Stockbrokers and Financial Advisers Association

26 March 2021

Email: AFCAreview@treasury.gov.au

The Director
AFCA Review Secretariat
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

REVIEW OF AFCA

The Stockbrokers and Financial Advisers Association (SAFAA) is the professional body for the stockbroking and investment advice industry. Our members are Market Participants and Advisory firms which provide securities and investment advice, execution services and equity capital-raising for Australian investors, both retail and wholesale, and for businesses. Practitioner Members are suitably qualified professionals who are employed in the securities and derivatives industry.

Our members are a small but important group of AFCA members. They represent the full range of providers from online providers providing execution-only services to full-service stockbroking and investment advisers.

Thank you for the opportunity to provide feedback on the review of AFCA currently being undertaken by the AFCA review team.

We note that our members attended a stockbrokers and investment advisers roundtable with the AFCA review team on 17 March 2021 and SAFAA separately attended a stakeholder roundtable on 18 March 2021 at which we provided member feedback.

Executive summary

SAFAA members fundamentally support an external dispute resolution service for retail consumers that is:

- free for complainants
- resolves complaints informally and in a timely fashion
- available to consumers who would not otherwise afford court proceedings or whose complaint would not justify going to court.

However, we consider that the AFCA scheme has developed in a way that is no longer just a protection measure for small consumer complaints. AFCA is now a scheme where:

- complainants can claim for amounts up to $1,085,000

- member firms can have a binding award of over $500,000 made against them
- decisions are based on discretion and members have no practical recourse to appeal
- complainants can bring claims eventhough they are wholesale investors
- if complainants are unhappy with the decision they can bring proceedings in a court of law after having had a 'dry run' in the AFCA system
- member firms settle claims rather than proceed to a determination due to the scheme's cost structure.

SAFAA members have provided case studies to the AFCA review team on a confidential basis that highlight each of the issues raised in this submission.

The stockbroking and investment advice sector has an exemplary record as regards the handling of customer complaints. The rate of investor complaints in the listed securities sector is very low and, to the extent that complaints do arise, they are being effectively dealt with through the licensees' IDR process. As reported in AFCA Complaint statistics, out of a total of 80,833 complaints received during the period 1 October 2019 to 30 September 2020, only 4,595 complaints related to investments and advice. Of this number, only 488 complaints (or 0.6%) were made against stockbrokers. To place this complaints figure into context, during the 2020 calendar year, there were 439, 360, 450 equity trades on the ASX. Of the 4,595 complaints related to investments and advice, 4,432 have been closed, with the majority of the complaints either falling outside of the rules or resolved by the financial firm.

Notwithstanding the small numbers of complaints made against our members, SAFAA considers that the AFCA scheme needs to be reviewed to take into account the various issues our members experience which impact on the procedural fairness and sustainability of the system.

Recommendations

SAFAA makes the following recommendations concerning the AFCA scheme:

- Changes be made to the AFCA Complaint Resolution Scheme Rules to:
    - require complainants to 'submit' to the AFCA jurisdiction when they lodge a complaint and agree to be bound by the final decision. Alternatively, the rules could be changed to require complainants pay at least a nominal fee should they not accept AFCA's preliminary view and progress the matter to a final decision;
    - reduce the amount of discretion that AFCA can exercise when dealing with complaints;
    - clarify that AFCA does not have jurisdiction to hear complaints from wholesale clients and include wholesale client complaints as a mandatory exclusion; and
    - require complainants who have not made a complaint first with a member firm to be referred back to the member firm to lodge a complaint directly with it before being able to lodge a complaint with AFCA.
- AFCA exclude from its complaint statistics cases where the complaint is resolved in the IDR stage of the complaint process, even if the complainant has lodged the complaint with AFCA before the IDR stage has ended.
- AFCA change its processes to ensure that:

- complaints that are outside the scope of the scheme are dealt with at the registration stage to reduce the backlog of cases and fees that are charged to member firms; and
- all rules review and joinder of claim and jurisdictional decisions are decided at the rules review stage before a conciliation fee is charged.

- Lower the monetary jurisdiction for investments and advice complaints to reflect an amount better suited to a scheme designed to resolve small consumer claims using informal methods.
- AFCA develop a precedent bank of decisions that assists AFCA Decision Makers make consistent, predictable and rational decisions and adopt common methodologies for calculating awards in order to improve certainty for stakeholders.
- Improve the AFCA fee schedule to improve transparency and certainty around how complaints are categorised.
- Recalibrate the complaint fee structure to ensure that member firms are not disencentivised from defending complaints brought against them that have no merit.

Our detailed comments on the questions raised by the AFCA review team are below.

Detailed comments

Question 1 Is AFCA meeting its statutory objective of resolving complaints in a way that is fair, efficient, timely and independent?

Lack of procedural fairness

An essential issue for our members is the lack of procedural fairness that arises from the design of the AFCA system:

- Complainants are not bound by the decisions of AFCA while member firms are.
- The AFCA process is free for complainants, while member firms are required to pay higher fees the further the complaint progresses through the system.
- The AFCA Complaint Resolution Scheme Rules allow AFCA to exercise significant discretion as to what complaints are accepted and how they will be dealt with. Complaints submitted outside of the statute of limitations are an example of this. AFCA's ability to accept claims for non-financial loss up to $5,400 are another.

The result is that the model operates unfairly for member firms.

Complainants do not have to accept the final outcome. Unlike member firms, there is no commercial incentive for complainants to resolve complaints early on in the AFCA process. The further a complaint progresses through the AFCA process, the more fees are charged to the member firm.

Dissatisfied complainants can commence legal proceedings in court, despite having made the financial firm defend a complaint at AFCA first.

There is no downside for complainants lodging frivolous, vexatious or meritless complaints as they don't have to pay for the claim to be lodged and don't experience any consequences if the claim is rejected.

AFCA's discretionary Complaint Resolution Scheme Rules result in uncertainty for member firms. AFCA can decide to accept complaints that are outside the statute of limitations period if it considers that special circumstances apply.[1]

SAFAA considers that if complainants were bound by AFCA decisions it would afford procedural fairness to both parties and improve the operation of the system.

SAFAA recommends that the AFCA rules be changed to require complainants to 'submit' to the AFCA jurisdiction when they lodge a complaint and agree to be bound by the final decision.

