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1 July 2008

Financial Services and Credit Reform Green Paper
Corporations and Financial Services Division
Treasury
Langton Crescent
PARKES ACT 2600

By fax: (02) 6263 2770

Dear Sir or Madam

**GREEN PAPER:
FINANCIAL SERVICES AND CREDIT REFORM**

Comments by Financial Ombudsman Service Limited ("FOS")

Introduction

1. This letter sets out comments made by FOS on the proposals in the Green Paper *Financial Services and Credit Reform: Improving, Simplifying and Standardising Financial Services and Credit Regulation* (June 2008). The comments have been prepared by the office of FOS and do not necessarily represent the views of the board of FOS.

Information about FOS

2. FOS is an independent dispute resolution scheme that has been formed through the consolidation of three schemes – the Banking and Financial Services Ombudsman ("BFSO"), the Financial Industry Complaints Service ("FICS") and the Insurance Ombudsman Service ("IOS"). FOS is approved as an external dispute resolution ("EDR") scheme by the Australian Securities and Investments Commission ("ASIC"). FOS commenced operations today.
3. Replacing the schemes previously operated by the BFSO, FICS and the IOS, FOS now provides free, fair and accessible dispute resolution for consumers unable to resolve disputes with financial services providers that are members of FOS. Membership of FOS is open to any financial services provider carrying on business in Australia including providers not required to join a dispute resolution scheme approved by ASIC.
4. It is estimated that FOS covers up to 80% of banking, insurance and investment disputes in Australia. As well as its functions in relation to dispute

resolution, FOS has powers to identify and resolve systemic issues and obligations to make certain reports to ASIC.

5. FOS is led by me as Chief Ombudsman and governed by an independent board of consumer representatives and financial services industry representatives.
6. The comments in this document draw on the experience of the BFSO and FICS in dealing with disputes concerning the products discussed in Chapters One to Six of the Green Paper.
7. The BFSO considered and sought to resolve disputes between Australian financial services providers that were members of the BFSO and their individual and small business customers. It was an alternative to litigation and free to individuals and small businesses. The BFSO's members included Australian banks and their related corporations, Australian subsidiaries of foreign banks, foreign banks with Australian operations and other Australian financial services providers.
8. FICS considered and sought to resolve disputes between consumers and members of the financial services industry relating to life insurance, managed investments, some friendly societies, financial advice, stock broking, investment advice and sales of financial or investment products. It was an alternative to litigation and free to consumers. Its members included life insurers, funds managers, friendly societies, stockbrokers, financial planners, pooled superannuation trusts, timeshare operators and other Australian financial services providers.

Executive summary

9. In broad terms, FOS supports the proposals to transfer responsibilities to the Commonwealth to eliminate problems such as inconsistencies, overlaps or gaps in the existing framework to regulate financial services and credit. FOS also supports the initiative to improve the regulation of debentures. As acknowledged in the Green Paper, more consideration may need to be given to certain areas in need of reform in order to develop or advance reform proposals.
10. FOS's comments on the proposals set out in the Green Paper may be summarised as follows:

Chapter One	FOS favours Option Two, which is to transfer responsibility for regulating all aspects of credit products to the Commonwealth.
Chapter Two	FOS favours Option One, which is to provide for consumer protection regulation in respect of trustee corporations pursuant to the <i>Corporations Act 2001</i> ("Corporations Act").
Chapter Three	FOS favours Option Two, which is to regulate margin loans as "financial products" pursuant to the <i>Corporations Act</i> .
Chapter Four	FOS generally supports the proposals in relation to debentures.
Chapter Five	FOS notes that the Green Paper does not present options for reform in regard to property spruikers.

Chapter Six FOS favours Option One, which is to transfer responsibility for regulating all aspects of credit products to the Commonwealth.

