Submission to The Treasury:

Review of the Australian Financial Complaints Authority

From: Institute of Public Accountants

April 2021

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The Manager
AFCA Review Secretariat
The Treasury
Langton Crescent
Parkes ACT 2600

By email: AFCAreview@treasury.gov.au

Dear Sir/ Madam

Review of the Financial Complaints Authority

The Institute of Public Accountants (IPA) welcomes the opportunity to offer our views on the review of the Australian Financial Complaints Authority (AFCA) and we appreciate the extension of time provided.

In preparing this submission, we have undertaken consultation with members who practice in the financial advice sector and/or have interacted with AFCA.

The IPA is one of the three professional accounting bodies in Australia, representing over 42,000 accountants, business advisers, academics and students throughout Australia and internationally. Three-quarters of the IPA's members work in or are advisers to small business and SMEs.

Our submission to the review appears below.

If you have any queries or require further information, please don't hesitate to contact Vicki Stylianou, Group Executive, Advocacy & Policy, either at vicki.stylianou@publicaccountants.org.au or mob. 0419 942 733.

Yours sincerely

Vicki Stylianou
Group Executive, Advocacy & Policy
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1. Terms of Reference dated 19 February 2021

1.1 The Terms of Reference for the Review of the Australian Financial Complaints Authority provide an opportunity for "feedback on the operation of the Australian Financial Complaints Authority (AFCA) since its establishment and to consider whether further enhancements should be made to ensure the external dispute resolution (EDR) scheme is appropriately calibrated and operating effectively", including to consider whether AFCA has been effective in resolving complaints in a way that is fair, efficient, timely and independent.

1.2 In responding to these issues, it is noted that the Terms of Reference provide that the submissions should address matters relating to whether AFCA is delivering against its statutory objectives, and the effectiveness of its internal review mechanism.

2. IPA's response to the Terms of Reference

2.1 Appropriate Calibration of the Scheme

2.1.1 The IPA recognises the need for an accessible, low cost EDR process for consumers and small businesses.

2.1.2 A question that arises under the AFCA dispute resolution scheme is whether it is appropriately calibrated as between consumers and financial firms that are themselves small businesses.

2.1.3 It seems to be an accepted view that the members of AFCA will have far greater resources than consumers[i]. However, this will not always be the case. The members of AFCA range from very large financial firms (eg banks) to sole traders and small businesses.

2.1.4 In considering whether the powers and processes of AFCA are calibrated appropriately, it is necessary to recognise that their operation impacts small financial firms differently to larger members that have the capacity to absorb the costs and time of the EDR processes.

2.2 Is AFCA meeting its statutory objective of resolving complaints in a way that is fair, efficient, timely and independent?

2.2.1 *Costs and AFCA's Fee Structure*

(a) A mandatory requirement of the AFCA dispute resolution scheme is that complainants are exempt from payment of any fee or charge in relation to a complaint.[ii] While this legislative requirement speaks to the cost of participating in the EDR scheme, AFCA's Operational Guidelines to the Rules also provide that a member financial firm is not permitted to recover its costs from a complainant in connection with AFCA's consideration of a complaint.[iii]

(b) A consequence of the no cost to complainant principle is that there is no disincentive to pursuing frivolous or vexatious claims. While consumer interests may be said to be appropriately weighted when the member is a large financial services provider, this weighting can operate unfairly when the member is a sole trader or small business in the following respects:

(i) the funding mechanism in place under the AFCA scheme incentivises financial firms to resolve disputes at the initial stages. If a frivolous or baseless claim is pursued, this mechanism penalises the member unfairly;

(ii) the impact of the time and resources required to respond to complaints impacts small members disproportionately where the complaint is frivolous or baseless.

(c) There are a number of ways that this imbalance could be addressed, while continuing to ensure that a fair weighting between consumer and member interests is achieved.

(d) AFCA adopts a tiered dispute resolution process pursuant to which it can provide the parties with a preliminary assessment of the complaint, setting out relevant information and how AFCA thinks that the complaint should be resolved[iv].

