Association of Financial Advisers Ltd
ACN: 008 619 921
ABN: 29 008 921
PO Box Q279
Queen Victoria Building NSW 1230
T 02 9267 4003 F 02 9267 5003
Member Freecall: 1800 656 009
www.afa.asn.au

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Head of Secretariat
AFCA Transition Team
Financial Services Unit
The Treasury
Langton Crescent
Parkes ACT 2600

By email: afca@treasury.gov.au

Dear Taskforce Members

AFA Submission – Consultation: Establishment of the Australian Financial Complaints Authority

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for over 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 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 has very serious concerns about the consequences of raising the monetary limit and the compensation cap as recommended in the Ramsay Review and as proposed by the Government. AFSL's are required by ASIC to have Professional Indemnity Insurance, however the number of PI Insurance providers has fallen over recent years, premiums have escalated rapidly and policy terms have tightened. Previous efforts by ASIC to increase the extent of cover have failed. This is for a particular reason – PI Insurers do not want to be exposed to large payments on the basis of decisions by EDR schemes where there is no right of appeal and where normal court processes are not applied. These proposals are likely to lead to a significant increase in the cost of PI Insurance and the departure of some insurers from the market. We believe that this is a fundamental issue potentially affecting the viability of the sector.

The AFA is strongly opposed to the view emerging from the Ramsay Review that consumers should have much greater access to EDR schemes. We firmly believe that the Courts need to remain an important part of the dispute resolution infrastructure and given the significantly different processes that are employed, EDR schemes should continue to service clients who have lower level claims.

The Ramsay Review final report includes a section on international comparisons and domestic schemes in other industries. The compensation caps on none of these comparisons are anywhere near where the Ramsay Review have recommended the Australian Financial Services Industry should be. The other domestic industries have a cap of no more than $50,000, and this will typically apply to larger companies.

Court processes allow for claimants to be cross examined and their evidence to be tested. Court decisions are subject to appeal. False claims in a Court are subject to legal consequences. For all these reasons, large claims should be assessed by the courts and not by EDR schemes. We are of the opinion that EDR schemes play an important purpose to provide cost free dispute resolution for smaller scale claims, and the scope should not be extended as proposed.

The AFA is very conscious that there is a lot of pressure on costs in the financial advice sector as a result of a number of recent changes. We are also concerned about the cost impact from the introduction of AFCA. There are a number of areas where additional costs could flow such as panels and the independent assessor. It is also important to note that the lack of any competition going forward will impact the incentive to keep costs to a sensible minimum. The Explanatory Memorandum indicates that AFCA will drive a $43.85M increase in the cost for industry. These cost increases are likely to have further implications in terms of the cost of financial advice and a reduction in access to financial advice and the affordability of that advice.

The very limited time that has been made for this consultation is in our view detrimental to the outcome. This consultation paper has raised 41 questions, some of which have deep and significant implications. Treasury should be aware that there are other major consultations occurring at this same time on “strengthening penalties for corporate and financial sector misconduct”, along with consultation by the TPB on corporate governance for professional associations and ASIC’s consultation on the financial literacy strategy. A two week timeframe for this consultation does not do justice to the importance of this reform.

We have primarily focused our feedback on the implications for the financial advice sector.

Response to Questions Raised in the Consultation Paper

Part 1 – Terms of Reference

1. Are there any other principles that should be included in the guiding principles for AFCA’s establishment?

We note the reference under compliance to the Ramsay Review recommendations. We question whether this should be included here as there remains strong opposition to some of the Ramsay Review recommendations.

We also note that there is no recognition in these guiding principles of the rights of financial service providers or the sustainability of each relevant sector of the financial services industry. There needs to be a balance between the interests of consumers and financial service providers.

These principles will not guarantee good consumer outcomes, particularly if they result in a significant increase in the cost of providing financial advice and a reduction in access and affordability of financial advice.

