Professor Ian Ramsay  
C/- EDR Review Secretariat  
Financial System Division  
Markets Group  
The Treasury  
Langton Crescent  
PARKES ACT 2600

By email: EDRReview@treasury.gov.au

17 October 2016

Dear Professor Ramsay,

AFA Submission –Review of the Financial System External Dispute Resolution Framework

The Association of Financial Advisers Limited (AFA) has served the financial advice industry for 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 required to be 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 wealth.

Introduction

The AFA supports the independent review of the dispute resolution framework in the financial services system. The outcomes and experiences of AFA Members show that the financial
system’s disputes resolution framework is largely working effectively, efficiently and at a lower cost than what would otherwise be achieved through the courts. We also note that the timeframes to finalise disputes have improved in recent times – largely through the efforts of the Financial Ombudsman Service (FOS).

We accordingly provide some insight and recommendations about how the framework can be improved in the areas where the experiences of participants in the system indicate that improvement is required. These recommendations are a reflection of the experiences of AFA Members and AFS Licensees from the AFA network, more of whom are members of FOS than the Credit and Investments Ombudsman (CIO). As FOS and CIO have similar jurisdictions and Terms of Reference, we request that the below recommendations are taken by the Panel as applicable to both schemes – not just limited to FOS.

Our members also assist their clients with life insurance claims. This includes claims on policies held within superannuation accounts which are often dealt with through the Superannuation Complaints Tribunal (SCT). Accordingly, further recommendations are outlined below relating to SCT and in particular the overlap between SCT and FOS.

Summary of the AFA’s recommendations

Fairness and transparency

1. Establish a Determination review system with limited grounds for review with cross-jurisdictional functions
2. Introduce a summary decision process for fee disputes
3. Create guidance for ‘fair in all the circumstances’ decisions

Last resort measures

4. The Australian Law Reform Commission to research possible changes to the Corporations Act to address unpaid Determinations
5. An independent process be established to set jurisdictional monetary caps and limits
6. The Australian Law Reform Commission to review the practice of splitting claims through EDR schemes.

The AFA’s recommendations for improvement

Fairness and transparency

Our network of financial advisers and licensees consider that the fairness of the dispute resolution system needs improvement, especially since FOS made changes to its procedures last year. There have been particular instances of apparent unfairness or lack of procedural fairness that indicate that some latent unfairness exists in the system. As a new professional standards regime is introduced over the coming years, transparency will become a greater issue as consideration will need to be given to information sharing with professional bodies once a new code of ethics and monitoring bodies are appointed to ensure that investigations into financial advisers are not unnecessarily duplicated. Further, the sheer volume of court cases that have been needed to review EDR scheme processes and decisions indicates the need for a low cost review system to ensure EDR scheme decisions are fair and transparent. The costs of these EDR reviews
could have been better directed toward achieving fair and reasonable outcomes and supporting the EDR framework.

**Recommendation 1**

**Establishing a Determination review system with limited grounds for review with cross-jurisdictional functions.**

The outcome of the recent case of Goldie Marketing Pty Ltd v FOS further reinforces that in some exceptional cases there needs to be a low-cost process for disputing parties to seek administrative reviews of EDR scheme decisions. Further, as financial services are sometimes provided through several channels or with the involvement of several service providers who are members of different EDR schemes, jurisdictional limitations exist to prevent effective resolution with some disputes. The AFA proposes that a scheme be established with dual functions to review EDR scheme decisions administratively with a minimum of formality and at a low cost compared to the courts and to address the gaps between the current EDR schemes.

**Review**

External dispute resolution schemes are supposed to be a low cost alternative to the courts. Some disputes are so complex, involve too much money, have too many parties or have particular jurisdictional issues that require judicial review instead. The proposed higher review system would not cover those disputes. Instead, it would consider whether certain EDR scheme decisions were fairly and transparently made to avoid disputes begun through EDR schemes becoming adversarial after the fact.

