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EDR Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

By email EDRreview@treasury.gov.au

To whom it may concern

We welcome the opportunity to provide a submission to the Review Panel in response to the Supplementary Issues Paper - *Review of the financial system external dispute resolution framework*.

Given we have already made a substantive submission to the Review, comments in this submission are narrow and specific to certain questions provided in the paper.

We hope this submission adds value to the Panel's consideration of these key issues.

Please do not hesitate to contact me and my colleagues if we can further assist with the Panel's important work.

Yours sincerely,

Josh Mennen
Principal
MAURICE BLACKBURN

Maurice Blackburn submission in response to the Supplementary Issues Paper - *Review of the financial system external dispute resolution framework*

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?

In relation to paragraph 29 and specifically the definition of a dispute, ie that it "has been the subject of a decision", we have specific reservations.

We have had matters where the Credit & Investment Ombudsman (CIO) has declined to process matters to conclusion because the Financial Service Provider (FSP) has gone into administration or been deregistered. If a claimant needs a decision to access SOLR then such practices must cease and those matters where decisions were not given should be reopened.

In relation to paragraph 31, the implications of shutting out all claimants who have had decisions from an External Dispute Resolution (EDR) scheme in the past is inconsistent with the guiding principle of Equity.

This approach would disadvantage a claimant who pursued his or her claim before the commencement of the SOLR in favour of a claimant who waited until after the SOLR commenced, despite the fact that they may have suffered losses at the same point in time.

The SOLR should be available to claimants who suffered losses from 2008 being the year that the GFC impacted on Australian financial products.

In relation to paragraph 32, and specifically that "separate arrangements may need to be put in place to address legacy uncompensated losses", we assert that EDR schemes including the Australian Financial Complaints Authority (AFCA) should waive time limits for disputes lodged in respect to FSP's who have become insolvent where the loss was suffered from 2008.

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?

There is a lack of clarity regarding the number and size of cases where FOS or CIO declined jurisdiction. FOS and CIO only accept disputes against FSPs that are registered Members. When an FSP loses its AFS Licence or no longer provides financial services it's EDR scheme membership ceases. Hence these determinations are from matters where the FSP ceased trading or became insolvent after the dispute was lodged, and any statistics of those entities do not include cases where the FOS or CIO declined jurisdiction.

So whilst the totals in paragraph 43 are concerning, they only tell part of the story.

The paper correctly notes that ASIC does not approve professional indemnity insurance arrangements for FSPs and that it does not have "data about the renewal of advice licensees' professional indemnity insurance cover".

This is problematic and a monitoring and approval regime should be introduced. The Panel could administer same and report to the regulator.

These arrangements would ideally include claimants being able to access direct recourse to professional indemnity insurers through EDR schemes including AFCA when it commences operations from 1 July 2018.

This is obviously contrary to the ASIC December 2015 report (as per paragraph 62) that PI insurance *"is neither intended nor designed to provide compensation directly to consumers*". However we would assert that ASIC's position taken on that point is contrary to the common law doctrine of "direct recourse" and the statutory regimes which grant claimants the right to look beyond the insured wrongdoer and seek recovery directly from the relevant PI insurer.

In that regard, we refer the Panel to the newly introduced *Civil Liability (Third Party Claims Against Insurers) Act 2017* (NSW) section 1(a): *If an insured person has an insured liability to a person (the claimant), the claimant may, subject to this Act, recover the amount of the insured liability from the insurer in proceedings before a court.*

These laws represent the benchmark for facilitating a fair and effective direct recourse regime.

We also refer to the New South Wales Law Reform Commission Report 143 - Third Party Claims on Insurance Money: Review of s 6 of the Law Reform (Miscellaneous Provisions) Act 1946 that catalysed that Act.

That report confirmed that the new provisions would ensure that a PI insurer:

- would not be liable for more than it would have been liable to pay under the insurance contract; and

- can rely on the same defences that the insured could have relied on in an action brought by the claimant.

Hence it cannot be said that PI insurers are prejudiced by this form of "direct recourse".

We also point to section 601AG of the *Corporations Act 2001* (Cth) and s 51 of the *Insurance Contracts Act 1984* (Cth) which allows the plaintiff to litigation to proceed directly against the insurer when the insured defendant is absent because it is a deregistered company, or he or she is a dead or missing individual.

