FINANCIAL OMBUDSMAN SERVICE AUSTRALIA

Financial Ombudsman Service Limited
ABN 67 131 124 448
GPO Box 3, Melbourne VIC 3001
T 1800 367 287
F 03 9613 6399
E info@fos.org.au
W www.fos.org.au

3 December 2015

Mr Percy Bell
Corporations and Schemes Unit
Financial System and Services Division
The Treasury
100 Market Street
Sydney NSW 2000

Dear Mr Bell

Proposed industry funding model for ASIC

1. Issue of unpaid compensation

The present review of ASIC's funding provides an opportunity to address the continuing issue of unpaid FOS determinations. While this issue was identified as a pressing issue in the interim report of the Financial System Inquiry (FSI), unfortunately, the issue was left unaddressed in the final report.

FOS submissions to the FSI and other recent inquiries explain the nature and scale of the problem and our detailed proposals for a last resort compensation scheme to address the problem of unpaid FOS determinations.

The most recent edition of *The FOS Circular*, released in October 2015, indicates the scale of the issue of unpaid FOS compensation. It provides the following statistics.

- From 1 January 2010 to 30 September 2015, 33 financial services providers were unwilling or unable to comply with 133 determinations made by FOS in favour of consumers.
- The value of the outstanding amounts awarded by these determinations was $12,564,735.82 plus interest as at 30 September 2015.
- Including interest and adjusting for inflation, the real value of this uncompensated loss was $16,592,456.55.

2. Broad acceptance of importance of addressing unpaid compensation issue

There appears to be general agreement by participants in the financial sector industry, consumer organisations and ASIC that the issue of unpaid FOS determinations of compensation is a problem that needs to be addressed.[1] FOS

[1] For example, see:

- Pages 3-83 to 3-86 of the Financial System Inquiry Interim Report, July 2014 regards this as the missing element in the current package of reforms to lift standards and professionalise the financial advice sector.

3. Challenge in getting broad agreement on the design of a funding mechanism

On 1 June 2015, we released an updated proposal to establish a compensation scheme of last resort. This proposal is designed to reduce the costs involved in the establishment and operation of a compensation scheme and address any concerns about the potential for moral hazard.

Illustrative modelling produced on behalf of FOS at various times has shown the costs of a scheme should be modest.[2] However, it has been a challenge to gain agreement, from industry participants, on the basis of contributions by firms and sectors under the arrangements.

4. How the ASIC levy addresses the design of an appropriate funding mechanism

We consider that the funding issue could be efficiently and appropriately addressed by including a mechanism for funding of a last resort compensation scheme as part of the proposed industry funding model for ASIC (ASIC Funding Model).

If the ASIC Funding Model is adopted, ASIC will collect levies from its regulated population. It will divide industry sectors into subsectors and introduce tiering to allow levies to reflect different levels of supervision required. Accordingly, it will use detailed industry data and have a well-developed methodology and administrative mechanisms in place for the calculation and collection of a regulatory levy.

This structure could be used as the basis for arrangements to fund a last resort compensation scheme. Levies to fund the scheme could be simple additions to levies to be collected under the proposed ASIC Funding Model. The amount of the additional levies could be calculated by reference to the tiering structure under that model.

The ASIC Funding Model provides for annual consultation on proposed levy mechanisms and for a comprehensive review of the model every five years. The ASIC Funding Model also permits levies to be adjusted where necessary.

- ASIC's submission in August 2014 to the FSI
- ASIC's submission in December 2014 to the Inquiry into the Scrutiny of Financial Advice being conducted at present by the Senate Economics References Committee (Submission 88)– particularly paragraph 237
- The joint submission in May 2015 by 7 consumer organisations to the current Inquiry into the Scrutiny of Financial Advice (Submission 125)

[2] Cost estimates calculated for different scheme models are set out in section 5.3 of the updated proposal to establish a compensation scheme released by FOS on 1 June 2015. The estimates were produced by Professional Financial Services Pty Ltd in 2009 and Grant Thornton in 2014.

Given the flexibility of the model, its ability to take account of stakeholder feedback and its provisions for regular reviews, the model has inbuilt mechanisms relevant to the funding of a compensation scheme. These features would ensure that funding for the compensation scheme was adequate, the distribution of funding across sectors was appropriate and the administration of the scheme was cost effective.

5. Similar industry-wide arrangements funded by levy arrangements

Funding through a levy collected by ASIC would be consistent with the approach adopted for other industry-wide arrangements in Australia such as the Superannuation Complaints Tribunal (SCT) and the Companies Auditors and Liquidators Disciplinary Board (CALDB).

The Financial Services Compensation Scheme in the United Kingdom, which is designed to reduce gaps in consumer protection, provides a possible model for an Australian compensation scheme. The United Kingdom scheme is funded under the framework for regulatory levies in that jurisdiction.

6. Further information

If we can assist by discussing issues, or providing further information, please do not hesitate to contact us. Our contact for this matter is our Policy & Liaison Adviser, Carolyn Bruns at cbruns@fos.org.au or on (03) 9613 7389.

Yours sincerely

Shane Tregillis
Chief Ombudsman
Financial Ombudsman Service