Stockbrokers And Financial Advisers Association Limited

13 June, 2017

By email: EDR@treasury.gov.au

The Manager
Financial Services Unit
The Treasury
Langton Place
PARKES ACT 2600

Dear Sir / Madam,

CONSULTATION PAPER MAY 2017
DISPUTE RESOLUTION IN THE FINANCIAL SYSTEM

We refer to the Consultation Paper of May 2017 in relation to the implementation of the Recommendations of the Final Report of the Review Panel on the Review of the Financial System External Dispute Resolution and Complaints Framework *(the EDR Review Panel).*

We note that the Government has already accepted all of the Recommendations of the EDR Review Panel.

By way of background, in our Submission dated 7 February 2017 in relation to the proposals in the *Interim Report* of the EDR Review Panel, *we did not support* the key proposals put forward, in particular, the proposals for increases in the monetary limits, and for enhanced Internal Dispute Resolution (IDR) obligations. We also expressed serious concerns that the creation of a single EDR body could result in anti-competitive and inefficient outcomes.

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Our comments are limited to the section entitled Regulatory Impact in the Consultation Paper.

Regulatory Impact

Question 8

What will be the regulatory impacts of the new EDR framework?

SAFAA members have no doubt that the new EDR framework will result in **increased costs**, which will either have to be absorbed by members, or will increase the cost of providing financial services to retail clients.

SAFAA is concerned that the EDR proposals, following on from a whole host of increased regulation over the past 5 years, *is making the cost of providing financial advice to retail clients prohibitively expensive*. Firms are increasingly choosing to cease providing services to retail clients, whilst others have been obliged to raise costs to a level which is becoming increasingly unaffordable to the retail public.

It appears to us that the government has used a failure in one sector of the financial market as the rationale for a sweeping new EDR framework that applies to all sectors of the financial market. By adopting a one-size-fits-all approach to regulating financial services, higher costs are being imposed on the stockbroking sector when there was no problem to start with.

SAFAA members are also very concerned that other issues still being considered by the Review Panel (i.e., the potential establishment of a scheme of last resort and allowing redress to be sought for previous disputes) will only seek to exacerbate the negative outcomes that will almost certainly flow from the adoption of a one-size-fits-all approach. Accordingly, it is our view that *it is inappropriate to proceed with the implementation of some recommendations before the Review Panel has issued its report in relation to these further issues.*

(a) Impact of increased monetary limits

In our Submission on the EDR Interim Report, we noted that claims lodged with FOS in relation to stockbrokers are at the lower end of the scale – they are no more than 5% of the disputes received by FOS. Furthermore, FOS figures in respect of stockbrokers show a consistently low and falling level of complaints lodged with FOS. In the previous financial year, there were, in fact, more awards by FOS in the stockbroking sector *in favour of the Licensee* than in favour of the complainant.

We are of the view that *different classes of monetary limits should apply to different financial sectors to reflect the realities in each sector*. The existing FOS monetary limits are the highest for comparable EDR schemes globally, according to the figures in the EDR Interim Report itself. Moreover, the apparent justifications for increasing the relevant compensation caps (such as housing prices) have absolutely no relevance to the stockbroking industry.

Relevantly, in addition to FOS, clients of stockbrokers also have access to the *National Guarantee Fund* as a further avenue to recover claims against stockbrokers for the categories of claim specified in the Corporations Act.

There is ample justification therefore for the *existing monetary claim and compensation limits* to be *retained* for EDR claims in respect of the stockbroking sector.

Our members have little doubt that increasing monetary limits to the levels proposed will inevitably result in an *increase in the cost of PI insurance*, and potentially, higher deductibles being required. *This outcome would be even more likely if clients were entitled to seek redress for past disputes under the new scheme.*

It is impossible to quantify the likely increases in cost at this time. However, our members believe that they will follow from the greater risks posed to insurers by increased contribution caps, allowing clients to seek redress for past disputes (particularly where the Licensee only has limited historical insurance coverage) and the pattern of awards that are made by AFCA under the new framework over time. That is, the true impact will not be known until after the scheme has been in operation.

The other financial impact will, of course, follow from the impact of the new, higher, awards. This may lead to stockbrokers having to carry higher deductibles to offset additional costs.

Finally, an issue that has not been addressed is the impact of a *multiplier effect*, where one complaint is treated by the EDR body as comprising multiple separate claims. This has already been occurring at FOS, and the financial impact of this approach continuing under AFCA, but with higher monetary limits applying, is a serious concern.

