SR Group Submission to the Australian Financial Complaints Authority (AFCA) in response to the AFCA Scheme Amendment Authorisation

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Timeline:

5 May 2016: Then Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP, announced the establishment of an independent expert panel to lead a review into the financial system's external dispute resolution (EDR) and complaints framework. The expert panel was chaired by Professor Ian Ramsay. (http://kmo.ministers.treasury.gov.au/media-release/054-2016/)

31 May 2017: The review into the financial system's EDR and complaints framework was issued with an amended Terms of Reference and asked to consider and make recommendations on the establishment, merits and potential design of a compensation scheme of last report ("CLSR").

6 September 2017: The panel overseeing the review of the financial system EDR and complaints framework delivers its Supplementary Final Report ("the Ramsay Report"). The Ramsay Report recommended the establishment of a CSLR and makes further recommendations as to the design and criteria of a such a scheme.

21 December 2017: Kelly O'Dwyer announced that the government will defer its consideration of the recommendations of the Ramsay Report until after the completion of the Royal Commission. (http://kmo.ministers.treasury.gov.au/media-release/124-2017)

1 February 2019: Commissioner Kenneth Hayne QC delivers the findings of the Royal Commission in his Final Report. The Final Report makes 76 recommendations, one of which is for the establishment of a CSLR. The Final Report recommends that the mechanism and criteria of the CSLR be aligned closely to the recommendations of the Ramsay Report.

The Royal Commission made the following comments regarding the CSLR in its final report:

> *"The (Ramsay) panel concluded that there was 'merit in considering' providing access to redress to consumers and small businesses who had 'a viable claim against a financial firm at the time of the dispute' where one or more of four criteria were met:*
>
> - *the firm was no longer operating;*
> - *the firm was not a member of an EDR body; …*

(https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf)

22 February 2019: Opposition Leader Bill Shorten announces the design of a compensation scheme should Labor be elected to parliament. The proposed Labor scheme will include:

- An increased compensation threshold of $2 million for both consumers and small business;
- Increased compensation cap from $5,000 to $2 million for non-financial loss;
- The period for AFCA to consider misconduct cases extended from 12 to 24 months;
- The opportunity for claimants who have previously received unfavourable determinations to have their matter re-reviewed.

(https://www.billshorten.com.au/labor_announces_groundbreaking_bank_victim_compensation_scheme_friday_22_february_2019)

18 February 2019: the responsible Minister changed the Authorisation conditions for AFCA Limited to operate the AFCA scheme. The new conditions require AFCA to deal with complaints about conduct by financial firms (who are current members of AFCA) dating back to 1 January 2008. The Australian Financial Complaints Authority (AFCA) is seeking submissions on proposed changes to its Rules which will expand its jurisdiction to deal with eligible complaints about conduct dating back to 1 January 2008.

The Proposed Amendments to the AFCA Guidelines

Section F modifies the operation of the AFCA Rules solely in respect of legacy complaints to give effect to the change in authorisation conditions. No other class of complaints are affected by this Section.

Section F will only apply to complaints received during the period 1 July 2019 to 30 June 2020 (inclusive), after which time it will be removed from the AFCA Rules.

F.1 Application of this section

F.1.1 Legacy complaints will be dealt with under this section of the Rules as at 30 June 2019. All other complaints will be dealt with under the other sections of the Rules that apply as at the date the complaint was lodged.

F.1.2 Legacy complaints will not be subject to the time limits set out in B.4.

F.1.3 In all other respects, Sections A to E of the 30 June 2019 Rules will apply to legacy complaints unless modified by Section F. In the event of inconsistency between the other sections of the Rules and Section F, Section F prevails as it relates to legacy complaints.

F.2 Requirements for legacy complaints

F.2.1 AFCA will not consider a Legacy Complaint:

a) unless it is submitted to AFCA between 1 July 2019 and 30 June 2020.
b) about conduct that occurred and ended before 1 January 2008.
c) in relation to which a decision or determination has been made by a court or tribunal.
d) in relation to which a decision or determination about the merits of the complaint has been made by a Predecessor Scheme or AFCA.
e) that has previously been finally settled by the Complainant and the Financial Firm to whom the complaint relates (other than a complaint which can still be made under the Rules).
f) in relation to a superannuation death benefit.
g) that solely relates to a right or obligation arising under the Privacy Act.

