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Mr Phil Khoury
The Navigator Company Pty Ltd
c/- Financial Ombudsman Service
GPO Box 3
Melbourne VIC 3001

Dear Mr Khoury

We refer to your invitation to make submissions about the proposed terms of reference for the Financial Ombudsman Service, dated 19 March 2009 (the "**TOR Document**"). We confirm that we act for a number of AFS licensees who are members of FOS. We are instructed to make the following submissions.

DEFINITION OF "FINANCIAL SERVICES" – PAGES 68 AND 69 OF THE TOR DOCUMENT.

We see that FOS, like its predecessor FICS, has yet again failed to react positively to concerns previously expressed by many members of the financial services industry and to align FOS' definition of "Financial Services" with that of either the Corporations Act 2001, or the ASIC Act 2001.

Our concerns could be simply addressed by modifying FOS' definition of "Financial Services" to provide that it has the same meaning as section 12BAB of the ASIC Act 2001. This would have the effect of covering all the financial services defined under the Corporations Act 2001, as well as including "credit products" and "credit facilities" which are covered under the ASIC Act 2001.

The proposed FOS definition, like the previous FICS definition, represents an unwarranted and unjustified expansion of the FOS jurisdiction into areas well beyond that contemplated by Parliament when it introduced the financial services laws.

Section 912A(2)(b)(ii) of the Corporations Act 2001 contemplates membership of an external dispute resolution ("**EDR**") scheme (approved by ASIC) which covers complaints against licensees made by **retail clients** in connection with all of the **financial services** covered by the licensee. As mentioned above, the expression financial services is defined under section 766A.

However, under FOS' proposed approach, clause (viii) of the definition of financial services on pages 68 and 69 of the TOR Document includes as a financial service:

" ... financial or investment advice ... "

The Corporations Act 2001 deals with and refers to “financial **product** advice” – i.e. it relates to advice in relation to “financial products” as defined by the Corporations Act 2001. The expression “financial or investment advice” is not defined, so there is potentially an unlimited scope to the types of matters that could be covered under this heading.

The current FICS Rules are equally lax and imprecise and have already given rise to undesirable consequences. The problems with the current FICS definition of Financial Services:

*“Financial Services means **any form of service or advice for any product provided** [emphasis added] by a person participating in the financial services industry, and includes: ...”*

was seen in the NSW Supreme Court judgment - *Masu Financial Services Pty Ltd v FICS and Julie Wong No. 2* [2004] NSWSC 829. In that matter, the subject of the complaint was advice provided in relation to a directly held residential home unit in Melbourne – i.e. a direct holding in real estate. An award of compensation for the client was made by FICS against the AFS licensee. As you are aware, advice relating to a directly held residential home unit is clearly outside the scope of a financial service within the meaning of either the Corporations Act, or the ASIC Act.

FOS should not be considering any disputes in relation to matters that are not “Financial Services” as defined by the Corporations Act 2001. The legislation that provides the obligation for an AFS licensee to compulsorily submit itself to an organisation such as FOS is section 912A(2)(b)(ii) of the Corporations Act 2001 contemplates membership of an EDR scheme covering complaints against licensees made by retail clients in connection with all of the **financial services** covered by the licensee. We do not see that there is any legislative or political mandate for an EDR scheme to be making binding determinations against AFS licensees in relation to services other than “Financial Services” within the meaning of the Corporations Act 2001.

We again ask that FOS align its definitions with those of the financial services laws.

RULES RELATING TO FOS DISCRETION TO EXCLUDE CERTAIN DISPUTES

We once again express our very real concerns about the type of discretion that FOS is reserving for itself. Those concerns, and those discretions, are as follows:

- Clause 5.2(b) – “non-retail clients”. FOS has reserved for itself the discretion to exclude disputes which involve a complainant who is not a retail client as defined under the Corporations Act 2001. Our position is that FOS should not be considering any disputes from clients who are not retail clients. The legislation that provides the mandate for an AFS licensee to compulsorily submit itself to an organisation such as FOS is section 912A(2)(b)(ii) of the Corporations Act 2001 contemplates membership of an EDR scheme covering complaints against licensees made by **retail clients** in connection with all of the financial services covered by the licensee. We do not see that there is any legislative or political mandate for an EDR scheme to be making binding determinations against AFS licensees in relation to non-retail clients. It should not be a matter of a **discretion** exercised by FOS to unilaterally assume this jurisdiction. Consistent with the

terms of the financial services legislation, the EDR scheme should be available to retail clients, and not to non-retail clients.

