

# The AFCA Approach to determining compensation in complaints against Financial Advice Firms where the Responsible Entity of a Managed Investment Scheme has become insolvent

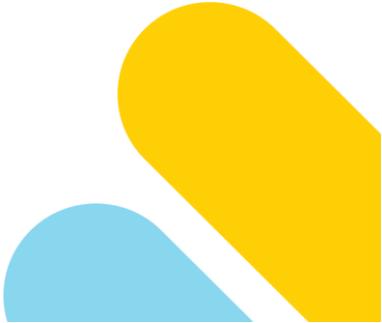
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AFCA Approach documents help consumers and financial firms to better understand how AFCA reaches decisions about key issues.

These documents explain the way we approach common issues and complaint types. However, it is important to understand that each complaint that comes to us is unique, so this information is a guide only. No determination (decision) can be seen as a precedent for future cases, and no AFCA Approach document can cover everything you might want to know about a key issue.

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# 1 Executive summary

## 1.1 About AFCA Approach documents

The purpose of AFCA's Approach documents is to explain how we look at common issues and complaint types. Approach documents provide greater clarity around what to expect from AFCA processes, explain how we investigate complaints and how we make decisions.

## 1.2 The purpose of this Approach

AFCA has already published "*The AFCA approach to calculating loss in financial advice complaints.*" This document should be read in conjunction with that document.

The purpose of this additional Approach document is to clarify how AFCA approaches liability and loss when a financial advice firm has been found to have breached its obligations to the complainant, in circumstances where the Responsible Entity (RE) of one or more Managed Investment Schemes (MISs) that the complainant invested in have subsequently become insolvent.

We have been asked to clarify this in the context of the Compensation Scheme of Last Resort (CSLR) which allows consumers to claim up to \$150,000 arising out of unpaid AFCA determinations, provided CSLR eligibility requirements have been satisfied.

## 1.3 Who should read this Approach?

**Financial firms**

**Consumer  
representatives**

**Consumers**

This approach is for financial firms, consumer representatives, consumers, and anyone else who wants to understand how AFCA applies legal principles, industry codes and guidance, and good industry practice when considering these complaints.

## 1.4 About financial advice complaints

Financial advice complaints do not make up a large number of the overall complaints received at AFCA.

Sometimes a consumer will make a complaint against a financial firm, complaining that they have received advice to invest in a Managed Investment scheme (MIS) that

has failed or not performed as expected. These complaints can raise questions about whether there have been breaches of legal and other obligations which have caused the loss, and if so, by whom.

Common advice complaints include (but are not limited to) the following:

-  **Inappropriate advice**
-  **Service quality**
-  **Failure to follow instructions/ agreement**
-  **Incorrect fees/ costs**
-  **Failure to act in client's best interests**

## 1.5 AFCA's purpose

AFCA is the independent external dispute resolution (EDR) scheme for the financial services sector. AFCA's purpose is to provide fair, independent, and effective solutions for financial disputes. We do this by providing fair dispute resolution services. We also work with financial firms to improve their processes and standards of service to minimise future complaints. In addition to resolving financial complaints, AFCA identifies, resolves, and reports on systemic issues and serious contraventions of the law.

## 2 How AFCA determines compensation

### 2.1 What complaints can AFCA consider?

#### 2.1.1 We can only consider complaints against AFCA members

AFCA can only consider complaints against financial firms that are members of AFCA. The complaint must also otherwise fall within AFCA's jurisdiction. This requires that the complaint must arise from or relate to the provision of a financial service (as defined in the AFCA Rules) to the complainant.

Under AFCA's Rules, we also cannot consider issues relating to the management of a fund as a whole, or complaints solely about poorly or under-performing funds (Rules C.1.5 (a) and (b)). This is the case for complaints against the RE of a MIS, or a financial advice firm, or both.

## 2.1.2 Our decision-making approach is in our Rules

If we assess that a financial firm has breached its obligations to the complainant, we may decide that the financial firm must compensate that complainant for the loss caused by the breach. We may also decide that a financial firm is required to take, or refrain from taking, particular actions. If a complainant accepts our decision, the financial firm is bound by that decision.