The Shortcomings of the Proposed Amendments

The SR Group believes that the AFCA consultation paper, draft amendments to the AFCA rules and draft amendments to AFCA's Operational Guidelines are fundamentally flawed and require significant revision prior to implementation. We have identified a number of issues with the proposed amendments and make a number of recommendations to address these issues.

The SR Group also note that the documents issued by AFCA regarding the proposed amendments all fail to effectively establish a link between legacy complaints and the proposed CSLR. SR Group believes the information provided as to the mechanism and operation of the CSLR is unclear and more transparency is required to establish this link.

In response to the Royal Commission Final Report, the Government wrote (*make appendix*):

> *"For there to be confidence in the financial system's dispute resolution framework, it is important that where consumers and small businesses have suffered detriment due to failures by financial firms to meet their obligations, compensation that is awarded is actually paid.* ***The CSLR will operate as a last resort mechanism to pay out compensation owed to consumers and small businesses that receive a court or tribunal decision in their favour or a determination from AFCA, but are unable to get the compensation owed by the financial firm — for example, because the firm has become insolvent.***
>
> *The CSLR will be established as part of AFCA.*
>
> *The Government also* ***agrees*** *to fund the payment of legacy unpaid determinations from the Financial Ombudsman Service and Credit and Investments Ombudsman. The Ramsay Review found that there was a strong case for these determinations to be paid.*
>
> *The Government* ***will also*** *require AFCA to consider disputes dating back to 1 January 2008 — the period looked at by the Royal Commission, if the dispute falls within AFCA's thresholds as they stand today. This will ensure that consumers and small businesses that have suffered from misconduct but have not yet been heard will be able to take their cases to AFCA. Consumers and small businesses will have twelve months from the date that AFCA commences accepting legacy disputes to lodge their complaint with AFCA." (emphasis added)*

It is clear from this response to the Final Report that the purpose of the scheme is to provide tangible redress to individuals and entities who have lost funds due to the misconduct of third parties but are unable to achieve redress from these third parties for whatever reason.

It is curious to note that the contending major political parties have different intentions as to the mechanism, criteria and operation of AFCA and the CSLR. The current government appear to favour a more limited, less accessible CSLR, and have effected rather specific guidelines to ensure as much. In contrast, the current opposition see merit in a broader, more permissive CSLR, with a more defined aim at providing redress to Australian consumers who have suffered wrongdoing. It is strange, and rather disappointing, that these parties are not aligned in their vision to provide practical redress to their constituents who have fallen victim to misconduct. The CSLR, by its very design, should be permissive in nature, and seek to provide the maximum amount of redress as practically possible.

A permissive CSLR is also, in the long run, more commercial to the Australian Commonwealth, although it may not appear as so immediately. The proposed mechanism of AFCA and the CSLR in its current iteration will exclude many potential claimants from accessing compensation. Without delving into the ethics behind this reasoning, this appears to save the Commonwealth money by paying out less claims.

However, the vast, vast majority of these claimants are middle-aged and elderly Australians who are approaching, or have passed, retirement age and are no longer income earning members of the work force. Similarly, these same claimants have generally lost the majority of their savings, or retirement 'nest-egg' due to misconduct, and without receiving compensation or tangible redress, these Australians will require from financial assistance from the government for the rest of their lives. The cost of supporting these elderly, unfunded Australians will be a far bigger impost on the Commonwealth and its available funds than if compensatory payments were made under the CSLR. These compensatory payments would not only allow these older Australians to fund their own retirement, but also assist family members and future generations through the transfer of wealth, who would potentially seek financial assistance from government bodies such as Centrelink.