- Clause 5.2(h) – Complainant commencing legal proceedings against FOS members after lodging and commencing a dispute with FOS. Under the current FICS Rules there is a requirement that, where a complainant commences legal proceedings, they must discontinue their existing complaint lodged with FOS. The proposed rules provide that FOS, at its discretion, may continue to deal with a dispute where the complainant subsequently commences legal proceedings. There are very significant and obvious problems that arise in the event that there are simultaneous hearings in a commercial arbitration scheme (FOS) as well as court litigation under which different rules and procedures apply. Again, this should not be a matter for FOS' discretion. It should be prohibited, as is currently the case. Where a client chooses to commence legal proceedings, the entirety of the dispute should be heard as part of a single court process. In addition, it is absolutely unreasonable that a FOS member should have to defend itself in two arenas, in relation to the same matter, simultaneously.

EXPANDED GROUNDS FOR AWARDING COMPENSATION – CLAUSE 9.2

We express grave concern in relation to the proposed expansion of grounds for awarding compensation by FOS. Our concerns are as follows. The proposed new grounds for compensation include:

- compensation not merely for direct loss, but also “consequential” loss;
- compensation in respect of certain “non-financial losses”, such as discretionary awards for “physical inconvenience”, “time taken” to resolve the situation (although one would have thought that the ability of FOS to award interest (see - clause 9.4) would have covered this issue), interference with the complainant's “expectation of enjoyment” or interference with the complainant's “peace of mind”.
- to the extent that the dispute pertains to privacy issues, compensation for injury to the complainant's “feelings” or “humiliation suffered”.

There should be no circumstances in which FOS contemplates making such determinations unless there is a general right of appeal by the FOS member to the courts.

FOS MEMBER MAY BE REQUIRED TO PAY COMPLAINANT'S COSTS – CLAUSE 9.3

It has always been understood that the FOS member is required to pay all of FOS's costs in relation to the determination of a matter. The FOS member is also expected to meet all of the FOS member's own costs, regardless of whether the FOS member is successful or not – a complainant cannot have a costs order made against them in the event that the complaint fails. This is so regardless of how a complainant behaves as part of the dispute process, or no matter how untenable their case or argument is. There is also no device similar to that which applies to Calderbank Offers designed to encourage reasonable and rational conduct on the part of the complainant.

The fact that the process is at no cost to the complainant but entirely met by the FOS member, and the absence of the discipline that comes with the apprehension of the award of costs against the complainant means that there is no incentive for a complainant to conduct a dispute reasonably. We can provide examples of how this has led to needlessly expensive, time wasting and inefficient dealings in the dispute resolution process.

Rather than address some of the problems that such a system has created, it appears that FOS is bent on making the position more problematic. FOS is doing this by proposing that, again irrespective of a successful outcome of the FOS determination or otherwise, FOS has the discretion to require the FOS member to contribute to the complainant's legal, "other professional" (whatever that means) costs or travel costs incurred by the complainant in the course of the dispute.

Our concerns are as follows:

Firstly, the clause, as currently drafted, appears to provide an absolute discretion to FOS in determining whether the FOS member is required to make such a contribution. The draft terms of reference make reference to the fact that "normally" FOS will not require the FOS member to reimburse the complainant. However, this level of absolute discretion and uncertainty is neither reasonable nor acceptable. Unlike the court system, this clause is not expressed in a manner to make clear that it is the **successful** complainant only that may recover any legal costs. Why should an unsuccessful complainant be in a position to extract a further financial detriment from a FOS member where it has been determined that the FOS member is not at fault?

Secondly, the costs to which the FOS member may be required to contribute do not appear to be limited to legal costs but may also include "other professional" and travel costs incurred by the complainant. Any proposed award of costs should be limited to reasonable legal costs only – again subject to the complainant being successful in relation to their complaint.

The current FICS Rules provide for a discretionary award by FOS of a payment of up to \$2,500 in relation to costs the complainant has incurred. In the event that FOS does permit the award of certain costs to a complainant, which is not a position that we accept in any way, then a low cost limit similar to the current limit would probably not attract resistance from FOS members, due to the de minimis principle.

INTEREST – CLAUSE 9.4

We note that there is a significant change in relation to the interest that may be awarded by FOS. Previously, there was a limit of \$50,000 on the amount of interest that could be awarded (FICS Rule 34.1). We note that the proposed amount of interest that could in future be awarded is unlimited. This clearly is an unwelcome additional potential impost on AFS licensees in the current difficult market.

REMOVAL OF MONETARY LIMITS AND REPLACEMENT BY CAPS

We note that it is proposed that the former monetary limits be scrapped, and be replaced by the introduction of monetary caps. This means that no disputes would be excluded from FOS due to the dispute exceeding the monetary jurisdiction. Instead, the dispute would be determined by FOS, but, compensation would be limited to a monetary cap.