Alternatively, the rules could be changed to require complainants pay at least a nominal fee should they not accept AFCA's preliminary view and progress the matter to a final decision.

SAFAA recommends that the Complaint Resolutions Scheme Rules be amended to reduce the amount of discretion that AFCA can exercise when dealing with complaints.

The issue of wholesale clients

Background

SAFAA has been concerned for some time about the extent to which AFCA accepts complaints from sophisticated and hight-net-worth investors (wholesale clients). SAFAA's view is that the exercise of jurisdiction to hear complaints from wholesale clients is not the basis upon which the EDR framework was legislated by Parliament and is an issue of fundamental unfairness to member firms.

These concerns were outlined in our submission to AFCA dated 29 June 2018 in relation to the proposed AFCA rules which we include with this submission as **Appendix A.**

Meaning of retail client and wholesale client

What constitutes a retail client and a wholesale client is not subject to discretion, but is clearly set out in the Corporations Act.

Section 761G (1) states:

> *For the purposes of this chapter, a financial product or a financial service is provided to a person as a* ***retail client*** *unless subsection (5), (6), (6A) or (7) or section 761 GA, provides otherwise.*

Section 761G (4) states:

> *For the purposes of the Chapter, a financial product or a financial service is provided to, or acquired by, a person as a* ***wholesale client*** *if it not provided to, or acquired by, the person as a retail client.*

In other words, a client is presumed to be a retail client for the purposes of Chapter 7 of the Corporations Act unless they fall within the specified named subsections.

The most relevant sections for stockbroking and investment advice businesses are sections 761 (7) and 761 GA of the Corporations Act.

[1] AFCA Complaint Resolution Scheme Rules B.4.4.2

Section 761 G (7) (c) and (d) relevantly provides:

> *For the purposes of this chapter, if a financial product is not, or a financial service (other than a traditional trustee company company service) provided to a person does not relate to a general insurance product, a superannuation product or an RSA product, the product or service is provided to the person as a retail client unless one or more of the following paragraphs apply:*
>
> *c) the financial product, or the financial service, is not provided for use in connection with a business, and the person who acquires the product or services gives the provider of the product or service, before the provision of the product or service, a copy of a certificate given within the preceeding 6 months by a qualified accountant (as defined in section 9) that states that the person:*
>
> *i) has net assets of at least the amount specified in regulations made for the purposes of this subparagraph; or*
>
> *ii) has a gross income for each of the last 2 financial years of at least the amount specified in regulations made for the purposes of this subparagraph a year;*
>
> *d) the person is a professional investor.*

As regards section 761 G (7) (c) the net asset amount prescribed by the regulations is $2.5 million and the gross income amount prescribed by regulations is $250,000.[2] This category of wholesale investor is commonly referred to as a high-net-worth client. Accountant's certificates are typically maintained on the client's file.

A professional investor is defined in section 9 of the Corporations Act and includes a person who controls at least $10 million.

Section 761GA provides the following meaning for sophisticated investors:

> *For the purposes of this Chapter, a financial product, or a financial service (other than a traditional trustee company service or a crowd-funding service) in relation to a financial product, is not provided by one person to another person as a **retail client** if:*
>
> *a) the first person (the licensee) is a financial services licensee; and*
>
> *b) the financial product is not a general insurance product, a superannuation product or an RSA product; and*
>
> *c) the financial product or service is not provided for use in connection with a business; and*
>
> *d) the licensee is satisfied on reasonable grounds that the other person (the **client**) has previous experience in using financial services and investing in financial products that allows the client to assess:*
>
> *i) the merits of the product or service; and*
>
> *ii) the value of the product or service; and*
>
> *iii) the risks associated wth holding the product; and*
>
> *iv) the client's own information needs; and*
>
> *v) the adequacy of the information given by the licensee and the product issuer; and*
>
> *e) the licensee gives the client before, or at the time when, the product or advice is provided a written statement of the licensee's reasons for being satisfied as to those matters: and*

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2 Corporations Regulation 7.1.28 (1) and (2)

f) the client signs a written acknowledgment before, or at the time when, the product or service is provided that:

i) the licensee has not given the client a Product Disclosure Statement: and

ii) the licensee has not given the client any other document that would be required to be given to the client under this Chapter if the product or service were provided to the client as a retail client; and

iii) the licensee does not have any other obligation to the client under this Chapter that the licensee would have if the product or service were provided to the client as a retail client.

Chapter 7 of the Corporations Act thereby draws a distinction between retail and other clients[3]. The consumer protection provisions[4] apply only to retail clients; this recognises that other clients "do not require the same level of protection, as they are better informed and better able to assess the risks involved in financial transactions"[5].

In 2012, substantial changes were made to the regulation of personal financial advice by the Future of Financial Advice or "FoFA" reforms[6]. Their objective was to "improve the quality of financial advice while building trust and confidence in the financial advice industry through enhanced standards which align the interests of the adviser with the client and reduce conflicts of interest"[7]. One reform was to insert Pt 7.7A into Chapter 7 of the *Corporations Act*[8]. Part 7.7A requires providers of personal advice to retail clients[9] to "act in the best interests of the client in relation to the advice"[10] and to give priority to the interests of the client[11].

The requirement to be a member of a dispute resolution system

The requirement to be a member of an approved EDR scheme is a license condition imposed on an AFS licensee that provides advice to retail clients.

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3 See also Australia, Senate, *Financial Services Reform Bill 2001*, Revised Explanatory Memorandum at 8-9 [2.26]-[2.28].

4 See, eg, *Corporations Act*, ss 941A, 941B, 946A, 949A, 961B, 961G, 961J.

5 Australia, Senate, *Financial Services Reform Bill 2001*, Revised Explanatory Memorandum at 8 [2.25].

6 *Corporations Amendment (Future of Financial Advice) Act 2012* (Cth); *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth).

7 Australia, Senate, *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2012*, Revised Explanatory Memorandum at 3. See also Australia, Senate, *Corporations Amendment (Future of Financial Advice) Bill 2012*, Revised Explanatory Memorandum at 3.

8 *Corporations Amendment (Future of Financial Advice) Act 2012* (Cth), Sch 1, item 10.

9 *Corporations Act*, s 961(1).

