

22 May 2023

Executive General Manager Jurisdiction  
Australian Financial Complaints Authority  
GPO Box 3  
Melbourne VIC 3001  
Email: [consultation@afca.org.au](mailto:consultation@afca.org.au)

Dear Sir or Madam,

### **AFCA Rules and Operational Guidelines - Proposal 5**

I refer to the AFCA Rules and Operational Guidelines - Proposed Amendments - Consultation Paper dated March 2023.

This is my submission in respect of Proposal 5.

Chapter 7 of the Corporations Act 2001 (Cth) has various definitions for persons who do not fall within the definition of retail clients (section 761G(4)). The term wholesale clients encompasses all clients that are not retail clients. The greatest number by far of people who are classified as wholesale, are so classified because of an accountant's certificate. Two smaller categories of wholesale clients are professional investors and sophisticated investors. The expression "professional investors", generally refers to professionals, financial services businesses, and investors who control at least \$10 million. In general terms, sophisticated investors are those with enough experience with relevant financial products and services so it is thought they can look after themselves.

The intention regarding the compulsory financial services alternative dispute resolution schemes was always that retail clients could access AFCA. This proposition is clearly evidenced by the fact that applicants for financial services licences that deal with and service wholesale clients exclusively are not required to become AFCA members.

Licensees that service both retail and wholesale clients are required to be AFCA members. When these licensees join AFCA (and its predecessors FICS and FOS) they are and were required to comply with the mandatory FICS/FOS/AFCA Rules. The complexity of the provisions of the Corporations Act has meant that the Rules are not consistent with the legislative framework as it applied to the distinction between retail and wholesale clients. This has perverse consequences. For example, a wholesale client that is serviced by a licensee that has authorisations to service wholesale clients only, cannot access AFCA because the licensee is not a member of AFCA. However, a wholesale client that is serviced by a licensee that has authorisations to service both wholesale and retail clients can access AFCA.

AFCA has the discretion to exclude wholesale investors but rarely exercises this discretion. Where a financial firm is a member of AFCA, AFCA will very likely hear a complaint from a wholesale client of that financial firm.

Being a member of AFCA means that a client can make a complaint to AFCA, and all of the costs of that complaint will be paid for by the financial firm. There is no risk or cost to the complainant client. A complaint can easily cost a financial firm \$20,000 - \$50,000 in AFCA and legal fees. These are the direct costs. There are also major indirect costs. Substantial staff and proprietor time are almost always lost dealing with AFCA complaints. Professional indemnity insurance premiums increase. There is an effect on the morale of the proprietor and the staff involved. All of these are incurred whether the complaint is worthy or not. If the complaint is not worthy, there is no compensation for the financial firm, and there are no consequences for the complainant. The complainant can choose whether or not to accept an AFCA Determination. The financial firm has no such choice and has no ability to appeal an AFCA Determination. A complainant can fail in AFCA, having caused substantial financial and other costs to the financial firm, and then proceed to a regular court.

It is an unlevel playing field.

Some of that can be justified when there is a power imbalance between a retail client and a financial firm. It cannot be justified when the dispute is between a financial firm and a wholesale client. The vast bulk of AFCA members who are financial advisers are small businesses. They are mum-and-dad businesses, and the proprietors and staff work hard every day to stay in business.

Even the large businesses which are members of AFCA will often seek indemnity from an individual adviser of the amounts awarded by AFCA, or at the very least the excess from the professional indemnity insurance policy.

The assets of wholesale clients are often greater than the assets of the financial firm, or the authorised representative who will frequently be required to indemnify the financial firm.

The financial firm and the authorised representatives are real people, and they should not have to pay the costs of access to AFCA by wholesale investors.

### **Proposed wording of Proposal 5 does not require AFCA to exclude wholesale investors**

The proposed wording of Proposal 5 will not require AFCA to exclude wholesale clients, sophisticated investors or professional investors.

### **Proposed wording of Proposal 5 would mean blame is wrongly placed on the financial firm where a client has been incorrectly classified, perhaps due to an incorrect accountant's certificate**

As set out above, there are 3 ways that a client can be classified as not being a retail client (i.e. wholesale, sophisticated or professional).

The clear intention of the legislation (Section 761G(7)(c) of the Corporations Act 2001 (Cth)) is that a financial firm should be able to rely on a certificate issued by an accountant. It is not the financial firm that makes the important decisions as to whether the client has net assets of \$2.5 million, or gross income in each of the last 2 years of \$250,000. It is the accountant.

Proposal 5 however will have the effect that where the client has been incorrectly classified, even when this is not the result of any failure by the financial firm, the client should still be able to access AFCA. When we say this, it's important to remember that most of these financial firms are small businesses. The costs imposed on these small businesses through the AFCA process are real costs, both in money, time and stress. This means that the financial firm will be penalised for the errors of others. A financial firm should be able to rely upon an accountant's certificate.

## **Government response supports the exclusion of wholesale clients, sophisticated investors and professional investors.**

We note from the Government Response to The Review of the Australian Financial Complaints Authority dated November 2021, the government believes that non-retail clients (including wholesale clients) should be excluded. This is clear by the references to the certificate from a qualified accountant. The government clearly believes that where a certificate has been provided by a qualified accountant the client should be excluded from AFCA.

### **Access to the courts**

If a person does not have access to AFCA, they are not without redress. Virtually all complaints regarding professional negligence are made through the courts. For example, where an accountant, an architect, a surveyor or a doctor makes an error to the disadvantage of a client, the client may take action through the courts. The courts are a fair system, where the rights of both plaintiff and defendant are protected through a system developed over hundreds of years. All Australians have access to the courts. Wholesale clients, sophisticated investors and professional investors should use that system, where the rights of the plaintiff and defendant are balanced, and each side bears the costs and consequences of their actions.

### **Conclusion**

The ability of clients to access AFCA gives them access to a forum heavily weighted against the financial service provider as all costs of the process are borne by the financial firm. There is no disincentive of any kind for a client to make a complaint to AFCA. Because of this, it is appropriate that access to AFCA should be limited to retail clients which was always the government's intention since it has never been mandatory for licensees whose ASIC-issued authorisations provide that they service wholesale clients only to become AFCA members. People who are not retail clients have access to the courts.

In place of the wording in AFCA Proposal 5, I recommend the following

*“AFCA should exclude complaints from persons who are not retail clients unless there is evidence that they have been incorrectly classified as a result of actions by the financial firm.”*

Yours sincerely



Michael Soucik

**Managing Director**