Issue 1 – Monetary Limits

2. Specific monetary limits. As AFCA will be a new EDR scheme, is it appropriate to maintain specific limits for income stream risk disputes, general insurance broking disputes; and third party motor vehicle insurance?

The AFA believes that a limit on income stream risk disputes needs to be retained. A payment of $8,300 per month represents approximately $100k per year and $500k over five years. Some Income stream policies could pay benefits for 40 years or more, so we are talking about very sizable judgements. A monthly monetary limit should be retained for income stream risk products.

3. If these specific limits are to be retained, should there be an increase in the limits?

As noted above, an income stream risk product at the level of the monthly cap, would pay $500k over 5 years, which is consistent with the proposed lump sum compensation cap. The AFA does not believe that it needs to be increased.

4. Impact on Professional Indemnity Insurance. Are there any anticipated effects on firms that will be disproportionate to any increase in specific increased monetary limits?

The AFA has very serious concerns about this proposal. Throughout this review and consultation process we have not seen any evidence that the implications on PI Insurance have been adequately considered. What does "disproportionate" mean? The feedback that we have from licensees and from insurance brokers is that there is a genuine expectation that some insurers will exit the market, that insurance premiums will increase materially, that excesses will increase significantly and that new entrants to the financial advice market will struggle to find PI insurance and will therefore not be able to operate. Every indication that we have received is that it will be impossible to quantify the impact in the timeframe that we have been given and that this will be a matter of simply waiting to see the problem emerge. However, by that point it will be too late.

We strongly recommend that any increase in the monetary limit and compensation cap is deferred until the implications of such a move is comprehensively reviewed.

We would also like to make the point that the Ramsay Review proposal to eventually increase the compensation cap to the level of the monetary cap ($1M) is fundamentally flawed. The consequences of this would be to decimate the PI Insurance market for financial advisers. There is no basis to have EDR schemes fully replace the role of the courts in considering large scale claims.

We believe that one of the other consequences of increasing the monetary limit and the compensation cap is the likelihood that plaintiff lawyers will increasingly focus on the area of financial advice. Whilst some clients might need assistance from lawyers in preparing a complaint, most clients will be able to make submissions to AFCA without the need to agree to give something like 30% of any benefit to a third party. We do not believe that this is in the best interest of consumers and is also likely to have further implications on PI insurance.

Issue 2 – Enhanced Decision Making

5. **What measures may assist in ensuring AFCA's decision making processes promote consistency while:**
   - **Deciding each case on its merits based on the facts and circumstances of the complaint; and**
   - **Maintaining the objective of achieving fairness and flexibility to adapt to changed circumstances?**

The principles set out on page 10 of the consultation paper represent a sensible approach.

It is not apparent to us that the proposed legislation has done anything to increase the consistency in the outcomes. Whilst we note the work of the existing EDR schemes to promote improved outcomes, our members still report significant deficiencies in the system and variability in outcomes. Our members refer to situations where they have been subject to pressure to settle a matter when they do not believe that they have done anything wrong. They believe that consumers can readily misrepresent the circumstances, yet expect to avoid being challenged on this. Unfortunately, a number of our members express genuine concern about the fairness of the current EDR system.

6. **Are there any other principles that may assist in ensuring AFCA provides fair, efficient, timely and independent decisions?**

In the AFA's view, the EDR system already works very much in favour of the consumer. To make it fairer for all parties, there needs to be greater capacity to test the veracity of complaints and to have decisions reviewed and appealed.

7. **To what extent should these principles be reflected in the Terms of Reference, while allowing for operational flexibility?**

The seven dot points on page 10 should be reflected in the terms of reference. We don't believe that they go far enough to ensure that decisions are made on an equitable basis. More needs to be done to enable decisions to be tested and certain conduct challenged.