(e) If a preliminary assessment is provided that a complaint is hopeless and the complainant proceeds to determination of its complaint and the binding determination of AFCA is to reject the complaint, then it is submitted that it would be appropriate for either or both of the following to occur:

(i) the member be relieved of the additional costs consequences of membership that arises by reason of the matter not resolving early; and/or

(ii) AFCA have power to determine that the complainant pay costs of small financial firm members, where AFCA deems it fair to do so, noting the time and resource requirements demanded of small members. This principle is not inconsistent with the mandatory requirements of an external resolution scheme expressed in the *Corporations* Act 2001; and is consistent with the usual tenet that costs follow the event in legal review processes. While recovery of a costs determination from a complainant is likely to be difficult, the existence of the power to make such a determination will provide a disincentive to pursue frivolous claims to determination.

Similar powers can be seen in other tribunals and legislative processes directed to protecting consumers. For example, in Victoria the *Retail Leases Act 2003* makes provision for compulsory alternative dispute resolution processes and for the parties to bear their own costs of any tribunal proceeding, unless the Tribunal is satisfied that it is fair to order the payment of costs because: *"(a) the party conducted the proceeding in a vexatious way that unnecessarily disadvantaged the other party to the proceeding; or (b) the party refused to take part in or withdrew from mediation or other form of alternative dispute resolution under this Part"* [v]

2.2.2 *One Stop Shop and PI Insurance*

(a) A matter raised in reviews of predecessor bodies to AFCA, and that remains applicable to AFCA, is the ability of complainants to enforce a determination in their favour.

(b) In the context of unpaid determinations of the Financial Ombudsman Service, the Australian Lawyers Alliance made a submission to the Senate Standing Committee on Economics that AFCA have power to join a member's professional indemnity insurer to a complaint, and to bind the insurer to a determination in favour of a complainant. The IPA does not support this proposal and agrees with the position of ASIC that professional indemnity insurance "is neither intended nor designed to provide compensation directly to consumers".[vi]

(c) However, it is submitted that a member should have the right to join its professional indemnity insurer to a complaint of its own volition in circumstances where the insurer has not granted indemnity under the member's professional indemnity policy. This will achieve two important outcomes, consistent with the aims of AFCA:

(i) firstly, and importantly, it will assist to address the possibility of determinations made in favour of consumers not being paid. At present, small members may lack the assets or resources to make a payment absent insurance cover; and

(ii) it supports the aim of AFCA being a "one stop shop". Absent the ability to join its professional indemnity insurer, a member is forced to both proceed with the EDR process and to commence separate Court proceedings against its insurer to seek indemnity, leading to delays and costs, consequences for the member that are higher than if the entire dispute was heard and determined by a Court.

(d) The IPA has been advised by IPA members that they have sought to access the AFCA dispute resolution process with respect to a particular matter involving their PI insurance underwriter (who is a member of AFCA). The IPA member was advised that AFCA did not have jurisdiction to deal with the matter, even though there was no apparent reason for this decision. The IPA member was a small firm with limited resources and had already gone through a protracted Court action costing them tens of thousands of dollars. The Court action was resolved when the plaintiff (former client) eventually withdrew the proceedings and was unable to pay costs to the IPA member.

Internal review mechanism

2.2.3 *Jurisdiction*

2.2.4 AFCA itself determines whether a complaint falls within its jurisdiction[vii]. AFCA is able to review a decision to exclude a complaint, on the objection of the complainant within a specified timeframe and if AFCA is satisfied that the objection "may have substance".[viii] It is submitted that this review power should be broadened to the review of a decision to include a complaint, on the application of the member, to minimise the prospect of AFCA acting outside of its authority.[ix]

2.2.5 *Consistency of Decisions*

(a) A risk inherent in the AFCA dispute resolution scheme is a perception that AFCA will act as an advocate for consumers[x] leading to a loss of confidence in both the fairness of the process, the independence of AFCA and the consistency of decisions that may be made. Ensuring a perception of fairness and consistency of decision making supports the interests of both consumers and members.

(b) The current scope of the role of AFCA's Independent Assessor to review complaints is too narrowly defined to enable a review of:

(i) whether AFCA has acted independently; or

(ii) the substance of an AFCA decision.

(c) Given that AFCA decisions are binding on members but not on complainants[xi] and the options for review of decisions are limited, the IPA submits that it is appropriate for AFCA to have an internal review mechanism

where the substance of its decision can be reviewed. The IPA would be happy to make further submissions about how that process ought to operate.

