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28 June 2017

Dear Expert Panel,

AFA Submission – Review of the Financial System External Dispute Resolution Framework: Supplementary Issues Paper

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for 70 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are required to be practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting wealth.

Introduction

The AFA supports measures to better ensure that parties who receive determinations from an EDR scheme are paid. We are concerned that this has been a continuing factor in the financial services industry and the financial advice profession in particular. We assume that this represents a

continuation of factors that have fallen out of the global financial crisis. It is appropriate that action is taken to address this issue

It is our view that prior to the establishment of a compensation scheme of last resort that the Government should consider other measures to take action against financial firms and their directors/officers who fail to pay benefits under accepted determinations and to also investigate whether changes to professional indemnity insurance arrangements might ensure a better outcome for consumers.

We have made two high level recommendations below and also addressed each of the questions raised in the Supplementary Issues Paper.

Summary of the AFA's recommendations

Heading

1. The Government (presumably via the Australian Law Reform Commission) to research possible changes to the Corporations Act to address the causes of unpaid determinations.
2. Review the compensation system to address the inadequacies with professional indemnity insurance.

The AFA's recommendations for improvement

The integrity of the dispute resolution system absolutely requires compliance with awards of compensation that have been fairly and independently determined. Whilst we understand that in some limited cases, licensees have little choice but to apply for administration due to unforeseen circumstances or due to the contribution of third parties which were unable to be considered by the EDR scheme due to jurisdictional issues, the system may make it too easy for licensees generally to choose non-compliance – where directors of licensees elect to place their company into administration despite a rigorous investigation and finding of misconduct against representatives of the licensee.

It is clear to the AFA that to be effective, dispute resolution systems must be complemented by reforms and reviews of the legal framework that currently permit non-compliance and any other issues that impact of the effectiveness of EDR schemes. To this end, the AFA recommends the following actions be undertaken.

Recommendation 1

The Government (presumably via the Australian Law Reform Commission (ALRC)) to research possible changes to the Corporations Act to address the causes of unpaid determinations

The AFA believes that the underlying causes of unpaid determinations must be considered in assessing what action needs to be undertaken. This has been identified as an important problem that underpins or undermines the effectiveness of dispute resolution and the consumer protections framework. While the Expert Panel on Dispute Resolution has begun considering *whether* to establish compensation schemes of last resort and the design issues, it does not appear to be considering the causes of unpaid determinations. In the AFA's view, it is better to seek to fix the current problems before considering a workaround solution.

In the AFA's view, it is far too easy for directors of licensees to hide behind their duty to their shareholders or other perceptions of their director duties whilst disregarding their licencing requirements and conditions and their personal responsibilities to the community. The directors of financial services firms should be held to ethical and social responsibilities equally or above their duties to their shareholders. If the professionalism of financial advisers is to rise, then the way directors of financial firms execute their responsibilities when considering insolvency should also be looked at through a lens of common sense and community good. There should be a way in which to hold determination avoidance in the same light as other corporate misbehaviour.

Financial firms who place themselves into voluntary administration only for a similarly named, located and managed company who has acquired the customers, assets and networks of the former (but without the liabilities) should be prevented from re-joining the same or another EDR scheme, and even before that – be prevented from obtaining a licence to operate. We know that work has begun on considering the problem of phoenix activity and there have recently been some prosecutions on this front. The AFA also appreciates that this is a complex problem and not one that is easily resolved.

However, phoenix activity is the symptom of the problems, not the cause. The complexity of the issue is why the AFA supports the ALRC being given the task of investigating structural contributors to unpaid determinations as well as exploring other options to mitigate against the risks of unpaid determinations. This needs research and focussed consideration as well as a diverse range of views to inform the Government about potential options to resolve the problem.

The AFA considers that there may be changes to directors' duties and directors' limited liability rules that could be available to limit the practice. If we are going to reform dispute resolution and require the new scheme to enforce its decisions, then we should also consider how insolvency practitioners and regulators could be equipped to prevent companies with open EDR disputes from choosing non-compliance over their social responsibility. Particularly where the non-compliance is repeated, there should be better deterrence measures available.

We acknowledge this may be a departure from current corporate law doctrines. However, the AFA considers that $15 million of unpaid consumer losses over 10 years (and counting) is a large enough figure to justify the Government committing to look at the causes of unpaid determinations as well as last resort options. You cannot have the latter without the former. Otherwise, you permit moral hazard to become an impediment to the success of the new AFCA scheme and undermine the success of other measures to restore the social licence to financial services.

