Consultation feedback report

The AFCA Approach to determining compensation in complaints against Financial Advice Firms where the Responsible Entity of a Managed Investment Scheme has become insolvent

January 2024

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Overview of the consultation process

About the consultation

AFCA has developed a range of Approach documents to help stakeholders understand how AFCA assesses and determines complaints under its Fairness Jurisdiction.

On 6 November 2023, AFCA issued a draft Approach to determining compensation in complaints involving Financial Advice Firms where the Responsible Entity of a Managed Investment Scheme has become insolvent. The public consultation process ran from 6 November 2023 to 1 December 2023. The Approach document shared during consultation was in draft form. AFCA has considered the feedback from all stakeholders before finalising the Approach.

The consultation sought feedback on the draft Approach from affected stakeholders and interested members of the Australian community.

Overview of submissions received

AFCA received five formal submissions from a number of different stakeholder groups including:

- 2 submissions from peak bodies
- 1 submission from a consumer action group
- 1 submission from the Law Council of Australia
- 1 confidential submission

All non-confidential submissions have been published on the AFCA website here.

Summary of engagement

- **517** member firms attended our Investments and Advice Member Forum
- **7** one-on-one engagements occurred with industry associations / representatives
- **5** full submissions were made to AFCA
- **1,000** visitors viewed the consultation webpage

The consultation is now closed

AFCA has considered all submissions and provided an overview of AFCA's response to the submissions in this feedback report, which marks the end of the consultation process.

AFCA's consideration of stakeholder feedback

AFCA thanks all stakeholders for their considered, thoughtful, and helpful feedback during the consultation process. We have reviewed all stakeholder feedback and summarised the key themes in this report.

Summary

During the consultation, stakeholders sought clarity on a number of matters, including:

- How AFCA assesses complaints and apportions loss in the event a Managed Investment Scheme (MIS) (that was the subject of the advice) had failed.
- How AFCA determines complaints and calculates loss in relation to financial advice complaints generally.
- Further explanation in the case studies to make it clear that advice providers would not be held liable for client losses relating to the RE of a MIS becoming insolvent, if the advice provider demonstrates they were not involved in, or could not have reasonably known about the failure, when the advice was provided.

Some stakeholders also provided other technical feedback.

AFCA's objective is to align the Approach with relevant laws and to clarify existing AFCA practices. The Approach does not create new obligations. We have listened to stakeholder feedback and in response have made changes to several sections of the Approach, clarifying its scope and effect.

We have set out the key feedback and our response below.

Stakeholder feedback

Scope of the Approach

During consultation, stakeholders were mostly interested in understanding how AFCA would assess complaints and apportion loss in the event that a MIS (that was the subject of the advice) had failed. They observed that the apportionment scenarios in the draft Approach document would only impact a small number of complaints in practice and that the Approach document should make this clear.

AFCA response

The draft Approach sought to describe how and when AFCA would apportion loss between financial advice firms and Managed Investment schemes (MISs). It covered both where the relevant MIS was solvent and where it was insolvent (e.g., the MIS had failed). It included a discussion of the proportionate liability laws and how we would apply these to complaints. We clarified that many claims against financial

advisers are “non-apportionable” at law and also that we are unable to apportion liability to a firm that is not a member of AFCA, because, for example, it has failed.

We agree that in practice the apportionment scenarios outlined in the draft Approach arise relatively rarely, having regard to the nature of advice complaints more generally.

Therefore, we have made changes to target the scope and effect of the Approach. It now only covers our approach to loss in circumstances where a MIS (or MISs) have failed and can no longer be a party to the matter. This also aligns with the primary purpose of the Approach which is to respond to concerns about how AFCA’s decision making could interact with exposure and eligibility for the Compensation Scheme of Last Resort (CSLR).

The final Approach is therefore specifically directed to situations where AFCA receives a complaint about advice to invest in one or more MISs that have subsequently failed and the RE(s) have become insolvent. The key point is that in determining such complaints about the advice received we look at the adviser’s obligations and whether the breach has caused the loss. We do not attribute liability to the financial advice firm for failures on the part of the RE, where the financial advice firm has not breached any obligation.

