14 June 2017

Manager

Financial Services Unit

Financial System Division

The Treasury

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IN WORD AND PDF FORMAT

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Dear Colleagues

Consultation Paper: Improving dispute resolution in the financial system (Paper); Exposure Draft Treasury Laws Amendment (External Dispute Resolution) Bill and Regulations 2017 (ED Bill and ED Regulations respectively) and Exposure Draft Explanatory Material (EDEM)

The Financial Services Council (**FSC**) has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies.The industry is responsible for investing more than $2.7 trillion on behalf of 13 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Thank you for the opportunity to provide a submission on this topic.

Our comments are set out below.

FSC Submission 14 June, 2017:
Consultation Paper: Improving dispute resolution in the financial system (Paper); Exposure Draft Treasury Laws Amendment (External Dispute Resolution) Bill and Regulations 2017 (ED Bill and ED Regulations respectively) and Exposure Draft Explanatory Material (EDEM)

General comments

1. We note that on 9 May 2017, the Government announced the creation of a new framework for dispute resolution with a 'one-stop shop' EDR scheme which will be known as the Australian Financial Complaints Authority (**AFCA**). AFCA will replace the Financial Ombudsman's Service (**FOS**), the Credit and Investments Ombudsman (**CIO**) and the Superannuation Complaints Tribunal (**SCT**) and will consider disputes about *Financial Firms* (as defined in the ED Bill and Regulations);
2. For completeness, we note the following in relation to the proposed external dispute resolution (**EDR**) framework:-

(a) According to the material and other Government announcements, AFCA will be based on an ombudsman model and will be established by industry as a public company limited by guarantee. It is expected that AFCA will be operational by 1 July 2018;

(b) Financial Firms will be required to be members of AFCA as a condition of their licence. AFCA members will be contractually bound to comply with the AFCA's terms of reference (**ToR**) which will apply to the operation of the EDR scheme by AFCA;

(c) The superannuation division will be a copy of the SCT in many respects, with similar statutory powers, modified as the circumstances require;

(d) Other relevant governance and operational matters are summarised in the EDEM.

3. As a matter of general principle, the FSC supports the concept of more effective and fairer EDR processes. However, we are concerned to ensure that the proposals mechanically "work", particularly in the superannuation context, appropriate safeguards such as rights of appeal and review exist and that the higher monetary limits and compensation caps than currently exist for FOS and CIO matters can be justified. We also express reservations to what is termed in the material as "strengthened regulatory oversight", that is the powers conferred upon ASIC in relation to

AFCA. We are also concerned to see that elements of the broader concepts of due process and procedural fairness has some role to play in the AFCA regime (albeit perhaps modified to take into account the alternative dispute resolution processes envisaged by the proposals). In our view, this is consistent with the policy intent of the AFCA regime and indeed can only strengthen it and its integrity. We are concerned to see that these issues are given appropriate consideration and detailed consultation occurs prior to the finalisation of the AFCA regime;

4. In this context, appropriate consideration needs to be given to the AFCA Terms of Reference (**ToR**). Our preference would be that the ToR be limited to operational matters (such as time limits, monetary limits and the skill set of panellists), rather than the legal powers of the body. The latter concept should be subject to explanation in the legislation and general administrative law principles;
5. Given the increase in compensation caps and th**e** absence of appeal rights for non-superannuation matters, it seems to us to be fundamental that the jurisdiction of AFCA not be engaged until such time as the complainant has exhausted appropriate and relevant internal dispute resolution processes;
6. We note that if in due course, it were to be determined that the non-superannuation jurisdiction of AFCA was to be raised to $1million, then, this should only occur after detailed consultation has been undertaken, including consideration of issues concerning procedural fairness.
7. The EDR system, as it currently stands, provides financial services providers with a choice of provider of EDR services, at least in theory. Under the proposed framework, the Minister will only approve one EDR scheme. It is therefore important to ensure that there is sufficient consultation with industry and other stakeholders to ensure that the new scheme is robust in all aspects;

Ministerial Powers

8. We note in relation to the Minister's powers that

(a) The Minister will have the power to authorise an EDR scheme after taking into account a more detailed list of matters.

(b) The Minister will have the power to revoke an EDR scheme's authorisation.

(c) The Minister will need to take into account various scheme functions, as set out in the legislation, when considering whether to authorise an EDR scheme.

