AFCA Funding Model Overview

July 2018

Executive summary

On 1 November 2018 the Australian Financial Complaints Authority (AFCA) will replace the Financial Ombudsman Service (FOS), the Credit and Investments Ombudsman (CIO) and the Superannuation Complaints Tribunal (SCT). AFCA will be a consolidated external dispute resolution (EDR) scheme to resolve complaints about products and services provided by financial firms (Firms).

AFCA will be required to ensure that it has adequate funding to effectively manage the transition from existing schemes and to manage its ongoing complaint resolution services in accordance with its authorisation requirements, whilst providing certainty to Firms regarding the costs of EDR.

Cost containment and providing an efficient and effective service will be a key focus for AFCA. So too is our focus on meeting the service needs of consumers, small businesses and AFCA members. We are focused on expenditure being directed towards enabling a smooth transition for the establishment of AFCA, skilling our staff, investing in technology to streamline services, and providing effective outreach and member support services.

AFCA recognises that providing certainty to Firms regarding the likely costs of EDR is important for annual budgeting arrangements. An important focus is to also ensure that disruption to Firms through the establishment of AFCA is kept to a minimum. Taking this into account, AFCA is proposing an interim funding model that is broadly based on the existing EDR scheme funding arrangements, and that meets the principles outlined in AFCA's authorisation requirements and ASIC Regulatory Guide 267.

As such, a three-phase funding model approach has been developed, consisting of initial transition funding for establishing AFCA, an interim funding model, and a long-term funding model. The focus of this consultation paper is on the transition and interim funding arrangements for AFCA.

The AFCA funding model

Under the new framework, AFCA will require adequate funding to transition from existing schemes into AFCA and to manage all ongoing obligations. To ensure this can be effectively managed with minimal disruption to members and operations a three-phase funding model approach has been developed:

Phase I – Transition funding

- Meeting the costs of AFCA's establishment so that it is adequately prepared to receive and handle complaints from commencement on 1 November 2018.

- Transition funding covers both the governance-related costs (including legal, financial, audit and other compliance costs) and the costs of establishing and operationalising AFCA (project management, complaint reporting applications, website development, technology, training, communications and engagement, and other similar costs) to be ready to receive up to 1,000 complaints in the first week of commencement. In the May 2018 Federal Budget, the Government allocated $1.7 million as contribution to AFCA's 2018-19 establishment costs.

Phase II – Interim funding model

- To apply for the first three years of AFCA operations (FY2018/2019 – FY2020/2021). During this period a hybrid funding model is proposed to be applied - based on aspects of the existing scheme funding arrangements for Firms that are FOS and CIO scheme members, and the APRA levy model for superannuation trustees who become AFCA members.
- The first two months of funding in 2018-19 cover the operations of the FOS scheme (operated by AFCA), funded by FOS members who transitioned their membership to AFCA on 1 May 2018, with the next two months funded by both FOS and CIO members[1]. The subsequent eight months will fund the newly formed AFCA from its commencement on 1 November 2018, and will be managed in accordance with the interim funding model, outlined in this funding model overview.
- The interim funding arrangements will apply while AFCA establishes an evidence base of complaint volumes and complexity in an expanded jurisdiction, and settles complaint handling approaches and required skills/resources to manage the full range of complaints.

Phase III – A long-term funding model

- A long-term funding model – to be adopted following a full funding review based on complaint forecasts, operational efficiency savings across the consolidated scheme, and resource requirements for the long-term future of AFCA.
- The review will seek options for a revised funding model developed from consultation with stakeholders and settlement by the AFCA board following discussion with the Minister for Revenue and Financial Services and the Australian Securities and Investments Commission (ASIC). The long-term funding model is proposed to be implemented from July 2021.

[1] Based on the CIO Scheme transitioning to AFCA on 1 September 2018.

Components of the proposed AFCA funding model

The proposed AFCA funding model has three components. These reflect and take into account the existing user pays, industry funded model used by the predecessor Ombudsman schemes.

The three components of the proposed funding model are:

1. Membership levy based on the size and type of business
2. User charge based on the number of complaints (for Firms with more than one complaint closed past the initial Registration and Referral stage)
3. Complaint fees based on complaint complexity and the resolution stage reached.

