Stockbrokers And Financial Advisers Association Limited

By email: afca@treasury.gov.au

20 November, 2017

Head of Secretariat
AFCA Transition Team
Financial Services Unit
The Treasury
Langton Place
PARKES ACT 2600

Dear Sir / Madam,

CONSULTATION PAPER NOVEMBER 2017 – AUSTRALIAN FINANCIAL COMPLAINTS AUTHORITY (AFCA) TOR ISSUES

We refer to the Consultation Paper of November 2017 ("the Consultation Paper") released by Treasury in relation to the Terms of Reference ("TORs") and other establishment issues for the Australian Financial Complaints Authority ("AFCA").

The Stockbrokers and Financial Advisers Association Limited ("SAFAA") welcomes the opportunity to provide submissions in relation to certain issues in the Consultation Paper. We have not addressed all Issues in the Consultation Paper. Instead, we have concentrated on the issues that have the most potential impact on the stockbroking sector.

ISSUE 1 – Monetary Limits

We note that the Consultation questions 2 to 4 are framed as follows:

Specific monetary limits
2. As AFCA will be a new EDR scheme, is it appropriate to maintain specific limits for:
• income stream risk disputes;
• general insurance broking disputes; and

• *third-party motor vehicle insurance?*

3. If these specific limits are to be retained, should there be an increase in the limits?

Impact on Professional Indemnity Insurance

4. Are there any anticipated effects on firms that will be disproportionate to any increase in specific increased monetary limits?

It is not entirely clear from the drafting, particularly of Question 2, whether the question of sub-limits for other financial sectors, such as the stockbroking sector, is open for submission. We are proceeding on the basis that it is open for SAFAA to make submissions that a specific stockbroking sector monetary limit is also appropriate. We cannot see why consultation should be limited to only those three sectors named in Question 2.

SAFAA submits that **there is a strong case to retain the existing FOS monetary limits as sub-limits in the AFCA Terms of Reference for disputes arising in the stockbroking sector.**

In SAFAA's previous Submission on the EDR Interim Report, we argued that **different classes of monetary limits should apply to different financial sectors** to reflect the unique characteristics of each sector.

For example, a dispute between a bank and a customer over a mortgage on a residential property in Sydney is likely to involve millions of dollars.

By contrast, a dispute between a stockbroker and a client over the sale of a parcel of shares in a listed company might typically be in the region of $10,000.

Consultation Question 2 appears to acknowledge the merits of differential sector limits.

Reasons for retaining existing FOS monetary limits for stockbroking disputes

The reasons which support the retention of the existing monetary limits are as follows:

1. The existing limits ($500K claims/$309K awards) are already the **highest of any comparable scheme** in any other country. We note that the limits are higher than the relevant UK scheme (£150,000 equivalent A$248K) and the Singapore scheme (equivalent A$100,000). It is only matched by the Canadian scheme (equivalent A$361K).

2. There is **no evidence that stockbroking clients are suffering** by not being able to access EDR because of the current monetary limits. In this regard, we attach two Tables obtained from FOS setting out statistics for stockbroking disputes lodged with FOS for FY 2015-16 and FY 2016-17.

   From these statistics, it seems quite clear that the level of disputes brought by clients of stockbrokers is a miniscule percentage of the overall number of financial disputes lodged with FOS. If one were to add the numbers of Credit Industry and Superannuation disputes to the disputes total, the percentage of stockbroking disputes becomes even smaller. Year on year, the number of stockbroking disputes has been falling.

   Furthermore, the outcomes of the disputes recorded by FOS show that most are settled by the broking firm, and of those which proceed to a determination, there are more determinations in favour of the FSP (either final or preliminary view) than in favour of the consumer.

   These statistics illustrate just how well the current stockbroking industry EDR framework has worked.

   SAFAA acknowledges that the picture in other industry sectors in financial services may be different, and that the monetary limits may not be adequate in those other sectors. However, SAFAA submits that in respect of the stockbroking sector, the existing monetary limits are adequate and should be retained.

   We note that there is to be a review in 18 months to consider whether the increased monetary limits are working. In SAFAA's submission, the approach should be to leave the existing monetary limits in place for stockbroking disputes, and the review should instead be into whether that specific sector limit is still working.

