

The AFCA Approach to calculating loss in financial advice complaints

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We have created a series of AFCA Approach documents, such as this one, to help consumers and financial firms better understand how we reach decisions about key issues.

These documents explain the way we approach some common issues and complaint types that we see at AFCA. 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 key issues.

1 At a glance

1.1 Scope

Financial advice can help consumers make decisions about their money. Consumers may consult a financial adviser for help on how to make and achieve financial goals, and for guidance on making investments.

The types of financial firms that provide financial advice include financial planners, stockbrokers and advisers employed by banks, superannuation trustees and managed funds.

This document sets out how we identify loss in financial advice complaints, and the way we work out how much compensation we may award. The approach has been adopted from AFCA's predecessor scheme, the Financial Ombudsman Service.

1.2 Summary

Who should read this document?

- Financial firms, consumers and consumer representatives who have a complaint at AFCA about financial advice.
- Anyone who wants to understand how AFCA calculates loss in financial advice complaints.

Summary of the AFCA Approach

In financial advice complaints, we ask consumers to identify the loss they say they have suffered as a result of the inappropriate financial advice they received.

We then identify whether each claimed item of loss is a direct loss, and whether the consumer should be awarded compensation.

Where inappropriate financial advice has been provided, the purpose of compensation is to place the consumer in the financial position they would have been in if the financial adviser had provided appropriate financial advice.

If a financial firm has provided misleading information, the purpose of compensation is to place the consumer in the financial position they would have been in had the financial adviser not misled them.

We work out the amount of a consumer's loss by comparing the consumer's actual financial position as a result of the inappropriate financial advice (or the misleading conduct) with the financial position they would have been in if they had received appropriate financial advice (or had not been misled by the adviser).

2 In detail

2.1 The AFCA Approach

At AFCA, the most common types of complaints we see about financial advice are where the consumer says that:

- the advice was inappropriate, or
- the adviser misled the consumer about risks associated with their advice.

Inappropriate financial advice is financial advice that is unsuitable for the consumer's financial situation, needs and objectives.

Our [Rules](#) outline the types of complaints we can consider, and how we can resolve them.

The Rules explain that there are limits to the amount of compensation we can award consumers.

For complaints involving financial advice that are not provided under a superannuation trustee's Australian Financial Services license (AFSL), we are able to award consumers up to \$500,000 per claim for direct financial loss and up to \$5,000 for loss that is not a direct loss.

We cannot award more than \$500,000 in total for direct and indirect financial loss combined.

If a financial adviser has provided advice under a superannuation trustee's license AFSL then there are no monetary limits, as it falls within AFCA's definition of a superannuation complaint.

The main differences in jurisdiction are:

- a superannuation complaint is not subject to monetary limits, but we can only remedy any unfairness or unreasonableness found to exist in the superannuation provider's decision in relation to the complaint.
- a complaint under our general jurisdiction is subject to monetary limits and we will have regard to what is fair in all the circumstances in deciding whether any compensation is payable.¹

In all instances when we consider financial advice complaints, we ask the consumer to show us the total amount of the loss, and to provide information about each item of loss that makes up the total amount.

¹ AFCA Operational Guidelines, p.90

2.2 Deciding what is appropriate compensation

If a financial firm has breached their duty to a consumer, we will consider whether compensation is appropriate.

The purpose of compensation is to place the consumer in the position they would have been in had there been no breach of duty.

To do this, we will compare the consumer's financial position after suffering the adviser's breach of duty with the financial position they could have expected to have been in if the adviser had not breached their duty. The difference between the two positions is the amount of the loss the consumer has suffered.

In many complaints, it is clear what a consumer's position would have been had the breach not occurred. For example, where a consumer has received inappropriate advice which caused them to invest in an unsuitable portfolio of investments, we will usually assume that the consumer would instead have invested in a suitable portfolio of investments if they had been advised properly.

To work out the direct financial loss a consumer has suffered as a result of investing in unsuitable investments, we need to consider what would have been a suitable alternative.

We will look for an alternative portfolio of investments with the correct mix of defensive and growth assets.

To do this, we may need to use either a suitable benchmark asset allocation used by the financial firm or a comparable benchmark asset allocation.

In some complaints it may not be clear what the consumer's position would have been if the breach of duty had not occurred. In these types of complaints, we will look at:

- how the consumer's money was invested immediately before it was invested in the disputed investments
- whether the consumer was satisfied with their investments immediately before they made the disputed investments
- whether the consumer actively sought the financial adviser's advice or had responded to an invitation to obtain advice
- if the consumer had actively sought the advice, the reason why they had done so
- whether the consumer had told the adviser that they had any investment preferences.

3 Context

The case study below is based on a determination by one of AFCA's predecessor schemes, the Financial Ombudsman Service. While previous determinations (by AFCA or by its predecessor schemes) are not binding precedents, where relevant they will inform AFCA's approach to an issue.

3.1 Case studies

Case 1

Mr & Mrs Smith were both in their early 60s and had received an inheritance of \$1,000,000. In early 2006 they sought advice from a financial firm about how to invest this money. The financial firm recommended Mr & Mrs Smith each invest \$500,000 in allocated pension accounts and advised them to invest 90% in growth investments and 10% in defensive investments.

The allocated pensions initially performed well, but the global financial crisis caused capital losses. Concerned about the poor performance of their investments, in October 2008 Mr & Mrs Smith withdrew \$340,000 and \$315,000 respectively, incurring capital losses of \$160,000 and \$185,000. Mr & Mrs Smith complained about the financial firm's advice. They said that they believed they had invested 40% in growth investments and 60% in defensive investments, and were shocked to learn they had in fact been invested 90% in growth investments and 10% in defensive investments.

Mr and Mrs Smith lodged a complaint with FOS. We considered that the financial firm's advice was inappropriate because it exposed Mr & Mrs Smith to a greater level of investment risk than they were prepared to take on. We said that the amount of the loss suffered should be measured by comparing Mr & Mrs Smith's actual net position as at October 2008 (when they withdrew the money) with the net position they would have been in as at October 2008 if they had received appropriate advice.

Based on all the information, we considered Mr & Mrs Smith would have invested in a moderately conservative allocated pension accounts with 40% growth 60% defensive investments. So, we compared the difference between the inappropriate 90% growth, 10% defensive investments and the appropriate 40% growth, 60% defensive investments as at October 2008. The comparison showed that Mr Smith had lost \$35,500 and Mrs Smith had lost \$45,000, and we determined that the financial firm should pay this amount of compensation.

3.2 References

Definitions

Term	Definition
Consumer	an individual or small business owner who uses the services of a financial firm
Financial firm	an organisation or individual that is a Member of AFCA

Useful links

Document	Title / Link
Rules	www.afca.org.au/rules
AFCA Approaches	We have published other documents that outline the AFCA Approach, including the AFCA Approach to financial difficulty complaints. www.afca.org.au/approach
AFCA website	The AFCA website contains more information about what we do, the types of complaints we can consider, and our complaint resolution processes. www.afca.org.au .