Mortgages, mortgage broking and non-deposit taking institutions

11. FOS agrees that responsibility for regulation of all aspects of mortgages should be transferred to the Commonwealth, for the reasons set out in the Green Paper. Accordingly, FOS does not favour Option One.
12. The Green Paper explains that transferring responsibilities for regulation of certain products from the States and Territories to the Commonwealth would result in significant benefits in respect of those products, including:
 - regulation under a single legislative regime, rather than a combination of legislative regimes;
 - regulation that is consistent throughout Australia; and
 - regulation under legislation that is not particularly difficult or slow to amend.
13. FOS is of the view that these benefits would also assist and promote the satisfactory resolution of disputes concerning those products, particularly in relation to the application of consistent regulations to credit related disputes, irrespective of where the disputant may reside.
14. Option Two involves transferring responsibilities for regulation of a broader range of products than Option Three. Based on this consideration, FOS prefers Option Two to Option Three.
15. We recognise that a two stage approach to reform may be required, however. A two stage approach would be to implement Option Three as soon as possible to enable the Commonwealth to take responsibility for regulation of all aspects of mortgages while further discussion and analysis is conducted to determine whether Option Two should be implemented.
16. The Green Paper indicates that Option Three would adopt the approach in Chapter 7 of the Corporations Act. It does not indicate what approach Option Two would adopt or whether that issue has been addressed. In FOS's view, consideration should be given to alternative models that could be followed under Options Two and Three. One alternative would be to enact Commonwealth legislation based on the Uniform Consumer Credit Code.
17. On pages 13 and 14 of the Green Paper, the following points are presented either as arguments against Option Two or arguments for Option Three:
 - Option Two would cause government and business to incur "significant transitional and ongoing costs";
 - It may not be appropriate to regulate all of the products referred to in the Green Paper as "other credit products" ("OCP") in the same way and on a national basis. It may be necessary, for example, to impose specific rules to take into account the characteristics of certain products or varied needs of consumers; and

- Under Option Three, States and Territories could continue to play a role in the regulation of OCP "where a local network and on the ground contacts are important considerations".
18. The Green Paper does not appear to provide any information to explain or support the first point regarding the costs of Option Two. To allow Options Two and Three to be more fully compared, we think that it would be helpful to have information to use to assess the following questions:
- Would the costs of Option Two be disproportionately greater than the costs of Option Three? If not, it seems that costs would not be a consideration against Option Two;
 - Would the costs of Option Two nevertheless be justified (as costs of improving regulatory arrangements)?
 - Have the savings to be achieved by adopting Option Two been taken into account?
19. The second point suggests that there may be a need for regional variations. In support of this, the Green Paper cites "difficulties in maintaining the uniform credit regime among states", on page 13, as "evidence" of regional differences that may need to be accounted for in the regulation of OCP. The difficulties in maintaining uniformity across the States and Territories may have arisen due to factors other than regional differences that may need to be taken into account in regulation. Such regional differences may not actually exist in the relatively homogenous credit market.
20. Even if there are some factors that justify different regulatory requirements, we do not believe that this makes uniform national regulation inappropriate. For example, ASIC could be empowered to grant exemptions, relief or modifications to allow national laws to be tailored to operate with variations where required and justified.
21. The third point relates to the States and Territories having a role to play because they are "on the ground". We cannot find any explanation of this point in the Green Paper. It appears to be an argument in favour of leaving regulatory responsibilities for OCP with the States and Territories. This would be inconsistent with the general thrust of the paper, and in our view, it is not a convincing reason for not transferring the responsibility for credit regulation to the Commonwealth. As we have seen with the regulation of other financial services, ASIC is able to have people "on the ground" in the various States and Territories and there is no reason why arrangements could not be put in place to ensure that local resources are available for the regulation of credit.
22. The Green Paper draws attention to the disadvantages of having some products subject to State and Territory regulation and other products subject only to Commonwealth regulation. This is indeed the case now, where the vast majority of financial services is regulated by the Commonwealth and mortgages and other credit products, which are closely related to other regulated financial services, are not.
23. If Option Three were adopted, the boundary between Commonwealth responsibilities and State and Territory responsibilities for regulation of particular

products would simply move. There would still be a boundary with all the attendant difficulties and confusion that that entails.

24. We note that OCP are often sold in packages with mortgages. For example, it is common for credit cards to be linked to mortgages. This is another factor that causes FOS to prefer Option Two to Option Three. Under Option Three, mortgages would be subject only to Commonwealth regulation, while OCP (which could be packaged with mortgages) would remain subject to State and Territory regulation.
25. The Green Paper refers to further discussion and analysis that could be conducted to determine whether the States and Territories should continue to be responsible for regulating OCP. FOS prefers Option Two to Option Three. However, if it is not practical, or politically achievable, to implement Option Two in the short term, then Option Three should proceed. If further discussion and analysis of Option Two results in a recommendation that Option Two be implemented, then that could be done at a later date.

