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Manager
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Dear Sir or Madam

New dispute resolution framework and implementation of the Australian Financial Complaints Authority (AFCA)

Mills Oakley values the opportunity to make the **enclosed** submission on the consultation paper for the new dispute resolution framework and proposal to implement AFCA as a single external dispute resolution (**EDR**) scheme as released by the Treasury on 17 May 2017.

We support the changes proposed by the Treasury Laws Amendment (External Dispute Resolution) Bill 2017 (**EDR Bill**) and associated draft regulations.

In the **enclosed** Submission to Treasury we submit that the proposed framework could be strengthened and greater accessibility and transparency would be available to the financial services industry and consumers if the types of financial products that an authorised EDR scheme is required to consider was included as a matter that the Minister is required to consider when deciding whether to authorise the scheme.

This would create greater certainty for AFCA's members and their customers and at the same time would not affect the intended flexibility of the EDR scheme to engage with a wide range of financial disputes.

We further submit that the proposed statutory power joining third parties to superannuation complaint proceedings should be refined to ensure that any medical professional joined to the proceedings is only joined where that person's medical or other certification is a pre-requisite to the payment of a disability benefit.

If you have any questions or require further information please do not hesitate to contact Michael Chapman on +61 3 9605 0079 or mchapman@millsoakley.com.au

Yours sincerely

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Mills Oakley Submission to Treasury – Australian Financial Complaints Authority

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1 Mills Oakley

Mills Oakley is a full-service commercial law firm servicing clients across all Australian capital cities and a number of regional centres. With nearly 100 Partners and 500 staff across offices in Sydney, Melbourne, Brisbane, Canberra and Perth, we are confident in our reputation for efficiently delivering high-quality legal services.

Mills Oakley values the opportunity to make a submission on the consultation paper in respect of the new dispute resolution framework and proposal to establish the Australian Financial Complaints Authority (**AFCA**) as a single external dispute resolution (**EDR**) scheme that will deal with all financial disputes released by the Treasury on 17 May 2017.

The Financial Services team at Mills Oakley has extensive experience in assisting financial services businesses and customers of those businesses resolve financial services disputes through internal and external dispute resolution processes, including through FOS and the SCT, and in the Court system.

Our submission is derived from our experience advising our clients in the establishment of managed investment schemes and their restructure, particularly in distressed or insolvent circumstances, including extensive litigation; and acting for stakeholders in the superannuation industry to resolve total and permanent disability claims.

2 EDR reforms

Overall, we support the changes proposed by the Treasury Laws Amendment (External Dispute Resolution) Bill 2017 (**EDR Bill**), the establishment of AFCA and the increased monetary limits jurisdiction and flexibility to proactively engage with the subject matter of modern financial disputes.

We consider the proposed changes will give greater recourse to customers of Financial Services Providers (**FSPs**) outside the Court system, provide for greater accountability by FSPs, and encourage earlier and more effective resolution of disputes.

This submission responds to Questions 3 and 4 of the consultation paper, being:

3. *Are there any issues that are currently in the Bill that would be more appropriately placed in the terms of reference or issues that are currently absent from the Bill that should be included in the Bill?*
4. *Are there any additional issues that should be considered to ensure an effective transition to the new EDR scheme?*

3 EDR bill: Framework for designation of Financial Products

The EDR Bill is structured as enabling legislation to establish an EDR scheme with the relevant authorising provisions. As is appropriate for legislation of this type, the Bill does not give guidance about the types of financial products the EDR scheme will consider or the FSPs (defined as “Financial Firms”) that would be required to be members.

However, the result is that the EDR Bill draws attention to the uncertainty about the *types* of financial products and services that may be considered by an authorised EDR scheme that is an issue under existing legislation.

In particular, because AFCA is proposed to be a "one stop shop" for all financial services disputes, including small business disputes, and will take over the functions of the Financial Ombudsman Service (**FOS**) and the Credit and Investments Ombudsman (**CIO**), which are restricted from considering certain financial products, there is uncertainty about how far the jurisdiction of AFCA will extend.

This causes further uncertainty about the types of FSPs that will be required to be members of the scheme and the nature of their membership. For example, it is not apparent whether external administrators of credit providers will be required to be members of AFCA in their own right or would be bound by the membership of the insolvent entity they are administering.

We do not consider that the EDR Bill should specify the financial products it will consider that the Financial Firms that will be bound by it – it is appropriate for this to be dealt with in the legislation that is primarily relevant to the type of financial service provided – however, we submit that a better regulatory outcome would be achieved if:

- An authorised EDR scheme is required to state in its terms of reference the financial products that it considers; and
- The authorising provisions for approval of an authorised EDR scheme includes a requirement that the Minister take into account the types of financial products that the EDR scheme expects to consider.