We are not proposing that all voluntary administrations be subjected to the same rules or investigation – just in relation to the specific problem of unpaid financial services determinations. Areas that the AFA considers the ALRC should be tasked with examining include:

- whether to restrict licensees from entering liquidation specifically when an award of consumer compensation is outstanding;
- introduce conditions upon directors' limited liability rules to place a more direct obligation (or caveat) upon the directors' personal assets when they put their companies into liquidation whilst an EDR case is open or EDR scheme award of compensation has been made; and
- examine how to effectively prevent companies suspected of being a phoenix company re-joining the same or a different EDR scheme or obtaining another licence until the company directors satisfy ASIC that it is not a phoenix company.

- Applying banning provisions to directors and officers of financial firms that have gone into administration only to re-emerge in another form.

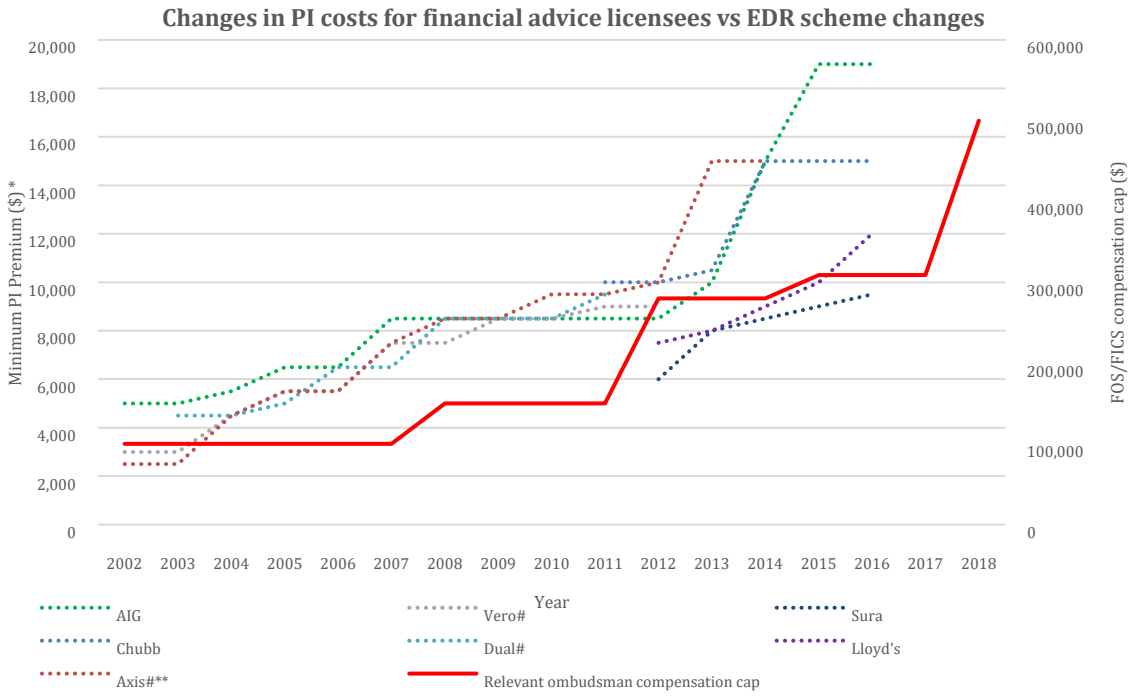
The AFA considers that if the ALRC is tasked with researching this issue, that work would complement Treasury's recent consultations on improving corporate insolvency laws and the Australian Tax Office Taskforce's work. Without a detailed study of the causes of and solutions to unpaid determinations, there seems less value in establishing compensation schemes of last resort.

Recommendation 2

Review the compensation system to address the inadequacies with professional indemnity

The ALRC being tasked with exploring options to avoid unpaid determination outcomes should also be complemented by consideration of the adequacy of the professional indemnity insurance regime. Whilst the AFA considers this is best handled by the ALRC while it considers the other causes and contributors to unpaid determinations, the recent enquiries by ASIC into professional indemnity adequacy should also be taken into account and reviewed independently.

In particular, the extent to which advice licensees are unable to afford their professional indemnity excess as well as their annual premiums should be examined to determine what impact that has had on the accumulation of unpaid determinations. The following is a summary provided by a professional indemnity insurance broker about the historical changes in the minimum professional indemnity cost for financial advisers as the compensation cap has increased:



Premiums are excl GST and stamp duty

* min PI premium are for AFS licensees with a maximum turnover of $400,000, coverage consists of $2.5 million in any one claim and $5 million in the aggregate and average excess of $10,000

** known prior to 2005 as Dexta

exited the market (Dual in 2013, Vero in 2014 and Axis in 2016)

The above analysis shows that there has been an increasing trend over the last 15 years for professional indemnity insurance costs to increase when EDR scheme compensation caps change.