10 *Corporations Act*, s 961B(1). Section 961G requires that the advice provided be appropriate to the client.

11 *Corporations Act*, s 961J. For the purposes of Pt 7.7A, "advice" refers to personal advice, "client" refers to a retail client, and "provider" refers to the individual who is to provide the advice to the client: *Corporations Act*, s961(1) and (2). See also Australia, Senate, *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2012*, Revised Explanatory Memorandum at 5 [1.1].

Section 912A (1) (g) provides as follows:

> *A financial services licensee must……..if those financial services are provided to persons as **retail clients** (our emphasis added):*
>
> *(i) Have a dispute resolution system complying with subsection (2);*

Section 912A (2) sets out the requirements for a compliant dispute resolution system as follows:

> *To comply with this subsection: a dispute resolution system must consist of:*
>
> *(a) An internal dispute resolution procedure that:*
> *(i) Complies with standards, and requirements, made or approved by ASIC in accordance with regulations made for the purposes of this subparagraph; and*
> *(ii) Covers complaints against the licensee made by retail clients in connection with the provision of all financial services covered by the licensee: and*
> *(b) [repealed]*
> *(c) Membership of the AFCA scheme.*

The interplay between section 912A (2) and section 912 (1) (g) provides that it is only in respect of retail clients that licensees have an obligation to have a dispute resolution system that includes membership of the AFCA scheme.

Historically, there was only one approved EDR scheme available for AFS Licensees, namely the Financial Industry Complaints Service. This was merged with the Banking and Financial Services Ombudsman and the Insurance Ombudsman Service in 2008 to form the Financial Ombudsman Service (FOS).

During the consultations by FOS regarding its Terms of Reference, SAFAA (then called the Securities and Derivatives Industry Association) made strong submissions that the provisions of the Terms of Reference allowing FOS to accept disputes by clients of a member firm who were not retail clients were unfair, as they went beyond the framework enacted in the legislation imposing the requirement to be a member of such a scheme. SAFAA argued that there would be grounds to argue that this part of the Terms of Reference was ultra vires the Corporations Act.

Alternatively, SAFAA considered that there were grounds to argue that the decision to approve FOS as an EDR under the Corporations Act was open to legal challenge, given that it effectively mandated AFS licensees to subject themselves to a jurisdiction that went beyond that which was mandated by Parliament. In order to continue their business as a provider of advice to retail clients, AFS licensees had no choice but to join FOS, there being no alternative EDR scheme available to licensees.

In the consultation by AFCA in regard to its rules, SAFAA made the same points regarding the definition of the eligible claimants who were entitled to lodge a dispute with AFCA. SAFAA asked for the definition be narrowed to bring it within the scope provided by the legislation. Our submissions were not accepted. Accordingly, we consider that the issue of the AFCA Rules being ultra vires to the extent that they extend the jurisdiction beyond the scope of the class of clients who are the subject of the licensing provisions in the Corporations Act is a live one.

Numbers of wholesale client complaints

As pointed out previously, only a small number of total AFCA complaints are made against SAFAA members.

We note that the AFCA Review Team has asked for the percentage of wholesale client complaints compared to the total AFCA complaints against our members for the period 1 October 2019 to 30 September 2020. Obtaining an overall percentage across our membership for that period is difficult. Many of our members do not have any AFCA complaints against them at all for that period of time. We have obtained data from various of our members as to claims brought against them by wholesale clients to AFCA which is contained in **Attachment A.** What is significant is that for those members who provided data, a large portion of their total complaints involved wholesale clients.

AFCA's position on accepting wholesale client complaints

SAFAA wrote to AFCA in April 2020 highlighting its concerns about AFCA exercising jurisdiction to hear complaints from wholesale clients.

AFCA's response to SAFAA's letter made it clear that it holds the view that it is entitled to hear wholesale client complaints.

The basis for its position is AFCA's incorrect understanding of the licensee obligations contained in section 912A. It considers that the requirement to have a dispute resolution system for retail clients only relates to the requirement to have an internal dispute resolution system and that the external dispute resolution system requirements are not limited to retail. This position is clearly wrong.

Another argument put forward by AFCA is that its terms of reference do not exclude complaints being brought by wholesale clients.

Currently AFCA's Complaint Resolution Scheme Rules provides that AFCA *may* consider excluding a complaint where a complaint is about a financial service where the complainant is a wholesale client within the meaning of the Corporations Act, but is not a small business.[12] SAFAA members report that AFCA never exercises this discretion to exclude a complaint brought by a wholesale client.

Why do wholesale clients bring complaints before AFCA?

There are many aspects of the AFCA scheme that operate as strong incentives for wholesale clients to bring complaints against member firms in a way that is in inherently unfair to member firms and impacts negatively on the efficiency of the AFCA scheme.

- AFCA is a no-cost scheme for complainants.
- AFCA members have to pay the costs as the complaint progresses through the system.
- Decisions are not binding on complainants. If a complainant does not like the decision it can progress it further through the AFCA system or commence court proceedings (after a cost-free 'dry run' through the AFCA system).
- Decisions are binding on AFCA members. If a decision is made against them they have limited grounds for appeal.
- Complainants can be awarded up to $542,500 in compensation and make claims for amounts up to $1,085,000.

[12] AFCA Complaint Reslution Scheme Rules, C.2.2 (j)

- AFCA is a complainant-friendly jurisdiction.

Why exclude wholesale clients from AFCA's jurisdiction?

The issue that goes to the heart of the issue of fairness and to the concerns of our members is that wealthy and sophisticated clients are able to avail themselves of a dispute resolution service that Parliament never intended to apply to them.

AFCA is meant to provide a mechanism for low-cost access to justice to consumers who may not otherwise have the resources to bring such complaints through other legal channels such as a court. Wholesale investors have the means to pursue complaints through the court system. It is not uncommon for wholesale investors who lodge a complaint with AFCA to have legal representation or retain legal advice, which shows such complainants are financially capable of undertaking court proceedings.

It is not only unfair to member firms for AFCA to recategorise a client from wholesale to retail, but runs counter to the legislative scheme underlying Chapter 7 of the Corporations Act. It is not uncommon for high-net-worth clients to follow higher risk strategies in the pursuit of higher returns (such as options trading, alternative investments etc), that are not open to retail clients. This is one of the features of being a wholesale client – they are able to avail themselves of a greater array of financial products and services than retail clients and in so doing may take greater risks.