We submit that these requirements will increase accessibility of AFCA to consumers, including small business, without undermining the important aim of ensuring that AFCA is flexible and responsive to new developments in financial services.

4 Terms of Reference: Financial Product to be considered

The new EDR framework proposes that AFCA is flexible and responsive to new developments and, accordingly, whilst the standards that AFCA must adhere to will be set out in the legislation, the way in which AFCA will operate will be determined by the AFCA board and set out in AFCA's terms of reference.

The minimum requirements that an authorised EDR scheme would be expected to include are:

- The matters that the Minister will take into account when considering whether to authorise an EDR Scheme as set out in proposed section 1046(2); and
- The scheme functions under proposed section 1047.

Notably, proposed section 1046(2) requires the Minister to consider the accessibility of the EDR scheme, its independence, accountability and it expertise, among other things. However, there is no minimum requirement set as to the *types* of financial products that the authorised EDR scheme will determine.

Similarly, the scheme functions set out in section 1047 include that the EDR scheme is to consider complaints against members and ensure they are dealt with in a fair, equitable, independent and timely manner, but do not set out any function to determine the types of financial products it will consider.

Arguably, those matters should be made clear in the terms of reference of an authorised EDR Scheme. In particular, if the Minister is to determine whether an EDR Scheme has the requisite independence and expertise, the Minister should also consider:

- The types of financial products, and whether AFCA has the expertise to do so; and
- The Financial Firms selling those financial products, and whether the AFCA has the independence and accountability to consider a dispute involving those parties.

The matters that the Minister will take into account when authorising a scheme under section 1046(1) and which ASIC will consider when issuing a direction on scheme function under section 1049 are the matters that will form the basis of AFCA's terms of reference that will create contractual obligations for the Financial Firms that are required to become members. It is of course important that the requirements are clearly expressed so that those members can understand their obligations.

However, it is possibly even more important that the terms of reference clearly state the financial products that AFCA will consider because this is likely to be the first point of reference by any customer of a Financial Firm who wishes to resolve a dispute. If the types of financial products that may be considered by AFCA are not set out in the terms of reference, it limits accessibility of the scheme to FSP customers who would experience difficulty determining whether the EDR scheme applies to their circumstances without obtaining legal advice.

This, in turn, increases the transparency and trust that the customer can place in the EDR scheme and will ultimately assist the customer to understand and accept any determination by AFCA.

Whilst under the EDR Bill ASIC will have the power to issue regulatory requirements as to how AFCA should perform its scheme functions, those functions are the same matters that the Minister must consider when authorising the EDR scheme at its commencement. This does not give ASIC the flexibility to expand the remit of scheme nor give certainty as to its proposed function.

In our view, whilst there are compelling reasons to allow the AFCA board flexibility to determine its operational capacity under its terms of reference, it will lead to a stronger and more accessible regulatory outcome if the types of financial products that the EDR scheme expects to consider is included in proposed sections 1046(2) and 1047.

5 Membership of EDR Scheme

The new EDR framework proposes that membership of AFCA will be compulsory for all Financial Firms, which includes Australian Financial Services licensees, unlicensed product issuers, unlicensed secondary sellers, credit providers and credit representatives, among others.

As the types of financial products (or services) that will be subject to the new EDR framework is not defined, the definition of Financial Firms is necessarily wide, as it should be.

However, as a consequence there is some uncertainty about whether certain FSPs will be Financial Firms under the EDR Bill and this, in turn, creates uncertainty for FSPs in determining their regulatory and compliance requirements and for the customers of FSPs in determining whether AFCA applies to their dispute without seeking external advice.

By requiring the terms of reference of an authorised EDR scheme to set out the types of financial products that it will consider, much greater clarity would be achieved. It is submitted that this clarity would be further increased if the terms of reference set out the types of FSPs that are Financial Firms that are required to be members of AFCA.

A related uncertainty is whether external administrators of a Financial Firm, such as the registered liquidator of a credit provider, will be required to hold membership of AFCA separately, or will operate through the credit provider's membership of AFCA, or will not be bound by AFCA at all.

6 Example: Agribusiness Investment Loans

A prominent example of a financial product that has previously slipped through the EDR net is loans taken out by investors ('Growers') to invest in agribusiness managed investment schemes. Such Growers are predominately unsophisticated borrowers and,

but for the investment nature of their loans, would be considered retail investors who entered into a consumer credit facility.