This is to be expected due to the nature of insurance covering risk levels. However, this was also at a time that coverage of policy terms became more narrow and focussed.

Proposed further increases in monetary limits and compensation caps are likely to put additional pressure on professional indemnity insurance, resulting in a real risk that financial firms – especially the smaller of them – will seek to exit the market or turn to general advice business models. Further, as the professional indemnity market is a competitive market, there is an additional risk that insurers will exit the space (as they have done in the past) thereby placing further pressure on supply and the cost of insurance.

Other issues with professional indemnity that the AFA consider should also be explored include:

- the differences in professional indemnity insurer interpretations about what falls into the fraud and dishonesty exclusions contained in many professional indemnity policies. We understand this is an area that ASIC has recently looked into;
- whether the minimum coverage requirements of ASIC Regulatory Guide 126 cover multiple EDR claims in every case and whether an aggregate limit should apply in cases of multiple claims;
- whether there are ways that non-payment of professional indemnity premiums can be better monitored by ASIC. In particular, data sharing between ASIC and insurers should be explored; and
- whether there are any other causes of professional indemnity policy terms or claim applications that have contributed to unpaid determination.

The AFA wishes to ensure that a holistic approach is taken to the problem of unpaid determinations. This is mostly to ensure that the effectiveness of the new EDR scheme is maximised. Further decisions on compensation schemes of last resort should be made only after thorough consideration of the underlying causes of the problem – including the adequacy of professional indemnity insurance.

Response to Questions Raised in the Supplementary Issues Paper

Scope and principles

1. Is the Panel's approach to the scope of these issues appropriate? Are there any additional issues that should be considered?

The AFA believes that the scope reflects the Terms of Reference as agreed by the Government and we are not aware of any other issues that should be considered.

2. Do you agree with the way in which the Panel has defined the principles outlined in the Review's Terms of Reference? Are there other principles that should be considered?

The AFA is supportive of the principles that are noted on page 6 of the Issues Paper, however we make the following additional comments:

- Efficiency needs to apply for the benefit of all parties. This includes the collection of any funding for a scheme and also ensuring that the cost to the industry is as low as possible.
- We note and support the inclusion of the reference to moral hazards; however, we would

suggest that this does not sit neatly under the heading of regulatory costs. We set out below our concerns relating to moral hazards and the potential for a narrow scheme to place biases in the complaints system.

Compensation scheme of last resort

Existing compensation arrangements

3. What are the strengths and weaknesses of the existing compensation arrangements contained in the *Corporations Act 2001* and *National Consumer Credit Protection Act* 2009?

The AFA considers that the existing EDR scheme under the Corporations Act (and equally under the National Consumer Credit Protection Act) provides strong mechanisms to protect the interests of financial services consumers. Considering where the EDR schemes started, the access and limits of the current scheme are likely to cover a high proportion of the relevant market place. It is further noted that consumers also have access to the Court system and there are numerous legal firms that will willing assist impacted clients in this process, for a fee. Legal firms have in recent years started advertising their services with respect to financial services and are operating on a "no win no fee" basis.

It is our view that the EDR scheme that is required under the Corporations Act is one option for consumers, however it is not the only option. It is important that this review is not undertaken on the basis that EDR schemes are the only option for consumers.

The fact that there are currently a number of determinations that have been left unpaid is an obvious weakness in the system and it is appropriate that action is taken to address this.

As per any scheme of this nature, key issues include getting the balance right in terms of equity and access and also consistency of outcome.

4. What are the strengths and weaknesses of the National Guarantee Fund, the Financial Claims Scheme and Part 23 of the *Superannuation Industry (Supervision) Act 1993*?

The AFA is unable to comment on the strengths and weaknesses of these three schemes, however we note that the exclusion of self-managed superannuation funds from the Superannuation Industry (Supervision) Act was a key issue with the Trio Capital collapse back in 2009. It is noted that the exclusion of SMSF's has not been addressed as a key factor in this Issues Paper.

5. Are there other examples of compensation schemes of last resort that the Panel should be considering?

The AFA is not aware of any other examples of such schemes that the Panel should investigate.

Evaluation of a compensation scheme of last resort

6. What are the benefits and costs of establishing a compensation scheme of last resort?

The benefits of a compensation scheme of last resort are as follows:

- It would have a beneficial impact upon consumer confidence in the financial services industry, however the level of consumer awareness of complaint mechanisms is not strong and the gap in terms of claims against insolvent parties is only likely to be known by a very limited number of people.
- Having access to compensation for people who have lost as a result of the misconduct or

error by a financial service provider will assist in providing redress to people impacted. This will have flow on benefits in terms of the mental impact on these consumers and their need to access Government support.

