

**Review of the financial system
external dispute resolution
framework – Supplementary
Issues paper – Compensation
Scheme of Last Resort**

Submission by Legal Aid Queensland



Review of the financial system external dispute resolution framework – Compensation Scheme of Last Resort

Introduction

Legal Aid Queensland (LAQ) welcomes the opportunity to make a submission on the Supplementary Issues Paper of the Review of the Financial System External Dispute Resolution Framework concerning a Compensation Scheme of Last Resort.

LAQ provides input into State and Commonwealth policy development and law reform processes to advance its organisational objectives. Under the *Legal Aid Queensland Act 1997*, LAQ is established for the purpose of “giving legal assistance to financially disadvantaged persons in the most effective, efficient and economical way” and is required to give this “legal assistance at a reasonable cost to the community and on an equitable basis throughout the State”. Consistent with these statutory objects, LAQ contributes to government policy processes about proposals that will impact on the cost-effectiveness of LAQ’s services, either directly or consequentially through impacts on the efficient functioning of the justice system.

LAQ seeks to offer policy input that is constructive and based on the extensive experience of LAQ’s lawyers in the day to day application of the law in courts and tribunals. We believe that this experience provides LAQ with valuable knowledge and insights into the operation of the justice system that can contribute to government policy development. LAQ also endeavours to offer policy options that may enable government to pursue policy objectives in the most effective and efficient way.

LAQ’s Consumer Protection Unit lawyers have extensive experience providing specialist advice and representation in consumer law matters. The unit provides advice to clients as well as lawyers and financial counsellors throughout Queensland in relation to mortgage stress, house repossession, debt, contracts, loans, telecommunications and unsolicited consumer agreements.

LAQ deals with the financial system external dispute resolution (EDR) framework on a daily basis. This submission is informed by that knowledge and experience.

Questions

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?

LAQ submits that the Panel’s approach to the scope of issues is appropriate.

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?

LAQ supports the principles outlined by the Panel in the Review’s Terms of Reference. In LAQ’s

submission all these principles are important. However, for a consumer the ability to access any scheme in an efficient and equitable way is the most important consideration.

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*?

In LAQ's view the existing compensation arrangements contained in the *Corporations Act 2001* and *National Consumer Credit Protection Act 2009* have the following strengths and weaknesses:

Strengths

- (a) The obligations are placed on the licensee.
- (b) The obligations are clear and easy to understand.

Weaknesses

- (a) Professional indemnity insurance does not provide protection for every situation that causes loss to a consumer.
- (b) Insurance is expensive for business and may lead to some businesses self-insuring.
- (c) The evidence of unpaid determinations in the Financial Ombudsman Service (FOS) and the Credit and Investments Ombudsman (CIO) suggests the existing compensation arrangements do not provide adequate protection for all consumers who suffer loss.

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*?

LAQ submits that the strength of the National Guarantee Fund is that it protects consumers who are making claims for loss that results if a market participant becomes insolvent. Similarly the Financial Claims scheme provides protection from loss for consumers if their authorised deposit taking institution (ADI) or general insurer fails.

Evaluation of a compensation scheme of last resort

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

In LAQ's experience there are a significant number of consumers who have not received substantive access to justice because a firm, which has caused loss to the consumer, does not have the financial resources or insurance that covers the loss caused or the conduct which has caused the loss.

The benefits of establishing a compensation scheme of last resort are:

- (a) that it would provide these consumers with substantive access to justice that compensated their loss.
- (b) it would improve confidence in the EDR and court systems.
- (c) it would improve confidence in the financial sector more generally.

LAQ acknowledges that there will be some costs to industry in the scheme being set up and the potential of the industry being required to make on-going contributions to the scheme. In LAQ's submission, these costs are outweighed by the benefits to both consumers and the industry as confidence in the financial system improves.

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

LAQ is not aware of any existing regulatory framework impediments to establishing the scheme.

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?

LAQ acknowledges that a compensation scheme may create a small risk of moral hazard in that it might encourage some consumers to engage in riskier financial behaviour. However, in LAQ's experience this is only a small minority of consumers. The vast majority of consumers engage in risk averse financial behaviour.

Furthermore, LAQ submits that the compensation scheme of last resort is likely to increase consumer confidence in the industry. This increased confidence in the industry is likely to see consumers engage more with the industry and its participants, find more information out about industry participants and may lead to them making better financial decisions by choosing firms that are expert in financial matters.

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

In LAQ's submission, the relevant change since Richard St John's Report is the evidence provided by FOS and the CIO that a significant number of unpaid determinations which means there is a significant number of consumers who have not received compensation. These unpaid determinations show that the current arrangements, including the additional assurance recommended by the St John Report, are not protecting consumers.