From reviewing the provided documents in detail, we believe the proposed amendments (namely, the addition of section F) to the AFCA guidelines are fundamentally flawed. Curiously, we note that neither of the documents make reference to the compensation scheme as recommended by the Royal Commission, or even use the word compensation. In regard to AFCA's consultation paper and draft amendments, we believe the following guidelines are erroneous and/or defective:

1. **Section A.4.2: The requirement to be a current member of AFCA.**

This section is applicable to both current complaints and legacy complaints, which is problematic in consideration of the wider scope of legacy complaints. When dealing with legacy complaints, it is highly possible, probably even likely, that a large number of entities for whom complaints exist about have experienced an insolvency event or similar in the wake of their misconduct. It follows that many of these entities will have been wound up and de-registered over the 11-year period for which legacy complaints can be made. Obviously, such entities will not be current members of AFCA, and to exclude individuals from the legacy scheme on this basis is illogical. Excluding claims against entities which are no longer active and/or current members of AFCA will prevent a larger number of potential claimants from accessing the scheme.

2. **The requirement to a compulsory member of AFCA.**

Legacy complaints can only be made about compulsory members of AFCA, that is, entities which are required to hold AFCA membership due to a licence or legislative condition. Entities which participate in the AFCA scheme voluntarily are not available to be claimed against. I do note that all AFSL holders, credit representatives and superannuation trustees are required to be members of AFCA, though we do not consider this requirement to be necessary whatsoever. It makes little sense to exclude any AFCA member, or any financial services firm for that matter, from being claimed against.

3. **Section F.2.1(b): The requirement for misconduct to have been perpetrated on or after 1 January 2008, without consideration as to whether the loss was suffered or whether the complainant was aware that misconduct had occurred at this point.**

This section is exclusive in design and will result in many individuals being unable to access redress due to technicalities and small timing issues. This is not the intended purpose of the scheme. Potential claimants will have suffered loss due to misconduct in a variety of circumstances. Many situations exist in which potential claimants will not be presently aware that misconduct had occurred immediately. To exclude potential claimants on this basis is unnecessarily unfair.

For illustration, below a list of hypothetical examples in which a potential claimant has had misconduct causing detriment perpetrated upon them. However, under the proposed AFCA rules, each example would be excluded from applying to AFCA's legacy complaints department, pursuant to section F.2.1(b). This creates a situation where the interests of the consumer are being placed last and the intended function of the scheme, i.e. to compensate victims of financial misconduct, is not being met.

- ***Example 1*:** A financial adviser (FA) gives inappropriate advice to a client in November 2007. The FA advises his client to invest in an investment scheme associated with the FA, without disclosing their relationship to the scheme or the drastic commissions the FA was receiving for promoting it. Subsequently, the investment the client was inappropriately advised into collapses in February 2008, with nil funds available to be recouped by the investor. The investor in this situation would not be eligible to make a claim to AFCA's legacy complaints department, as, per the proposed legislation, the misconduct was deemed to have occurred in November 2007.
- ***Example 2:*** The directors of a managed fund breach the Corporations Act 2001 by engaging in a series of uncommercial transactions in 2007. The directors make a number of loans to related entities on second and third mortgage bases. The loan recipient later enter insolvency, and no assets are available to be recouped by the managed fund which extended the loan. This massively impairs the value and earning capacity of the managed fund. The managed fund struggles for 18 months then collapses to insolvency in 2009. Under the proposed legislation, investors in the managed fund would have no claim for recourse;
- ***Example 3:*** An individual is given an investment margin loan in 2007 which is disproportionate to their repayment capacity and financial literacy. A downturn in the value of the securitising asset triggers margin calls which cripple the investor, which forces them to sell the asset at a substantial loss to meet their margin loan payments, and the investor is left in a far worse financial position than before they 'invested'. Upon inspection of the terms of the loan, it is apparent that the loan should never have been extended to the individual in the first place and constitutes inappropriate and predatory lending. However, as the loan was originated prior to 1 January 2008, the investor has no claim.

It follows logically that had a claimant been aware of the misconduct contemporaneously, they would have taken steps to preserve their funds prior to losing them.