Prior to the Goldie Marketing case, the EDR decisions that were judicially reviewed by the courts were primarily brought by a financial services provider. Each case brought to the courts sought to review the procedural aspects of the decision – whether it be that the EDR scheme:

- had the jurisdiction/authority to make the decision,
- followed the correct procedures or procedural fairness, or
- whether evidence presented was appropriately considered.

The AFA is not commenting on the end decisions reached; our concern is the costs of reviewing these procedural aspects. In the 20 years since financial services external dispute resolution was formed, there have been over 40 cases before courts examining administrative aspects of the schemes. Many of these cases involved high legal costs, lengthy court procedures and evidentiary arguments before the matter was finally decided – which all added substantially to the total cost of the dispute. We do not propose the merits of EDR scheme decisions to be reviewed by this review process, but instead we suggest an avenue be provided for procedural issues to be considered without needing to refer the matter to the courts.

**EDR schemes should have a review system to support them** with the power to do the same as appellate courts to ensure that binding Determinations are fairly and transparently made. This may involve some disputes being referred back for merits review as appellate courts do. We envisage this review process would not be burdened by the adversarial rules on evidence but a simpler set of guidelines for reviewing EDR scheme decisions built around fairness and

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1 See for the list of administrative reviews of EDR scheme decisions in Appendix 1.
transparency. The independent body charged with this task would also be empowered to make recommendations to the EDR schemes on changes to their processes to avoid future issues arising and facilitate fairer and more transparent processes.

Additional functions

In addition to procedural (otherwise known as administrative) reviews, the review process body could also take on other functions. An additional function of this process could be to consider the cross-jurisdictional or multi-jurisdictional disputes that cannot be dealt with effectively by a single EDR scheme due to limitations on jurisdiction. For example:

- the category of disputes that involve securitisation loans – where there is a mortgage manager/originator and a different funder,\(^2\)
- disputes that involve a financial product issuer that is or was a member of FOS and a financial adviser that is a member of CIO, and
- disputes about life insurance held within super, which may have complaints about the superannuation trustee’s handling of the claim through the SCT as well as the claims decision by the life insurer.

Should any of these types of disputes be lodged with an EDR scheme, the scheme can refer the matter to the review system for a merits consideration or to determine which scheme should consider the dispute. This function of the review scheme should also have the ability to recommend amendments to EDR scheme Terms of Reference to address systemic failures or gaps in process.

Establishing an EDR scheme review or oversight body could then become the foundation for other Ombudsman and dispute resolution schemes to obtain support for their jurisdictions – whether it be as a low cost review process to avoid unnecessary litigation or to assist with cross-jurisdictional or multi-jurisdictional matters. In this sense, the review system could operate on a similar basis to the ‘triage/concierge’ process that was recently proposed by CIO.\(^3\) This is a preferable option to resolve some of the issues with the current framework than it is to merge the three schemes because as noted in the introduction of this submission, the AFA considers that many aspects of the three schemes and the framework generally are functioning well and delivering fair outcomes for all.

Recommendation 2

Introducing a summary decision process for fee disputes that costs licensees less than the current systems do in order to discourage abuses of process, particularly for fee disputes less than $10,000. It is a key peculiarity of the financial services system that permits consumers of professional financial services to make misrepresentation or non-disclosure claims about fees without needing some form of substantiation first. Other professional dispute resolution schemes and processes do not allow for fees to be disputed to the same level or cost to the professional.

\(^2\) These complex disputes are the subject of a specific jurisdictional Memorandum of Understanding between FOS and CIO to determine which scheme is to deal with the dispute, determined by who the mortgage originator is a member of, available at page 122 of the CIO Rules.

The AFA considers that **there is an inherent moral hazard to the current process** because it costs the professional's licensee at least $3,800 (FOS cost) before an independent merits assessment of the fee disclosure claims will take place. In our Members’ view, **this is an unfair system that allows recalcitrant clients to engage with professional financial advisers without good faith** because they have the ability to renege on any costs agreement simply by alleging misrepresentation or non-disclosure of the fees.