As we have highlighted previously, different provisions in the Corporations Act apply to clients depending on whether they are retail or wholesale. For example, wholesale clients are not subject to the statement of advice requirements that retail clients are. Financial advisers who advise wholesale clients are not subject to the FASEA Code of Ethics or education requirements.

This is because the Parliament has decided that wholesale clients don't require the consumer protections that are afforded retail clients.

It is not uncommon, however, for a client to suddenly 'transform' from a wholesale to a retail client when an investment does not perform as well as was hoped, and for them to lodge a complaint with AFCA to reimburse them for the market risk they took

For investments such as exchange traded options, the facts underlying such discputes and trading strategies can be very complex. They often extend to a period of trading spanning years. SAFAA has communicated its concerns to AFCA about the abilities of AFCA adjudicators to hear such disputes, or to obain all of the evidence and documentation necessary to properly determine the matter. This is another reason why wholesale client complaints should not be dealt with by a consumer dispute resolution scheme that is not bound by the rules of evidence.

Allowing wholesale investor complaints to be considered under its jurisdiction is creating a backlog of complaints that would be better dealt with by a court. Furthermore, AFCA attention to complaints from wholesale investors means that other complaints for which the AFCA scheme was designed are subject to lengthy delays.

Wholesale investor claims often involve large amounts. Member firms are bound by AFCA's decisions (apart from some limited exceptions). This exposure to large claims against which they essentially have no appeal is one issue impacting on our members' ability to source affordable Professional Indemnity insurance cover.

SAFAA recommends that the Complaint Resolution Scheme Rules be amended to clarify that AFCA does not have jurisdiction to hear complaints from wholesale clients and include wholesale client complaints as a mandatory exclusion.

Unfair and inefficient processes

SAFAA has provided confidential case studies highlighting AFCA's unfair and inefficient processes in dealing with client complaints. In particular our members report issues arising from a failure of AFCA staff to effectively triage or manage complaints when they are first lodged with AFCA.

Complaints that have not been dealt with by the member firm's IDR process

AFCA continually accepts complaints that have not been the subject of a member firm's internal dispute resolution process. Member firms are then required to pay AFCA fees for a complaint that could have otherwise been resolved at the IDR level. This also means that the complaint is included in the member firm's complaint statistics. This is particularly problematic if the firm would have been able to resolve it through the IDR process without a complaint to AFCA being required.

The government is planning to introduce a compensation scheme of last resort (CSLR) to protect retail clients. We understand that financial advice firms will need to fund it and levies will be risk-based. AFCA complaints data is likely to form part of the information used to calculate risks and levy amounts. This makes it even more important that AFCA only deals with complaints that fall within its remit, as to do otherwise will impact the basis upon which CSLR levies are calculated.

AFCA's complaints backlog could also be reduced if it was not burdened by multiple disputes that could otherwise have been resolved at the IDR stage.

We recommend that complainants should be referred back to the member firm to lodge a complaint directly with it before being able to lodge a complaint with AFCA. Additionally, AFCA should exclude from its complaints statistics complaints where the complaint is resolved in the IDR stage of the complaint process, even if the complainant has lodged the complaint with AFCA before the IDR stage has ended.

Failure to effectively triage claims

AFCA continues to accept vexatious and frivolous complaints, rather than rejecting them at first instance. This results in member firms being required to pay AFCA fees and creates issues in managing the expectations of Professional Indemnity insurers concerning the likely outcome of a claim.

Examples of complaints that should have been summarily dealt with, but were allowed to proceed include, those:

- that have been made before
- that are out of time
- that are made with incomplete documentation
- where the complainant was not a client of the member firm.

Cases are often progressed to the conciliation stage prior to decisions being made in respect of a rules review submission. This makes it difficult for a member firm to settle the case for an appropriate amount at the conciliation stage, as it is unclear what the likely AFCA determination will be or whether the case would even proceed past a rules review.

SAFAA recommends that changes be made to AFCA processes to ensure that:

- complaints that are outside the scope of the scheme are dealt with at the registration stage to reduce the backlog of cases and fees that are charged to member firms.

- all rules review and joinder of claim and jurisdictional decisions are decided at the rules review stage before a conciliation fee is charged.

Jurisdictional limits

The current monetary limit for a 'claim' ($1,085,000) is considerably more than the minimum monetary jurisdiction for the NSW Supreme Court ($750,000). AFCA is able to award a maximum amount of $542,500, which is considerably more than the minimum monetary jurisdiction for the NSW District Court ($100,000).

While the AFCA Complaint Scheme Resolution Rules provide that AFCA will generally try and resolve a complaint by informal methods, AFCA decision makers may have regard to legal principles, but are not bound by the rules of evidence or previous AFCA decisions.

The effect of this jurisdictional limit is that AFCA is making decisions that are binding on member firms in circumstances where some of these claims:

- are for amounts that would normally be dealt with by the District and Supreme courts and
- are lodged by individuals who are financially capable of undertaking court proceedings
- involve issues that would be better dealt with by a court due to their size and complexity.

Member firms have no effective legal recourse for appealing such determinations, despite being for a claimed amount where appeals would be warranted if the complaint was made to a court.

SAFAA understands that for complaints brought in respect of financial products such as mortgages and superannuation matters, the current jurisdictional limit may be appropriate. However, we consider that a 'one-size-fits-all' approach to claims limits is creating an unfair system for complaints brought by investments and advice complainants. Complainants seeking large amounts of compensation against SAFAA members typically involve questions of investment suitability. These complaints are complex and more suitable for the courts to determine.

In June 2018 SAFAA warned AFCA of significant increases in the costs of obtaining appropriate professional indemnity insurance and difficulties in obtaining cover as a result of AFCA's increased claim and compensation limits.[13]

SAFAA recommends that the monetary jurisdiction for investments and advice complainants be lowered to reflect an amount better suited to a scheme designed to resolve consumer claims using informal methods.

Question 2 Is AFCA's dispute resolution approach and capability producing consistent, predictable and quality outcomes?

SAFAA's members have raised the following concerns about AFCA's dispute resolution approach that impacts on its ability to provide consistent, predictable and quality outcomes.