The potential costs of a compensation scheme of last resort are as follows:

- It might pose the issue of a moral hazard as the protection might mean that both financial services providers and consumers may take more risks than they would otherwise be willing to take.
- Where the compensation scheme of last resort is narrowly based, such as only covering financial advisers then it might influence consumers and their advisers to focus their recovery efforts on the financial adviser even when other parties are either fully or partially to blame.
- Where the compensation scheme of last resort is narrowly based, such as only covering financial advisers then it might influence EDR case assessors to attribute fault to financial advisers as it may better ensure that the consumer has some level of cover.

7. Are there any impediments in the existing regulatory framework to the introduction of a compensation scheme of last resort?

If such a scheme was to proceed then it would need to have legislative backing. A narrowly based compensation scheme of last resort that covered unpaid EDR determinations would be relatively straight forward to provide for in legislation. Should the scheme have a retrospective element or should it address complainants other than unpaid EDR determinations then the legislative impact is expected to be much greater.

There are likely to be a range of related legislative amendments, including reference to such a scheme in Financial Services Guides.

8. What potential impact would a compensation scheme of last resort have on consumer behaviour in selecting a financial firm or making decisions about financial products?

It is firstly noted that few consumers would be likely to be aware of a future compensation scheme of last resort, unless it was publicised and was required to be included in Financial Service Guides. Once clients were aware of this provision then it is certainly possible that they could be willing to take more risk than they would otherwise be willing to take, based upon the knowledge that they are likely to have greater access to compensation should things go wrong.

Historically one of the reasons why some clients may choose a large institution is the greater comfort that they will be protected in the event that something went wrong. This may become less of a factor if a compensation scheme of last resort existed.

9. What potential impact would a compensation scheme of last resort have on the operations of financial firms?

The Greatest impact is likely to be the additional cost that such a scheme will place on financial firms. This would be a much greater factor if past disputes were included in the scheme.

Whilst it would be nice to assume that such a scheme would place greater focus upon licensees and financial advisers taking more steps to remove incompetent and unethical advisers from the market place, in reality this is unlikely as it is often not particularly easy to identify when other advisers lack the necessary competencies or ethical standards to operate.

10. Would the introduction of a compensation scheme of last resort impact on competition in the financial services industry? Would it favour one part of the industry over another?

In terms of financial advisers, at present it is likely that the advisers working for or authorised by a licensee that is owned by a large institution are likely to use financial strength as one of their selling points. A compensation scheme of last resort, depending upon how it is designed, might have some impact upon the perception of importance of being a client of a large institution. This might result in a more level playing field for smaller licensees.

Further, however, the additional costs of such a scheme if it was industry funded would have a negative impact upon competition in the financial advice marketplace. The additional costs alongside other recent increases in the cost of running a financial advice business are likely to impact upon the number of advisers in the market and the affordability of financial advice. Depending upon the extent of the additional cost, this is likely to have a much greater impact upon smaller businesses, who may no longer be able to serve average Australians due to increasing costs.

11. What flow-on implications might be associated with the introduction of a compensation scheme of last resort? How could these be addressed to ensure effective outcomes for users?

It is possible that such a scheme could lead to greater risk taking by financial advisers and also a greater inclination to exit the industry when they run into trouble, with the knowledge that their clients may be better looked after by having early access to a compensation scheme of last resort.

The other key implication is an increase in the cost of running a financial services business and particularly a financial advice licensee and practices. This is likely to have a flow on implication for the cost of providing financial advice and affordability for consumers.

12. What other mechanisms are available to deal with uncompensated consumer losses?

The AFA is not aware of any other mechanisms.

13. What relevant changes have occurred since the release of Richard St. John's report, *Compensation arrangements for consumers of financial services*?

The Richard St. John report was commenced in 2010, which was shortly after the full impact of the Global Financial Crisis had emerged and before the commencement of the Future of Financial Advice reforms. It was therefore completed before the full impact of the Future of Financial Advice reforms were known and before the impact was experienced. It is our expectation that the introduction of the Best Interests Duty and other new obligations will have had a significant impact upon the quality of financial advice in that timeframe.

Whilst it is now five years since the Richard St. John report was released, it is unlikely than any changes in the industry have served to increase the need for or appropriateness of a compensation scheme of last resort.

Since the Richard St. John report was released there have been few material financial collapses involving retail clients and therefore a reduction in material factors driving complaints on a large scale. It is expected that reforms since the global financial crisis, will serve to reduce the likelihood of a repeat of the large-scale losses that were observed at the time of the global financial crisis.

