FINANCIAL ADVICE ASSOCIATION AUSTRALIA

Lead Ombudsman – Investments and Advice
Australian Financial Complaints Authority
GPO Box 3 Melbourne VIC 3001

Via Email: consultation@afca.org.au

1 December 2023

Dear Mr Singh,

The AFCA Approach to determining compensation in complaints involving Financial Advisers and Managed Investment Schemes

The Financial Advice Association of Australia[1] (FAAA) welcomes the opportunity to provide feedback on AFCA's consultation on the draft approach to determining compensation in complaints involving Financial Advisers and Managed Investment Schemes (MISs).

We have set out our feedback on the draft approach paper below, however in summary our concerns are as follows.

1. **Limited Relevance.** Evidently, this area will only impact a small number of complaints, given the non apportionable considerations, however this has not been made clear.

2. **Clarity.** Some of the key concepts, such as how AFCA determine complaints and calculation of loss have not been adequately explained or referenced in the draft approach, leaving a lack of clarity about the impact this AFCA approach will have on financial advisers.

[1] The Financial Advice Association of Australia (FAAA) was formed in April 2023, out of a merger of the Financial Planning Association of Australia Limited (FPA) and the Association of Financial Advisers Limited (AFA), two of Australia's largest and longest-standing associations of financial planners and advisers.

The FPA was a professional association formed in 1992 as a merger between The Australian Society of Investment and Financial Advisers and the International Association of Financial Planning. In 1999 the CFP Professional Education Program was launched. As Australia's largest professional association for financial planners, the FPA represented the interests of the public and (leading into the merger) over 10,000 members. Since its formation, the FPA worked towards changing the face of financial planning from an industry to a profession that earned consumer confidence and trust, and advocated that better financial advice would positively influence the financial wellbeing of all Australians.

The AFA was a professional association for financial advisers that dated back to 1946 (existing in various forms and under various names). The AFA was a national membership entity that operated in each state of Australia and across the full spectrum of advice types. The AFA had a long history of advocating for the best interests of financial advisers and their clients, through working with the government, regulators and other stakeholders. The AFA had a long legacy of operating in the life insurance sector, however substantially broadened its member base over a number of decades. The AFA had a strong focus on promoting the value of advice and recognising award winning advisers over many years. The AFA had strong foundations in believing in advocacy for members and creating events and other opportunities to enable members to grow and share best practice.

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3. **The tone of the message.** The way some of the sections are worded, suggests that financial advice firms will be responsible for the full loss, despite a lack of clarity on how loss is determined and calculated and in the context of other parties contributing to the loss.

4. **Lack of suitable and adequately specific examples.** The examples provided in the case studies are very high level and provide little insight into the circumstances under which this approach may apply.

This consultation presents an important opportunity to improve AFCA's draft approach and address the existing perception, which is reinforced by the current drafting of this document, that the vast majority of complaints and consumer loss involving financial advice and MIS issues will be paid for by financial advisers.

Background

The practical reality is that a very small percentage of advisers have experienced a complaint that proceeds to AFCA. Based on AFCA matters that proceeded to a decision in the 2022/23 year, it is likely that less than 1% of financial advisers were impacted by this experience.

Despite the very limited exposure to the AFCA complaints process, many advisers have a perception that the process is very much biased in favour of the consumer, and that when a product fails, advisers are often the last party standing and thus bear a disproportionate share of the cost of complaints. Financial advisers predominantly work in or operate small businesses, and as a result, losing a case at AFCA can have a huge financial impact on them (despite the contribution from PI insurance, given increasingly large deductible levels). Having a matter go to AFCA can also cause a great deal of stress and reputational damage, regardless of the outcome.

For all these reasons, it is important that documents like the draft approach provide as much context as possible and avoid the inclusion of statements that will be misunderstood. As it stands, how AFCA operates is not well understood by the advice profession, so a high level of understanding should not be assumed. It is certainly better for all stakeholders that advisers have a much better understanding of the AFCA complaints process and confidence in how AFCA operates. We have set out below, some suggested changes to improve the meaning and clarity of the draft approach to assist in achieving this outcome.

Apportionable claims and potential relevance

We note the discussion on the proportionate liability statute in section 2.3, and the reference to the following matters, that are not apportionable at law in relation to advice complaints:

- Failure to act in the client's best interests.
- Inappropriate advice.

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- Failure to prioritise the client's interests.

As these matters make up the bulk of advice complaints, there would be very few advice complaints where the loss would be apportionable under the law. This feeds the perception that all compensation payable in an AFCA complaint will be borne by the adviser, regardless of fault by another party. It is vital that the application and scope are clear in AFCA's approach to complaints involving financial advice and MISs.

Recent complaints statistics from AFCA would suggest that the other complaint categories make up a small proportion of total advice complaints. It is also likely that many of the other complaints, such as failure to provide advice and service issues, are less likely to have any interdependency with MIS complaints. We encourage AFCA to be clear with respect to the limited applicability of the concept of apportionment and provide more specific examples of when it might apply. There is reference to misleading and deceptive conduct, however we would welcome the detailed description of a case that might cut across both advice and MISs. We also suggest that commentary on the history of AFCA's handling of such matters would be helpful.