Whilst AFA Members appreciate that clients should have the right to raise claims of misrepresented or undisclosed fees with a free dispute resolution service, the current fee structure often leads to unwelcome encouragement of licensees to resolve disputes on a commercial basis due to the cost of a merits review. This is untenable in the AFA’s view and inconsistent with other professions. It also has a latent effect because compensation paid or costs waived on a commercial basis are still a cost to the business which affects the future accessibility of financial advice when dispute resolution costs are apportioned across the practitioner’s client base.

The AFA considers that a fair manner to deal with misrepresentation and non-disclosure claims about fees would be to **lower the EDR scheme fee for dealing with fee disputes**. One option could be set EDR scheme fees as a proportion of the amount in dispute. For example, a 10 per cent proportion cost would mean that a $3,000 fee dispute between an adviser and client would result in a FOS fee for the adviser to pay of $300. This is much more sensible than $3,800. Whilst the AFA appreciates this means that non-fee disputes would have to pick up some of the cost of resolving fee disputes, in our Members’ view, **the cost is worth the deterrence value for vexatious people who may seek to abuse the EDR process** to renege on agreed fees.

We envisage that this change could be accommodated within both the Fast Track process of FOS as well as the Preliminary View process for higher value fee disputes. The process could also be adopted within CIO’s processes to ensure consistency. In both cases, the proportionate EDR cost would be applied to an initial view of the merits of the dispute which would permit the adviser’s licensee to present a defence to the claims about misrepresentation or non-disclosure, including documentary evidence to establish full and frank disclosure of fees. Whilst this is theoretically available in the current processes, many licensees – especially larger ones who have dealt with FOS and CIO repeatedly due to their size – are in the practice of offering commercially resolutions if the fee value in dispute is anywhere in the order of $5,000.

It is a necessary part of the EDR scheme system that directs all EDR scheme costs toward the licensee. This, however, influences licensees to make commercially sensible decisions to offer resolutions where the cost to defend against the claims exceeds the value of the claims. Whilst we accept this for investment loss, a fee dispute is another matter entirely when the system requires the licensee to be liable for the merits review cost of at least $3,800 before the merits of the apparent misrepresentation or non-disclosure is even tested. This part of the process needs to change to ensure the system is not abused and fairness is improved.

**Recommendation 3**

**Creating guidance for ‘fair in all the circumstances’ decisions** for EDR schemes to adhere to.

EDR schemes are required to substantiate reasons for any departure from the law, 4 and

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experiences indicate they largely do in those limited cases. Where legal authority is not cited or when a Determination relies upon variations of the phrase ‘fair in all the circumstances’ to justify a decision, the AFA considers that principles of fairness require equal consideration of the consequences to be borne by both parties if a decision that is adverse to their respective interest may result.

In years past, Determinations often did not always state the reasons why an Ombudsman considered it to be ‘fair in all the circumstances’ that an award of compensation was made. They unfortunately sometimes simply said something along the lines of “I consider it fair in all the circumstances to award compensation of $X” without showing how that figure was arrived at. Determination reasons have improved with new Ombudsman and Adjudicator appointments but the reliance on a fairness reason to adjudicate a dispute does not always appear to be consistent amongst the business units of FOS or across the other EDR schemes.

Further, there is an appearance – justifiably or not – amongst some licensees and AFA Members that fairness factors considered in Determinations are often only those that relate to what would be fair to the applicant (i.e. the consumer). The AFA has yet to see a Determination that made more than a passing reference to what the consequences of an award of compensation would be for the licensee or the adviser involved.