For superannuation trustees, the interim funding model provides for an annual levy based on the APRA levy model, rather than the three funding components outlined above.

Authorised Credit Representatives (ACRs) will continue to pay only a membership administration fee, with all complaints referred to the relevant Licensee.

Key impacts of the interim funding model

FOS members

- Existing FOS members will be largely unaffected by the AFCA interim funding model, as it is broadly based on the FOS funding model.
- Approximately 70% of all revenue will be derived from complaints fees and a user charge, with the remainder derived from membership fees, reflecting a user-pays approach.
- For Authorised Credit Representatives (ACRs) a membership administration fee of $55 will be applied per ACR.

CIO members

- CIO members will also be subject to the three funding components outlined above, with approximately 70% of revenue derived from complaint fees and user charge, with the remainder derived from membership fees.
- A majority of CIO members are likely to receive a reduction in membership fees. Smaller members will have a minimum membership levy of $350 rather than $400 currently paid in 2017-18.

- For the minority of CIO members that have complaints lodged against them with AFCA, as AFCA will be funded by a user pays model, there may be an increase in complaint fees compared with those currently paid to the CIO. Complaint handling requires the use of AFCA staff resources, which will not be subsidised by membership fees of AFCA members that don't have complaints.
- For ACRs an annual membership administration fee of $55 will be applied per ACR, rather than $145 currently paid in 2017-18.

Superannuation trustee members

- A superannuation membership levy will be collected to cover the first eight months of AFCA's operation in 2018-19, as well as a proportionate share of the AFCA establishment costs. Individual trustee levies will be calculated by applying the same fund data utilised for the existing APRA levy paid by superannuation funds.
- Any Superannuation trustee members that were already existing FOS or CIO members will not pay a general AFCA membership levy, only a superannuation membership levy.
- Superannuation trustee members will not pay individual complaint fees for superannuation complaints. Any Superannuation trustee members that were already existing FOS or CIO members, however, will be charged complaint fees for any complaints received against them that come within AFCA's non-superannuation jurisdiction.

Principles applying to AFCA's funding model

The interim and long-term funding models have been developed in line with a set of four principles outlined in the AFCA scheme authorisation requirements[2]. The principles, seen below, ensure that the interim phase and long-term funding models address the recommendations of the Ramsay Review, the amendments to the *Corporations Act 2001*, and provide the optimal outcomes for all relevant scheme stakeholders.

Principle
1. The funding model will be such that the AFCA Board can be confident that AFCA will consistently raise the revenue necessary to meet the costs of effective operation and ongoing enhancements of a service that satisfies the relevant external dispute resolution (EDR) benchmarks

2 The scheme authorisation requirements for funding are outlined in the *Establishment of the Australian Financial Complaints Authority* paper produced by the Australian Government

Principle
2. The model will provide a fair allocation of annual membership levies to AFCA members according to their size, incorporates incentives to resolve disputes early and, as appropriate, reflects attributes of a user-pays approach
3. The model will seek to minimise direct sectorial cross-subsidisation to the extent practicable
4. The model will support an efficient and reliable system for the collection of revenue.

Longer term funding arrangements

AFCA recognises that a longer-term funding model will need to be developed based on the experience of operating a single scheme, having an evidenced-based understanding of the volumes and types of complaints that AFCA will handle across all industry sectors, and having had the opportunity to engage with its full range of members and consumer bodies.

The first operating year of AFCA will essentially be a transitional year – one of embedding the new attributes of a single, consolidated scheme. It won't be until the end of a second full year of complaint activity that AFCA will be in a position to conduct a full funding model review. AFCA's aim at that time will be to have a consistent funding model for all sectors, including the superannuation sector.[3]

A full funding review is intended to be conducted early in the third year of operation, and will be based on complaint forecasts and resource requirements for the long-term future of AFCA. It is proposed that this review will see options for a revised funding model developed for consultation with stakeholders and settlement by the AFCA Board, following discussion with the Minister and ASIC. The expectation is to have a consistent funding model applicable to all financial firms, irrespective of what sector they operate in.

3 This timing would also coincide with the full transition from APRA levy funding to the ASIC user-pays model