS will proceed to make a written determination by either an Ombudsman or a FOS Panel, as the Chief Ombudsman or his or her delegate decides.

Panels are made up of an Ombudsman, a consumer representative, a medical representative (for medical indemnity disputes only) 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 (if any) issued before the determination process began.

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

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, if the FSP so requests, 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.

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 or the appointment of an expert to report to FOS).

A failure by a party to comply without reasonable excuse can allow FOS to stop the process and/or draw an adverse inference from the failure and continue with its consideration of the dispute.

FOS operates on a "without prejudice" basis meaning that information obtained through FOS may not be used in any subsequent court proceedings unless required by an appropriate court process.

Despite the "without prejudice" protection, this process would be a useful intelligence tool. For example, the knowledge of one party to a dispute of the existence of information pertaining to that dispute may allow that party to know what to look for in discovery if the matter went to court.

A party can refuse to consent to the other party having access to their information 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.

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.

While FOS must have regard to each of the items listed above, it is not strictly bound by any individual item. For example, the Operational Guidelines state that FOS may decide that an FSP should have met

a higher standard of conduct than the minimum industry standard set in a particular industry code.

It is also important to note that FOS is not bound by any legal rule of evidence.

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 be required to pay more than \$3,000 per dispute.

Types of remedies (see TOR paragraph 9)

FOS' remedial 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 (defined as "indirect 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. Changes have been made to the previous draft TOR in relation to caps applicable to General Insurance Brokers.

Disputes first lodged with FOS or with a predecessor scheme before 1 January 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 lodged between 1 January 2010 and 31 December 2011 (see TOR paragraph 3.2 and Schedule 1)	Disputes lodged on or after 1 January 2012 (see TOR paragraph 3.3 and Schedule 2)
<p>Claim on a Life Insurance Policy or a General Insurance Policy dealing with income stream risk or advice about such a contract.</p> <p>But—if the claim is in excess of the monthly limit and (1) the total amount payable under the policy can be calculated with certainty by reference to the expiry date of the policy and/or age of insured and (2) is less than the “other” limit (see last row, below) the “other” limit applies.</p>	\$6,700 per month	\$7,500 per month
<p>Third party claim on a General Insurance Policy providing cover in respect of property loss or damage caused by or resulting from impact of a motor vehicle.</p>	\$3,000	\$3,000
<p>Managed investments claims, stockbroking claims, claims made in relation to securities and any derivative products and financial planning claims (other than advice pertaining to a Life Insurance Policy).</p>	\$150,000	Now in other, i.e. \$280,000
<p>Claims against a General Insurance Broker except where the claim solely concerns its conduct in relation to a Life Insurance Policy.</p>	\$100,000	\$150,000
<p>Other</p>	\$280,000	\$280,000

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, but is not obliged to 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 *is* obliged to do the following:

- 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, and
- 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.

Changes to the TOR

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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