# The AFCA Approach to fixed interest investments

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We have created a series of AFCA Approach documents, such as this one, to help consumers and financial firms better understand how we reach decisions about key issues.

These documents explain the way we approach some common issues and complaint types that we see at AFCA. However, it is important to understand that each complaint that comes to us is unique, so this information is a guide only. No determination (decision) can be seen as a precedent for future cases, and no AFCA Approach document can cover everything you might want to know about key issues.

# 1 Purpose of this approach

## 1.1 Scope

The purpose of this document is to explain AFCA's approach to fixed interest investments. Its publication is consistent with AFCA's obligation to deal with complaints in a cooperative, efficient and timely way and to make decisions that are fair in all the circumstances. It is important to understand that the information in it is a guide only. Each complaint that comes to AFCA will be considered on its merits.

## 1.2 Summary

A typical complaint about a fixed interest investment generally would involve an investor complaining that they have lost some or all of their capital from an investment that they understood to be secure. Often the complaint is brought against the adviser who recommended the investment.

In considering such complaints AFCA will consider:

- what the investment was;
- the rate of return promised; and
- the entity issuing the investment.

Once this assessment has been made, AFCA will then determine whether the investment was appropriate for the complainant's circumstances and whether the advisor (or the issuer) adequately disclosed the risks of the investment. The risks of capital loss are particularly important to consider in this regard.

## 1.3 Who should read this document?

- Parties to an AFCA complaint
- Anyone who wants to gain a better understanding of fixed interest investments, and AFCA's considerations when reviewing them.

# 2 Jurisdiction

## 2.1 AFCA's purpose

AFCA is the independent external dispute resolution (**EDR**) scheme for the financial services sector. AFCA's purpose is to provide fair, independent and effective solutions for financial disputes. It does this by providing fair dispute resolution services. AFCA also work with financial firms to improve their processes and standards of service to minimise future complaints. In addition to resolving financial complaints, AFCA identifies, resolves and reports on systemic issues and serious contraventions of the law.

### 2.2 AFCA's jurisdiction

#### AFCA can consider complaints against financial firms that are members of AFCA.

When a complaint is not resolved by agreement, negotiation or conciliation, an AFCA decision maker will make a decision. The decision reflects what is fair in all the circumstances having regard to legal principles, applicable industry codes or guidance, good industry practice and previous decisions of AFCA or predecessor schemes (which are not binding).

When assessing the conduct of a financial firm, AFCA will have regard to the law, relevant codes, and industry practice at the relevant time.

The AFCA decision-maker may decide that a financial firm must compensate a consumer for direct financial loss, indirect financial loss or non-financial loss. They may also decide that a financial firm is required to take, or refrain from taking, particular actions. If a consumer accepts an AFCA decision, the financial firm is bound by that decision.

#### Fair in all the circumstances

AFCA's decisions are intended to reflect what is fair in all the circumstances of each complaint. This includes providing a fair outcome in cases where we find an error or breach has occurred.

In assessing what is fair, we apply a standard of fairness which focuses on concepts such as fair dealing, fair treatment and fair service. This allows us to assess the conduct of a financial firm over the life cycle of the firm's relationship with its customer.

The primary focus of our investigation is to assess whether the financial firm breached its obligations to the consumer. However, we also consider the conduct of the consumer when determining a fair outcome.

## 3 In detail

### 3.1 What is a fixed interest investment?

A 'fixed interest' investment is one that pays a regular rate of interest for a specified term with the expectation that the principal will be repaid at the end of the term (maturity date). The interest rate can be set (fixed), or it can change over the term of the investment (variable). Traditionally such investments are considered safe, secure investments, but this is not always the case.

Fixed interest investments include:

- term deposits

- government bonds
- corporate bonds, debentures, and notes
- managed funds.

A term deposit is an investment that locks away an amount of money for an agreed length of time. The investor can't access the money until the term is up. In return, they'll get a guaranteed rate of interest for the term selected (the longer the term the better the rate of return). With these products the investor will know exactly what the return on their money will be. Term deposits are offered generally by banks and have a high degree of security.

Another form of fixed interest investment is a "Government Bond". As the name suggests, Government Bonds are bonds issued and backed by government. These investments guarantee a return of capital and payment of a fixed rate of return in the interim. The rate offered is not generally high, but an investor's capital is secure in that they will only lose funds if the Government has no money to pay them.

Corporate bonds work the same way as Government Bonds, except they are riskier as interest and capital payments depend on the solvency of the corporation issuing them. A corporate bond issued by a blue-chip company such as BHP is less risky than one issued by, for example, a speculative mining company.

"Debentures" and "notes" are also forms of fixed interest investments. As with corporate bonds they are offered by corporations to raise funds but have higher degrees of risk then corporate bonds. "Unlisted unsecured notes" for example are issued by companies off-market and are generally not secured by the company's assets.