Procedural fairness of EDR – a repudiation of centuries of legal tradition

An area that has a considerable bearing on the impact of the proposals is the procedural limitations of the EDR process. This was highlighted in our Submission on the Interim Report, and it was also raised in the submission lodged by one of SAFAA's members, Patersons Securities Limited. However, it does not appear to have been addressed in the proposals.

An EDR scheme *is not required to test a claim according to legal principles*, or apply legal process to ascertain the facts, in the way that would be required in a court of law.

Furthermore, it is extremely difficult for a Licensee to appeal an EDR decision in a court of law. In that regard, a number of Superior Court decisions have found that the Licensee has no recourse to the courts to correct what was found to be an incorrect decision by the relevant EDR body. This strikes at the heart of justice.

Whilst some investor claims, such as in relation to a mortgage or insurance issues, are likely to revolve around a limited set of factual issues, this is not true of all financial services. In relation to advice regarding shares, the relationship and the advice given will usually relate to ongoing communications and circumstances extending over a period of time, as well as complex matters relating to the movements in the stock market.

EDR decision makers do not have the powers to compel the production of documents and other evidence, or to compel witnesses to attend. EDR determinations are therefore often made without all of the facts and information needed to properly test and decide the claim.

Whilst obviously an investor who has suffered loss as a result of the actions of a licensee should be entitled to seek to recover that loss, when the $ amount of compensation reaches figures of the type that the Government has now accepted for EDR schemes, we strongly argue that claims of that size should be the subject of a more rigorous process to establish the truth, including the ability to obtain production of documents including from third parties.

Whilst the advantages flowing from the introduction of mandatory EDR in the Corporations Act were access to quick and inexpensive resolution of disputes, the shortcomings inherent in EDR were addressed by a cap on claims and awards under EDR.

If the monetary limits are increased to the levels proposed for all classes of disputes, EDR decision makers will be empowered to adjudicate disputes that would ordinarily be decided only by a Supreme Court.

For these reasons, the monetary limits for EDR schemes should not be increased without further examination of whether different caps should apply to different disputes and without a careful examination of whether any new EDR body is going to have persons sufficiently qualified to adjudicate disputes for higher amounts of compensation (whatever these amounts might be).

In addition, Licensees should have a real means of appealing an EDR decision. In the absence of this, the basic legal rights of Licensees will be eroded. This is likely to be one more factor influencing Licensees to cease acting for retail investors.

These disturbing proposals lead our members to have grave concerns that claimants, either with or without no-win no-fee litigation lawyers, will make use of the bargaining advantage that the higher claim *rough justice* EDR process will afford to extract commercial settlements for claims that would not otherwise have survived genuine scrutiny.

This is a further factor which supports the concerns that we have outlined above, the financial impact of which is something that will only emerge over time if the proposals are enacted.

(b) Internal Dispute Resolution (IDR) reporting costs

In our Submission on the EDR Interim Report, we challenged the need for increased Internal Dispute Resolution reporting. In our Submission, ASIC already does (or should) enquire into IDR processes as part of its AFSL monitoring program, and requiring another level of administrative reporting imposes additional cost with no benefit.

If a complainant has been satisfied by the IDR process within a Licensee, then the process has done its job. Query what benefit there is to anyone to report this fact, and what possible comparisons can be drawn from the information that is reported by different licensees with totally different business models.

If complainants are not satisfied by the IDR process, then they have a no-cost option to pursue EDR, which information is already gathered and reported on by the EDR body.

We are disappointed that this Recommendation has been adopted, and increased administrative cost will inevitably be incurred in the additional IDR reporting.

The precise cost of the reporting obligation cannot be ascertained at this point.

Commencement of new EDR framework

One issue of utmost importance is the date of commencement of any new framework. SAFAA urges that any new provisions should not apply to claims arising prior to the date of commencement of the proposed new legislation. It should definitely not be applicable to claims that are outside the limitation period applicable to the claim, or in relation to which the licensee's insurance cover may no longer be in effect. To do otherwise would be to introduce retrospectivity and unfairness to the new framework.

That being so, and as noted above, the Government should await the further report from the Review Panel before implementing any of the proposed changes so that the effect of the proposed changes can be considered in context.

CONCLUSION

We would be happy to discuss any issues arising from these comments, or to provide any further material that may assist. Should you require any further information, please contact Peter Stepek, Policy Executive, on (02) 8080 3200 or email pstepek@stockbrokers.org.au.

Yours sincerely,

ANDREW GREEN
Chief Executive