Stockbrokers and Investment Advisers Association
Serving the interests of investors

16 May 2023

By email: consultation@afca.org.au

Executive General Manager Jurisdiction
AFCA
GPO Box 3
Melbourne Victoria 3001

Dear Sir/Madam

AFCA RULES AND OPERATIONAL GUIDELINES – PROPOSED AMENDMENTS

The Stockbrokers and Investment Advisers Association (SIAA) is the professional body for the stockbroking and investment advice industry. Our members are Market Participants and Advisory firms that provide securities and investment advice, execution services and equity capital-raising for Australian investors, both retail and wholesale, and for businesses. Practitioner Members are suitably qualified professionals who are employed in the securities and derivatives industry.

The history of the stockbroking profession in Australia can be found here.

Our members are a small but important group of AFCA members. They represent the full range of providers from online providers providing execution-only services to full-service stockbroking and investment advisers.

SIAA welcomes the opportunity to provide feedback on the proposed amendments to the AFCA Rules and Operational Guidelines. While the proposed amendments relate to various matters, SIAA's feedback is limited to the proposed amendments to the Operational Guidelines on how AFCA deals with complaints lodged by wholesale investors.

Introduction

SIAA members fundamentally support an external dispute resolution service for retail consumers that is:

- free and accessible for complainants
- resolves complaints informally and in a timely fashion
- available to consumers who would not otherwise afford court proceedings or whose complaint would not justify going to court.

SIAA has argued for some time that changes should be made to the AFCA Complaint Resolution

Scheme Rules to clarify that AFCA does not have jurisdiction to hear complaints from wholesale clients and to make wholesale client complaints a mandatory exclusion.

Executive summary

- The exercise of jurisdiction to hear complaints from wholesale clients is not the basis upon which the EDR framework was legislated by Parliament and is an issue of fundamental unfairness to member firms.
- It is only in respect of retail clients that licensees have an obligation to have a dispute resolution system that includes membership of the AFCA scheme (meaning wholesale only licensees may not even be members of the AFCA scheme).
- AFCA should not have a discretion to exclude a wholesale client complaint – wholesale client complaints should not be accepted by the scheme at all. In any event the awarding of the discretion to AFCA has not worked – The Review found that AFCA never exercised its discretion to exclude a wholesale client complaint.
- We recommend that changes be made to the Rules that make it clear that the AFCA complaint scheme is limited to retail clients and that AFCA does not have power to consider complaints brought by wholesale clients. Complaints from ALL categories of wholesale clients should be excluded from the scheme – not just those from professional and sophisticated investors.
- High net worth investors were specifically called out in the government's response as being investors who should have their complaints excluded from AFCA as a matter of course.
- The Consultation Paper proposes an incorrect approach to the implementation of the Review's recommendation. The Review did not recommend that AFCA exercise its discretion to exclude complaints – it recommended that certain complaints be excluded from the scheme altogether.
- If wholesale client complaints are not excluded from the AFCA scheme as a matter of course, the rules should be amended to exclude complaints from all wholesale investors, unless there is evidence that they have been incorrectly or inappropriately classified.

Consideration of complaints relating to wholesale clients

For some time, SIAA has expressed our members' concerns about the extent to which AFCA accepts complaints from wholesale clients. SIAA's view is that the exercise of jurisdiction to hear complaints from wholesale clients is not the basis upon which the EDR framework was legislated by Parliament and is an issue of fundamental unfairness to both member firms and other retail complainants accessing the EDR scheme. That wealthy and sophisticated clients are able to avail themselves of a dispute resolution service that Parliament never intended to apply to them goes to the heart of the issue of fairness and to the concerns of our members.