The last concept appears to have no equivalent as such in the current EDR regime. The first two are similar to the existing ASIC powers;

9. In addition we note that the Minister's authorisation of an EDR scheme will also be subject to the following conditions:

(a) A condition that the operator of the scheme must be a company limited by guarantee;

(b) A condition that the operator of the scheme must perform the scheme functions and comply with any regulatory requirements and direction issued by ASIC;

(c) A condition that the scheme must have an independent assessor;

(d) A condition that material changes to the scheme must not be made without prior ASIC approval; and

(e) Any other conditions that the Minister specifies in the authorisation.

We also note that currently ASIC effectively has approval powers in respect of the ToR for FOS. Nevertheless, in relation to these powers and conditions we ask that there be some more granular identification of the circumstances in which the Minister will exercise his powers and the circumstances in which ASIC is likely to issue directions;

10. We confirm our previous comments that it is preferable the ToR be restricted to operational matters.

ASIC Powers

11. We note that it is proposed that ASIC have enhanced powers under the AFCA scheme. There do not appear to be any equivalents to these powers under the existing FOS regime. In particular,

(a) ASIC will have the power to issue regulatory requirements relating to the performance of the scheme functions.

(b) All material changes to the ToR of an authorised EDR scheme must first be approved by ASIC.

(c) ASIC will have the power to issue directions to the scheme operator **to increase limits on the value of claims or to undertake specific measures to comply with a condition of authorisation of the scheme(emphasis added).**

The latter in particular seems to give power to extend the reach of the AFCA scheme in a monetary sense. Although the EDEM at paragraph 1.73 refers to some elements of administrative law controls, how this will work in practice and how industry, rather than the AFCA, can take objection to these matters is not clear. Certainly, given the issues we raise in our submission as to the compensation and jurisdictional matters for the AFCA regime, highlight the need for there to be detailed and careful consideration given to these matters. The relevant paragraph reads as follows-

1.73 The written direction will include a statement of reasons and may also include the time by which the operator must comply with the direction, or the period of time during which the direction is in force. Any timeframe provided by ASIC to carry out the specified direction must be reasonable. [Schedule 1, Part 1, item 2, subsections 1051(3) and (4)]

12. Our view is that ASIC should be able to make recommendations to AFCA but not give directions. It is not appropriate that a regulator should have a coercive power in respect of an independent, statutory body. The

role of ASIC in this context should be seen as facilitative and not compulsive.

Procedural Fairness and like matters

13. We previously have made reference to concepts of due process and procedural fairness.

The current ToR for FOS provide that *FOS is not bound by any legal rule of evidence* (Rule 8.1) and FOS

will do what in its opinion is fair in all the circumstances, having regard to each of the following:

a) legal principles;

b) applicable industry codes or guidance as to practice;

c) good industry practice; and

d) previous relevant decisions of FOS or a Predecessor Scheme (although FOS will not be bound by these).

(Rule 8.2).

14. This formulation leads to uncertainty for Financial Firms. This is because Financial Firms have obligations to "consumers" of their products which are imposed in accordance with the law in a broader sense both general law and statutory. Thus, RSE licensees and REs have general law and statutory duties to act in the best interests of their members, to avoid and manage conflicts and numerous other obligations. An insurer has an obligation to its insureds and to its reinsurers to manage contracts of insurance, including assessing claims, in accordance with the terms and conditions of the underlying contract of insurance and all applicable laws. As an ***alternative dispute resolution*** (**ADR**) system, FOS is designed to provide consumers with an easily accessible alternative to the formal structures and outcomes applicable to litigation. In some circumstances we observe this may lead to the risk of poor outcomes for consumers, in particular:

(a) A consumer who accepts a decision on the basis that it is legally correct may have a less favourable outcome than a consumer who lodges a dispute with FOS, and

(b) A risk of increased costs to consumers increased fees and premiums, of claims paid outside the terms and conditions of the underlying governing rules of the product or contract of insurance and all applicable laws.