4. Section F.2.1(c): Will not consider a complaint already considered by a court of tribunal.

This section has potential to preclude claims where a court judgement has been made but no practical restitution has been achieved by that court case. This is especially relevant in assuming that these guidelines will govern the administering of compensation payments.

There are many examples where determinations have been made, where a party has been found guilty of misconduct. These parties are often ordered to pay compensation and/or repay the misappropriated funds. Often, the parties who have been ordered to make these payments take every attempt to avoid

paying the ordered amount, such as declaring bankruptcy, and no practical redress is achieved for the victims of their misconduct. This creates a situation where the complaint has been considered by a court or tribunal, but no tangible resolution or compensation has been received by the victims. It is simply illogical for such victims to be excluded from accessing the AFCA legacy complaints department and CSLR on this basis.

Similarly, many investors attempt to achieve redress through the courts themselves. It is important to realise that investors who have recently had their funds misappropriated are often experiencing some degree of financial hardship as a result. As such, many scorned investors engage the services of litigation funders and legal firms offering 'no win no fee' services. In exchange for these 'no win no fee' services, these firms often demand a high fee in the event a result is achieved. In these situations, it is highly common for settlement offers to be accepted by the litigators in order to recover their costs, without achieving practical redress for the investors they represent whatsoever.

Overall, these proposed amendments appear to miss the intended function of AFCA and the CSLR which is, to provide redress for people who have suffered financial loss or detriment due to the misconduct of external parties. The guidelines in their current form are exclusive rather than permissive and appear to be a tokenistic attempt to follow the recommendations of the Royal Commission without providing practical redress to affected individuals. There is also no reference to a need to exhaust available avenues before accessing the scheme, which is inherent in the name 'compensation scheme of **last resort**'.

SR Group's Suggested Amendments

A) The mechanism of the compensation scheme of last resort – to be administered by the Australian Financial Complaints Authority

Another shortcoming of the proposed AFCA legacy complaints department and the CSLR is the lack of clarity surrounding the mechanism of the CSLR. The Ramsay Report discusses the mechanism of the scheme, in which the newly formed AFCA would have its jurisdiction extended to consider complaints dating back to 1 January 2008. AFCA would be empowered to adjudicate on legacy complaints and make determinations about whether compensation should be paid to claimants.

Once AFCA has made a determination that compensation should be paid, AFCA should take all reasonable steps to enforce such a payment to be made by the offending party or their insurance, if applicable. In many circumstances, this will not be available. In such circumstances, where AFCA has determined that the claimant is entitled to compensation which cannot be obtained through the perpetrating party, the claimant should be directed to the compensation scheme of last resort.

The CSLR exists as a pool of funds with which to service claimants with unpaid determinations from AFCA. The CLSR should, upon being satisfied that the claimant has undertaken all reasonable steps in seeking compensation, use its pool of funds to make the awarded compensation payments.

In exchange for receiving compensation from the CSLR, the claimant will subrogate any future claims against the offending party to the government, who, at their own discretion, may seek to recover their expended funds by prosecuting the offending party. The government is undeniably far better resourced than general Australian consumers, and can use their vast resources, which include the Australian government solicitors and the police, to far more effectively recoup the funds they expended in making a compensation payment under the CSLR.

B) Exhausting All Avenues;

SR Group believes the CSLR must be set with predetermined guidelines, whereby any member or group of members applying for compensation must have exhausted every possible avenue of appeal (with evidence) prior to qualifying for the CSLR. We agree with the Government, that it is to be retrospective over eleven years, dating back to 1 January 2008.