3. The **likely impact on the cost of PI Insurance**.

   If the compensation caps are to be increased dramatically, there will be an inevitable increase in PI insurance premiums as a result of the higher risk posed by those increased compensation caps.

   As the FOS statistics which accompany this submission demonstrate, many of the claims that are lodged against stockbrokers are unmeritorious.

   At present, claims which exceed the existing compensation caps are subject to the Court process. In the case of such claims, the cost consequences associated with bringing an unmeritorious claim in that forum (ie, the losing party pays the

successful party's costs) act as a deterrent to the bringing of claims which have poor prospects of success.

However, if the compensation caps are increased significantly, that deterrent will no longer exist. Moreover, in circumstances in which claims which exceed the existing compensation caps but which fall within AFCA's jurisdiction will not be tested in the same rigorous way in which claims will be tested by a Court, the level of risk faced by stockbrokers (and their insurers) is greater. The inevitable corollary of this fact is that PI insurance premiums will increase.

There is also the risk that increasing the compensation caps significantly will lead to an outcome whereby plaintiff law firms begin offering to make claims via AFCA on a 'no win, no fee' basis. This may result in an outcome whereby large claims which should ultimately fail are lodged with AFCA in the hope that a negotiated outcome can be reached. Again, this presents a higher risk profile for an insurer.

Finally, many stockbrokers have deductibles in the vicinity of $150,000 to $300,000. That being so, claims that are presently made via FOS do not present a significant level of risk to an insurer. However, if the compensation caps are increased significantly, this will yield an outcome where insurers are potentially 'on the hook' for much larger payouts.

Each of these factors will almost certainly result in increased premiums. It is not possible for, not is it reasonable to expect, SAFAA to quantify what these additional premiums will be. This is because insurance involves actuarial science and it is not possible for insurers (or, for that matter, anyone else) to state with any precision by how much premiums will increase until the final AFCA model and jurisdictional limits are set. Nevertheless, the increased risk posed by the higher compensation caps and the fact that larger claims will be determined outside of the rigorous Court process will undoubtedly lead to increased premiums.

4. For larger stockbroking disputes, the Courts remain the appropriate forum to adjudicate the matter. For example, a dispute over a $500,000 mortgage or life insurance policy might involve a significant dollar amount, but the issues to be determined may not be excessively complicated. However, a dispute over share or options trading involving more than $500,000 will almost certainly raise complex trading, factual and/or legal issues. All the available documentation and evidence will be needed in order to reach a proper decision.

In SAFAA's submission, a court should determine disputes of this nature. Courts have the necessary powers to compel the production of evidence, which FOS does not have, nor will AFCA.

SAFAA believes that EDR has its place, but in the case of these types of disputes, only up to a certain point.

We note that the AFCA arrangements do not include any of the safeguards that we believe would justify the higher claims limit in respect of the types of more complex disputes that might arise in relation to securities trading.

5. Further to Paragraph 4 above, the absence of any right of appeal in relation to disputes which raise the complex issues of a larger stockbroking dispute is an inherently unfair outcome. For this reason, we submit that the current monetary limits for the stockbroking sector should be maintained.

   If the compensation cap is to be lifted significantly, an appeal right should exist with respect to claims over a certain amount. Such an appeal does not need to be a hearing *de novo*. Rather it could be limited to an appeal on a question of law.

ISSUE 3 – Use of Panels

We refer to Consultation question 9 as follows:

9. Are there other factors that should be taken into account when considering whether a panel should be used?

It is the experience of our Members that FOS Panels often have great difficulty in dealing with the complexity associated with stockbroking disputes.

Whilst there might be an industry professional on the panel, the types of dispute that end up before a panel are so complex that they can only be dealt with by industry professionals and persons with relevant legal experience. That being so, and particularly if the compensation caps are to be lifted significantly, resources need to be dedicated to ensuring that panel members are appropriately qualified (ie, there should not be a consumer representative dealing with stockbroking claims for more than $250k).

These concerns are heightened in circumstances in which stockbroking disputes will account for a tiny percentage of the disputes that will be addressed by AFCA (presumably well less than 5%).

That being so it is understandable that the industry would be concerned that insufficient resources will be directed to ensuring that there are appropriately qualified individuals determining complex stockbroking disputes.

