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Mike D'Argaville
Legal Counsel
Australian Financial Complaints Authority (AFCA)

By email: submissions@afca.org.au

Dear Mr D'Argaville

AFA Submission – Consultation: AFCA Rules Amendment Authorisation

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for over 70 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are currently practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting their wealth.

Introduction

The Australian Financial Complaints Authority (AFCA) scheme is an External Dispute Resolution scheme that is mandatory for all Australian Financial Services Licensees. It is a scheme where participating entities are contractually bound to comply with a set of rules that dictate which complaints will be considered and the way that these complaints will be dealt with. This is in effect a contractual arrangement between the AFSL and AFCA. It seems remarkable to us that the Government can change that contractual arrangement between the AFSLs and AFCA without any ability for consultation with AFSLs. In our view, this decision to extend the application of the scheme to the period dating back to 1 January 2008 is entirely arbitrary. The selection of this date seems to be that it is the effective beginning date for the original request from the Royal Commission to provide details of misconduct. We see no basis for this date to be used to extend the application of the AFCA EDR scheme. We particularly note that the selection of this date will result in the potential inclusion of matters that related to the Global Financial Crisis.

It is important to understand the full implications of the extension. The current AFCA rules are based on the eligibility to make a complaint being limited to six years from the time the complainant became aware of the loss. To open the AFCA scheme up to complaints back to 1 January 2008, represents a period of 11.5 years as at 1 July 2019 and 12.5 years as at 30 June 2020. This is effectively a doubling of the eligibility period.

We note that the new authorisation condition is fundamentally different to the conditions that applied in the original 23 April 2018 AFCA Scheme authorisation and we question whether this new condition reflects the intent of the powers provided in Section 1050. It is not clear that the creation of such a condition as set down in this Amendment Authorisation is what was intended in paragraph 1.44 of the Revised Explanatory Memorandum to the Bill. We also note that paragraph 1.44 of the Revised EM only refers to 'revoke or vary a condition specified by the Minister'. This paragraph does not refer to the creation of an entirely new condition.

> 1.44 The Minister may choose to revoke or vary the conditions specified by the Minister in the notifiable instrument and must specify the day the variation or revocation comes into force. [Schedule 1, item 2, subsection 1050(5)].

We therefore question whether what the Minister has done, was part of the original intention of the AFCA legislation. If this was the intent, then it certainly was not explained in the Revised Explanatory Memorandum to the Bill.

We oppose this measure for the following reasons:

- The inclusion of matters dating back to 1 January 2008 will result in the inclusion of complaints that would be outside the statute of limitations if they were considered by a Court of Law.
- AFSLs, in many cases, may struggle to find documentation in relation to these matters, as the obligation to retain records has already passed.
- The people responsible for the matter may have long since left the business and in the case of an AFSL with authorised representatives, they may have moved to another licensee or the business may have been sold to a new owner. We think that it is unfair to put the new owner of an AFSL in a position of responding to a matter that was never considered as part of the due diligence that they undertook in the purchase of the business, because it was outside the AFCA complaints eligibility period and the statute of limitations.
- There is a reason for statutes of limitation. How will AFCA respond to suggestions of verbal statements that the client asserts an adviser made in the lead up to the experience of a loss? How can they reasonably rely upon assertions of verbal statements that might have been made as long ago as 12 years, when the advice was originally provided?
- This initiative will likely encourage some legal firms and other complaints service providers to go chasing clients on the basis of no-win no-fee arrangements and an unrealistic expectation of the probability of success.
- Given the extended age of these matters, the cost to financial firms to investigate these complaints will be significantly increased, as they need to search archives or seek to recover information from other sources.
- This will likely force up the cost of professional indemnity insurance and also in a number of cases, leave AFSLs exposed to matters that were the subject of product or advice type exclusions on their professional indemnity insurance policy. There is a risk that this may result in the AFSL's PI arrangements no longer complying with the requirements in Section 912B of the Corporations Act and Regulatory Guide 126.
- In the past, where a product has failed, and the client was unable to take action against the product provider, they often decided to take action against the financial adviser. If any fault was found in the conduct of the financial adviser then they often took full responsibility for

the client's loss. We do not believe that this is fair, and this remains an ongoing concern for us as part of the implementation of this Government initiative.

- Even if the amount of money awarded for claims during this extended period is not substantial and that the majority of decisions are made in favour of the financial firm, there will still be a significant amount of fees that need to be paid to AFCA (noting that the exact fees are yet to be finalised).

It is our view that this is a flawed proposal that is likely to create numerous unintended consequences. This is also an example of retrospective legislation that is inconsistent with the accepted convention for legislative change.

We understand that the intent may be to better allow clients who have suffered loss to access compensation, however provisions were available at that time to seek compensation and opening this up again by applying these new rules on an entirely retrospective basis seems unreasonable.

We also appreciate that AFCA is responding to an additional condition placed upon them by the Government and that they are consulting on how this is best implemented.

Response to Questions raised in the Consultation Paper

1. Does the proposed change satisfy the requirements of the new authorisation conditions?

We broadly consider that what has been proposed will satisfy the requirements of the authorisation condition, however we have expressed a number of reservations.

In the definition of 'excluded complaint' in Section 9(4) of the Amendment Authorisation, item (f) refers to a complaint that has previously been finally settled. We question what is meant by finally settled. Does this simply require a resolution, or a payment or a formal settlement deed? We set out below our concerns about the position that AFCA is taking on this matter.