Issue 3 – Use of Panels

8. **How should AFCA balance the advantages of using panels in certain circumstances against efficiency and service implications including cost and timeliness of its decision making?**

The AFA supports the use of panels, however notes that if the role of the panel is simply to review the work of the case assessor then the value is limited. To have any genuine benefit, the panel needs to look at the source documents and to talk to the relevant parties.

We are conscious that the utilisation of panels is likely to have an impact upon the cost of AFCA and the flow-on cost to industry. For this reason, we believe that panels should be used for particularly complex cases and for quality control purposes. They will most likely also slow down the process of the completion of complaints.

9. Are there other factors that should be taken into account when considering whether a panel should be used?

It is our view that panels could be used for quality assurance purposes and to test the consistency of processes and thinking. It is important to leverage the skills on the panel and to use them to challenge existing practices.

10. How best can AFCA provide clear guidance to users about when a panel should be used?

We do not believe that there is a requirement for a high level of visibility of the use of panels in the process. This could be simply noted on the final report.

Issue 4 – Independent Reviews

11. Apart from the review of the impact of the higher compensation cap, are there other aspects of AFCA's operations that should be subject to independent review within the first three years of its commencement?

The initial commencement of AFCA is subject to significant risk as the entity is being built from scratch. There are a range of risks, particularly with respect to resources and the creation of processes. The first independent review should assess the effectiveness of the establishment phase.

We believe that any independent review needs to speak to focus groups of participants from each constituent industry sector. In the case of financial advisers, it is important to speak to them directly to get their view on the issues with the EDR system.

Issue 5 – Independent Assessor

The legislation includes a requirement for the scheme to have an independent assessor. The Explanatory Memorandum provides little additional detail, other than a reference to reviewing the services provided to users in the handling of the disputes. The term "users" is not defined, in the Explanatory Memorandum or in the consultation paper, although it is addressed in the Ramsay Review final report. It is the view of the AFA that both parties should be able to make a complaint to the Independent Assessor.

We note that the consultation paper states that the independent assessor will not review the merits of an AFCA decision. We do not believe that this is clearly set out in the Explanatory Memorandum and believe that such a constraint significantly diminishes the value of the independent assessor role. How can they perform their role without assessing cases?

12. How and where should the charter of the independent assessor be defined? Who should be able to make a complaint to the independent assessor?

We believe that the charter for the independent assessor should be set out in the Terms of Reference for AFCA. This is the core document that defines the rules for AFCA.

We strongly believe that both complainants and financial service providers should be able to complain to the independent assessor. We also believe that a financial adviser, who might be a representative of a licensee who is the subject of a complaint, should also have the ability to make a complaint to the independent assessor.

13. What safeguards should be put in place to ensure the assessor remains 'independent' (for example should there be restrictions on early termination of the independent assessor)?

The appointment of the independent assessor should be made by the AFCA Board rather than AFCA management. The AFCA Board should also have the ability to terminate the independent assessor, however the basis for any termination should be disclosed in the annual report. The AFCA Board includes consumer representatives and industry representatives and the mechanisms should be in place to appropriately manage the appointment and termination process. The ability to terminate an independent assessor who is not meeting expectations should not be restricted.

14. Should the independent assessor have guaranteed access to the AFCA Board?

Yes. If they are appointed by the Board, then they should have ongoing access to the Board.

15. What other reporting arrangements should be in place (for example, if there is serious misconduct or a system issue)?

The independent assessor should report to each Board meeting and have regular discussions with the chair of the Board.

16. Should the independent assessor publish their findings in each case on an anonymised basis?

Yes the reports should be published. It is most likely that the information would be shared internally within AFCA, and it should therefore be made publicly available. We believe that full transparency is appropriate.

17. What should happen if AFCA disagrees with the independent assessor's decision?

We believe that the most appropriate solution in such a case is for it to be considered by the Board of AFCA, who would need to make the final decision.