[13] Letter from SAFAA to [redacted], AFCA dated 29 June 2018, page [redacted]

Impartiality

The recent judgment of the NSW Supreme Court in *DH Flinders Pty Limited v Australian Financial Complaints Authority Limited*[14] highlighted that when AFCA exceeds its boundaries it can cause an injustice to other parties and can possibly lead to an unfair outcome.

In obiter, the judge commented that AFCA 'was hardly behaving in a manner procedurally fair to DH Flinders nor in a manner that was impartial. I think Mr [redacted] was correct to submit that AFCA had here "entered the fray" and was acting in an advisory relationship with the Complainants.'[15]

SAFAA members have reported that the behaviour discussed in the DH Flinders case is not an anomaly and have provided case studies where AFCA has behaved more as a consumer advocate than an impartial consumer complaints service. Examples of this behaviour include instances of case managers during conciliation proceedings:

- prompting complainants to raise concerns about additional financial products
- directing questioning of complainants on issues not the subject matter of the complaint.

While no one has an issue with AFCA assisting complainants to articulate their case and helping them work out what their grievance relates to, in order for AFCA to be an *independent and impartial* complaints resolution service, it must not act as a consumer advocate.

Consistency and transparency in decision making

When determining complaints, the AFCA Decision Maker must do what they consider fair in all the circumstances having regard to various matters including previous relevant Determinations of AFCA.[16]However, they are not bound by rules of evidence or previous AFCA decisions.[17]

SAFAA members consider it is important that AFCA provides consistency, predictability and transparency in decision making, as this contributes to fairer outcomes for both complainants and member firms. Consistent, predictable and transparent decision making provides member firms and complainants with greater certainty as well as a more informed basis upon which to base their decisions concerning the complaint.

SAFAA members report that they experience inconsistencies in AFCA decision making as well as a lack of transparency as to how decisions are reached including:

- decisions unsupported by the evidence
- the use of inconsistent claims calculation methodology
- decisions that represent a contravention of the common law.

This creates uncertainty for our members as they are unsure of the expected outcome of a claim and are unable to properly advise their Professional Indemnity insurer of the likely outcome of a claim.

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[14] [2020] NSWSC 1690

[15] At para 135

[16] AFCA Complaint Resolution Scheme Rules A.14.2

[17] ACFA Complaint Resolution Scheme Rules A.14.3

SAFAA recommends that in order to improve certainty for stakeholders AFCA develop a precedent bank of decisions that assists AFCA Decision Makers to make consistent, predictable and rational decisions and adopt common methodologies for calculating awards.

Dispute resolution capability

SAFAA members report the following issues concerning requests for documents:

- AFCA asks for large number of documents that are outside the scope of the claim.
- The system of document exchange often slows down cases. AFCA waits for both parties to provide their documents and then exchanges them, rather than providing the documents to the other party on receipt. This latter method is the one used by the courts.
- It is obvious that AFCA decision makers have not read all the documents provided when they make their decision.

Question 3 Are AFCA's processes for the identification and appropriate response to systemic issues arising from complaints effective?

SAFAA members report an inconsistent approach from AFCA on this issue.

Question 4 Do AFCA's funding and fee structures impact competition? Are there enhancements to the funding model that should be considered by AFCA to alleviate any impacts on competition while balancing the need for a sustainable fee-for-service model?

In the recently issued AFCA Two Year Report 1 November 2018 – 31 October 2020, AFCA reported that 72% of all claims are resolved by agreement or in favour of complainants.

SAFAA's view is that most of the claims made against SAFAA's members are settled for purely commercial reasons, in order to avoid the costs of the AFCA complaints process, and therefore do not accurately reflect the legal worthiness of the claims that are made. Member firms have no incentive to defend claims that have no substance. Complainants are not liable to pay any fees and are incentivised to pursue the claim through each stage of the system. The AFCA fee structure accordingly impacts on competition and the sustainability of the AFCA scheme.

AFCA charges 'flexible' complaint fees, as well as charging member firms an industry levy.

Complaint fees are charged according to:

- the 'stage' a complaint is resolved; and
- the 'complexity' of the complaint as determined by AFCA.

The AFCA fee schedule is included as **Attachment B.**

Complaint fees are charged at each stage through which the complaint progresses. Complaints classified as 'complex' attract higher fees than complaints classified as 'standard'.

There is no transparency or certainty as to how AFCA decides on whether to classify a complaint as 'complex' or 'standard', nor how the case is to be progressed though the stages.

As we have stated earlier, claims that should be knocked out at the registration and referral stage (and member firms charged $100) are commonly progressed through to the conciliation stage (at which member firms are charged $2,755 for a 'complex' matter).

Our members report that it is commercially sensible to settle complaints even where the complainant has not suffered a loss and there is no merit to the complaint.

This is because:

- AFCA decision making is often inconsistent and unpredictable and member firms are uncertain as to how decisions will be made;
- decisions are binding on the member firm with limited grounds to appeal;
- even if AFCA makes a final determination against the complainant, the member firm will be required to pay complaint fees of $14,745;
- AFCA can award amounts in excess of $500,000 to the complainant; and
- costs in management time in responding to AFCA complaints and the fees charged for the complaint to process through the scheme make it uneconomic for member firms to defend claims.

We note that these commercial decisions are not captured in the AFCA statistic noted above.

SAFAA recommends that there be greater transparency and certainty around how complaints are categorised for the purposes of the AFCA fee schedule and that the complaint fee structure be recalibrated to ensure that member firms are not disencentivised from defending complaints brought against them that have no merit.

Question 5 Do the monetary limits on claims that may be made to, and remedies that may be determined by, AFCA in relation to disputes about credit facilities provided to primary production businesses, including agriculture, fisheries and forestry businesses remain adequate?

SAFAA has not received any feedback from members concerning the adequacy of monetary limits on claims made by primary producers.

Question 6 AFCA's Independent Assessor has the ability to review complaints about the standard of service provided by AFCA in resolving complaints. The Independent Assessor does not have the power to review the merits or substance of an AFCA decision. Is the scope, remit and operation of AFCA's Independent Assessor function appropriate and effective?

SAFAA considers that it is important for the improved performance of AFCA for an independent assessor to be able to review problems member firms are experiencing concerning the operation of the scheme.