Potential design of a compensation scheme of last resort

14. What are the strengths and weaknesses of the ABA and FOS proposals?

The ABA and FOS proposals are very different. The FOS scheme is broad and embraces past disputes and legal judgements, whereas the ABA scheme is quite narrow, being unpaid EDR determinations only and limited to just financial advisers and excludes past disputes. Other differences include the role of AFCA in the administration of the compensation scheme of last resort. FOS have suggested that it should be completely independent, whereas the ABA suggest that administration services should be provided by AFCA.

We question the ABA justification that this should be specifically for financial advisers and funded by financial advisers. It should be noted that financial advisers only make up 53% of existing unpaid determinations, which would mean that nearly 50% of impacted consumers would not be covered. Page 1 of the Issues Report refers to a reference to $5 billion of financial losses suffered by Australian investors in recent years, which is sourced from the 2014 Financial System Inquiry. This reference refers to losses involving Storm Financial, Opes Prime, Westpoint, Great Southern, Timbercorp and Banksia Securities. Of these, only Storm Financial was a financial planner operation. Whilst financial advice may have been a factor in some of the complaints related to the other matters, they were all primarily product failures. It would therefore seem inappropriate for a compensation scheme of last resort to singularly focus upon financial advisers.

The scope proposed by the ABA is unnecessarily narrow and misses some of the other key areas of unpaid determinations.

15. What are the arguments for and against extending any compensation scheme of last resort beyond financial advice?

As addressed above, the history of collapses is much broader than financial advice. The other key factor that needs to be considered is that despite the reported $5 billion of losses in recent years, there is only $14.5 million of unpaid EDR determinations. Of the unpaid determinations, financial advice only represents 53%. This very much raises the question as to whether this proposal is addressing the core issue or not.

The AFA strongly opposes a scheme that is specifically for financial advice complaints. It is our view that such an approach would serve to incorrectly suggest that financial advice is the source of the majority of financial services losses. There are a number of commentators in the financial advice space that suggest that financial advisers have unfairly taken a lot of blame for product failures and through the EDR process picked up responsibility for matters that were predominantly product failures.

We further note that the proposal from Westpac, mentioned on page 44 recommends the inclusion of maladministration in lending. This would suggest that there is some disagreement in the banking sector as to what the scope of the scheme should be.

16. Who should be able to access any compensation scheme of last resort? Should this include small business?

As stated previously, the AFA believes that other actions should be taken to address unpaid determinations prior to the establishment of a compensation scheme of last resort.

Whilst we do not support a compensation scheme of last resort, should a scheme be supported by Government, then we would recommend that it be limited to clients who have received a determination from an EDR that has not been paid as a result of the financial firm becoming insolvent. To the extent that small business can access an EDR scheme then we believe that they should be eligible.

17. What types of claims should be covered by any compensation scheme of last resort?

As stated above, whilst we do not support a compensation scheme of last resort, should one be supported by the Government then we believe that it should be restricted to clients who have received a determination from an EDR that has not been paid as a result of the financial firm becoming insolvent. As such it should include any unpaid determination that was addressed by the EDR scheme.

18. Should any compensation scheme of last resort only cover claims relating to unpaid EDR determinations or should it include court judgments and tribunal decisions?

It is the AFA's view that should such a scheme be implemented by the Government then it should be limited to claims related to unpaid EDR determinations. We put this view forward on the basis that clients who have received a judgement as a result of taking action through the courts have legal means to enforce a judgement.

19. What steps should consumers and small businesses be required to take before accessing any compensation scheme of last resort?

The process in terms of seeking payment from the financial firm should play out fully prior to the client being able to make a claim against the compensation scheme of last resort. In our view action should be taken initially by the EDR scheme against a financial firm who has failed to pay a determination. It might be that at a certain point in the process, the EDR scheme should have the powers to report this to ASIC who could then provide a final warning before suspending the licence.

It should only be after the firm has been placed into administration and liquidated before a claim should be made via a compensation scheme of last resort.

20. Where an individual has received an EDR determination in their favour, should any compensation scheme of last resort be able to independently review the EDR determination or should it simply accept the EDR scheme's determination of the merits of the dispute?

It is our view that determinations of an EDR might change in the light of additional information that later becomes available on a particular financial firm or adviser. However, it is more likely that the more an EDR scheme knows about a particularly financial firm then the more likely they are to have firmer grounds for the determinations that was made previously. There might be circumstances that would be to the contrary where more recent information might change a decision in favour of the financial firm.

Thus, it would be our view that the EDR determination should not be reviewed in detail again unless there is new information that has come to hand with respect to either the matter or the particular financial firm or adviser who was the subject of the complaint. Reassessing the case in the absence of new information would in the majority of cases drive additional cost without any benefit.

21. If a compensation scheme of last resort was established and it allowed individuals with a court judgment to access the scheme, what types of losses or costs (for example, legal costs) should they be able to recover?