18. When should a review of the functions and operations of the independent assessor be undertaken?

It would seem to make the best sense to have a review of the independent assessor as part of the overall AFCA independent review. There is no reason to separate it and there is an interdependency that should be considered as part of the AFCA independent review.

Issue 6 – Exclusions from AFCA's Jurisdiction

19. Do existing exclusions from FOS and CIO jurisdictions present any unreasonable barriers to access the schemes?

The AFA does not believe that the current exclusions pose unreasonable barriers. Our concern is that these exclusions are not always applied effectively and that some frivolous or baseless claims are still considered and even if the outcome is that the complaint is denied, the financial service provider still ends out paying fees to the EDR scheme.

20. Is there more that could be done so that complaints lacking substance are excluded from being dealt with by AFCA?

We believe that there is more that could be done. In particularly we are concerned about small fee complaints where there is no basis, yet the EDR costs cause financial service providers to agree to

make a payment to avoid the cost of the complaint being escalated. Complaints should not be accepted unless they have substance.

21. What, if any, further practices should be adopted to ensure the correct balance between accessibility to the scheme and ensuring that complaints not appropriate for consideration by an EDR scheme are excluded?

The AFA believes that EDR schemes need to be particularly careful about coaching complainants in terms of the best approach to take action, where this advice might be around the best way to structure the complaint to at least achieve a partial result, even where there is little substance to the complaint. It might be appropriate that there is a more structured process for financial service providers to make an objection that a complaint is outside the terms of reference.

Issue 7 – Other Issues to be Addressed in the Terms of Reference

22. What requirements relating to accessibility should be included in AFCA's terms of reference?

We believe that it is important that complaints about financial services, particularly where they represent a significant amount of money should be put in writing. There are various means to put things in writing including via web forms, however we do not think that it is acceptable to operate on the basis of a verbal complaint. This does not mean that a third party cannot play a role in assisting with documenting the basis of the complaint. It is important to ensure that disadvantaged groups have access to the EDR scheme.

23. Having regard to the current FOS terms of reference and CIO what practices and topics are of sufficient ongoing significance that they should be addressed in the AFCA terms of reference?

We do not have any feedback in response to this question.

24. Are there any matters not currently included in the FOS terms of reference/CIO rules that warrant inclusion in AFCA's terms of reference?

The AFA strongly believes that in order to provide fairness to all parties, there needs to be an ability for financial service providers to challenge certain decisions. This would most likely not be all decisions, and might be limited to decisions above a certain threshold. The inability to challenge decisions where the financial service provider believes there is a fundamental mistake has broad implications, including in terms of the impact on PI insurance and the overall confidence in the EDR system.

Part 2 – Superannuation

Issue 8 – Additional Elements of the Superannuation Dispute Resolution Process to be Addressed in Terms of Reference

25. What additional matters related to superannuation should be addressed in AFCA's terms of reference (as opposed to operational guidelines)?

The AFA view is that who can make a complaint, time limits and exclusions should be part of the terms of reference. The terms of reference should contain the high level principles and should provide clarity for users.

26. What matters related to superannuation would benefit from the additional flexibility that comes from being addressed in operational guidelines?

The operational guidelines would be expected to include the procedural detail and be more inwardly focussed rather than externally focussed.

Issue 9 – Disputes Currently Before the SCT

27. What additional arrangements could be put in place to facilitate the transition of complaints that were lodged with the SCT prior to 1 July 2018, but are not yet 'dealt with' to be considered by AFCA? At what point could a complaint be considered to be 'dealt with' by the SCT?

The AFA view is that complaints that are lodged with the SCT should be completed by the SCT and not withdrawn and resubmitted to AFCA. This is simply inefficient and will unnecessarily drive up costs. It is noted that there are concerns about turn around times, however the fact that no new cases will be submitted to the SCT, should mean that turnaround times should improve, if current resources are retained.