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3. IPA member feedback on AFCA

3.1 AFCA was preceded by the Financial Ombudsman Service (FOS) and the Credit and Investment Ombudsman Service (CIO), noting that the former was based in Melbourne and the latter in Sydney. The successor of these, AFCA, had its rules approved by ASIC on 6 September 2018.

3.2 Overall, IPA members are supporters of the EDR process as it 'offers a speedy and low cost resolution to consumers of financial services and as such gives consumers of financial services enhanced confidence in the financial system. Often, EDR is misunderstood and not appreciated as being an integral part of the financial regulatory environment. If the intent of legislation is to have advisers act in the clients' best interests, noting s961(B) of the Corporations Act, then the workings of an effective AFCA supports the intention of the Parliament.

3.3 It is worth noting, that an effective AFCA gives confidence to holders of Australian Financial Service Licensees (AFSL) and authorized representatives that there exists an impartial umpire that can vindicate the diligent work of advisers in the event of a complaint. AFCA then helps to improve and maintain high standards.

3.4 There has been recent criticism of AFCA acting as advocates for consumers. This was highlighted by Justice Stevenson in DH Flinders Pty Ltd -v- Australian Financial Complaints Authority Limited [2020] NSWC 1960. This judgment further highlighted that AFCA was acting outside its authority. [these are the words from an IPA member who is also studying law]

3.5 The following case study was provided by an IPA member who holds a full AFSL:

- Whilst supportive of AFCA, it was much easier to obtain information and have a working relationship with the CIO being based in Sydney.
- My experience with AFCA is that it is very process driven. This is not meant as a criticism.
- In the past decade our business has only had two complaints.
- The first complaint was a client who wanted a "reprimand" to be issued due to a perceived breach of her privacy. This complaint was dealt with by CIO and they followed due process. The problem was that her complaint did not fit any of the CIO rules as the matter was two years old, we had no business relationship with her as a former client and no loss was suffered. The foregoing raises the issue of costs. There was no result because of no fault but the process was a cost to our business despite no financial loss to the former client.
- The second complaint was processed via AFCA. The amount of claim was for $3,000 for superannuation fees paid for no service being received. As mentioned, AFCA is very process driven.
- The complaint was forwarded to us as the superannuation fund advised the client to make the complaint. Our business had never received a complaint from the client.
- It was necessary for us to produce ten years of all records in dealing with the client. This required looking into archives for old copies of the Statement of Advice (SOA) and other such materials.
- The main intent of AFCA was to have someone settle with the client. No consideration was given as to matters of justice.
- Eventually the superannuation fund must have admitted their liability and we were advised of no further action.
- The frustration did not end there, as I was not able to ascertain from AFCA as to what circumstances existed that the matter was withdrawn from our liability.

- What the (expensive) exercise did teach our business is that we had appropriate guidelines and records in place to defend our position.
- The other aspect of having dealt with AFCA is that the AFCA staff were approachable and were willing during the "investigation" to openly share information. They were not judgmental and were transparent in assisting all parties to arrive at a resolution. However, I make the observation that the amount in dispute was $3,000, not $30,000 or $300,000. My view is that for such a small sum of money, a large amount of resources were deployed (notably asking for a ten year old SOA). AFCA may like to consider other more effective and less resource intensive ways of dealing with small claims.

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[i] See, for example, *AFCA: the first foothill between Australia's Twin Peaks*, A Schmulow, V Dore, J Reardon, W Hanna, *Law and Financial Markets Review, 2020 at p 204*
[ii] s 1051(2)(d) of the *Corporations Act 2001*
[iii] Operational Guidelines to the Australian Financial Complaints Authority Complaint Resolution Rules dated January 2021 [A.1.3]
[iv] Australian Financial Complaints Authority Complaint Resolution Rules [A.12.1]
[v] ss 92(2)
[vi] Australian Securities and Investment Commission report *Professional indemnity insurance market for AFS licensees providing financial product advice,* December 2015, at pp 14-15
[vii] AFCA Rules, above n iv [A4.4]
[viii] AFCA Rules, above n iv [A.4.6]
[ix] See *DH Flinders Pty Ltd -v- Australian Financial Complaints Authority Limited* [2020] NSWC 1960.
[x] *DH Flinders Pty Ltd ibid*
[xi] Corporations Act s. 1051(4)(e)