The AFA does not believe that a compensation scheme of last resort should be available for court

judgements. Should the Government choose to extend it to court judgements then we would suggest that any payment was limited to the client loss and not extended to cover costs of any form. It would be suboptimal to treat similar matters differently.

22. Should litigation funders be able to recover from any compensation scheme of last resort, either directly or indirectly through their contracts with the class of claimants?

The AFA opposes the concept of a litigation funder having access to payments from a compensation scheme of last resort. The intention of such a scheme should be to provide partial reimbursement for clients who have been unable to be paid on a determination due to the financial firm becoming insolvent. As the AFA believes that any scheme should only cover a client who has already received a determination under an EDR scheme, there should be no reason for a litigation funder to be involved.

23. What compensation caps should apply to claims under any compensation scheme of last resort?

The AFA notes that in the table on page 18 of the Issues Paper that there is only one genuinely comparable system, being the United Kingdom Financial Services Compensation Scheme, which appears to have a cap of 50,000 British Pounds, which is equivalent to approximately $AUD 85,000. The Canadian, United States and European Union schemes are also much narrower and not directly relevant to the circumstances being considered here.

The AFA would agree with the UK model that a compensation scheme of last resort should be a limited compensation scheme and should not allow for the full payment of larger determinations. In this way, it does provide recognition for the client and some compensation. It also reflects the circumstances that the party who they have a legal claim against has become insolvent and that the outcome is an alternative, partial solution.

The AFA believes that a lower cap should apply and that this should be broadly consistent with the UK scheme.

24. Who should fund any compensation scheme of last resort?

The AFA acknowledges the Government's recent steps to ensure that the industry funds the cost of ASIC and therefore assumes that the Government would expect this to be industry funded. It is however noted that the Fair Entitlements Guarantee is funded by the Government with the Government seeking to recover any missing funds from the liquidation. It is noted that the Government does not seek to recover this money from other companies in the Australian economy as a result of action taken under the Fair Entitlements Guarantee. If the Government chose to proceed with a prospective narrow scheme and sought industry funding, then we would recommend that this be kept to a minimum and be collected in the most efficient manner possible.

25. Where any compensation scheme of last resort is industry funded, how should the levies be designed?

Where the scheme was industry funded, then it would be preferable that an efficient solution could be found. It is noted that there are many banks, super funds, insurance companies and well over 1,000 AFSL licensees. Any levy would need to reflect the size of the financial services firm. It is recognised that there are a range of options to collect such funds, however it is further noted that it would not make much sense to collect a relatively small amount directly from many of the smaller businesses. It may be more efficient to apply a size threshold above which the levy applies.

26. Following the payment of compensation to an individual, what rights should a compensation scheme of last resort have against the firm who failed to pay the EDR determination?

Similar to the Fair Entitlements Guarantee, the scheme should have first rights to claim an amount up to the level of the payment under the scheme. In this way, they would stand in the shoes of the claimant for the amount of the scheme payment.

27. What actions should ASIC take against a firm that fails to pay an EDR determination or its directors or officers?

The AFA would support reform in this area to place more accountability on firms and office holders where the firm fails to meet it's obligations as a result of either an EDR determination or a court judgement. It is our view that we should take steps to minimise the risk of determinations not being paid, rather than to focus upon additional actions such as a compensation scheme of last resort in the context that determinations go unpaid.

In this regard, we believe that it would be appropriate to consider the application of banning provisions against directors and key personnel where there is evidence to suggest that a particular firm has taken steps to deliberately avoid payment of determinations, yet remains in the industry.

28. Should any compensation scheme of last resort be administered by government or industry? What other administrative arrangements should apply?

The best body to administer the scheme will depend upon a range of factors in the design of a scheme, should the Government choose to proceed with a compensation scheme of last resort. The key factors would include the funding model, the work level and type undertaken by the scheme, and the scope of the cases that the scheme would address. Should the role of the scheme be broader, then the level of resources and skills would be greater. This would lend to it being aligned to an EDR scheme to leverage the existing resources.

29. Should time limits apply to any compensation scheme of last resort?

Time limits should apply and in our view, they should be relatively short. It might be that within two years of the financial firm being declared insolvent that claims under the compensation scheme of last resort would expire. To assist claimants, it would be necessary for a public list of insolvent firms to be maintained.

30. How should any compensation scheme of last resort interact with other compensation schemes?

The interactions between the EDR scheme and any compensation scheme of last resort would depend upon a range of decision being made in the design of such a scheme. Assuming that a compensation scheme of last resort was run in a manner similar to the EDR scheme, then it should be a close relationship with regular interaction with respect to specific cases and financial firms.