However these statutes relate to litigation through the State and Federal courts and are lacking uniformity across States. That may encourage forum shopping which is undesirable. Further, litigation is obviously prohibitively daunting and costly for most victims of financial wrongdoing. That is why EDR schemes such as FOS, CIO and the Superannuation Complaints Tribunal (SCT) exist. What is therefore needed is a right of direct recourse by consumers via an EDR forum.

One option for reform may be to establish a condition of licencing that FSP's PI insurers are registered and contractually bound by EDR decisions in relation to which the PI insurer is on risk (we accept that such an arrangement could only function prospectively as the PI insurer would not have been party to a previous EDR decision). At the very least, EDR schemes should include in its register of FSP Members the name and details of the relevant past and current PI insurers. This will help deserving claimants to receive compensation and lessen the burden on the SOLR.

The St John Report of 2012 recommended that licensees provide additional insurances to ASIC in relation to their professional indemnity insurance cover. We support this.

Finally, there are inadequacies of the Corporations Act that are worth noting in this context.

For instance, it is our experience that in pursuing a financial adviser, who is in liquidation, it is very difficult to work out who the PI insurer is and the liquidator typically will not disclose. Again this is an issue that potentially could be monitored by the Panel and reported to the regulator and/or subject of legislative reform via the Corporations Act.

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?

It is our view that the introduction of a scheme would favour FSPs who are EDR members over accountants, auditors, property advisers, mortgage brokers and the like who consumers can misunderstand as being providers of advice when they are not. Such an impact would therefore be positive and increase consumer confidence

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?

Introduction of a scheme would result in costs being passed on to consumers. However, we believe that the net benefit to consumers needs to be articulated, but it is also important that the PI insurance issues be resolved.

To better understand the capacity of PI insurance to play a role, the Panel could request analysis of PI insurance profit margins over recent years.

Another implication may be, as per paragraph 91, circumstances inducing riskier behaviour by financial firms and/or may reduce the incentive for stringent regulation or rigorous administration of the existing compensation arrangements.

We believe it would be appropriate to mitigate this risk by increasing the appropriate penalty regimes for FSPs.

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

As discussed earlier, the Report led to the introduction of the pioneering Civil Liability (Third Party Claims Against Insurers) Act 2017.

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

We have a specific reservation in relation to the FOS proposal that access be limited to claimants being "retail" clients. As a consequence, this excludes wholesale and 'sophisticated' clients as defined in the Corporations Act. However one of the common basis for complaint by complainants is that they were miscategorised as such by the FSP who gave the advice. Such people should not be excluded. Furthermore, even where clients are correctly categorised as wholesale or 'sophisticated' clients, the legal tests for such categorisation are based on the income or assets rather than the knowledge of the client which unfairly exposes vulnerable clients with a large asset base such as a recipient of a court settlement or inheritance.

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

We have reservations regarding the suggestion in paragraph 96 that a claimant has to prove they received an EDR determination in their favour to be eligible. Obviously people can't access an EDR if the FSP is not a member of an EDR scheme.

Under s912A(2) and 1017G(2) of the Corporations Act, AFS licensees, must have a dispute resolution system that consists of:

(a) IDR procedures that comply with the standards and requirements made or approved by ASIC and that cover complaints made by retail clients in relation to the financial services provided; and

(b) membership of one or more ASIC-approved EDR schemes that covers—or together cover—complaints made by retail clients in relation to the financial services provided (other than complaints that may be dealt with by the SCT).

When an FSP loses its AFS Licence or no longer provides financial services it's EDR scheme membership ceases. Hence the EDR scheme no longer has any jurisdiction over the former member or its PI insurer.

In the subsequent paragraph (97) the issue is raised where a firm is insolvent and unable to defend an EDR matter. It could be defended by a PI insurer in the name of the FSP, and there is also the discretion of the EDR case manager to effectively ensure a decision is made.

The issue of class actions in paragraph 99 is an important question. We believe those eligible for a class action should still have access to the scheme but the doctrine of 'double recovery' would obviously apply to prevent unjust enrichment.

We acknowledge however that a viability analysis of allowing consumers of agribusiness to access the SOLR where losses are retrospective should be conducted with possible restrictions imposed where they have had an opportunity to access some relief via a class action.