15. As discussed, however, the FOS regime effectively is an ADR (process designed to provide a less formal, less legalistic approach to dispute resolution. This is the intention also in respect of the AFCA regime. However, by way of general observation and accepting the implications for Financial Firms mentioned above, some of our members have observed that it would be appropriate going forward if AFCA had appropriate regard to the elements of concepts of procedural fairness and due process law even if it were not strictly bound by them. In this context, it has been mentioned that determinations should be arrived at by reference to principles of procedural reasonableness according to the *Wednesbury* principle (i.e. a reasoning or decision is unreasonable if it is so unreasonable that no reasonable decision-maker acting reasonably could have made it). It would be helpful if appropriate consideration could be given to these issues in formulating the AFCA ToR. We confirm that our members remain supportive of the ADR concept and that it is a necessary adjunct to building and maintaining consumer confidence in the financial services system. However, in formulating the legislation and ToR and indeed rules of practice for AFCA it would be useful if these suggestions were considered. For example, we would envisage that elements of procedural fairness, due process and written reasoning based on established and accepted precedent, would have some role to play here;

Publication of decisions

16. The ED Bill and Regulations should specify that AFCA must publish its decisions in an anonymised form.

17. If AFCA published its decisions this would better inform Financial Firms and consumers, helping:

(a) To improve Financial Firms' processes, procedures and documentation, and

(b) To reduce the number of disputes being referred to AFCA which have little prospect of success.

Appeals process

18. At one level, it might be argued that if concepts of fairness were applied strictly, the ED Bill should provide **both** consumers and Financial Firms with a right of appeal against a decision by AFCA, for example, as follows:

(a) Consumers for any reason, and

(b) Financial Firms on questions of law.

19. We appreciate however that, particularly in the context of non-superannuation matters, AFCA will continue the FOS approach of being an ADR process, with a balance between consumer and Financial Firm interests with the desirability of building trust and confidence in the complaints processes and IDR and EDR measures;.

20. We note that the current FOS ToR provide consumers with the right not to accept a Recommendation or Determination by FOS, and bring an action in the courts or taken any other available actions against the financial services provider (Rule 8.9). However, the FOS ToR do not provide financial services providers with a similar right;

21. These principles may well remain appropriate if the monetary compensation cap of AFCA in non-superannuation matters remains, comparatively, low. However, more significant questions arise if, as appears to be envisaged, the AFCA jurisdiction in such matters is raised to $1million. We discuss this point in more detail below;

Auditing of decisions

22. The legislation should provide ASIC with the power to form an independent panel of experts periodically to audit a cross section of AFCA's decisions, to ensure that AFCA has followed due process, including providing clear and transparent reasons for its decisions.

Superannuation

23. We note the following in relation to superannuation matters-

(a) The EDR decision-maker will have the power to join certain persons to a superannuation complaint.

(b) The EDR decision-maker will have the power to obtain information and documents from people where the information or documents are relevant to a superannuation complaint.

(c) The EDR decision-maker will have the power to require certain person to attend conciliation conferences.

(d)The EDR decision-maker may refer questions of law to the Federal Court.

(e) When making a determination regarding a superannuation complaint, the EDR decision-maker will have all the powers, obligations and discretions conferred upon the original decision-maker.

(f) A determination of an EDR decision maker in relation to a superannuation complaint comes into effect immediately unless specified.

(g) Determinations of the EDR decision maker will be subject to appeal to the Federal Court on questions of law in relation to superannuation complaints.

24. The above rules appear to be equivalent to and comparable with the current SCT rules and on that basis we would support in principle the "superannuation division "of the AFCA having such powers. As we have said

in our prior submission on this topic, the major difficulties from our members' perspective with the current SCT operations have been those of resourcing and funding for the SCT. If the AFCA regime, were to address these issues, ie, the current difficulties did not continue under the new regime and the substantive aspects of the SCT jurisdiction continued, then this would be welcome;

25. It is preferable that there be a "lift and drop" of the SCT into the superannuation division of AFCA. As indicated above, so far as we can tell, generally, this appears to have occurred. Nevertheless, there are some important issues we should highlight which require clarification-

(a) One of the current SCT rules is that matters relating to the operation of the fund as a whole cannot be the subject of a complaint to the SCT, ie, the intention is that it is a dispute founded in a decision of the trustee in relation to a specific member which can be the subject of complaint. We assume this will continue under the AFCA regime. However, we could not identify the means by which this is to occur. Further clarification is required in this context;

(b) Similarly, it is not entirely clear how the rules relating to death benefits and claim-staking processes are to be replicated in the superannuation division of AFCA. Again, clarification of the precise legislative mechanics is required;

(c) Another important issue here is to ensure the continuation of the SCT's power to be able to treat a complaint as withdrawn if it is considered lacking in substance and/or misconceived, without having to go through the full EDR process at the SCT. In this regard we note that our members have indicated that a significant proportion of SCT complaints are closed early as the SCT finds them to be lacking in substance and/or misconceived. If similar cases cannot be dismissed by AFCA on the same basis, Financial Firms necessarily will incur higher costs to deal with

superannuation disputes. In the result, such costs, in whole or in part, ultimately are met by fund members;