It is our view that if the financial firm has responded and included a full explanation of why they have declined the complaint and also given the complainant notice of the option to complain to their EDR scheme that existed at that time and referred to the two year deadline, then that deadline should remain applicable, particularly if the value of the complaint was within the compensation cap that applied at that time.

2. Do the Operational Guidelines adequately explain how Section F will apply?

Broadly, the Operational Guidelines do explain how Section F will apply. Under the Operational Guidelines section on page 2 of the AFCA Rules Change Consultation paper it states '*We will also provide AFCA members with information about relevant complaint fees and charges that will be applicable for legacy complaints'.* In our view, it would have been preferable to include the details with respect to the expected fees for legacy complaints in this consultation exercise.

Issues with Access to Supporting Documentation

We note the discussion about how AFCA will treat matters where records are no longer available and the circumstances where documents have legitimately been destroyed on the basis of being beyond the required timeframe. We consider the potential requirement to defend a complaint after the time that they are legally required to retain documents and when they were legitimately destroyed, to be unreasonable. Where the financial firm no longer has the documents or access to the parties that were involved in the matter, seeking to firstly understand the matter and then defend the matter is simply unfair.

Regarding the complaint resolution processes, Section F.1.3 of the draft Operational Guidelines provides that AFCA may *'apply particular approaches to legacy complaints, given the unique nature of considering historical misconduct in circumstances where evidentiary issues make establishing a position difficult'.* Again, we ask the question, in the circumstance where establishing a position is difficult, how does AFCA propose to approach or address the matter? We would suggest that clarification or guidance be provided in Section F to outline AFCA's proposed methodology.

We note the statement in F.1.3 of the draft Operational Guidelines, '*If, due to the passage of time, there is so little information that we cannot resolve the complaint fairly and in accordance with our obligations under the AFCA Rules, and any other relevant obligations, we may consider whether we should not investigate the complaint further. We will not lightly exclude a complaint for this reason*.' We are concerned that due to the passage of time, both the complainant's and the AFCA member's recollections of an event, without supporting evidence, may be inaccurate at best. Whilst we acknowledge the proposal appears to make allowances for AFCA members to not provide information where it falls outside of document retention rules (e.g. companies to retain financial records for seven years after the transaction), we would recommend that consideration be given to how information can be obtained and how this will be provided to each party.

For an older complaint matter to be considered, we would suggest that the complainant would need to provide some level of supporting documents and not just allegations of wrong-doing.

Eligibility Considerations

We note with interest the discussion in F.2 about the exclusion of acts or omissions prior to 1 January 2008. We ask the question about the capacity for a complainant to have a matter considered where the advice to purchase a particular financial product was provided prior to 1 January 2008, however it is argued that the client verbally questioned whether it should have been sold in early 2008 (start of GFC), however the client's assertion is that the adviser recommended against this. How will such a matter be assessed? This should not be assessed on the basis of the benefit of hindsight.

With respect to the reference to decisions or determinations made by a court or tribunal, we ask the question about whether the relevant tribunals should be named (F.2.1(c)).

We raised a question about the definition of a previously settled complaint under F.2.1(e). We note, with concern, that AFCA are asserting in the draft amendments to the Operational Guidelines that this is a matter for AFCA's discretion. We would not have assumed that where there has been a settlement that this should be subject to any discretion.

3. Do you have any other comments about the proposed change?

Section F.1 of the proposal states '*This applies regardless of whether or not the AFCA member is solvent or operating their business at the time the legacy complaint is submitted to AFCA',* however, in the event that the AFCA member is found to be answerable, how does AFCA intend to apply a penalty to the AFCA member if they are no longer operating or insolvent? This requires further clarification by AFCA.

Whilst the proposed insertion of Section F may potentially have an impact on AFCA members with respect to both the engagement of resources to respond to a complaint, as well as the potential for financial compensation to be funded by an AFCA member, there appears to be no protection for AFCA members against possible vexatious or misleading claims from consumers. That is, there appears to be no deterrent to the consumer lodging the complaint against an AFCA member where no basis exists. This may lead some consumers to make a claim in the hope of obtaining a benefit or

compensation to which they may not otherwise be entitled. We are particularly concerned if they take this approach based upon an expectation that the documentation may have been destroyed.

The conventional practice with respect to access to client files for AFSLs who operate an Authorised Representative business model was for many years a contractual arrangement, where the AFSL could request the client file from the adviser, even after the financial adviser had left the licensee. This is no longer the accepted convention, however it did apply almost universally until ASIC started to publicly state concerns about this model in 2011. Given the potential timeframe for these complaints, there is also a risk that the business or the client book has been resold more than once and it may be particularly difficult for the AFSL to track down and obtain a copy of the client file.

The consultation has not discussed the potential issues where the matter could involve multiple AFSLs during the time of the relationship with the client and how they will approach such matters.

Concluding Remarks

The AFA supports an environment where the consumer should feel protected and be able to be compensated against loss from wrongdoing. However, there has to be a level of balance, fairness and reasonableness. The AFA does not support this change to the AFCA Rules for the reasons discussed above. Requiring AFSLs to respond to complaints well after a timeframe that they were legally required to retain records for, is simply wrong. We believe this is retrospective change that is unnecessary and unreasonable.

The AFA welcomes further consultation with AFCA should it require clarification of anything in this submission. If required, please contact us on 02 9267 4003.

Yours sincerely,

Philip Kewin
Chief Executive Officer
Association of Financial Advisers Ltd