These concerns were outlined in our submission to AFCA dated 29 June 2018 in relation to the proposed AFCA rules as well as our comprehensive submission to the independent review dated 26 March 2021. A link to that second submission is here. We do not intend to repeat our various

arguments concerning wholesale clients availing themselves of the AFCA complaints service. We have made these points many times in our regular bi-monthly stakeholder meetings with AFCA. We do however wish to emphasise the following points:

- What constitutes a retail client and a wholesale client is not subject to discretion. It is clearly set out in the Corporations Act.
- It is only in respect of retail clients that licensees have an obligation to have a dispute resolution system that includes membership of the AFCA scheme.
- Different provisions in the Corporations Act apply to clients depending on whether they are retail or wholesale. For example, financial advisers who advise wholesale clients are not subject to the best interest duty or statement of advice requirements. Nor are they subject to the Financial Adviser Code of Ethics or Education standards. This is because the Parliament has decided that wholesale clients don't require the same consumer protections that are afforded retail clients.
- There are many features of the AFCA scheme that operate as strong incentives for wholesale clients to bring complaints against member firms in a way that is inherently unfair to those firms.
- It is not only unfair to member firms for AFCA to re-categorise a client from wholesale to retail, but runs counter to the legislative scheme underlying Chapter 7 of the Corporations Act. It is not uncommon for high-net-worth clients to follow higher risk strategies in the pursuit of higher returns (such as options trading, participation in initial public offerings or alternative investments etc), that are not open to retail clients. This is one of the features of being a wholesale client – they are able to avail themselves of a greater array of financial products and services than retail clients and in so doing may take greater risks, having the resources and/or sophistication to absorb and assess those increased risks.
- AFCA is meant to provide a mechanism for low-cost access to justice to consumers who may not otherwise have the resources to bring such complaints through other legal channels such as a court. Wholesale investors have the means to pursue complaints through the court system. It is not uncommon for wholesale investors who lodge a complaint with AFCA to have legal representation or retain legal advice, which shows such complainants are financially capable of undertaking court proceedings.
- The burden on the AFCA scheme from handling wholesale complaints also creates delays for legitimate retail participants of the AFCA scheme, increases the workload for AFCA adjudicators and significantly increases the funding requirements (recovered from member firms).
- For some of our member firms, the majority of claims brought against them under the AFCA scheme have been from wholesale clients.

Review findings

AFCA's current discretion to exclude wholesale client complaints

Currently, AFCA's Complaint Resolution Scheme Rules (Rule C.2.2 (j)) provide that AFCA has the

discretion to exclude a complaint brought by a wholesale client. As we have stated before, we consider that AFCA should not have a discretion to exclude a wholesale client complaint – wholesale client complaints should not be accepted by the scheme.

The Operational Guidelines state that AFCA will not exercise its discretion to exclude a complaint *merely* because it is submitted by a wholesale client. In our view, this Operational Guideline makes no sense as we consider that wholesale client complaints should not be accepted by AFCA at all.

The Review found that while the discretion to exclude a wholesale client complaint was used by the precursor scheme (FOS) in approximately 30 instances, AFCA **never exercised it.** It also found that the Operational Guidelines are more restrictive of AFCA's discretion than they should be. The Review concluded that *if a complaint is lodged by an apparent wholesale client, and AFCA has made sufficient enquiries to rule out that they have not been incorrectly or inappropriately classified by the financial firm, AFCA should have the discretion to exclude the complaint* (Paragraph 5.54 Review of the Australian Financial Complaints Authority).

We note with interest the Review's findings that AFCA should look to more actively exercise its existing discretion to exclude wholesale complaints. It has been frustrating, to say the least, for our member firms that AFCA has previously refused to exercise its discretion to exclude wholesale client complaints in a complaint resolution scheme set up to deal with retail clients. We are pleased that the refusal of AFCA to exercise its discretion has been called out by the Review. To provide certainty for member firms and potential participants in the AFCA scheme it should be clearly identified that participants cannot access the scheme as a wholesale client. We recommend that as a result of the Review's finding, changes be made to the Rules that make it clear that the AFCA complaint scheme is limited to retail clients and that AFCA does not have power to consider complaints brought by wholesale clients. Making such a rule change will make it clear once and for all that the AFCA complaint scheme is for retail clients only and will relieve AFCA of the need to exercise any discretion.