By way of example, a complainant with a \$500,000 dispute could, after the introduction of the \$280,000 monetary cap from 1 January 2010, have their dispute determined by FOS and could receive a monetary award in relation to that dispute that did not exceed the aggregate of:

- the amount of the monetary cap; plus
- the amount of interest awarded by FOS; plus
- the amount of costs awarded by FOS under clause 9.3.

This could mean that if the complainant's dispute related to circumstances 5 years prior to the lodging of a dispute, in circumstances in which FOS is prepared to award interest at a rate to 4% p.a. and the complainant incurs \$15,000 in costs that FOS deems compensatable, the FOS member could face a compensation bill of \$355,662.

The aggregate effect of the replacement of the monetary limit with a monetary cap (which would logically result in an increase in the number of complaints the FOS members could face) as well as the change in the value of the respective limit/ caps and the removal of limits on the award of interest and costs could mean a dramatic increase in the level of potential payouts that FOS members could face.

This proposed change is occurring at a time when FOS members and their PI insurers can least afford such a change due to the current market conditions. It is worth remembering that the current market changes cannot be viewed as merely a cyclical down turn where the net impact cannot be accurately anticipated, as FOS suggests in the preamble of the TOR Document. FOS' approach appears to be that it chooses to not focus on the current market conditions but has decided instead to take a long term perspective. FOS appears to take this position despite everyone from the mainstream media to the Commonwealth Government expressing views that the current market crises represent the single worst financial conditions in the past 70 years. It is a crisis without parallel in our workings lives which demands that corporations (including AFS licensees), organisations (such as FOS), nations and even international bodies reconsider the way they operate their systems and procedures, and the demands that they place on their own, as well as other parties' resources.

In that context, we urge that FOS reconsider:

- the proposed near **doubling** in the increase of limits/ caps (from \$150,000 to \$280,000) in effectively just 8 months time;
- the maintenance of the monetary limit jurisdiction rather than monetary cap;
- the maintenance of limits on both interest and costs that can be awarded, with the possibility that the future costs award be adjusted in line with CPI.

REVIEW OF MONETARY VALUE REMEDIES – ESSENTIALLY AT FOS DISCRETION – CLAUSE 9.7

Clause 9.7(a) provides an objective review mechanism for monetary values for FOS determined remedies to disputes (the monetary limits or monetary cap) based on the greater of the CPI or Male total average weekly earnings. However, clause 9.7(b) makes a mockery of these objective benchmarks by providing that the FOS Board

may periodically review and increase the limits as it considers appropriate. The overall effect of clause 9.7 is to provide the FOS Board with essentially an absolute discretion to increase limits as and how it sees fit. This is completely at odds with the current system of consultation and voting. The proposed change is entirely inappropriate in the context of an entity in relation to whom persons subject to its decisions have no right to appeal.

We urge that FOS delete the provisions of clause 9.7(b) to remove this discretion on the part of the FOS Board.

DEFAMATION PROCEEDINGS – CLAUSE 13.3

Clause 13.3 provides that a Financial Service Provider shall not instigate defamation action **of any kind** against a complainant in respect of allegations made by the complainant about the Financial Services Provider to FOS. The definition of a Financial Services Provider (see page 69 of 81 of the TOR Document) is not restricted to an FOS member, but is expanded to include any employee, agent or contractor of the FOS member including any person who has actual, ostensible, apparent or usual authority to act on behalf of the FOS member, or authority to act by necessity in relation to a financial service.

The financial services industry, and financial services practitioners, conduct their trade on the basis of trust, reputation and perceived credibility. There has been a disturbing trend recently for complainants to seek to exploit this vulnerability by taking matters beyond the controlled confines of the orderly dispute resolution process, and to seek to extort concessions, or to do deliberate damage to, persons and entities by making adverse public statements (often misrepresentations due to outright falsehood, or selective and partial information disclosures).

It is entirely understandable, and we agree, that information and communications provided by a complainant to FOS as part of the dispute resolution process be subject to qualified privilege so that a complainant can fearlessly put their side of the argument before FOS. However, it is entirely another matter for a complainant to be free to make defamatory statements to the general public, the media or to parties and entities that are not the subject of the FOS dispute resolution process.

It is also entirely inappropriate that FOS seeks to remove from individuals or entities that are not themselves FOS members the ordinary rights afforded to everyday Australian citizens (including the complainants) in relation to the issue of defamation protection. To the extent to which clause 13.3 extends beyond defamatory materials published in communications between parties to the complaint, and used solely as part of the FOS dispute resolution process, those provisions should be deleted.

We would be happy to discuss further any of the matters raised in the above submission.

Yours sincerely

MARK HALSEY