We favour a more comprehensive explanation of the concept of non-apportionable claims, including what the legal references are (given they may differ from state to state) and what specific court cases exist that highlight this issue. Given that the vast bulk of advice complaints fall into the above categories that are not apportionable under the law, it is important to explain this concept more clearly. Also, we seek clarity on whether non apportionable losses apply to other sectors within the financial services industry, such as MISs.

We ask for clarity about what the liability is for the Responsible Entity of the MIS, if they have breached their obligations where there is also an advice failing that results in a non-apportionable claim and the full loss is therefore attributed to the financial advice firm. Does this mean that the Responsible Entity escapes without any obligation to compensate; or whether the client is awarded more than 100% of their loss? Either way, the balance in this outcome seems unfair and unreasonable.

We note that the examples of non-apportionable claims in section 2.3 all relate to financial advice complaints. Including examples of non-apportionable claims relating to breaches of the law by MISs would provide greater balance and clarity to the document.

We recommend that the approach paper include a table showing what type of complaints are apportionable and what are not. More detail and a table presentation would be beneficial.

Section 2.3 states: "The proportional liability statutes also do not apply where all the potential wrongdoers who contributed to the losses are not parties to the complaint and are not compellable to become parties". We suggest a clear and direct statement as to the meaning of this element of Section 2.3 is needed.

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Clarity of message

Working through this document has highlighted a number of areas where we expect that the financial adviser population will be uncertain and could thus benefit from improved understanding. This includes the following:

- The type of complaints that AFCA often receives, including those that are relevant to the substance of this approach paper. Whilst AFCA reporting highlights that the most common advice complaints are "inappropriate advice" and "failure to act in the client's best interests", advisers have no further detail on what these matters could look like. Admittedly there is also product level data, such as "SMSF", "Shares" and Superannuation Fund", however it does not give any insight into what the advisers have done wrong.
- Repeatedly in this approach document, there are statements about the financial firm being responsible for 100% of the loss, however, how does AFCA calculate the loss? There is a separate approach document on 'calculating loss in financial advice complaints', however that document only provides one example, which, whilst being more detailed than the examples in this draft approach, it's still not particularly instructive. In addition, there is no reference in this draft approach paper to the calculating loss approach paper. Understanding AFCA's approach in terms of the cause of loss and the calculation of loss is critical.
- Does "fair in all the circumstances" also take into account what is fair to the adviser? Given that financial advisers are predominantly small businesses, who have a lot at stake in losing a complaint at AFCA, understanding how the application of the EDR principles of fairness and equity work is important. Concepts and statements in this draft approach, including with respect to non apportionable claims, parties who are not members of AFCA and insolvent MISs, suggest that financial advisers can be held responsible for 100% of the loss, even when other parties are also at fault. In our view, this is not fair in all the circumstances.

Critical to the understanding of this approach paper is clarity on the assessment of client loss. As an example on loss calculation, if an adviser placed a client into a multi-sector growth option (80% growth), when their correct risk profile was balanced (60% growth), then the adviser might be responsible for the difference between the performance of the growth option and the balanced option. If the complaint arose at a time that the market had fallen substantially, and the growth option was down by 20% and the balanced option was down by 15%, then the attributed loss would be 5% of the total portfolio. There is little, if anything, in this draft approach paper that makes this point clear.

As another example, if the client invested $100k in an MIS investment option that failed, and it was assessed that the client's risk profile only warranted a $50k investment, then the attributable loss ought to be $50k, not $100k. AFCA confirmation of the calculation of loss in terms of such

examples would provide much needed clarity and reassurance on the EDR process, for all stakeholders (including PI insurers).

Tone of the message

We believe that some of the phrasing in this document will cause concern for financial advisers. This is because it is in some places unclear, and in others appears to imply that an unfair liability will be placed upon the advice firm. We have highlighted a few examples below:

- Page 5 – "the financial firm may be found to have breached its obligations *and be 100% liable* for the complainant's loss".
- Page 7 – "If the claim is not apportionable at law, AFCA may hold the party that breached the non-apportionable claim *entirely responsible* for losses arising from the breach. This is irrespective of any other actual or potential breach by another party."
- Page 7 – Heading - 2.4 – "It will usually not be fair in all the circumstances to apportion liability if a potential wrongdoer is not a party to the complaint".
- Page 7 – "Additionally, if the complainant's compensation were to be reduced by apportionment to a party that is not an AFCA member or otherwise not a party to the proceedings, the complainant could potentially incur costs to pursue that other party in other forums."
- Page 10 – "In this case, the decision maker could *attribute 100% of the loss* to the financial advice firm."
- Page 10 – "Because a breach of the financial advice firm's duties to provide appropriate advice and act in the best interests of the complainant under the Corporations Act 2001 are not apportionable (even though the defective PDS / misleading or deceptive statement claim is apportionable), the financial advice firm could be *held entirely responsible for the loss*."
- Page 12 – "This is because it may not be fair in such circumstances to reduce compensation to the complainant on the basis the RE may be partially responsible for the loss…"

In some cases, the wording is talking about the client's loss and does not adequately address the issue of what caused the loss and how the loss for AFCA's purposes should be calculated. It also suggests that the financial advice firm will pick up the entire cost, even in circumstances where other parties have contributed to the loss. We ask that you consider how this wording will be perceived by the advice population in the absence of greater clarity on some of the key concepts that exist in the AFCA regime.