Complaints to be excluded from the AFCA complaints scheme

In answer to our call for mandatory exclusion of wholesale client complaints, AFCA argued that such an exclusion would reduce consumer protection and noted that a number of complaints lodged with AFCA involve consumers being *incorrectly categorised* as 'wholesale' by the financial firm. The Review gave an example of a retiree obtaining advice in relation to their superannuation savings who invests in a financial product in excess of the $500,000 threshold (product test) and a relatively unsophisticated consumer with assets with a value above $2.5 million (high net worth investor) who is unable to navigate the complexity of the financial system. Presumably these are the clients who have been '*incorrectly or inappropriately classified'* that AFCA argues should have their complaints considered by the scheme irrespective of the fact they are wholesale clients.

We agree with the Review that wholesale client complaints should be excluded from the AFCA scheme. We note that the Review found that where there has been evidence that a client has been incorrectly or inappropriately classified their complaints should be accepted by the complaints scheme.

We strongly disagree with the Review's recommendation that only professional and sophisticated investor complaints be excluded from the scheme - leaving other wholesale client complaints within

the ambit of the scheme. We consider complaints from ALL categories of wholesale client should be excluded from the scheme – not just those from professional and sophisticated investors.

It is important to note, that the Review recommended that AFCA should **exclude** complaints from professional and sophisticated investors, unless there is evidence that they have been incorrectly or inappropriately classified - there is no mention of AFCA exercising a **discretion** to exclude the complaints. The recommendation is clear that the Review intended the position to be black and white as regards those investors – unless there was evidence they were incorrectly or inappropriately classified, complaints from that category of investor were to be excluded.

High net worth investors

We do not agree with the review that sophisticated investors are more likely to be consciously choosing to relinquish protections for retail investors than other categories of wholesale investors. In fact, we consider that the opposite is the case. A person who qualifies as a wholesale client under the 'high net worth' tests contained in section 708 (8) and section 761G (7) (c) of the Corporations Act does not automatically become a wholesale client by virtue of their wealth or income; they must actively request this classification by obtaining a certificate from an accountant which must be renewed every two years.

Unless they choose to become a wholesale investor and keep their certification up to date, an investor who meets the income or asset threshold is subject to the same restrictions and protections as any other retail investor. High net worth investors therefore take deliberate steps to opt out of the retail investor regime and consciously sign away protections applied to retail investors by seeking the wholesale certification. Importantly, they must obtain a certificate from a qualified accountant who is required to certify that the investor satisfies either or both of the two limbs of the wealth test. Qualified accountants are required to be members of recognised professional accounting bodies to meet the definition. As professionals, they are required to exercise their professional judgement and retain evidence in support of their certification.

The high net worth accountant's certificate has to be renewed every two years – it is not a 'set and forget' process. If the certificate expires and is not replaced, the client is no longer a wholesale client under the relevant section of the Corporations Act.

In practice, our member firms providing advice confirm that they take a nuanced approach. They rely on the asset or income threshold test as an objective measure while also taking into account the sophistication and financial knowledge of the client. Member firms have in many instances developed robust processes for onboarding wholesale clients that ensure they are aware of the consequences of no longer being categorised as retail, with clients required to sign and return an acknowledgement letter.

The clients have therefore twice opted out of being categorised as a retail client and the consumer protections attached to that category. In addition, clients meeting the high net worth and product tests by their very nature are clients with significant resources, such that they are deemed to be able to directly access independent legal advice and potentially fund court proceedings. In line with the original intention of the EDR scheme as being a scheme to assist investors with fewer resources to access a fair and equitable dispute resolution service, there is no need (and it is disadvantageous to legitimate retail participants) for high net worth and product test clients to access the service.