Internal Dispute Resolution (IDR)

26. We note that it is proposed under Schedule 2 to the ED Bill that there will be amendments to the Corporations Act, NCCP Act and relevant regulations to introduce *an enhanced IDR framework*. As we understand it, the purpose of this is to extend current IDR requirements to entities required to hold an RSE licence. Clarification is sought that the intention here is to extend AFSL-like IDR requirements to non-AFSL holders, who, nevertheless hold or should hold an RSE licence. In this regard paragraphs 2.16 and 2.17 of the EDEM state-

> *Under the enhanced IDR framework, trustees of regulated superannuation funds (other than SMSFs) and approved deposit funds that are not required to hold an AFS licence, but hold a RSE licence will now be required to have an IDR procedure which complies with ASIC standards.*
>
> *The Superannuation Industry (Supervision) Regulations 1994 (SIS Regulations) and the Retirement Savings Accounts Regulations 1997 (RSA Regulations) will be amended to ensure that these trustees are required to have the same IDR requirements as AFS licensees, and this will be a condition of their RSE licence. These requirements will replace those contained in section 101 of the SIS Act.*

27. We do not have any inherent issues with this concept if our interpretation is correct. However, care will need to be taken to ensure that any such changes are future-proofed (to accommodate for example the outcomes of the insurance in superannuation cross-industry working group) and "work" with the existing superannuation regimes;

28. We also suggest that Government consult with ASIC and Financial Firms prior to finalising the reporting criteria, to ensure that the criteria are well-defined and understood, to better facilitate accurate and reliable comparisons between financial services providers;

No equivalents in current law

29. We note that there are a number of other provisions which do not have equivalents, according to the EDEM, in the current law. These are as follows-

(a) RSE licence holders must have adequate IDR procedures that comply with the standards and requirements made by ASIC.

(b) All ***Financial Firms*** are required to report their IDR activities in accordance with ASIC requirements.

(c) ASIC will be provided with the power to determine the content and form of IDR reporting by Financial Firms.

It would be useful for all of industry to understand how these reporting requirements might play out and what the content of the reports might look like going forward. A number of these measures could be addressed by appropriate regulation. We assume that there will be further consultation on these measures in due course with industry, particularly as systems changes are likely to be required. In this context, we note that benchmarking reporting was adopted by FOS in 2017. However, we confirm our observations that further information is required as to the purpose and intended use of the data

Compensation Caps[1]

30. The FSC supports speedy and effective dispute resolution processes which are user-friendly. However, the subject matter of the process should be appropriate. This is so particularly when the FOS and AFCA regimes also are ADR process existing outside the traditional court-based litigation

[1] The discussion in this part is confined to "non-superannuation "matters.

processes. For example, we note that the current FOS jurisdictional limit on income protection matters is $8300 per month. Increasing the eventual limit as proposed to $1 million appears to us to have the outcome that virtually all income protection policies will be included within the scope of AFCA. This is compounded by the fact that ASIC under the ED Bill will have power to give directions to AFCA to increase the limit of value of claims. Higher value claims are likely to be complex claims and in certain cases it may well be more appropriate that traditional court-based litigation continues to perform a function;

31. In other claims, the current maximum total value of the remedy that may be decided upon by FOS (excluding compensation for costs and interest payments) for insurance claims is $309,000;

32. The current monetary limits are significant given that FOS is not bound by the law, and financial services providers have no prescribed rights of appeal. As we understand it, it is proposed that AFCA will commence operations with a minimum $500,000 compensation cap for non-superannuation consumer disputes. However, there will be consultation on whether consumer disputes relating to general insurance products should move immediately to a compensation cap of $1 million. In addition, it seems that ASIC will have power as the legislation is currently drafted to give directions as to increases in compensation limits;

33. In our view, the monetary limits should be considered further after AFCA's ToR have been finalised. In any event, as we have observed the following should be considered-

(a) Procedural fairness and due process should be specifically contemplated by the ToR and more so than is the case currently in the FOS ToR;

(b) Depending on the ultimate outcome in due course of the compensation limit rules, and, after, as we have said

appropriate consultation, consideration ought to be given to providing Financial Firms with a right of appeal, say to the Federal Court on a question of law; and

(c) AFCA's Terms of Reference provide a cap "per month" for income stream claims (as per the current FOS ToR).