In many cases, an award of compensation is considered to be an indicator of misconduct and in turn higher risk attribution by the licensee’s professional indemnity (PI) insurer. Further, should a licensee not draw upon it’s PI insurer to pay compensation, the cost must necessarily be borne by the businesses other customers and clients in a modern commercial enterprise. There is also the effect that an award of compensation has upon a financial adviser’s professional association membership and the effect that an adverse Determination may have on the adviser’s practice when a subsequent investigation into a breach of the relevant professional association’s Code of Conduct has occurred. Then there are adviser contribution terms in representative agreements and excess issues that affect future sustainability of a practice.

These are all matters that affect licensees and professionals and consequently impact the fairness of a dispute decision just as much as the financial and non-financial loss that a consumer has incurred. The AFA would like to see fairness principles be consistently applied across the dispute resolution system in future to ensure that both perspectives of fairness are equally considered. Just as when a departure from the law takes place, decisions relying upon the fairness of the result should also be justified. We understand that other associations have raised a similar concern with the Panel in their submissions as well.

Last resort measures

The AFA acknowledges the difficulties that unpaid Determinations represents. The integrity of the dispute resolution system absolutely requires compliance with awards of compensation that have been fairly and independently determined. Whilst we understand that in some isolated cases, licensees have little choice but to apply for administration due to unforeseen circumstances or due to the contribution of third parties that was unable to be considered by the EDR scheme due to jurisdictional issues, the system may make it too easy for licensees generally to choose non-compliance - where directors of licensees elect to place their
A company into administration despite a rigorous investigation and finding of misconduct by representatives of the licensee.

Notwithstanding this, the AFA does not currently support FOS’s proposed compensation scheme of last resort as the full solution to the problem. Instead, we consider that the legal framework that permits non-compliance and some deterrence measures should be examined before taking a path that could support moral hazard. That is, the scheme of last resort should be a measure of last resort – or a final measure – only after other options that contribute to the outcome have been explored and exhausted first. To this end, the AFA recommends the following before further consideration is progressed on a compensation scheme of last resort.

**Recommendation 4**

The Australian Law Reform Commission (ALRC) to research possible changes to the Corporations Act that could:

- restrict licensees entering liquidation specifically to avoid paying an award of compensation;
- place conditions upon directors’ limited liability rules to place a more direct obligation upon directors who put their companies into liquidation whilst an EDR case is open or EDR scheme award of compensation has been made, and
- examine how to effectively prevent phoenix companies re-joining the same or a different EDR scheme as well as the general issue of regulatory approval for phoenix activity.

The AFA considers that these three areas contribute to the problem of unpaid Determinations because it is far too easy for recalcitrant directors of licensees to hide behind their fiduciary duty to their shareholders whilst disregarding their licencing requirements and conditions. We seek to prevent the reoccurrence of historical examples where financial planning practices, mortgage brokers and other licensees place themselves into voluntary administration only for a similarly named or located and managed company to take over their customers and re-join the same or another EDR scheme.

We support the ALRC being given the task of investigating structural contributors to unpaid Determinations as well as exploring other options to mitigate against the risks of unpaid Determinations. The AFA considers that there may be changes to directors’ duties and liability available and widening administrators’ and regulators’ powers could be explored to prevent companies with open EDR disputes from choosing non-compliance. This is especially where the non-compliance is a repeated one and thereby indicative of a wider systemic issue or risk management problem in the company.

Whilst we acknowledge this may be seen as a departure from corporate law doctrines, we consider there is merit in exploring the elements that enable financial services companies from entering voluntary administration where there are open disputes or unpaid Determinations. We are not proposing that all voluntary administrations be subjected to the same rules or investigation, nor that this extend into other industries at this point – just in relation to the specific problem of unpaid Determinations.
Exploring options to avoid unpaid Determination outcomes could also involve consideration be given to the contribution that practices being unable to afford their PI excess has on unpaid Determinations resulting. One option the AFA considers worthy of exploring before implementing a compensation scheme of last resort is whether licensees who have PI insurance could place an amount equal to a multiple of their PI excess (such as two times) into a trust administered by their EDR scheme. In this way, there may at least be hope of a successful PI claim which can mitigate against unpaid Determinations resulting.