However, 'Grower loans' are excluded from the protections under the consumer credit laws introduced in 2010 under the National Consumer Credit Protection (**NCCP**) Act because they are not predominately for a personal, domestic or household purpose. This means that the responsible lending requirements of the NCCP Act do not extend to Grower loans and ASIC has "woefully inadequate"[1] powers to manage regulatory outcomes. Lending in this space is therefore largely unregulated.

Compounding the issue, a Grower loan was found not to be a "Financial Service" strictly within the meaning given to it in the *Corporations Act 2001* (Cth) (**Act**).[2] As a result, FOS and CIO specifically exclude Grower loans from the financial products they may consider.[3] This decision was reached with reference to the NCCP Act definitions of consumer credit.

Growers can only engage with FSPs' internal review processes or ultimately the Court if they wish to dispute their loans, but have no avenue to EDR. This has led to a number of unsatisfactory outcomes.[4]

Further, as demonstrated by a number of high-profile agribusiness collapses, such as Timbercorp and Great Southern, the lending entity has been placed in receivership and the Grower loans are either subject to recovery activity by the external administrator or the loans have been sold and assigned to a third party such that the loan recovery process is not subject to any EDR process.

The EDR Bill, as proposed, does not clarify whether the Grower loans would be addressed in AFCA's terms of reference. It appears that, without legislative intervention, Grower loans would continue to be excluded from determination. This seems at odds with the intended function of the NCCP, AFCA and the EDR reforms, particularly as it is intended that AFCA as a "one stop shop" for credit disputes would have the power to determine small business credit disputes up to a monetary limit of $2 million, which are necessarily commercial (as opposed to consumer) credit issues.

Whether that it is a satisfactory regulatory outcome in respect of Grower loans is a separate consideration – and we submit the responsible lending obligations should be extended to loans for predominately investment purposes, as proposed by the *National Consumer Protection Amendment (Credit Reform Phase 2) Bill 2012*) – but it serves to highlight the uncertainty that would exist if the types of financial products an authorised EDR scheme will consider is not a relevant matter for the scheme's authorisation.

7 EDR bill: statutory power to handle superannuation complaints – joining third parties

The EDR Bill, as proposed, preserves the key statutory powers currently granted to the Superannuation Claims Tribunal (**SCT**) by the *Superannuation (Resolution of Complaints) Act 1993* (Cth) (**SROC Act**). We welcome this preservation, as the existing framework of the SCT is legally and procedurally sound.[5]

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[1] 'Bitter Harvest - Agribusiness managed investment schemes' Report, The Senate Economic References Committee, 11 March 2016, paragraph 11.85

[2] *Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (Receivers & Managers Appointed) (In Liquidation) & Ors* [2014] VSC 516 per Croft, fn. 845.

[3] It should be noted that submissions by some consumer groups, such as the Holt Baker Action Group, that the FOS and CIO monetary limits preclude consideration of Grower Loans are incorrect. Raising the monetary limit, whilst welcome, would not resolve the jurisdictional issues around Grower loans.

[4] This was acknowledged in the National Consumer Protection Amendment (Credit Reform Phase 2) Bill 2012 released by Treasury for public consultation in 2013 that proposed extending the NCCP Act regulations, among other things, to credit predominately for investment purposes.

[5] Notwithstanding the worsening issues with resourcing and delay, in respect of which we refer to the SCT submission to the EDR Review Secretariat dated 7 October 2016.

However, we are concerned about certain implications which arise as a result of changes to the language of specific provisions of the EDR Bill which have been adopted from the SROC Act.

The EDR Bill adopts the SROC Act's language with respect to the power of the decision-maker to join third parties to superannuation complaints. A comparison of the wording as set out in the EDR Bill and the SROC Act is below (emphasis ours):

EDR Bill	SROC Act
1053 Other parties may be joined to the superannuation complaint (1) The person who is to determine a superannuation complaint (the ***EDR decision-maker***) may join, as a party to the complaint, any of the following persons whom the EDR decision-maker decides should be a party to the complaint: (a) … (b) … (c) … (d) a person whom the EDR decision-maker decides is responsible for determining either or both of the existence and the extent of a disability (whether total and permanent or otherwise), if the subject matter of the complaint relates to a benefit in respect of the disability, whether under a contract of insurance or otherwise.	**18 Parties to a complaint** (1) The parties to a complaint under section 14 are: (a) … (b) … (c) … (d) If the subject matter of the complaint relates to a disability benefit (whether under a contract of insurance or otherwise) and the Tribunal decides that a person **other than a trustee or insurer** is responsible for determining either or both of the existence and the extent of the disability (whether total and permanent or otherwise) – that person.