31. Are there any aspects of compensation schemes of last resort in other sectors and jurisdictions that should be considered in the design of any compensation scheme of last resort?

The AFA is not aware of any additional factors that should be leveraged in the design of a

compensation scheme of last resort for the financial services industry.

Legacy unpaid EDR determinations

32. What existing mechanisms are available for individuals who have legacy unpaid EDR determinations to receive compensation?

A person that is impacted by the failure of a member of an EDR scheme to pay a determination has little additional avenues to pursue payment, other than potentially to take EDR action against alternative parties or to take court action against the key management personnel in the relevant financial services provider.

33. Is there a need for an additional mechanism for those with legacy unpaid EDR determinations to receive compensation? If so, who should fund the payment of the legacy unpaid EDR determinations?

Whilst we note the personal impact on clients from poor financial services, including poor financial advice, however we do not support current financial services providers picking up the bill for the past miss-deeds of others. This is certainly not equitable and would potentially be damaging to the industry including current clients as it will increase the cost of the delivery of services.

Providing access to redress for past disputes

Circumstances which have prevented access to redress

34. Other than circumstances that may be covered by a compensation scheme of last resort (such as outstanding unpaid determinations), what kinds of circumstances have given rise to past disputes for which there has not been redress? Are there any other classes besides those identified by the Panel?

We note the reference in the Supplementary Issues Paper to circumstances where the client was unable to access redress, such as the monetary value of the dispute exceeding the EDR scheme monetary limit, the dispute being outside the EDR scheme's time limits and the client choosing not to pursue their dispute for unspecified reasons. The AFA does not agree that these circumstances should be considered as relevant in gaining access to any potential compensation scheme of last resort.

Firstly, it should be noted that EDR schemes are just one option for clients to pursue redress. They also have access to the courts. Whilst it is noted that there are often significant costs involved in taking legal action, there are a range of plaintiff legal firms that are publicly offering to assist clients in taking action. Where a client chooses not to take action either via an EDR or via the Courts then they should not be able to access recompense.

35. What evidence is there about the extent to which lack of access to redress for past disputes is a major problem?

The AFA is not aware of any evidence or research on the extent of a lack of access to redress for past disputes other than the high-level reporting provided by FOS, however we note that there has been extensive advertising by plaintiff legal firms about taking action against financial services and financial advice firms. In many cases they are willing to take this action on a "no win no fees" basis. Given that clients have either access to an EDR scheme or can talk to a lawyer on a "no win no fees" basis, we do not believe that there is a fundamental issue with a large group of people who have been denied access to redress.

Approaches to providing access to redress for past matters

36. Which features of other approaches established to resolve past disputes outside of the courts (whether initiated by industry or government) might provide useful models when considering options for providing access to redress for past disputes in the financial system?

As discussed above, we do not believe that there is a need for any further avenue for taking actions. Since clients can either take direct action through an EDR scheme or via the courts, we do not believe that there is any need for any further avenue of approach.

Evaluation of providing access to redress for past disputes

37. What are the benefits and costs associated with providing access to redress for past disputes?

The AFA opposes providing access to redress for past disputes. The avenues for action already exist and if the client has not taken action within the limitations of the existing system then they should not be offered a further option.

38. Are there any legal impediments to providing access to redress for past disputes?

We would envisage that a scheme providing access to redress for past disputes, that involved current financial services participants to pick up the bill, would involve a range of opposing arguments on the basis that this was retrospective. This might be on either constitutional grounds or alternatively as noted in the Issue Paper, subsection 12(2) of the Legislation Act 2003.

39. What impact would providing access to redress for past disputes have on the operations of financial firms?

The AFA is concerned that an open-ended scheme for past disputes that is paid for by current financial advisers could involve a significant cost to the industry that would have a substantial impact upon the cost of providing financial advice, which might reduce the access to financial advice and the affordability of financial advice.

40. What impact would providing access to redress for past disputes have on the professional indemnity insurance of financial firms?

The professional indemnity insurance market for financial advice has been under pressure for a number of years, with the cost of premiums increasing significantly and the terms and conditions being tightened noticeably. Providing access to redress for past disputes, if paid for by the impacted financial adviser, would most likely result in the professional indemnity insurance not covering the claim. This could have a significant impact on the financial advice firm that could even involve them closing down if they were subject to a large claim.

It is important to note that any significant disturbance to the professional indemnity market could have a significant impact upon both access to professional indemnity insurance and the overall viability of the industry.

41. Would there be any flow-on implications associated with providing access to redress for past disputes? How could these be addressed in order to ensure effective outcomes for users?

The AFA does not support providing access to redress for past disputes. Further we believe that this is completely unnecessary as impacted clients already have access to redress through the courts. This would be a fundamental change in the balance of the system that would likely involve significant additional cost pressures for financial advice firms.