In the draft Approach document we discussed the proportionate liability statutes. As this Approach is specifically limited to situations where the MIS has failed and the RE has become insolvent, consideration of the proportionate liability statutes is no longer directly relevant. This is because those statutes only apply where there are multiple parties to a complaint, for example where there are claims against both a financial advice firm and the RE of a (solvent) MIS.

However, for completeness, we confirm that breaches of the best interests duty and failure to give appropriate advice are classified as “non-apportionable” claims under the proportionate liability statutes and that this is consistent with how AFCA has always determined financial advice complaints, where there is more than one financial firm that has contributed to the loss.

Stakeholders also asked AFCA to provide details of each of the proportionate liability statutes that might apply to determining whether a claim is apportionable or not. Even though they are no longer required to be considered as part of the Approach for the reasons discussed above, these are listed in the Appendix to this report (as well as relevant case law).

Given the above, we have also amended the name of the Approach document. The document is now titled ‘The AFCA Approach to determining compensation in complaints against Financial Advice Firms where the Responsible Entity of a Managed Investment Scheme has become insolvent’.

Clarifying how loss is calculated and attributed

Some industry stakeholders said that how AFCA determines complaints and calculates loss in relation to situations where the MIS has failed and the RE has become insolvent was not adequately explained or referenced in the draft Approach, so the impact on financial advice firms was not clear. This led to concerns that the Approach could be interpreted as holding a financial firm legally liable for loss or damage that it had not caused.

More specifically we received feedback that the drafting of some sections suggested that financial advice firms would be held responsible for the "full loss" or "100%" of the loss a consumer has suffered, without clarifying how loss is determined and attributed and where other parties or conduct may have contributed to the loss.

Some stakeholders also noted that the draft Approach references '*failure to act in a client's best interests, inappropriate advice and failure to prioritise the client's interests*' as being not apportionable at law, and that as these make up the bulk of advice complaints, there will not be many cases where loss would be apportioned. This could lead to the perception that all compensation will be borne by the adviser, regardless of fault of another party.

AFCA response

This was the most substantive theme arising out of the consultation. We have consequently clarified in the updated Approach how AFCA calculates loss in such circumstances. In particular, we have again highlighted that a financial advice firm will only be held responsible for the financial loss that they have caused as a result of a breach of their obligations to the complainant i.e., they will not be held responsible for losses caused to a consumer by the failure of a MIS unless they breached their obligations.

There is a separate AFCA Approach document, *The AFCA Approach to calculating loss in financial advice complaints* which clarifies this. It states that in financial advice complaints we ask consumers to identify the loss they say they have suffered because of the inappropriate financial advice they say they received. AFCA will then assess the adviser's conduct and identify whether each claimed item of loss arises from the breach, and whether the consumer should be awarded compensation. Where inappropriate financial advice has been provided, the purpose of the compensation is to place the consumer in the financial position they would have been in if the financial adviser had provided appropriate financial advice. We call this the "But for" test.

Nothing in this Approach document changes this approach to determining and assessing loss. Financial advisers are and will only be held responsible for losses caused by breaches of their obligations to consumers.

In circumstances where a complaint is about financial advice related to a MIS that may have subsequently failed (and is no longer an AFCA member), we will consider whether the advisor breached their legal obligations and if they did so, we will consider “but for” the breach what would the complainant have invested in.

References to the proportionate liability statues in the draft Approach were introduced primarily to clarify that, at law, AFCA can generally not apportion liability for losses caused by financial adviser conduct to another party. It does not mean that they will become liable or responsible for loss arising out of the failure of a MIS, if they did not breach any obligations. To avoid any doubt, financial advisers will only be liable or responsible for loss caused as a result of their conduct. This is consistent with how AFCA has always determined financial advice complaints.

