Prime Action Support Group Inc
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12 April 2019

The Board of Directors
Australian Financial Complaints Authority Limited
GPO Box 3
MELBOURNE VIC 3001

Dear Board Members

PROPOSED AFCA RULES FOR RETROSPECTIVE COMPENSATION SCHEME OF LAST RESORT ("CSLR")

This Submission is made on behalf of the 6,400 members of Prime Action Support Group Incorporated, an action group representing the interests of investors in the Prime Retirement and Aged Care Property Trust (***"Trust"***).

Background

Trust investors collectively lost more than $500 million following its collapse in 2010.

ASIC commenced legal proceedings against various Directors of the Trust's responsible entity ***("Directors")*** in 2012, and following several years of legal proceedings and appeals, the High Court determined in December 2019 that several Directors had breached obligations that they owed to the investors and also committed numerous breaches of the Corporations Act. The High Court has referred the matter back to the Full Court of the Federal Court to determine the pecuniary penalties and disqualification periods to be applied to the Directors.

The Receivers and Liquidators also pursued various legal proceedings against the Directors and certain other parties. These actions were settled out of Court in February 2018 with reported settlement proceeds of $40m being shared between the Litigation Capital Management Ltd (as litigation funder), the Receivers and Liquidators.

Despite the success of both of the above proceedings, no funds have been returned to investors.

Two Trust investors also pursued claims through the Financial Ombudsman Service (**"FOS"**) and successfully demonstrated that the product disclosure statements issued by the Trust's responsible entity were misleading and deceptive. Again, despite receiving FOS Determinations in their favour, no compensation was paid as there were no funds available, noting that the Trust's Professional Indemnity Insurance Policy had been exhausted by claims made by the Directors.

Ramsay Review

The Review of the Financial System External Dispute Resolution and Complaints Framework (***"Ramsay Review"***) specifically considered the issue of a retrospective Compensation Scheme of Last Resort (***"CSLR"***) and noted as follows (emphasis added):

> *"KEY POINTS*
> *There is merit in considering providing access to redress to consumers and small businesses who had a viable claim against a financial firm at the time of the dispute and where:*
>
> *- **the financial firm was no longer operating, having ceased trading, gone insolvent** or being otherwise uncontactable or unable to pay; ..."*
>
> (Supplementary Final Report, p131)
>
> *"7.47. The Panel recognises that where a financial firm was no longer operating, a consumer or small business with a dispute would generally not have had access to redress.*
>
> *7.48. This raises concerns relevant to the Review Principles of equity and comparability of outcomes, as some consumers and small businesses may have had access to redress while others in similar circumstances may not have access to redress, with the difference arising from factors outside their control.*
>
> *7.49. The Panel therefore considers that **there is merit in considering providing access to redress for past disputes where the firm was no longer operating**."*
>
> (Supplementary Final Report, p139)

Royal Commission

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (***"Royal Commission"***) also considered the issue of a retrospective CSLR and concluded as follows (emphasis added):

> *"The (Ramsay) panel concluded that there was 'merit in considering' providing access to redress to consumers and small businesses who had 'a viable claim against a financial firm at the time of the dispute' where one or more of four criteria were met:*
> - ***the firm was no longer operating;***
> - ***the firm was not a member of an EDR body; ...***
>
> *The panel proposed further consideration of the issues and there is evident merit in that being done."*
>
> (Royal Commission Final Report, p482-483)

Proposed AFCA Rules

According to the AFCA Draft Amendments to the Operational Guidelines (emphasis added):

> *"A legacy complaint must be about a compulsory member firm of AFCA, who is required to hold membership of AFCA under their license, credit representative or other legislative condition, rather than a member firm who participates in the AFCA scheme voluntarily."*
>
> *A complaint must be about a Financial Firm that is a **current member AFCA member at the time the complaint is submitted** – see rule A.4.2. This applies regardless of whether or not the AFCA member is solvent or operating their business at the time the legacy complaint is submitted to AFCA."*

In considering the issue of a retrospective CSLR, it is noted that both the Ramsay Review and the Royal Commission favoured allowing access to redress for consumers where the financial firm was no longer operating.

Despite the considered and careful guidance provided by the Ramsay Review and the Royal Commission, the proposed AFCA Rules unilaterally exclude access to claims where the financial firm is no longer operating, and this is a major cause of concern.

Labor Party Policy

It is noted that, contrary to the proposed AFCA Rules, the Federal Labor Party has indicated that it intends to implement a retrospective CSLR aligned to the findings of the Royal Commission and include claims where the financial firm is no longer a member of AFCA.