The AFA wishes to ensure that a holistic approach is taken to the problem of unpaid Determinations before further compensation consideration of a scheme of last resort is again considered. This is because if FOS’s proposal is taken up, although the largest licensees would bear the initial cost of the compensation scheme, the costs will more likely than not flow down the chain raising costs across all licensees, practices and ultimately affecting the accessibility of quality financial advice. At a time when costs for financial advice are rising due to professionalisation, an industry levy to fund ASIC is imminent and other regulatory pressures are creating costs, a decision on a compensation scheme of last resort should be made only after thorough consideration.

Recommendation 5

An independent process be established to set jurisdictional monetary caps and limits. Currently the jurisdictional caps and limits set by each EDR scheme is done with ASIC’s approval of the respective Terms of Reference. The AFA has received feedback that there appears to be little justification for the current amounts. The current approach has the capacity to significantly increase a licensee’s exposure which has implications for future professional indemnity terms for the licensee and their representatives. Further feedback we have received is that the current limits and caps are too high given that there is no current avenue for appeal to a Determination against a licensee.

The AFA is not repeating previous submissions to EDR scheme independent reviews that EDR scheme awards should be capped at the total value of all claims against a licensee. Instead, the AFA considers that there should be particular reference and input from professional indemnity insurers and their actuaries to ensure awards will be able to be met at all times by the market. Whilst we acknowledge that both CIO and FOS consult on monetary limit changes, these are not independent processes. The AFA considers that the practice of independently reviewing EDR schemes with consultation from both industry and consumer groups should be extended to consideration of jurisdictional limits to ensure there is an impartially set substantive basis for those limits and caps in future.

Recommendation 6

The ALRC to review the practice of splitting claims at EDR. The AFA appreciates this practice has a foundation in law. Through the courts, claim amounts are tethered to each cause of action and set of facts. It has been judicially established, however, that EDR is a form of alternative dispute resolution which does not need to automatically follow legal precedents.\(^5\) The AFA considers that an EDR scheme’s Terms of Reference is therefore a good vehicle for departing from

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the adversarial manner of splitting claims. An EDR scheme’s terms of reference can therefore be used to restrict this practice, creating clear rules about how claim amounts are dealt with fairly through the low cost dispute resolution service.

The ALRC is an ideal forum to examine this issue. It has the ability to consider the legal frameworks, decided court cases, professional journals and publication material. The ALRC can also consider international methods of all dispute resolution systems to determine the relative benefits and costs of an alternative dispute resolution process. In considering this issue further, the AFA recommends that the Panel take into account the submissions to the FOS Independent Review conducted by Cameron Ralph Navigator in 2013 where the issue was raised by several industry groups and licensees. Despite significant industry concern about the practice and the contingent effect upon professional indemnity coverage which in turn contributes to unpaid Determinations, the issue remains unresolved.

Concluding remarks

Dispute resolution in financial services has been a source of many complaints over the years – from consumer groups, industry and advice professionals. In the AFA’s view, this is reflective of the difficult place that dispute resolution resides when consumers are at risk of significant financial loss, loss of assets and loss of protection. Effective dispute resolution is critical to ensuring that there is confidence and trust in the financial services sector, which contributes about 10 per cent to the Australian economy and is growing. The fact that not any particular group is perfectly happy with the framework indicates that there is some balance in the system and the system has been shown over time to largely function well.

Nevertheless, there are some areas that the AFA considers require improvement to create a fairer and more transparent system. The most pressing of which is the creation of a review process to ensure that participants of the system do not unnecessarily have to resort to the litigious processes to resolve their disputes or to have confidence in the integrity of the system. Establishing an oversight body could also serve several other functions and extend into other alternative dispute resolution areas. Other fairness improvements lie in creating guidance around how and when an EDR scheme can make a ‘fair in all the circumstances’ decision and introducing measures to deter people from abusing the fee dispute jurisdiction of EDR schemes.