Question 7 Is there a need for AFCA to have an internal mechanism where the substance of its decision can be reviewed? How should any such mechanism operate to ensure that consumers and small businesses have access to timely decisions by AFCA?

AFCA is intended to be a timely and cost-effective scheme for the resolution of consumer disputes.

Introducing an internal mechanism for a merits review would need to be carefully considered as it would introduce costs and delays into the scheme which would run counter to its intent.

However, AFCA's increased jurisdiction has resulted in it deciding increasingly complex matters and awarding substantial claims against member firms. There is also limited transparency or certainty for member firms as to whether matters are to be decided by a panel or an ombudsman.

Improvements to ACFA's scheme rules that reduce discretion and improve transparency and certainty would reduce the need for a merits review as would a reduction in the scheme's jurisdictional limits.

Conclusion

SAFAA stresses again its support for an external dispute resolution service for retail consumers. Our submission has set out our reasons for our view that the AFCA scheme has developed in a way that is no longer just a protection measure for small consumer complaints. Notwithstanding the small numbers of complaints made against our members, SAFAA considers that the AFCA scheme needs to be reviewed to take into account the various issues our members experience that impact on the procedural fairness and sustainability of the system.

SAFAA is happy to engage with the Review Team and provide whatever assistance is necessary to improve the operation of the AFCA scheme.

Kind regards

Judith Fox
Chief Executive Officer

ATTACHMENT A
PERCENTAGE FIGURES OF WHOLESALE CLIENTS

Stockbroker A	Since 10 June 2016 two matters have been referred to AFCA (or its predecessor) — both were from wholesale clients. There were also two historical claims made under the AFCA Legacy Scheme. One of these clients was wholesale and the other was retail (although there was limited available information in relation to that claim). For that firm the total percentage of wholesale claims is 75%.
Stockbroker B	Of 9 complaints that were referred to AFCA during the period 1 October 2019 to 30 September 2020, 6 related to wholesale clients. For that firm that total percentage of wholesale claims is 67%.
Stockbroker C	For the 2019 calendar year an average of 38.6% of claims were from wholesale investors. For one month during that period 66.67% of claims were from wholesale investors.
Stockbroker D	During the period 1 October 2019 to 30 September 2020 the firm had 3 complaints at AFCA and one of these was a wholesale client (33.3%).
Stockbroker E	During the period 1 October 2019 to 30 September 2020 85% of complaints were from wholesale clients

ATTACHMENT B
AFCA COMPLAINT FEES

Complaint Closed Status	Invoice Service Code	Resolution point	Fast Track	Standard	Complex
ALL					
CRGR	RGR	Registration & Referral	100		
CTOR	N/A	Rules Review	0		
CFCM1/CCM1	FCM1/CM1	Case Management 1	890		
CCM2	CM2	Case Management 2		2,225	2,515
CCM2	CM2C	Case Management - Conciliation		2,375	2,755
CFPRV	FPRV	Fast Track - Preliminary View	2,130		
CFDEC	FDEC	Fast Track - Decision	3,975		
CPRV	PRV	Decision - Preliminary View		5,655	7,055
CDEC	ODEC	Decision - Ombudsman		8,880	11,355
CDEC	PDEC	Decision - Panel			13,330
	OCON	Ombudsman Conference	1,415		

Stockbrokers And Financial Advisers Association Limited

29 June 2018

[redacted]
Legal Counsel
Australian Financial Complaints Authority
GPO Box 3
Melbourne VIC 3001

By email: submissions@afc.org.au

Dear Mr [redacted]

Submission on proposed Australian Financial Complaints Authority Rules

We refer to the consultation paper on the proposed Australian Financial Complaints Authority (**AFCA**) Rules, dated 1 June 2018 (the **Consultation Paper**), which invites written submissions in relation to the proposed AFCA Rules. The Stockbrokers and Financial Advisers Association Limited (**SAFAA**) welcomes the opportunity to provide comment.

We note that AFCA has stated in the Consultation Paper that consideration of its jurisdictional exclusions is outside the scope of the consultation[1]. Similar comments were made during the AFCA Rules consultation seminar on 13 June 2018. In each instance, the rationale was that the proposed AFCA Rules do not encompass any further extension or change to AFCA's jurisdiction beyond the Federal Government's reform program.

We respectfully disagree with this rationale in relation to AFCA's future consideration of complaints concerning the provision of financial services (other than in relation to superannuation)[2]. Specifically, there are two substantive changes to the proposed AFCA Rules, as compared to the current Financial Ombudsman Service (**FOS**) Terms of Reference and the Credit and Investments Ombudsman (**CIO**) Rules, which will extend AFCA's jurisdiction, as follows:

1. Removal of mandatory (CIO) or discretionary (FOS) exclusion for complainants that are not 'retail clients' under the *Corporations Act 2001* (Cth)[3]. Under the proposed AFCA Rules, AFCA will be obliged to consider complaints from such persons, provided they meet the general eligibility requirements.
2. Change in language concerning when AFCA can consider a complaint which is lodged after the stipulated time limits. Currently, FOS and CIO can only consider such complaints in

[1] See page 4.
[2] Our focus is naturally on financial services provided by our members, particularly investment advice and brokerage in relation to securities. These services require members to maintain an Australian financial services (**AFS**) licence (in accordance with section 911A of the Corporations Act) and complaints relating to these services are currently considered by FOS and CIO. Accordingly, references to 'financial services' in this submission are to financial services regulated under the Corporations Act, and we have not considered the position in relation to matters which are currently regulated by other legislation (such as the *National Consumer Credit Protection Act 2009* (Cth)) or under the jurisdiction of the Superannuation Complaints Tribunal.
[3] See section 761G.

'exceptional circumstances'. Under the proposed AFCA Rules, AFCA may consider them where 'special circumstances' apply.

We have included comment below in relation to these matters and respectfully request that the final AFCA Rules be amended to reflect the current jurisdictional limits of FOS and CIO[4], in particular as a) we have seen no evidence to suggest these changes have been mandated by the Federal Government, and b) extensions to AFCA's jurisdiction when compared to the predecessor schemes 'require detailed consideration and extensive consultation after the new scheme has commenced[5]'.

We have also added some general remarks concerning the establishment of AFCA below.