Part 3 – Governance

Issue 10 – Ensuring that Directors have Appropriate Skills and Experience Without being Simply Representatives of Sectional Interests

28. What measures could be put in place to secure sufficient knowledge of how different parts of the industry operate, while avoiding the representative tag for directors?

The important point is the necessary skills. In our view the representative tag is not such a factor. The reality is that there are not enough industry director roles on the AFCA Board to neatly cover every sector of the market and they will therefore need to provide cover for multiple segments of the market. The potential implication of this is that the Board lacks the necessary skills for each of the areas that they deal with. It is also important to note that the Directors are removed from management decision making or case decision making so the perceived risk is substantially reduced.

We believe that the AFCA should operate other forums to ensure adequate engagement with the market place. This might be achieved by having sector advisory forums.

The AFA would like to see a director appointed who has a genuine understanding of the financial advice sector.

29. What measures should be put in place to ensure the AFCA Board appropriately balances the considerations of currency of director knowledge of particular industry sectors, conflicts of interests, and breadth of competencies required?

It is often the case that Boards include people who are working part time or are recently retired. As a direct result this opens up the risk that their knowledge becomes outdated. For this reason, it would be important to ensure that there is an ongoing means of staying connected with industry. As stated above, the nature of the decisions being made by the directors is likely to mean that conflicts of interest are a less significant issue.

30. What needs to be addressed at a Board/constitution level and what can be addressed through additional governance arrangements established by AFCA such as industry sector advisory panel(s) for transition?

This issue can be addressed by a Board nominations policy, ongoing industry liaison and the utilisation of sector advisory forums.

Issue 11 – Board Responsibilities

31. Are there additional functions or responsibilities of the AFCA board that are not reflected in the constitutions of the existing schemes?

We are not in a position to respond to this question.

32. What benchmarks should AFCA have in relation to matters addressed in the ASX corporate governance principles, including board renewal, diversity, procedures for assessing board performance, management of conflicts of interest or of duty on the part of directors and executive staff, and remuneration policy?

Whilst it is noted that AFCA will be a company limited by guarantee, it is still appropriate to apply good corporate governance practices and principles. With respect to board renewal, we note that the ASX corporate governance principles, whilst raising this issue is not specific in terms of the maximum period on a Board. We recommend that the maximum term is set at seven years and that this is incorporated in the constitution for AFCA. Diversity, review of board performance and management of conflicts of interest can all be operated on the basis of the principles. Remuneration needs to reflect the fact that this is a not-for-profit entity, and this should be addressed accordingly.

33. Should the Constitution or governing rules provide that neither the board not individual directors can direct a decision-maker with regard to the outcomes of a particular dispute or class of disputes?

We agree that an individual director should not be able to direct the outcome for a specific case. We would also recognise that directing decisions on individual cases is not the role of the Board, however it is possible that the Board may be placed in a position where that is required, such as the situation where there is a disagreement between the CEO of AFCA and the independent assessor. Thus, it would be inappropriate to preclude this, where it was a joint decision of the Board. It may also be the case that the Board might provide advice to AFCA management on things to consider in the treatment of a class of disputes.

Part 4 – Funding

Issue 12 – Funding Matters for Consideration as Part of Authorisation

34. In addition to matters identified in paragraph 1-3 above, what other material should a company seeking authorisation to operate the AFCA scheme provide to demonstrate that it has satisfied the requirements of adequate funding and sufficient funding flexibility?

The items noted in paragraphs 1 to 3 on page 26 of the consultation paper reflect the core expectations of the authorisation process and the funding model. The AFA supports a funding model based upon a base cost (dependent upon size and nature of business) and a variable cost based upon the number of complaints processed and at what stage of the process they are resolved. We also agree that any cross subsidisation should be minimised.

It is important for any organisation to have a buffer to deal with unexpected outcomes or the seasonality of revenue and expense flows. It is unclear, whether the AFCA will be an existing entity with existing capital to address this need for a buffer, or one that starts with little capital.