Whilst the AFA has not closed the door on a compensation scheme of last resort to address the problem of unpaid Determinations, we consider that the risk that such a scheme may encourage moral hazard amongst licensees should justify exhausting other options to address the issue. We consider that the Australian Law Reform Commission is adequately placed and experienced to investigate measures to restrict companies entering administration while Determinations are unpaid or disputes open, to consider whether changes should be made to directors’ limited liability rules and to consider how best to restrict phoenix activity in the industry.

Further examination is also required of the effect of monetary limits that have not been independently examined and the practice of splitting claims. These measures must be considered before implementing a system that is likely to increase the cost of providing financial services and limiting he accessibility of great advice to more Australians.
The AFA welcomes further consultation with the Panel should you require clarification of anything in this submission. If required, please contact us on 02 9267 4003.

Yours sincerely,

Brad Fox  
Chief Executive Officer  
Association of Financial Advisers Ltd
Appendix 1 - Court decisions about the procedures and decisions of external dispute resolution schemes in the financial services system

1) Briffa v Hay (1997) 147 ALR 226
2) Collins v AMP Superannuation Ltd (1997) 147 ALR 243
3) Wilkinson v Clerical Administrative and Related Employees Superannuation Pty Ltd (1997) 77 FCR 469
4) Breckler v Leshem [1998] 57 FCA
5) Attorney General of the Commonwealth v Breckler (1999) 197 CLR 83
7) Retail Employees Superannuation Pty Ltd v Crocker (2001) FCA 1330
8) United Superannuation Pty Ltd v Harris (2001) FCA 1468
9) Sommer v NM Superannuation Pty Ltd [2001] FCA 923
10) Flexiplan Australia Ltd v Pankhurst & Others (2001) FCA 1535
11) Howitt-Steven v Unisuper Limited [2001] FCA 1599
13) MASU Financial Management Pty Ltd v Financial Industry Complaints Service Limited and Wong (No. 1) [2004] NSWSC 826
14) MASU Financial Management Pty Ltd v Financial Industry Complaints Service Limited and Wong (No. 2) [2004] NSWSC 829
16) Financial Industry Complaints Service Limited v Deakin Financial Services Pty Ltd [2006] FCA 1805
17) Smith v Superannuation Complaints Tribunal [2008] FCA 1528
18) Australian Reward Investment Alliance v SCT & Anor [2008] FCA 1548
19) Finch v Telstra Super Pty Ltd (No 2) [2008] VSC 527
21) Edington v Superannuation Complaints Tribunal [2010] FCA 504
23) In the Matter of Australian Property Custodian Holdings [2011] VSC
24) Board of Trustees of the State Public Sector Superannuation Scheme v Edington [2011] FCAFC 8
26) Gate v FOS [2012] NSWCTTT GEN: 12/51694
28) Bilaczenko v Financial Ombudsman Service Ltd [2013] FCA 1268
30) Bilaczenko v Financial Ombudsman Service Ltd [2013] FCCA 420
31) Wealthsure Pty Ltd v Financial Ombudsman Services Ltd [2013] FCA 292

33) Hannover Life Re of Australasia Ltd v Wright [2014] FCA 1163

34) Queensland Local Government Superannuation Board v Superannuation Complaints Tribunal [2014] FCCA 2473


36) Financial Ombudsman Service Limited v Pioneer Credit Acquisition Services Pty Ltd [2014] VSC 172


38) Goldie Marketing Pty Ltd v Financial Ombudsman Services [2015] VSC 292


40) Campbell v Superannuation Complaints Tribunal [2016] FCA 808

41) Financial Ombudsman Services Ltd v Utopia Financial Services Pty Ltd [2016] WASC 55