Removal of exclusion for non-retail clients

Under the proposed AFCA Rules, AFCA will be obliged to consider complaints relating to the provision of financial services from a person who is not a retail client under section 761G of Corporations Act (i.e. a 'wholesale client'[6]), provided they meet the eligibility requirements.

However, the current FOS Terms of Reference give FOS discretion to decline to consider complaints where the applicant is not a retail client[7]. The CIO Rules go further – given the definition of 'consumer', CIO cannot consider a complaint relating to financial services where the complainant is not a retail client[8]. Accordingly, the proposed AFCA Rules have removed the exclusion relating to non-retail clients and AFCA's jurisdiction will be extended compared to its predecessors.

In this regard, we have been unable to find any previous suggestion by the Federal Government (either pursuant to a recommendation in the *Ramsey Report* or otherwise) to expand AFCA's jurisdictional scope to non-retail clients; nor was it mentioned by the Australian Securities and Investments Commission (**ASIC**) in its consultation paper concerning proposed oversight of AFCA[9]. AFCA's mapping document, comparing the FOS Terms of Reference, CIO Rules and proposed AFCA Rules (the **Mapping Document**) simply notes that the proposed extension follows discussions with ASIC and Treasury[10].

In addition, it should be noted that the implementing legislation for AFCA[11] retains the current position in relation to dispute resolution for Australian financial services licensees, so that the relevant requirements (including mandatory AFCA membership) only apply to entities that provide financial services to retail clients[12]. We submit that if the Federal Government had intended to extend AFCA's jurisdictional scope to non-retail clients, this would have been reflected in the implementing legislation.

Further, in its consultation paper on the establishment of AFCA[13], Treasury asked whether the existing exclusions from FOS and CIO jurisdictions present any unreasonable barriers to accessing

[4] Subject to our comments in relation to a mandatory exclusion for wholesale clients (see below).
[5] Consultation Paper, page 4.
[6] Section 761G(4) provides that a person is a wholesale client if they are not a retail client under that section. In this context, we refer to 'non-retail clients' and 'wholesale clients' interchangeably.
[7] Rule 5.2(b).
[8] Rules 6.1(a) and 45.1.
[9] ASIC Consultation Paper 298 *Oversight of the Australian Financial Complaints Authority*.
[10] AFCA *Mapping of FOS Terms of Reference (TOR), CIO Rules and AFCA Rules*, June 2018, pages 11-12.
[11] *Treasury Laws Amendment (Putting Consumers First—Establishment of the Australian Financial Complaints Authority) Act 2018* (Cth).
[12] Corporations Act s912A(1)(g) and (2)(c).
[13] Treasury Consultation Paper *Establishment of the Australian Financial Complaints Authority*, November 2017

the schemes[14]. None of the resulting submissions from the Consumer Advocates Group[15], Legal Aid Queensland[16], Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**)[17] or Catherine Wolthuizen and Philip Cullum[18] (which can reasonably be seen a proxy for consumer and small business concerns in relation to the existing arrangements) recommended an extension of AFCA's jurisdiction to non-retail clients. The Legal Aid Queensland submission instead noted that the 'existing exclusions do not place an unreasonable barrier to accessing EDR schemes'[19].

Given the above, we do not accept that the proposed extension of AFCA's jurisdiction in relation to non-retail clients was part of the Federal Government's reform agenda nor see any need for change in this context. We accordingly request that the final AFCA Rules include an exclusion for non-retail clients (thereby reflecting the existing arrangements).

In this regard and given the discrepancy between the FOS and CIO exclusions[20], we submit that the better position is a mandatory exclusion for non-retail client complaints relating to financial services (as per the CIO Rules). As noted above, the implementing legislation for AFCA concerns retail clients only and the relevant dispute resolution obligations (including membership of AFCA) are the only 'general obligations' for AFS licensees under section 912A of the Corporations Act with this limitation (and therefore should not be considered as unintended).

An extension of AFCA's jurisdiction beyond retail clients, in relation to financial services complaints is accordingly inconsistent with its implementing legislation and should not proceed, noting that the AFCA Rules should reflect the requirements of the implementing legislation (which AFCA confirmed was a 'guiding principle' in designing them[21]).

Consideration of time barred complaints in 'special circumstances'

The proposed AFCA Rules include time limits for the consideration of complaints relating to the provision of financial services[22], which are generally consistent with the existing FOS and CIO restrictions[23] as well as statute of limitation legislation in NSW[24].

However, AFCA will be able to consider complaints submitted after the expiration of those time limits if it considered that 'special circumstances' apply[25]. This language differs from the current position, whereby FOS and CIO can only consider otherwise time barred complaints in 'exceptional circumstances'[26]. The Judiciary also have limited rights to extend limitation periods where it is 'just and reasonable to do so', although these generally only concern claims relating to personal injury or death[27].

[14] See question 19.
[15] A joint submission from the Consumer Action Law Centre, Consumer Credit Law Centre SA, Consumer Credit Legal Service (WA) Inc, Consumers' Federation of Australia, Financial Counselling Australia, Financial Rights Legal Centre and Public Interest Advocacy Centre, dated 29 November 2017.
[16] Treasury Consultation Paper –Establishment of the Australian Financial Complaints Authority, submission by Legal Aid Queensland, dated November 2017
[17] Establishment of the Australian Financial Complaints Authority, submission by ASBFEO, dated 20 November 2017.
[18] Establishment of the Australian Financial Complaints Authority - a response to the consultation paper, by Catherine Wolthuizen and Philip Cullum, dated 20 November 2017.
[19] Page 6.
[20] As noted above, FOS have discretion to exclude complaints by wholesale clients, whereas CIO must not consider such complaints where they relate to a financial service within the meaning of the Corporations Act.
[21] Consultation Paper, page 6.
[22] Proposed AFCA Rule B.4.3.1.
[23] FOS Terms of Reference, Rule 6.2(b) and CIO Rule 6.3.
[24] *Limitation Act 1969* (NSW), section 14.
[25] Proposed AFCA Rule B.4.4.2.
[26] FOS Terms of Reference, Rule 6.2(b) and CIO Rule 6.4.
[27] See for example sections 60C, 60D and 62A of the Limitation Act.

The Consultation Paper does not provide any background as to the basis for this proposed new language, nor does the Mapping Document (which simply notes the change)[28]. Similarly, while ASIC's regulatory guide on its intended oversight of AFCA[29] notes the concept of 'special circumstances'[30], there is no explanation as to what this means nor why it was changed from the previous 'exceptional circumstances' which applied to FOS and CIO.