Potential design of a compensation scheme of last resort

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

ABA Proposal

The strengths of the ABA proposal are:

- (a) it promotes a multifaceted approach to the risks of unpaid determinations to consumers. It is important that reforms such as the professionalisation of financial advice and reforms relating to AFS licensing criteria are also considered as complementary to the proposed scheme.
- (b) access to the scheme requires that all other redress avenues have been exhausted and that the business is insolvent or has been wound up.
- (c) the proposed scheme administration has a board with an independent chair, legal expert and an equal number of consumer and industry representatives.

The weakness of the ABA proposal is that it is restricted to the provision of financial advice. LAQ is aware that only 53% of FOS non-compliant firms are financial planners and advisors. It would be

inequitable to consumers to restrict a scheme to financial planning.

FOS Proposal

The strengths of the FOS proposal are:

- (a) the scheme covers all unpaid determinations or awards of AFS licensees from an EDR scheme, court or tribunal with appropriate caps on compensation.
- (b) the scheme would be prefunded by a levy on AFS licensees.
- (c) the scheme would be supported by a legislative requirement on AFS licensees to be a member of the scheme.

The weakness of the FOS proposal is that it restricts the compensation available to a portion of the EDR scheme limits. For reasons of equity and reducing complexity, any compensation caps placed on the scheme should match the existing compensation caps for the EDR schemes.

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

In LAQ's submission the primary reason for extending a compensation scheme of last resort beyond financial advice is that FOS' figures show that just 53% of its unpaid determinations come from financial planning and advice.

It would be inequitable and unfair to consumers who have issues with finance companies outside of the financial planning industry if losses caused by the financial planning industry were compensated by the scheme and losses caused by other financial service providers were not also compensated.

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

Retail and small business clients of an AFS licensee should be able to access any compensation scheme of last resort.

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

In LAQ's submission claims that meet the subject matter jurisdiction of the current EDR schemes should be covered by any compensation scheme of last resort.

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?

In LAQ's view the scheme should cover unpaid EDR determination, court judgements and tribunal decisions. It is important that consumers have access to the same potential remedies irrespective of the forum that they choose.

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

In LAQ's submission consumers and small business should be required to ensure that all other redress avenues have been exhausted and that the business is insolvent or has been wound up before coming to the scheme.

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?

LAQ is concerned that if the scheme had the ability to review the merits of an EDR determination about a dispute it will undermine consumer confidence in the EDR scheme and may undermine confidence in the industry as a whole. In LAQ's submission, it is highly unlikely that the introduction of the scheme would see a reduction in the quality of EDR decision making or in the internal quality assurance processes undertaken by an EDR scheme that might warrant the scheme reviewing the merits of EDR determinations.

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?

If the scheme was established and allowed individuals with a Court judgement to access the scheme, in LAQ's submission they should:

- (a) Only be able to recover the same types of losses as are recoverable under the EDR schemes. It is important that access to the scheme for consumers be equitable between all consumers.
- (b) Recover a percentage of their legal costs up to a fixed monetary cap.

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

The EDR compensation caps proposed by the Government as part of the introduction of the Australian Financial Complaints Authority (AFCA) should apply to any compensation scheme to ensure consistency.

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

In LAQ's submission, industry should fund the scheme in the way set out in the FOS proposal on page 30 of the Supplementary Issues Paper.

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

LAQ supports the UK Financial Services Compensation Scheme (FSCS) funding class model because it creates an incentive for firms within an industry to collectively improve the industry practice.

LAQ does not support the single class funding model because it risks firms or industries who engage in inappropriate practices being cross-subsidised by firms who treat consumers appropriately.

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?

In LAQ's submission the scheme should be able to access the usual court processes against a firm who has failed to pay the EDR determination.

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

LAQ supports the scheme administration set out in the ABA proposal which includes investigation of the possibility of the new EDR scheme providing the administrative services and collecting the scheme's levies.

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

In LAQ's view the same time limits as for recovering a debt should apply to making a claim under any compensation scheme of last resort. This time limit is appropriate as it gives a consumer the opportunity to exhaust all avenues for recovering the award or determination before applying to the scheme.

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

It is important that all compensation schemes work together and share procedures and operational ideas where appropriate.

Legacy unpaid EDR determinations

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

In LAQ's experience the existing mechanisms that are available for individuals who have legacy unpaid EDR determinations are limited because:

- (a) By accepting an EDR determination the consumer has compromised their rights to bring an action in Court.
- (b) There is no mechanism available to the consumer to bring a claim to enforce the determination in the EDR scheme.
- (c) Any court rights (if any) the consumer may have to try and enforce the EDR determination in Court will only lead to a pyrrhic victory where the company is insolvent or has no assets.