Design issues for providing access to redress for past disputes

42. What are the strengths and weaknesses of the Westpac proposal?

It was noted that the Westpac proposal indicated that the remit of such a scheme should be both poor financial advice and maladministration of lending. This is different to the ABA proposal which recommended that a compensation scheme of last resort should only apply to financial advice matters. Westpac have at least acknowledged that matters beyond financial advice need to be addressed as part of this consultation.

We appreciate that this is a proposal with respect to a 'bank related past issues forum', however this would have broader implications on the financial advice marketplace as it will result in confusion for consumers of financial advice.

The AFA would not argue against an individual firm (such as a bank) putting their own remediation scheme in place that addressed past disputes. The argument with respect to an imbalance in the capacity to resource legal action is noted and this is an important point that applies with respect to banks and other large institutions. This same argument does not apply with many of the smaller financial advice businesses that make up the membership of the AFA.

Should a particular firm or group of firms wish to implement a remediation program for past disputes then we would recommend that this does not require legislative reform and should be kept completely separate from AFCA.

43. What range of parties should be provided with access to redress for past disputes? Should all of the circumstances described in paragraphs 133-144 be included?

As previously stated, the AFA does not believe that existing participants in the financial services industry should pay for the mistakes of entities that are no longer participants. If a compensation scheme of last resort was implemented then the only circumstances in paragraph 133 that we would support is where the financial firm was insolvent at the time of the EDR complaint or where the EDR scheme closed the complaint as a result of the financial firm becoming insolvent before a determination being made. In all the other circumstances, the client had the option of making a complaint either via an EDR or through the courts and therefore should not have access to a new scheme.

44. What mechanism should be used to resolve the dispute and what criteria should be used to determine which disputes can be brought forward?

As stated above, the AFA does not support a scheme for past disputes and therefore does not intend to address the mechanism for resolving such disputes.

45. What time limits should apply?

As stated above, the AFA does not support a scheme for past disputes and therefore does not intend to address the time limits that should apply for resolving such disputes.

46. Should any mechanism for dealing with past disputes be integrated into the new Australian Financial Complaints Authority (once established) or should it be independent of that body?

As stated above, the AFA does not support a scheme for past disputes.

47. Who should be responsible for funding redress for past disputes? Is there a role for an ex gratia payment scheme (that is, payment by the Government)?

The AFA does not believe that any scheme to address the mistakes of past market participants should be picked up by the current advisers. We have also said that there are only very limited circumstances where remediation of past disputes should be considered. If this was to be implemented then we believe the only viable source of funding is the Government.

48. Should there be any monetary limits? If so, should the monetary limits that apply be the EDR scheme monetary limits?

As stated above, the AFA does not support a scheme for past disputes. In the event that such a scheme did eventuate, we would recommend that any limits were set at a level that was well below the current EDR scheme monetary limits and certainly well below that of the proposed monetary limits. We note that the United Kingdom scheme has a cap for investment claims of up to 50,000 British Pounds per person. We would therefore suggest that any Australian scheme should be set at a level where it is only a partial reimbursement for larger claims.

49. Should consumers and small businesses whose dispute falls within the new (higher) monetary limits of the proposed Australian Financial Complaints Authority but was outside the previous limits be able to apply to have their dispute considered? Should access to redress for past disputes be provided through a transition period whereby the higher monetary limits are applied for a defined period retrospectively? If so, what would be an appropriate transition period?

The AFA opposes the application of any higher monetary limits for past disputes during a transition period. If a claim was above the EDR monetary limit that applied at the time, then the client had access to the court system to seek redress. Given the availability of legal firms willing to operate on a "no win, no fee" basis, we do not believe that there is any need to make provisions for this group of clients.

50. If it is not possible to fully compensate all claimants, should a 'rationing' mechanism be used to determine the amounts of compensation which are awarded? Should such mechanism be based on hardship or on some other measure?

As stated above, the AFA does not support a scheme for past disputes and will therefore not provide comment on a rationing mechanism. As noted above, any cap should be significantly less than the monetary cap for the EDR scheme.

51. Are there any other issues that would need to be considered in providing access to redress for past disputes?

The key issues that have been addressed above are the retrospective nature of this proposal and the fact that a change of this scale would be likely to have a substantial impact upon the professional indemnity insurance market. For these reasons, the AFA is opposed to a scheme to provide access to redress for past disputes.

Concluding remarks

The AFA welcomes further consultation with the Expert Panel should it require clarification of anything in this submission. If required, please contact us on 02 9267 4003.

Yours sincerely,

Philip Kewin
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Association of Financial Advisers Ltd