34. The potential issue of some significance here then is that the ability to refer or appeal against decisions on questions of law is confined to superannuation matters. This may be appropriate and correct in the context of an alternative dispute resolution arrangement, however, the conclusion is not so readily reached where the compensation cap potentially is $1 million. If this were to be the case, this requires further detailed consideration and consultation;

35. As we have indicated previously, the position concerning judicial review of the exercise of Ministerial and ASIC powers should be clarified and indeed whether an industry participant (Financial Firm) might have the appropriate standing to challenge the exercise of power requires review).

Other comments

36. In this section, we make some additional comments in relation to miscellaneous, yet nevertheless important matters.

37. As all Financial Firms will need to put in place frameworks to follow mandated IDR processes ,AFCA should have jurisdiction only **after** the matter has been considered by the Financial Firm as part of its IDR process;

38. As the largest number of superannuation complaints currently relate to distribution of death benefits, this may present an opportunity to streamline the claims staking process set out in the SROC Act;

39. The funding model needs to be clarified and there needs to be industry buy-in, as this is to be an industry owned company limited by guarantee. The funding model needs to strike a balance between adequate funding and expense for the industry. AFCA should not be incentivised by

the fee structure to register complaints that are not within its jurisdiction or to accelerate the complaints process in order to increase its fee income. The current model of charging a substantial fee for initial registration should not be continued in the new model. In this context we do note that our members whilst very supportive of the need for better resourced EDR and ADR frameworks, have mentioned that it is important that, in developing the funding model, Treasury is mindful of the costs it imposes on Financial Firms given many of these costs are ultimately borne by consumers, such as members of superannuation funds and MISs and policy holders. Financial Firms thus, and particularly superannuation trustees, are already under considerable pressure to contain fees and costs in an ever fluid and increasing regulatory environment;

40. Under transition to AFCA, the SCT, FOS and CIO will be left dealing with legacy complaints and dwindling funding We request that Government consider whether AFCA could be "delegated" the existing functions of the three bodies;

41. Generally, we do agree in principle that an 'under one roof' approach is preferable to avoid consumer confusion and disparity between complainants and timeframes. We are concerned however, to ensure that the SCT and its approach in a practical sense will be preserved but with appropriate funding and resourcing. As we have indicated, the preservation of the substantive aspects of the SCT in a revised structure does appear to have been preserved. However, our members have expressed concern that the skill set of existing SCT panel members be retained, so in a practical sense, this and other transition issues do need to be addressed;

42. Members also have raised some very practical issues, including those set out below. We assume that in due course, these particular issues will be addressed by AFCA and the current bodies in the lead-up to transition to AFCA. The issues are as follows-

(a) Members would like to see insofar as is possible, an alignment in the approach of various divisions of AFCA including

presentation and content of decisions and use of principles and precedents;

(b) FOS previously has made comment concerning how it intends to refer to the FSC Life Insurance Code of Practice and members affected look forward to on-going engagement in this area;

(c) Members have commented that careful consideration should be given as to how AFCA integrates with Financial Firms. It has been noted for example that there have been considerable improvements to FOS integration with the member portal. We assume that this will be replicated in AFCA;

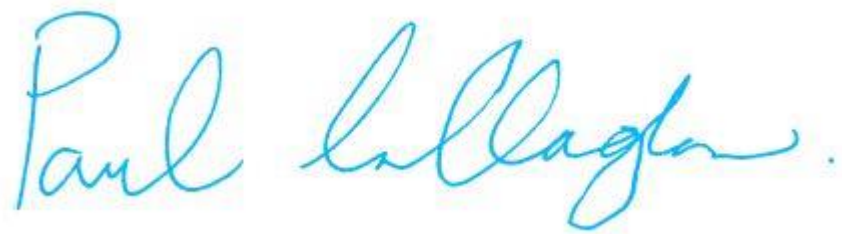
(c) There have been improved results to timeframes for all parties through FOS's fast track initiative and we suggest this be considered as the desired framework for AFCA;

(d) We assume that precedent value will be given to existing determinations in the various streams going-forward in AFCA;

(e) It would be useful for us to understand generally what steps are being taken by the current organisations in the transitional period to clear backlogs and reduce unresolved matters.

Should you have any questions, please contact the writer on 02-9299 3022.

Yours Faithfully



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