Further, the new language was not raised in Treasury's consultation paper on the establishment of AFCA in November 2017 (as acknowledged on page 14 of the paper). Indeed, while the Consumer Advocates Group noted in their submission to the consultation that capacity to consider complaints in exceptional circumstances was an essential feature of an effective external dispute resolution system[31], it did not suggest any extension beyond the current powers. Similarly, in its submission, Legal Aid Queensland noted that time limits are covered by the existing FOS Terms of Reference and CIO Rules and should be address in the AFCA Rules, without requesting any additional capacity[32][33].

Presuming 'special circumstances' are broader than 'exceptional circumstances', which the ordinary meaning would suggest, it appears that AFCA will have broader powers to consider time-barred complaints than its predecessors, without consultation or an explanation as to basis for the increase being provided.

Absent such consultation and an adequate explanation being provided and given that the change does not appear to have been included in the Federal Government's reform program[34], the proposed AFCA Rules should not extend AFCA's powers in this regard, particularly given the various policy considerations associated with limitation periods generally (including matters of equity and practical issues such as a lack of contemporaneous evidence for older cases) and the restrictions that apply to the NSW Judiciary under corresponding statute of limitations legislation (which reflect those policy considerations).

Accordingly, we request that the final AFCA Rules reflect the current FOS and CIO position, so that AFCA may only consider otherwise time-barred financial services complaints in 'exceptional circumstances'.

General observations

Notwithstanding AFCA's comments that this is a focused consultation covering a limited number of issues[35], we believe it is appropriate to restate our material concerns in relation to the establishment of AFCA generally and which have previously been raised in our various submissions in relation to the Federal Government's review of the financial system's external dispute resolution and complaints framework[36].

[28] Page 14.
[29] ASIC Regulatory Guide 267 *Oversight of the Australian Financial Complaints Authority*, issued 20 June 2018.
[30] See paragraph 168.
[31] See pages 16 – 17.
[32] See page 8.
[33] Neither the ASBFEO nor the Wolthuizen and Cullum submissions included any reference to a need for change in this regard.
[34] Once again, we have been unable to find any previous suggestion by the Federal Government (either following a recommendation in the Ramsey Report or otherwise) to expand AFCA's powers in this context.
[35] Consultation Paper, page 4.
[36] See for example, our submissions dated 7 February 2017, 13 June 2017 and 4 July 2017 in relation to the Review of the Financial System External Dispute Resolution and Complaints Framework and our submission dated 20 November 2017 in relation to the Treasury consultation on the Terms of Reference and other establishment issues for AFCA.

Specifically, we reiterate our strong objection to the arbitrary increase in AFCA's claim and compensation limits for financial services complaints, noting that:

a) The existing limits applicable to FOS and CIO are already the highest of any comparable scheme in any other country;

b) There is no evidence that consumers of investment advisory and brokerage services are suffering by not being able to access the current external dispute resolution schemes because of the current monetary limits[37]. As CIO noted in its submission to the Senate Economics Legislation Committee on the establishment of AFCA[38], FOS has never sought to increase its limits, notwithstanding its capacity to do so, while CIO has never seen a need for higher caps[39];

c) The Courts remain the appropriate forum to consider significant disputes relating to financial advice and brokerage, particularly given their general complexity;

d) The proposed AFCA arrangements do not include any of the safeguards that we believe are necessary to justify a higher claim limit (particularly rights to compel the production of evidence and party rights of appeal); and

e) Increased claim and compensation limits will result in significant increases in the cost of obtaining appropriate professional indemnity insurance and difficulties in obtaining cover.

More generally, higher claim and compensation limits for AFCA, when coupled with their broad capacity to consider all matters in making a determination (noting that AFCA will not be required to test a claim according to legal principles, including consideration of the contractual framework agreed between a financial service provider and its clients, which generally include limitations of liability except for negligence, wilful default or fraud[40]), *necessarily* increase the risks associated with providing financial services generally, and particularly the provision of financial advice and brokerage services.

A natural consequence of increased risk is for providers to seek greater rewards via higher pricing charged to clients. This upward pressure on pricing will likely be accentuated by increased professional indemnity costs (as noted above).

In addition, in our submission in February 2017, we noted that increased limits could result in a hollowing out of the market for small to medium advisory firms and that it would be a bad outcome if the only choice investors had was between the very largest financial service houses[41]. These concerns are amplified by the findings at the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry where issues surrounding vertical integration and failures to appropriately manage conflicts of interest or meet client 'best interest' obligations have blighted the reputation of the largest financial service houses that provide advice.

It is a perverse outcome that the higher claim and compensation limits for AFCA will likely have the effect of forcing more Australian consumers seeking investment advice and brokerage services to the very firms at the centre of the controversies identified by the Royal Commission, and to paying

[37] While we acknowledge the position may be different in relation to superannuation and credit related services, the proposed AFCA Rules already include differing rights and obligations vis-à-vis differing services, including differing claim and compensation limits. We see no reason why the existing limits could not be retained for financial services regulated by the Corporations Act.
[38] CIO submission to the consultation on the Senate Economics Legislation Inquiry into the Treasury Laws Amendment (Putting Consumers First — Establishment of the Australian Financial Complaints Authority) Bill 2017, dated 29 September 2017.
[39] Page 4.
[40] An AFCA decision maker must do what they consider is fair in all the circumstances and must simply *have regard* to legal principles (see proposed AFCA Rule A.14.2). They are also not bound by the rules of evidence or previous decision (see proposed AFCA Rule A.14.3).
[41] SAFAA submission to the Interim Report of the Review of the Financial System External Dispute Resolution and Complaints Framework, 7 February 2017, page 6.

higher prices to those entities. As the CIO feared in its submission to the Senate Economics Legislation Committee, the major banks will be the 'big winners' from the establishment of AFCA[42].

We accordingly request that the final AFCA Rules reinstate the claim and compensation limits which apply to FOS and CIO in relation to financial services regulated by the Corporations Act (including investment advice and brokerage).

Should you require any further information, please contact [redacted].

Yours sincerely,

Andrew Green
Chief Executive

[42] See footnote 38, page 5.