> *"Without the support of a Legacy Fund these candidates will not be able to support themselves through their retirement years. In fact, some have reached that stage in their life already… They did not intend to be robbed of their money. The greatest tragedy is that there is nowhere in the existing system that they can go to retrieve or recover their funds… This is the very reason why a Legacy Fund must be established." – Susie Bennell submission to the Senate Economics Legislation Committee, 2017.*

C) Duration and sources of funding for the CSLR

SR Group believes the CSLR should have a finite term of five years. Funding would come from the levy imposed on the big four banks and Macquarie in the May 2017 budget which hoped to raise $6.2 billion in revenue over the next four years. Fines for banking misconduct, including the Commonwealth Bank of Australia's $700 million settlement with AUSTRAC over anti-money laundering allegations can be used

for additional funding. This means the CSLR would be an entirely government funded scheme. Anything not claimed or used during the five years is rebated to the overall External Dispute Resolution pool.

D) Taxation Implications

All restitution should be treated as return of capital and must therefore be on a tax-exempt basis.

E) Allow claim eligibility against non-current and non-compulsory members of AFCA

In light of the reasoning outlined in the 'Shortcomings…' section above, AFCA should be able to consider and make determinations against non-current and non-compulsory members of AFCA. This will in turn allow potential claimants to be eligible for redress and compensation under the CSLR.

In order to prevent the potential claiming eligibility becoming too broad, CSLR claims should be restricted to entities which either:

i) Were, or should have been, an Australian Financial Services Licence holder at any point between 1 January 2008 and 30 July 2020; or
ii) Offered investment opportunities and/or financial services at any point between 1 January 2008 and 30 July 2020.

F) Allow claim eligibility for misconduct which occurred prior to 1 January 2008, but the claimant was not made aware of such misconduct and/or the loss did not occur until 1 January 2008 onwards

AFCA should be able to consider complaints in circumstances where the claimant was not reasonably made aware of the misconduct until after 1 January 2008. Similarly, in cases where the client was not made aware that they had incurred detriment until after 1 January 2008, claimants should also be eligible to make claims to AFCA's legacy complaints department.

Claimants should undertake reasonable steps to prove that they were not made aware of misconduct prior to 1 January 2008. As such, if news articles outlining the misconduct in question are available dating back to 2007, a claimant could not argue they were not reasonable made aware of the misconduct prior to 1 January 2008.

G) Allow for complaints where a Court or Tribunal has made a ruling but failed to award adequate compensation

For matters which have received a Court or Tribunal ruling not in favour of the claimant, these matters should be considered finalized and not eligible for re-consideration though AFCA legacy complaints.

For matters which have received a Court or Tribunal in favour of the claimant, and redress greater than 30 cents in the dollar for incurred losses has been achieved, these matters should be considered finalized and not eligible for re-consideration through AFCA legacy complaints.

For matters which have received a Court or Tribunal in favour of the claimant, and redress less than or equal to a maximum of 30 cents in the dollar for incurred losses has been achieved, these matters should be eligible for consideration through AFCA legacy complaints and thus eligible for compensation through the CSLR, if AFCA determine so.

H) Superannuation Claimants

The CSLR should also be for Superannuants who have been defrauded. For the Government, it will ultimately be cheaper to compensate victims to allow them to take care of themselves in retirement. The cost of thousands of pension and welfare dependent victims will far outweigh the cost of compensating them for money they had no right to lose.

These recommendations aim to provide actual, tangible redress to people who have suffered wrongdoing. It would appear at this stage that the scheme in its current iteration is a rushed attempt to have the scheme legislated. SR Group believe this should be implemented through a government directed document to AFCA regarding the process of CSLR claims. We also recommend for significant revisions to the AFCA Scheme Amendment dated 19 February 2019.

An integral point of considering Legacy Complaints should be to allow AFCA to adjudicate on claims where a financial firm no longer exists or is in liquidation. If a Determination is successful, and the claim is unable to paid, this should be pooled in with the payment of legacy unpaid determinations from the Financial Ombudsman Service and Credits and Investments Ombudsman. It has been reported that this will amount to $30.7 million in compensation to almost 300 consumers and small businesses. By allowing Legacy Complaints from firms that no longer exist or are in liquidation more consumers can be compensated for the unjust practices they were subjected to under the watch of the regulators. It would be grossly unfair for these claims to not be considered. This should be extended to all clients who are not able to receive successful determinations because the misconducting company has become insolvent.