In this regard, we note as follows (emphasis added):

> *"Labor will also establish a more comprehensive retrospective compensation scheme than the Government.*
>
> *Labor's scheme will cover more victims and will be entirely independent of AFCA."*
>
> ("*Fairer, Bolder, Stronger*", Labor Response to Royal Commission Report, February 2019)

> *"It [the compensation scheme] would also fulfil the "last resort" function Commissioner Kenneth Hayne recommended by considering applications from customers who cannot otherwise be compensated, because the relevant **financial service provider has become insolvent**."*
>
> ("*Labor Reveals 'Unprecedented' Compensation Scheme for Bank Victims*", Sam Clench, News Corporation, 22 February 2019)

> *"To oversee all decisions made by the scheme and ensure procedural fairness and consistency of decision making, Labor will establish an independent board made up of independent experts in the field, including representatives from industry and consumer groups and an independent chair, funded by a levy on AFCA members.*

The Board will determine access to the scheme, oversee decisions made by the scheme, and establish processes and procedures for how the scheme will resolve each type of dispute, and provide recommendations to Government about the precise funding model for the scheme.

The Board will also be responsible for considering applications from people who have a dispute with a financial service provider (FSP) ***that is now insolvent.***"

(https://www.billshorten.com.au/labor_announces_groundbreaking_bank_victim_compensation_scheme_friday_22_february_2019)

Equity and Funding Issues

We are deeply concerned that the AFCA Proposal, as currently outlined, creates a major inequity. Two claimants may have identical claims against two financial firms, with the first claim relating to an operating business and the second claim in respect of an insolvent or deregistered business. In these circumstances, it is possible that the first claim may be successful and the second claim unsuccessful. However, as the grounds for dismissing the second claim are outside the control of the second claimant, this outcome is grossly inequitable and unfair.

In other words, an investor whose life has been ruined by the illegal actions of a now insolvent operator should be just as entitled to compensation as an investor who has suffered the same misdeeds from a continuing entity.

Although there are equity issues in treating all claimants fairly, we note that there are also equity issues involved in having continuing entities pay compensation in respect of the misdeeds of defunct entities.

Rather than a binary outcome where all claims relating to defunct entities are either:

- excluded from the CSLR (ie. industry pays nothing towards these claims); or
- included in the CSLR (ie. industry meets the cost of these claims);

we submit that there is a compelling need for a ***balanced*** resolution to this issue.

We also agree that there is merit in requiring industry participants to contribute towards the cost of CSLR claims against defunct entities as these participants will ultimately benefit from the restoration of trust in the financial services sector provided by the CSLR and the Royal Commission findings.

The Federal Labor Party has proposed a balanced and equitable outcome as summarised below:

"Once the two year application period has ended, the total quantum of compensation ordered against insolvent FSPs will be considered and the Board will recommend a total cap for compensation to be pro-rated for consumers with a legitimate claim in this category, balancing the need to legitimately compensate consumers while not wanting other banks to unfairly pay for the unlawful conduct of now-insolvent companies."

(https://www.billshorten.com.au/labor_announces_groundbreaking_bank_victim_compensation_scheme_friday_22_february_2019)

In this way, claimants with cases against insolvent companies can pursue their claims under the CSLR, with the quantum of compensation being potentially scaled back based on the total claims, and the total funding available to CSLR from industry participants, Government and potentially other parties.

We note that substantial funds have already been gathered from industry participants via various penalties imposed on market participants for misconduct, as well as significantly increased levies from both ASIC and AFCA, which could be made available for a retrospective CSLR.

Having agreed that it is appropriate for industry participants to contribute to retrospective CSLR claims, we also recognise that the majority of participants provide a valuable service to the community in general and are integral in assisting many people achieve their financial aspirations and save for their retirement. CSLR claims are more likely to arise from the behaviour of participants who unfortunately do not act honestly or do not adhere to the requirements of the Corporations Act, as in the case of Prime Trust, and these participants should be removed from the industry as soon as this is recognised. In such circumstances it is not fair that the honest participants should alone carry the burden of losses incurred by those who have suffered from dishonest participants. For this reason, we submit that it is appropriate that the Government should also contribute funding towards the CSLR.

As is recognised in the Labor party proposal, it is unlikely that a sustainable and fully-funded CSLR model can be created and it may therefore be prudent to place a cap on the proportion of claims that will be met.

In acknowledging the sensitivities of administering a CSLR, we suggest that an independent Board should be appointed to oversee CSLR decisions and to champion procedural fairness and consistent decision making for claimants.

We also note that the Federal Budget is expected to return to surplus in 2019-20, thereby providing a potential opportunity for Government to contribute towards the cost of the CSLR and the restoration of trust in the financial services industry. Such a move would be consistent with the direction, and spirit, of both the Ramsay Review and the Royal Commission in allowing CSLR access to claimants of defunct entities.

Conclusion

In view of the above analysis, we would urge the AFCA Board to remove the proposed exclusion of claims where the financial firm is no longer a current compulsory member of AFCA.

We would urge the AFCA Board to adopt an equitable policy of treating claims against defunct entities as proposed by the Federal Labor Party.

Alternatively, given the Labor Party's policy on CSLR and the associated issues of equity, we would suggest that it would be premature and unnecessarily costly to implement the proposed AFCA Rules ahead of the next Federal election scheduled for May 2019.

We would also suggest that a two-year period be made available for the lodgement of legacy CSLR claims, and that an independent Board be established to review CSLR decisions.

Thank you for the opportunity to provide input on the proposed AFCA Rules and please do not hesitate to contact us if you would like any additional information.

Yours sincerely

PAJG Inc.

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