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?

LAQ supports the need for an additional mechanism to deal with legacy unpaid determinations. This additional mechanism is needed to ensure that consumers who have experienced inappropriate conduct causing them loss before any last resort scheme is implemented are treated the same way as those consumers who experience the same conduct after the proposed scheme of last resort is implemented.

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?

LAQ agrees with the list of circumstances set out by the Panel on pages 35-37 of the Supplementary

issues paper.

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

In LAQ's submission, it is difficult to provide quantitative evidence of the extent of the problem of lack of access to redress for past disputes. The reason is that it is impossible to know the number of cases that were never started by consumers because they received accurate legal advice that even if they were successful in bringing their claim against the insolvent company it was unlikely that they would successfully recover the majority of their loss.

LAQ gives advice to a number of consumers in this position. In LAQ's view these advices suggests that the lack of redress for past disputes is a significant problem.

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?

In LAQ's view the important features of the other approaches established to resolve past disputes outside of the Courts are:

- (a) they provide those people affected with a tangible recognition of the harm that has been done to them.
- (b) they provide monetary assistance to consumers to assist them to deal with the consequences they have suffered as a result of the harm they have experienced.

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?

LAQ regularly provides advice to consumers who are in severe financial hardship that has been caused by them having no access to redress for past disputes. This hardship is usually characterised by:

- (a) they are at risk of losing their home because of the loss caused by the previous bad behaviour of a member of the industry; and/or
- (b) their mental and physical health has been affected by the stress of trying to obtain redress for the harm they have experienced and then dealing with the financial hardship that resulted from being unsuccessful.

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

LAQ recognises that there may be some legal impediments to providing access to redress for past disputes. These impediments include:

- (a) time limits for bringing a claim may have expired.
- (b) relevant evidence or witnesses may no longer be available.

- (c) a firm's records of its dealings with the consumer may no longer be available.
- (d) it may be difficult to provide both parties to the dispute with natural justice and a fair hearing.

Design issues for providing access to redress for past disputes

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

In LAQ's submission, the strengths of the Westpac proposal are:

- (a) it provides a clear and simple funding model by imposing a levy on potential industry participants.
- (b) the proposed ad-hoc expert panel, which is similar to the existing FOS decision making panels, will provide an independent body for the claims assessment process.
- (c) the proposal is transparent and provides a simple and easy to access process for consumers.

However, LAQ is concerned by the feature of the proposal which allows the decision of the expert panel to be appealed to the Supreme/Federal Court. Allowing decisions of the Panel to be appealed will:

- (a) reduce confidence in the expert panel because there is a risk that their decision will not be a final one.
- (b) restrict the customer's access to redress because many consumers who are in the position of needing redress cannot afford to fund court action or appeals themselves.

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?

LAQ supports consumers and small business having access to redress for past disputes. LAQ supports the inclusion of all of the circumstances in paragraphs 133-144.

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

LAQ supports the appointment of an expert panel consisting of an industry representative, a consumer representative and an independent representative being appointed to resolve disputes.

In LAQ's submission the criteria for determining which disputes can be brought forward should be:

- (a) the dispute is not outside any statute of limitations.
- (b) the dispute has not previously been heard by a court, tribunal or EDR Scheme.

45. What time limits should apply?

LAQ supports the current court and EDR time limits applying.

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?

LAQ supports the Australian Financial Complaints Authority appointing the expert panel for resolving

claims for redress for past disputes. However, once appointed the expert panel should operate separately to AFCA to avoid any confusion that might arise concerning the scope of AFCA's jurisdiction to hear 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)?

To ensure consistency of approach, industry should fund both the compensation scheme of last resort and any scheme providing for the redress of past disputes.

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

LAQ supports the proposal that the EDR scheme monetary limits apply to the scheme for redress for past disputes. It is important that consistent monetary limits apply across all schemes to prevent confusion for consumers trying to enforce their rights.

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?

LAQ supports allowing consumers and small businesses, who have not previously had their dispute considered, access to redress for past disputes.

LAQ does not support applying the new higher monetary limits of AFCA retrospectively. LAQ does not support a transition period, where access to redress for past disputes will be provided at the new higher monetary limits.

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?

LAQ is concerned by the proposal that any rationing mechanism could be based on hardship criteria. Such a proposal is likely to further harm and victimise consumers who, as a result of the proposal, risk being placed in a competition with each other to see who is in the greatest hardship or financial difficulty.

If it was not possible to fully compensate all claimants, LAQ supports compensation being awarded on a pro-rata basis with reference to the loss suffered by each consumer.

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

LAQ is not aware of any further issues that need to be considered.