## 2.2 What this Approach does and does not cover

This Approach document only covers how AFCA determines and allocates loss where a consumer brings a complaint against a financial advice firm and where one or more MISs that were recommended by the firm have subsequently failed.

### 2.2.1 Multi-party complaints

It does not include how AFCA approaches a dispute where the financial advice firm and the RE of a MIS are joined, nor where an adviser shifts from one advice firm to another, or multi-party complaints in other areas of AFCA's jurisdiction.

## 2.3 AFCA's fairness jurisdiction

When assessing the conduct of a financial firm, we have regard to the law, industry codes, and standards of industry practice that were in place at the time of the conduct. We also have regard to past decisions, though these are not binding on AFCA.

Our decisions are intended to reflect what is fair in the circumstances of each complaint. In assessing what is fair, we apply a standard of fairness that focuses on concepts such as fair dealing, fair treatment, and fair service. We consider the conduct of all parties when determining a fair outcome.



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## 2.4 The AFCA Approach to calculating loss in financial advice complaints

There is a separate AFCA Approach document, titled “*The AFCA Approach to calculating loss in financial advice complaints*” which explains our approach to assessing financial loss.

It states that in financial advice complaints we first ask complainants to identify the loss they say they have suffered because of inappropriate financial advice (or any other breach of the financial advice firm’s obligations) they claim to have received.

AFCA will then assess:

- the financial advice firm’s conduct and whether it breached any of its obligations,
- whether the breach caused the loss,
- whether the consumer should be awarded compensation for the claimed loss.

Where inappropriate financial advice has been provided, the purpose of the compensation is to place the complainant in the financial position they would have been in if the financial advice firm had provided appropriate financial advice (i.e. “but for” the failure to provide appropriate advice, what position would the complainant have been in?)

## 2.5 The AFCA Approach to calculating loss does not change if a MIS has failed

In circumstances where a complaint is about financial advice related to a MIS that has subsequently failed (and whose RE is no longer an AFCA member) we will first consider whether the financial advice firm breached their legal obligations, for example whether the financial advice firm breached its duty to provide advice in the best interests of the complainant.

The financial advice firm will only be liable for loss that any such breaches have caused. Direct loss is calculated by applying the “But for” test. This test involves looking at the complainant’s actual losses and determining a hypothetical alternative portfolio that the complainant would have been in *but for* the financial advice firm’s breach. We then compare those losses to the portfolio the complainant should have been invested in had appropriate advice been provided. We must ultimately be satisfied that the breach/es **caused** the complainant’s loss.

So, in circumstances of a financial advice firm breaching its obligations, and where a MIS the complainant invested in has also failed, the failure will ultimately be taken into account as part of the loss calculation.

This is because the “But for” test requires a comparison between the complainant’s actual portfolio (which would include MIS losses) and the complainant’s hypothetical portfolio they would have been invested in “But for” the inappropriate advice.

However, and for the avoidance of doubt, if a MIS fails and the financial advice firm has not breached any obligations, they will not be responsible for the complainant’s losses, including those arising from the MIS failure.

## **2.6 AFCA will have regard to the complainant’s contribution to the loss**

When determining loss, AFCA will also have regard to the complainant’s conduct and any contribution they have made to the loss. This includes considering principles of mitigation of loss. AFCA will have regard to what is fair in all the circumstances in applying contribution.

This is determined on a case-by-case basis and could take into account, for example, the history of the financial advice firm/complainant relationship or the circumstances in which the complainant sought advice.

## 3 Case study

### 3.1 Case study on a complaint against a financial advice firm and a failed MIS

The complainant says the financial advice firm gave them inappropriate advice in advising them to invest in a growth profile and that they should have been classified as “balanced” investors. The financial advice firm recommended they invest in 10 separate MISs comprising a variety of asset classes. Two of the MIS’s subsequently failed and are no longer AFCA members.

The complainant thinks the RE of one of the failed MISs misled them too, but they cannot submit a complaint against the RE because the RE is insolvent and is no longer an AFCA member. In this scenario the possible outcomes are as follows:

#### **Option 1:**

The decision maker could find that the financial advice firm did not breach any obligation in providing advice to the complainant to invest in the MISs, including the ones that failed. No loss is payable to the complainant in such circumstances.