35. Are there any principles beyond those identified in paragraph 2 above that should underpin AFCA's funding model?

Paragraph 2 on page 26 of the consultation paper recognises principles of user pays, equity and simplicity, which we support. It is important that equity applies at multiple levels, including that members do not pay inappropriately for frivolous complaints or mistakes by AFCA.

36. Should the funding arrangements for superannuation and non-superannuation disputes be separate and distinct, given the very different nature of these disputes?

The funding model should be the same across the whole member base and apply consistent principles. Given the principles discussed above, there would be no reason to have a separate model for superannuation and non-superannuation disputes. We also make the point that the term superannuation disputes needs to be used carefully as advice related complaints on superannuation products are not likely to be treated in terms of the definition of superannuation disputes as used in this question.

Issue 13 – Interim Funding Arrangements

37. If an interim funding arrangement were put in place, what features should it have and when would it be appropriate to transition to a long-run funding model?

We do not appreciate the issues with building the longer-term funding model and have assumed that there should be access to sufficient information on the operations of the SCT to build an adequate solution. If it is a matter of learning from experience then we would assume that this could be done on the basis of one years experience. There is no reason for this to be drawn out unnecessarily.

38. What special considerations might need to be factored into an interim funding model to balance the need for adequate resources (certainty) with the principles (accuracy)?

The answer to this question depends upon the level of initial capital in AFCA. The less initial capital the higher the need to be more conservative with the initial funding model. It may be necessary to place a reduced emphasis on accuracy in the initial period in order to ensure certainty. We don't anticipate that this should be a huge issue if the implementation is well planned.

Issue 14 – Transparency and Accountability

39. Who are the key stakeholders AFCA is accountable to? What is the key objective and measure of importance to each stakeholder?

We believe that the key stakeholders and objectives are as follows:

- The Minister – Compliance with the law and public confidence in the system.
- ASIC – Compliance with the law.
- Financial Service Providers – Equitable outcomes, efficient operations and transparency.
- Complainants – fair outcomes in a timely manner.
- Other stakeholders include the independent reviewer(s), independent assessor, industry and professional bodies.

40. In addition to the accountability measures in the Bill, are there additional measures that should be embedded in AFCA's Constitution and/or terms of reference or reflected in ASIC guidance to ensure accountability to stakeholders?

It is our view that it is important to ensure that AFCA remains efficient and cost effective. As AFCA will be a monopoly operator there will be no market driven incentive to be efficient. Whilst the reporting of changes in fees to the Minister will provide transparency, this is not the same as accountability. The scale of AFCA and the multitude of members will make it difficult for any one sector of the financial services market to hold AFCA accountable.

41. Are there other conditions that could be put in place to ensure the scheme is accountable to members in relation to fees?

Members will be interested in ensuring that fees are kept to an absolute minimum. Management and the Board will need to be held accountable to members. There will need to be quality reporting on financial operations, unit costs for processing complaints, comparative benchmarking with similar operations in other sectors and the ability for members to question the Board and management. Whilst we appreciate that there will be costs involved, it is important to ensure that there is visibility and access to the Board and management. Members also need to take a close interest in the operations of AFCA in order to hold it accountable.

Concluding Remarks

As stated above, the AFA has serious concerns about the impact of the proposed increases in the monetary limit and compensation cap on the cost of PI insurance for financial advice businesses. We believe that this is a critical issue that has not been addressed. We do not believe that this should be changed at the same time as the establishment of AFCA and recommend that this be subject to comprehensive analysis before any change is made. This is too important an issue to not get right.

The establishment of AFCA is a fundamental change for the financial services industry. It is apparent that there will be a substantial disturbance and additional cost in the transition phase before it is likely that any substantial change in consumer outcomes will be achieved. From our perspective it seems that there is a lot of risk and only minimal potential upside.

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

Yours faithfully

Philip Kewin
Chief Executive Officer
Association of Financial Advisers Ltd