There is a minor but important omission in the EDR Bill at proposed subsection 1053(1)(d) of the Act, which we have highlighted in the comparison text.

The inclusion of the phrase '*other than the trustee or insurer'* in the SROC Act's version of the wording forms the basis of a statutory implication that the relevant 'determination' which the person who is to be joined to the proceedings is responsible for making is a 'determination' which can be or is typically done by a trustee or insurer.

The purpose of subsection 18(1)(d) of the SROC Act (as interpreted by the Federal Court)[6] is to permit the SCT to join a person to the complaint proceedings where that person's medical or other certification is a pre-requisite to the payment of a disability benefit. If the source of the benefit entitlement (be it a trust deed or insurance policy) provides for the determination on the benefit entitlement to be made by the nominated medical or other professional, then that person may be joined to the complaint proceedings for the purpose of having the reasonableness and fairness of that determination reviewed.

Without this phrase, the wording at proposed subsection 1053(1)(d) of the Act is unnecessarily vague, and could be interpreted as applying to any medical professional whose medical certification has been relied upon by a trustee or insurer in making a determination in relation to a disability benefit. It is submitted that this was not the purpose of the similar wording in the SROC Act and is an unnecessary departure from the powers vested in the SCT to join parties to the complaint proceedings.

Example 1.1 in the Explanatory Memorandum increases the uncertainty of the intended operation of proposed subsection 1053(1)(d) of the Act. In the given example, the proposed EDR decision-maker elects to join a medical professional to the

[6] See: *Seafarers' Retirement Fund Pty Ltd v Oppenhuis* [1999] FCA 1683 [at 24 – 25]; *Howitt-Steven v Unisuper Limited* [2001] FCA 1599

complaint proceedings on the basis that the medical professional advised the insurer of a total and permanent disablement benefit that the complainant was not totally and permanently disabled. Accordingly, the example supports the contention that the mere act of preparing a medical opinion upon which an insurer or trustee later relies is enough to constitute a joinder to the superannuation complaint proceedings. As noted above, this is not the intended operation of subsection 18(1)(d) of the SROC Act.

If the intention of proposed section 1053 is to expand the existing powers of the SCT in the way contemplated by Example 1.1 of the Explanatory Memorandum, additional scrutiny should be given to the policy implications of such an expansion, for example:

- Any medical professional whose expertise is relied upon in determining the entitlement to a disability benefit may be joined to superannuation complaint proceedings, which may reduce the number of medical professionals who are willing to assess and prepare reports for disability insurance claimants.
- The standard of scrutiny which applies to the determination of an insurer or trustee in the context of a disability benefit claim is different to the standard which applies to a medical professional's diagnosis of the existence or extent of a disability. Medical professionals joined to superannuation complaint proceedings may find themselves to have breached obligations they did not have at the time of making the diagnosis.
- Adding additional parties to a complaint increases the complexity, length, and cost of resolving that complaint. Further costs implications would flow should any of the parties to the initial superannuation complaint elect to appeal the determination of the EDR decision-maker to the Federal Court.

We consider that such an expansion is unnecessary, given that the EDR reforms already make adequate provision for the opinions of a medical professional to be tested during the course of a superannuation complaint by permitting the EDR decision-maker to compel the production of statements or documents under proposed section 1054 of the Act.

If the intention of proposed section 1053 is simply to import the existing powers of the SCT to the new EDR scheme, we consider that the wording of proposed subsection 1053(1)(d) should be amended as follows:

(d) *a person, **other than the trustee or insurer**, whom the EDR decision-maker decides is responsible for determining either or both of the existence and the extent of a disability (whether total and permanent or otherwise), if the subject matter of the complaint relates to a benefit in respect of the disability, whether under a contract of insurance or otherwise.*

Making the above amendment would ensure that the existing judicial interpretation of the mirror provision of the SROC Act carries through to the new EDR framework.

Correspondingly, Example 1.1 should be removed from the proposed Explanatory Memorandum.

8 EDR bill: statutory power to handle superannuation complaints – draft wording

We consider that the inconsistent treatment of the term '*superannuation complaint'* in the current wording of proposed Division 3 of the exposure draft EDR Bill gives rise to ambiguity as to the operation of certain sections.

The term 'superannuation complaint' is defined in proposed section 1052. It would improve the ease of interpretation of proposed Division 3 if the term 'superannuation complaint' was formatted consistently throughout the division and the generic term 'complaint' was removed and replaced with 'superannuation complaint,' where appropriate.