Use of case studies

Some stakeholders observed that the examples provided in the case studies were high-level and did not provide sufficient insight into the circumstances in which this Approach may apply. They requested that there be further explanation in the case studies to make it clear that advice providers would not be held liable for client losses relating to an insolvent MIS, if the advice provider can demonstrate they were not involved in or could not have reasonably known about a failure when the advice was provided.

AFCA response

It will be up to AFCA to determine on a case-by-case basis whether the financial adviser has breached any obligations owed to the complainant, and whether it is necessary to join a third party such as a MIS to a complaint.

We think that in practice most of the concerns raised about the case studies relate to the issue raised above (i.e., clarity about how loss is calculated in the first place), before any considerations of apportionment are considered.

This Approach has therefore been specifically limited to situations where the MIS has failed and the RE has become insolvent. Given the limited number of situations where this applies, we have therefore only provided one case study and sought to make it clearer about how we may determine liability for financial advice firms depending on the facts of the complaint. Given that these assessments are highly fact dependent, this case study is merely intended to be illustrative of the various outcomes that might arise.

Submission relating to the collapse of the Sterling Group

One stakeholder raised a range of issues relating to the collapse of the Sterling Group including about the experience of affected consumers who had made complaints to AFCA, the impact of the insolvency process and the lack of access of Sterling Group customers to the CSLR.

AFCA Response

AFCA acknowledges the very difficult circumstances for consumers arising out of the collapse of the Sterling Group, but this Approach document is intended to deal with the very specific issue of apportionment of liability (not eligibility for the CSLR) and the issues raised in the submission were outside the scope of this work.

Other technical feedback

One stakeholder made technical recommendations to clarify, among other things, that references to conduct of a MIS should correctly refer to the conduct of the RE of a MIS.

Another stakeholder recommended the Approach include reference to the AFCA Rule that covers compensation limits in these types of matters.

AFCA response

We have incorporated these technical changes where relevant.

Appendix

Glossary

Term	Definition
ASIC	Australian Securities and Investments Commission
Complainant	An individual or small business who has lodged a complaint with AFCA.
Consumer	An individual or small business owner (including a primary producer) who uses the services of a financial firm.
Financial adviser	A person or business whose job is to provide financial advice to consumers.
Financial Advice Firm	A financial firm that is a member of AFCA which is authorised to provide financial advice (as distinct from a product provider or other financial firm such as a bank or insurer).
Financial firm	A financial firm, such as an insurer, who is a member of AFCA.
Managed Investment Scheme	A managed investment scheme as defined in section 9 of the Corporations Act 2001 (Cth) that is registered with the Australian Securities and Investments Commission under Chapter 5C of the Corporations Act 2001 (Cth).

List of submissions

The table below is a catalogue of the submissions received during consultation.

No.	Stakeholder/ organisation
1	Financial Advice Association Australia
2	Financial Services Committee of the Business Law Section of the Law Council of Australia
3	Stockbrokers and Investment Advisers Association
4	Sterling First Action Group
5	Confidential submission

Proportionate liability legislation and case law

Jurisdiction	Legislative instrument
Cth	Competition and Consumer Act 2010 (Cth) – Part VIA

Jurisdiction	Legislative instrument
	ASIC Act 2001 (Cth) – Part 2, Division 2, Subdivision GA Corporations Act 2001 (Cth) – Part 7.10, Division 2A
ACT	Civil Law (Wrongs) Act 2002 (ACT) – Chapter 7A
NSW	Civil Liability Act 2002 (NSW) – Part 4
Vic	Wrongs Act 1958 (Vic) – Part IVAA
Tas	Civil Liability Act 2002 (Tas) – Part 9A
SA	Law Reform (Contributory Negligence and Apportionment of Liability) Act 2001 (SA) – Part 3
WA	Civil Liability Act 2002 (WA) – Part 1F
NT	Proportionate Liability Act 2005 (NT)

Jurisdiction	Case citation
Cth	*Selig v Wealthsure Pty Ltd* [2015] HCA 1*8*