Trustee corporations

26. Topics which cover the bulk of the experience of FOS with Trustee Corporations have been excluded from the scope of this consultation as these areas were covered in the Wallis Enquiry.
27. However, FOS agrees that there is a need for a more cost effective and timely alternative dispute resolution ("ADR") mechanism for beneficiaries to enhance the protections available for personal trust assets.
28. FOS favours Option One. It considers that consumer protection regulation pursuant to the Corporations Act would be appropriate in relation to trustee corporations, for the reasons set out in the Green Paper. FOS does not believe that the costs and burden of prudential regulation would be warranted. It also notes the points about competitive neutrality made in the Green Paper, which are arguments against Option Two.

Margin lending

29. From the experience of its predecessors in dealing with margin lending, FOS is aware that there is a significant education gap faced by investors who utilise margin lending facilities. Certainly, the majority of consumers who utilise margin lending facilities would appear to be largely ignorant of the hidden risks, as well as of the options available to lenders to force full repayment.
30. FOS favours Option Two. That option would, in FOS's view, afford the level of consumer protection that is required. The Green Paper indicates that Option Two is simpler and less costly than Option Three. As Chapter 7 of the Corporations Act applies in relation to the products purchased through margin lending, we believe that it is desirable for margin lending itself to also be regulated pursuant to Chapter 7.

Debentures

31. FOS agrees that there needs to be a harmonisation of the regulation of promissory notes, but is less certain that all promissory notes should be classed as debentures.

32. Classifying all promissory note issues as debentures would require the establishment of a trustee and a trust deed for each product, potentially at great expense to industry, whereas a classification of promissory notes as a financial product requires only the issuance of a Product Disclosure Statement. This is likely to be a more cost effective means of making the offering for business and affords all the protections of Chapter 7 to the retail investor.
33. Further, the inclusion of promissory notes into the definition of financial products more readily allows for the AFS licensing regime to automatically apply to the issuance of promissory notes without requiring detailed amendments to legislation or regulations.
34. Whether or not promissory notes are classed as debentures, FOS agrees that all debenture issuers should be required to obtain an AFS License and be regulated by ASIC. As a logical progression, this should mean that debenture issuers would require appropriate internal and external dispute resolution schemes.
35. FOS would also support a newly updated list of duties for the trustee of a debenture issuer in order to better inform trustees of their obligations and responsibilities. This would also provide increased transparency for debenture purchasers, who will be better informed as to what the purchaser is entitled to expect of the relevant trustee.

Property spruikers

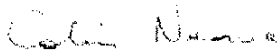
36. As acknowledged in the Green Paper, for many individuals, property investment is one of the largest investments they will ever make. Hence it is important for property investment advice, including advice given by property spruikers, to be regulated appropriately.
37. FOS has little experience in dealing directly with property spruikers, due to the fact that the vast majority of these entities are not AFS License holders and as a result are not members of an EDR scheme.
38. The interaction between the predecessor schemes of FOS and property spruikers has generally involved financial planning advice being provided in respect of the investment property, and therefore any deficiency in this advice has been dealt with under the Chapter 7 provisions.
39. Through this approach, successful consumers may recover their losses from their adviser, but this leaves the AFS Licensee in the position of either weathering the amount of the award, or litigating against the property spruiker itself for an actionable claim, if available, usually on the same grounds as are available to consumers directly. As a result, this does not solve the issue raised in the Green Paper, but instead shifts the exposure from the consumer to the financial adviser in the limited number of cases where advice was obtained and was defective.
40. FOS is aware of the recent developments in relation to property spruikers referred to in the Green Paper. However, FOS has not yet formulated its own views on possible options for reform in this area.

Other credit products

41 The options in Chapter Six correspond with Options Two and Three in Chapter One. For the reasons explained above in the comments on the proposals in Chapter One:

- FOS prefers Option One in Chapter Six; and
- FOS considers that, if it is not practical, or politically achievable, to implement Option One in the short term, then Option Two should proceed and further discussion and analysis of Option One should be conducted.

Yours faithfully



Colin Neave
Chief Ombudsman