#### **Option 2:**

The decision maker could find that the financial advice firm breached its obligations to provide appropriate advice and act in the best interests of the complainant. However, the breaches did not cause any loss to the complainant when the “But for” test to loss is applied.

This may occur where the complainant’s actual portfolio, including the inappropriate investments, performed better than their hypothetical portfolio including appropriate investments.

### **Option 3:**

The decision maker could find that the financial advice firm breached its obligations to provide appropriate advice and act in the best interests of the complainant and this breach caused loss to the complainant.

Assuming no contribution is found on the complainant's part, the decision maker would assess loss on a "But for" basis, i.e., but for the failure of the financial advice firm to provide appropriate advice and act in the best interests of the complainant, what position would the complainant have been in? The financial advice firm is liable and the failure of the two MISs is taken into account as part of the loss calculation. AFCA then considers whether this results in a fair outcome for all parties concerned.

In these circumstances, the financial advice firm would be responsible for the losses caused by the failure of the two MISs in the sense that they are part of the actual loss calculation. "But for" the inappropriate advice, the consumer would not have invested in the failed product.

However, this is only because the financial advice firm breached its obligations. The responsibility for the loss is not on the basis that the RE(s) mismanaged the MISs.

### **Option 4:**

The decision maker could find the financial advice firm breached its obligations to provide appropriate advice and act in the best interests of the complainant and this breach caused loss to the complainant.

The financial advice firm is liable, and the decision maker would assess loss on a "But for" basis as set out in Option 3 above. However, the decision maker finds in this instance that the complainant contributed to their loss. In this case, the decision maker may reduce the loss that the financial advice firm is responsible for by a proportionate amount.

The decision maker could also consider if the outcome was fair in all the circumstances, and if not, reduce the loss on this basis.

## 4 References

### 4.1 Definitions

Term	Definition
<b>ASIC</b>	Australian Securities and Investments Commission
<b>Complainant</b>	An individual or small business who has lodged a complaint with AFCA.
<b>Consumer</b>	An individual or small business owner (including a primary producer) who uses the services of a financial firm.
<b>Financial adviser</b>	A person or business whose job is to provide financial advice to consumers.
<b>Financial Advice Firm</b>	A financial firm that is a member of AFCA which is authorised to provide financial advice (as distinct from a product provider or other financial firm such as a bank or insurer).
<b>Financial firm</b>	A financial firm, such as an insurer, that is a member of AFCA.
<b>Managed Investment Scheme</b>	A managed investment scheme as defined in section 9 of the Corporations Act 2001 (Cth) that is registered with the Australian Securities and Investments Commission under Chapter 5C of the Corporations Act 2001 (Cth).

### 4.2 Useful links

Document type	Title / Link
<b>AFCA Rules</b>	AFCA Complaint Resolution Scheme Rules <a href="https://afca.org.au/rules">afca.org.au/rules</a>
<b>Operational Guidelines</b>	AFCA Operational Guidelines to the Rules <a href="https://afca.org.au/about-afca/rules-and-guidelines">afca.org.au/about-afca/rules-and-guidelines</a>
<b>Approach</b>	AFCA Approach to identifying a claim <a href="https://afca.org.au/about-afca/publications">afca.org.au/about-afca/publications</a>
<b>Approach</b>	AFCA Approach to calculating loss in financial advice complaints <a href="https://afca.org.au/about-afca/publications">afca.org.au/about-afca/publications</a>

### 4.3 Relevant Acts

Relevant Acts at the time of writing:

Document type	Legislative instrument
<b><u>Act</u></b>	<i>Corporations Act 2001</i> (Cth) <a href="http://legislation.gov.au/Details/C2017C00328">legislation.gov.au/Details/C2017C00328</a>
<b><u>Regulatory Guide</u></b>	ASIC Regulatory Guide 267 – Oversight of the Australian Financial Complaints Authority <a href="http://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-267-oversight-of-the-australian-financial-complaints-authority/">asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-267-oversight-of-the-australian-financial-complaints-authority/</a>