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

We recommend that at a minimum all claims that would come within the jurisdiction of an ASIC approved EDR scheme including AFCA should be prima facie eligible for consideration under the SOLR. That typically includes claims for breach of contract, negligence and statutory breach against a provider of financial services. It would also include unsuitable loans under the Credit Law, National Consumer Credit Protection Act, and unjust contracts under the NCC in respect to which FOS and CIO currently have jurisdiction.

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

It is reasonable to request that consumers either make an attempt to take a dispute to EDR which was unsuccessful because the FSP is not a Member, or there is a determination from a Court, Tribunal or EDR scheme in the consumer's favour. The lodgement of a Proof of Debt with a liquidator could also be considered as a pre-requisite, particularly where the FSP is no longer an a Member of an EDR scheme or cannot be sued without special leave.

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?

A claimant should have the right to raise any concerns held regarding the EDR decision, particularly in reference to a disagreement as to the quantification of losses. However the SOLR should not need to be resourced to reinvestigate each matter in detail when the EDR scheme has already decided on it and the consumer accepts the decision.

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?

First, it is our strong view that the scheme should apply where individuals who have a court judgment which has not been satisfied should be able to access a compensation scheme of last resort. The kinds of losses recoverable in such a situation should include reasonable legal costs on a solicitor client basis (as determined by the court or accepted by the scheme) but subject always to any overall caps on compensation which are ultimately adopted for the scheme.

Secondly and as a corollary we can see no basis for distinguishing between an amount unsatisfied pursuant following a judgment in individual litigation and an amount unsatisfied following a judgment (including a settlement approval) in class action litigation. If group members are out of pocket by reason of the insolvency or other incapacity to pay of a FSP and they have exhausted other means of redress then there seems no principled basis on which they should be refused the opportunity to participate in a compensation scheme of last resort merely because they have aggregated their claims rather than pursued them individually. There can be no suggestion of double compensation because compensation under the scheme will only be available to the extent that individuals or group member losses remain unsatisfied.

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?

Litigation funders ought not be permitted to directly claim compensation from any scheme of last resort. Where a litigation funding agreement is freely entered into between a funder and its client then absent a suggestion that that agreement should be set aside for misrepresentation, duress, unconscionability or any other reason the agreement prima facie should simply apply according to its terms. This may mean in some circumstances that clients will agree as part of an overall bargain to provide a portion of their compensation under the proposed scheme to the litigation funder in return for litigation funding. One can envisage situations where if the only compensation obtained was a small amount from the scheme it might be unconscionable for the litigation funder to seek a commission but equally in situations where substantial sums have ben outlaid by a litigation funder on obtaining a court judgment (which is ultimately unsatisfied) it may be entirely appropriate for the litigation funder to receive commission on amounts paid by the scheme.

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

Notwithstanding the fact that a SOLR should not be limited to matters where EDR schemes have made a decision, it is sound policy to consider some form of cap for SOLR payments.

One option is to take a *pari passu* approach (pay a percentage of the loss) or ideally a progressive *parri passu* approach (pay a percentage of the loss above a certain amount. Eg. Only 50% for losses $500k+).

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?

The scheme should have rights to recover the full financial impact although the capacity of the firm to pay could be an issue. Such an ability to pursue the directors of such firms would ideally prevent phoenix behaviour occurring.

Furthermore, and in relation to the suggestion of subrogation in paragraph 111, if the SOLR is paying compensation it follows that the scheme would acquire a right of subrogation to pursue the FSP or its PI insurer directly.

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

We would have significant reservations with an industry administered scheme. The conflict of interest is significant and it would undermine public confidence in such a scheme.

An efficient approach would have the scheme administered by a/the relevant EDR scheme with regulatory oversight.

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?

We work on daily basis with consumers, usually mum and dad investors, who have been hit hard by regulatory and market failures resulting in personal and financial distress for them and their wider family.

A SOLR would have provided them with a safety net, particularly for those Australians who were hit by failures of others during and since the GFC.

We strongly advocate that legacy claims be included and the catchment be as wide as practical. We strongly suggest the panel review and consider how these legacy claims relate to the systemic disputes where dozens and hundreds of consumers are involved.

Furthermore, direct recourse to the relevant PI insurer would provide a mechanism to receive compensation.

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

The significant weakness of the Westpac proposal is that non-bank past disputes should not be included, but banks pay their adverse decisions and are subject to Government protection. As such, Westpac is essentially saying that no past disputes should be included.