The important point we are making is that when the 'loss' is referred to in the approach document, most people reading the paper will think it means the client's nominal loss. Whereas it should make it clear the loss being referred to is the loss calculated by AFCA's calculation process. i.e.

where loss is **the difference between the actual outcome and the outcome that would have resulted from appropriate advice**.

Examples – lack of detail

The examples in the case studies do not provide adequate information to fully assess the implications of the approach to apportionment.

Section 2.5 describes AFCA's considerations when determining whether it is fair in the circumstances to apportion a non-apportionable claim. This includes consideration of "the extent of the respective wrongdoing of the parties, degree of respective culpability (that is, the degree of departure from the standard of behaviour required by law) and the proportion of respective causal contribution to the loss". However, the examples do not demonstrate application of the apportioning of a non-apportionable claim.

To illustrate our concerns with the examples, Option 3 states that the financial advice firm provided inappropriate advice, the breach caused the loss, and the decision maker could attribute 100% of the loss to the financial advice firm. This is very high level and does not provide any specifics to assist an adviser to understand the applicability or what the adviser did wrong (and the scale of the wrongdoing).

Option 6 is even less useful as it states the financial advice firm breached their obligation to provide appropriate advice, the PDS was defective, one or both breaches caused the complainant's loss and then because the loss was not apportionable, the financial advice firm could be held entirely responsible for the loss. This option is disturbing, as it is unclear what the mistake of the adviser was, to what extent it contributed to the loss, or why the adviser could be held fully accountable, when the Responsible Entity was also at fault. Examples like this only help to promote a view that financial advisers pay for complaints that they are not responsible for (or at least not fully responsible for).

The draft approach includes examples of both where an MIS is solvent and complaints involving insolvent MISs. However, it does not include an example of when an MIS becomes insolvent after a complaint has commenced. Section 3.4.e.iii of the AFCA Constitution states that cessation of membership "does not affect the Member's rights and obligations under clause 3.2(g) in respect of any complaint commenced to be processed under an external complaint resolution scheme (however described) operated by the Company before such cessation including any binding determination (however described) or any fees payable to the Company in respect of such a complaint". We therefore assume that the MIS would continue to be held accountable for any loss by the claimant that resulted from a breach by the MIS. We request that clarity on this be provided.

In summary, to make these examples more useful, we would like to see more detail on what the adviser did wrong, what the loss was, what caused the loss and how the liability of the adviser was assessed.

Other feedback

We offer the following additional feedback:

- Section 1.2 should identify financial advisers, Responsible Entities, and PI insurers as parties who should read the approach document.
- The final bullet point in Section 2.5 refers to business benefits. This is a little confusing, given that the Conflicted Remuneration regime prevents a product provider (such as an MIS) from giving monetary and non-monetary benefits to a financial adviser, other than with respect to those specific exemptions that exist in the law. The further reference to referrals also complicates this matter. Is this a referral of a client by the product provider to the adviser, or the referral of a potential client by the adviser to the product provider (without the provision of advice)? This could potentially imply that an adviser would be held accountable for the losses sustained by a person that they referred to the MIS, even if they did not provide advice. This seems unreasonable and we suggest this section needs to be clearer.
- We believe that the paper should address situations where an adviser has changed from one licensee to another, where the client was initially invested under the previous licensee, but remained invested under the current licensee, and how the loss is to be split between both licensees.
- Section 1.7 states: "If a consumer accepts our decision, the financial firm is bound by that decision." However, we note proposed changes to the AFCA rules that are currently subject to the Stage 5 approval process (to be completed by 31 December 2023), including amendments where 'if a consumer does not accept our decision within 30 days, the financial firm is not bound by that decision'. Should this proposed amendment be approved, the draft approach should be consistent with the updated rules.
- Section 2.4 refers to apportionment to a party that is not an AFCA member. Examples of non AFCA members relevant to advice/MIS complaints would be helpful. For example, only MISs registered with ASIC are required to be members of an EDR scheme.

Conclusion

We thank AFCA for consulting on this draft approach document. We believe that this is a good opportunity to provide greater clarity on how AFCA operates, and our feedback reflects that, including suggestions on how to improve the delivery of the message.

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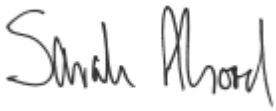
The FAAA would welcome the opportunity to discuss the issues raised in our submission in more detail.

Yours sincerely,



Sarah Abood
Chief Executive Officer
Financial Advice Association of Australia