It is for this reason that we consider that ALL categories of wholesale clients, including high net worth and product test investors should be excluded from the AFCA complaints scheme.

Greater detail on the wholesale investor tests can be found in our thought leadership paper 'Does the wholesale investor test need to change' here.

Government's response

In much commentary, the terms 'high net worth' and 'sophisticated investor' are used interchangeably, even though they are referring to different investor categories.

Confusingly:

- section 708 (8) of the Corporations Act (Chapter 6) defines high net worth investors (those who satisfy the product test or the net assets and/or gross income tests) as **'sophisticated investors'** in its heading
- section 761GA of the Corporations Act (Chapter 7) defines 'sophisticated investors' as those who satisfy the experience test.

Many people in the industry therefore refer to investors who have met the asset or income threshold for high net worth clients as 'sophisticated investors'. This practice is not limited to industry. In its response to the Review's recommendation that AFCA should exclude complaints from sophisticated or professional investors the government stated the following (our emphasis added):

The Government supports AFCA acting on this recommendation. The Government agrees that complaints from sophisticated and professional investors should be excluded, as these investors are not included in the retail consumer protection framework. ***A person must meet the asset or income threshold and actively opt in to the sophisticated investor classification by requesting a certificate from a qualified accountant every two years.*** *Sophisticated investors should be aware that in doing so they opt out of the accessible dispute resolution framework provided by AFCA, and should resolve their disputes via the conventional route of the courts.*

It is clear that in supporting the recommendation to exclude sophisticated investor complaints, the government intended to exclude complaints from investors who are not included in the retail consumer protection framework – this includes those investors who meet the asset or income threshold by requesting a certificate from a qualified accountant every two years. High net worth investors were specifically called out by the government as being investors who should have their complaints excluded from AFCA as a matter of course and the government supported AFCA acting on that recommendation.

The government did however support a carve out to the exclusion – wholesale client complaints should be excluded **unless there is evidence that the complainant has been incorrectly or inappropriately classified**.

Accordingly, our members strongly recommend that, if wholesale client complaints are not excluded from the AFCA scheme altogether, the rules be amended as per the government's intention contained in its response to exclude complaints from ALL wholesale investors, unless there is evidence that they have been incorrectly or inappropriately classified.

Proposed amendments

SIAA strongly opposes the proposed amendments. They amend the wrong rules in the wrong way.

We do not agree that AFCA has exercised its discretion *so as not to exclude retail clients who have been mis-classified*. The Review report specifically states that AFCA did not exercise its discretion to exclude a complaint made by a wholesale client. This finding is backed up by our members who are AFCA members. They have provided case studies of complaints brought by wholesale clients to AFCA that were not excluded.

We do not agree that the AFCA rules do not require change to address the issue of wholesale client complaints. We consider that the AFCA rules must be changed to make it clear that unless there is evidence that they have been incorrectly or inappropriately classified, AFCA will be **required** to exclude complaints from wholesale investors from its service. This amendment is needed as the current rule providing AFCA with a discretion to exclude has clearly not worked – the Review found that AFCA did not exercise its discretion to exclude a complaint made by a wholesale client.

The Consultation Paper states that the exclusion of these complaints will be implemented by AFCA clarifying '*its existing approach to the exercise of discretion'.* This shows a misunderstanding of the Review's recommendation. The Review does not recommend that AFCA exercise its discretion to exclude complaints – it recommends that certain complaints be excluded from the scheme altogether.

Accordingly, we support an amendment to the Rules that expressly excludes complaints from wholesale investors unless there is evidence that they have been incorrectly or inappropriately classified.

Conclusion

If you require additional information or wish to discuss this matter in greater detail, please do not hesitate to contact SIAA's policy manager, Michelle Huckel, at [redacted].

Yours sincerely

Judith Fox
Chief Executive Officer