The term "fixed interest investment" can also be used for managed investment schemes and other structured products that pay a fixed rate of return. However, some of these pose more risks to capital than others.

For example, it is not uncommon to see a managed fund described as "fixed interest" (or "enhanced fixed interest") with only 80% of the fund's assets being invested in "true" fixed interest investments. The remainder of the fund is invested in growth assets to enhance returns. This significantly increases the risk of the product and needs to be taken into account by the adviser in portfolio construction.

## 3.2 What will AFCA look at when assessing fixed interest investments?

### The nature of the investment

In considering complaints about fixed interest investments, AFCA will look at what type of fixed interest investment the investor was invested in. Was it a term deposit, government bond, corporate bond, managed fund, or something else?

### Who issued the investment?

AFCA will also have regard to the entity issuing the investment.  If the issuing entity is regulated by the Australian Prudential Regulated Authority (APRA) the investment will be safer because such entities have capital requirements specified by government. Such entities include banks, building societies, credit unions, life insurance companies and superannuation funds. A list of APRA regulated institutions can be found on the APRA website.

On the other hand, an investment issued by a private company will generally be riskier. This is because often the company issuing the investment will have exhausted all other funding sources before issuing the investment (i.e it may have initially tried to borrow funds from a bank but been refused because the bank viewed lending to the company as too risky).

### What is the rate of return promised?

AFCA will have regard to the rate of return promised. Normally the higher the rate of return, the higher the risk to capital.

### AFCA will look to how the investment is used in the portfolio

AFCA then looks at whether the risks were appropriate for the investor and adequately disclosed. This is dependent on the facts of each individual case. It does not necessarily follow that just because a riskier fixed interest investment was recommended, it was inappropriate. Rather the questions are more whether the risks were adequately disclosed, and whether the adviser adequately considered the risks in portfolio construction.

# 4 Application

## 4.1 Case study (AFCA Case 724986)

### Complaint

In early December 2019, the complainant was seeking to make changes to her savings plan through investing in term deposits. An internet search led her to fixed income products offered by Company M, a corporate authorised representative of the financial firm.

On 11 December 2019, the complainant invested $630,000 into the fixed interest product for a six-month period with a maturity date of 10 June 2020.

On 11 March 2020, Company M suspended payment of capital redemptions to investors in the products due to liquidity issues.

The complainant says the marketing material for Company M's fixed interest product was misleading and had she understood the actual nature of the product, she would not have invested.

She sought a full return of the invested capital, plus the agreed interest. The financial firm says the investment opportunity was offered to the complainant as a wholesale investor and relevant disclosures were made. It

### The financial firm made false and misleading statements

The financial firm had used sponsored link internet advertising, through Google AdWords and Bing Ads, so the websites for the financial firm debenture products appeared as sponsored links when consumers search for "bank term deposit" or "term deposit" online.

A provisional liquidator's report also indicated that the financial firm had indicated that the investment would be supported by 'first ranking, registered security' and 'the assets were otherwise unencumbered' however, this was not the case. The majority of the funds invested were provided to a related entity, [Company E] on an unsecured loan basis for a term of 10 years at a rate of 8% p.a. The Company did not hold any security over the assets of [Company E].

ASIC also brought proceedings against the financial firm alleging that the financial firm had indicated that the investments:

- Were comparable to bank terms deposits, and have a similar risk profile to bank term deposits, when they are debentures with a significantly higher risk profile,
- were specifically designed for people seeking "certainty and confidence in their investments", when investors may not receive interest and/or capital repayments, and could lose some, or all, of their investment, and
- provide capital growth opportunities, when they do not and
- the principal investment will be repaid in full on maturity, when investors may not receive capital repayments on maturity or at all, and because Company M could elect to extend the time for repayment for an indefinite period.

The Ombudsman was satisfied there was sufficient evidence the investment was not operated in accordance with the undertakings in the brochure to amount to misleading and deceptive conduct by the financial firm. The determination found the product's brochure contained false and misleading statements. The complainant relied on those statements to her detriment. The financial firm was required to pay the complainant $500,000 plus interest.

# 5 References

## Definitions

| Term | Definition |
|---|---|
| AFCA | Australian Financial Complaints Authority |
| Debenture | a medium to long-term investment issued by a company. You are lending money to the company. In return you will receive a regular and fixed interest amount for the term of the investment. The invested funds (principal) are repaid at the end of the term (maturity) |
| Cash Rate | the interest rate which financial institutions pay to borrow or charge to lend funds in the money market on an overnight basis |
| Complainant | a person or small business who has lodged a complaint with AFCA |
| FOS | Financial Ombudsman Service |

## Useful links

| Document type | Title / Link |
|---|---|
| MoneySmart: Investing in unlisted debentured and unsecured notes | Investing in unlisted debentures and unsecured notes |
| ASIC News: Investor alert | Investor alert: Fixed interest products – higher returns mean higher risks |
| List of APRA regulated institutions | www.apra.gov.au/adi/pages/adilist.aspx |