ISSUE 8 – Superannuation

We refer to Consultation question 25 as follows:

QUESTIONS FOR DISCUSSION
25. What additional matters related to superannuation should be addressed in AFCA's terms of reference (as opposed to operational guidelines)?

SAFAA does not make any Submissions in general in relation to Superannuation, this being an industry sector in which SAFAA members are not directly involved.

We note that the scope of what is meant by "superannuation dispute" is prescribed in section 1053. The section does not extend the term to a dispute in relation to trading in financial products by a stockbroker where the client account happens to be an account for a superannuation fund.

This is very important, and SAFAA supports this. Many client accounts within stockbroking firms are designated <<superannuation accounts>>, such as where the account represents trading by individuals operating their own self-managed super account. Any dispute with the stockbroker about the stockbroking service relating to such an account should be properly characterized as a dispute relating to advice or the service, as the case may be, and not as a superannuation dispute. The designation of the account should not mean that the dispute becomes a superannuation dispute simply for that reason.

ISSUE 12 – Funding

QUESTIONS FOR DISCUSSION
34. In addition to matters identified in paragraphs 1-3 above, what other material should a company seeking authorisation to operate the AFCA scheme provide to demonstrate that it has satisfied the requirements of adequate funding and sufficient funding flexibility?
35. Are there any principles beyond those identified in paragraph 2 above that should underpin AFCA's funding model?

36. Should the funding arrangements for superannuation and non-superannuation disputes be separate and distinct, given the very different nature of these disputes?

SAFAA Members consider the funding arrangements for AFCA to be of a high order of importance.

We make the following Submissions:

1. Members support the existing FOS approach of funding by way of a moderate annual membership fee plus a Case fee where disputes are accepted. SAFAA does not support altering the balance between membership fees and case fees, as this would not be a reward for firms who effectively manage client relations so that disputes do not arise, or if they do, are resolved without the need for recourse to EDR.

2. SAFAA strongly supports the principle that there should not be any cross subsidization between financial industry sectors. We refer to the FOS statistics for stockbroking disputes which are set out under Issue 1 above. Funding arrangements should be such that industries which have a high degree of disputation which makes its way to AFCA should bear the costs of this, and industries with a low record of consumer disputes should not have to cross-subsidise those other sectors.

3. We note that the UK scheme has a feature where the Financial Service Provider has the first 25 cases heard free. There is a concern amongst members that Case Handling fees can act as a tool for unmeritorious claimants to use in order to extract a payment from a FSP, rather than the FSP incurring the Case Fee. Whilst Members see this as a real risk, there was not any support for the “free cases” concept, because the cost of dealing with free cases would be subsidized by all other FSPs.

ISSUE 16 – Transitional

SAFAA supports the comment on Page 31 of the Consultation paper, that the preferred approach for the handling of legacy disputes is that they be transferred to AFCA, to be handled under the Terms of Reference applicable at the time of lodgment of the claims.

ADDITIONAL ISSUE – No Retrospectivity

SAFAA's submission on this issue depends on whether the existing FOS monetary limits are retained for stockbroking under AFCA as sector specific limits, as SAFAA has urged under Issue 1 above.

If they are not, and the $1 million limit is to apply, then a fixed date should be applied for any disputes to be brought under the increased limit. The new limit should not apply retrospectively such that claims can be brought against a Licensee who may not have, or may no longer have, insurance cover for the increased claims limit amount. Licensees who acted in good faith on the basis of the EDR framework in place at the time should not face liability for changes to the EDR framework which take place at a later point in time, and in respect of which they are no longer in a position to take steps to protect themselves.

ADDITIONAL ISSUE – Limitation Periods

Limitation periods should be strictly applied, at least in relation to stockbroking disputes. There is no legitimate reason why a potential claimant would not be aware of a stockbroking claim shortly after the claim arose.

ADDITIONAL ISSUE – Accountability

There should be a clear process whereby members of the scheme can complain about perceived issues with AFCA's handling of cases, and which requires the AFCA board to investigate and respond to such complaints.

Members should also be able to insist that a subsequent legal ruling on an issue of law be obtained at AFCA's cost from an appropriately qualified person (eg, a queen's/senior counsel), which ruling should then be applied by AFCA in future cases.

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