

# The AFCA Approach to terms of settlement

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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 At a glance

## 1.1 Scope

AFCA and its predecessor schemes seek to resolve complaints between a complainant and a financial firm in a cooperative, efficient, timely and fair way. Complaints resolved by mutual agreement are usually recorded in writing as terms of settlement.

This document sets out our approach to settling complaints or interpreting terms of settlement documents prepared by the parties, by outlining:

- what to consider with non-standard terms of settlement documents
- what governing principles should inform the terms of settlement
- how the terms of settlement should show the complaint is resolved
- how previous terms of settlement can affect a further or current complaint with AFCA.

This approach will help:

- the complainant before signing the terms of settlement
- the financial firm when drafting any terms of settlement.

The approach has been adopted from AFCA's predecessor scheme the Financial Ombudsman Service.

## 1.2 Summary

It is important when finalising a complaint at AFCA that the terms of settlement are a clear and accurate record of the agreement between the complainant and the financial firm. Otherwise, the resolved complaint could be jeopardised by later, further complaints about the content of those terms.

AFCA expects terms of settlement prepared by a financial firm to:

- be drafted fairly with a clear scope, usually in line with one of our standard templates
- follow our core guiding principles to protect each party's rights
- clearly set out the consequences of defaulting on the agreement
- where relevant, cover the financial firm's right to enter judgment on default or to restore legal proceedings, if the complainant breaches the terms.

If the complaint has been the subject of a binding determination by an AFCA Decision Maker under our general jurisdiction, terms of settlement must be provided (if at all) within the time allowed by AFCA, and:

- limited to the matters dealt with in the determination
- consistent with the determination.

In some complaints, we will also consider:

- previous terms of settlement that the financial firm and complainant have agreed
- liability in third party settlements, particularly in family law cases.

Under our superannuation jurisdiction, a binding determination by an AFCA Decision Maker has immediate effect. Terms of settlement for our superannuation jurisdiction are therefore relevant only for a negotiated outcome, including if the parties agree to accept AFCA's preliminary assessment.

## 2 In detail

### 2.1 Drafting terms of settlement

#### Who supplies the terms of settlement?

If the financial firm asks the complainant to agree to terms of settlement following a preliminary assessment (for all jurisdictions) or determination (in our general jurisdiction), it will have to prepare the document and cover the costs for this. The complainant should get legal advice on any non-standard terms of settlement. We may ask the financial firm to pay the complainant's costs for this.

However, AFCA may record the terms of any settlement reached in a AFCA telephone conciliation conference and provide it to the parties.

#### Does AFCA check the financial firm's terms of settlement?

We do not give the complainant legal advice on the effect of the financial firm's terms of settlement. However, we will review the terms of settlement to ensure they are consistent with the outcome of the complaint and the principles governing AFCA.

If we find the document unacceptable, we will ask the financial firm to redraft it to ensure it is consistent with the outcome of the complaint, and with AFCA's principles.

Also, if we consider a settlement raises sufficient concern that it should be investigated further, we may refer the settlement agreement to the relevant regulator under section 1053E Corporations Act and ASIC Regulatory Guide 267, paragraphs 267.60-267.64.

We may find the terms of settlement unacceptable where:

- the scope is unreasonably wide, especially where the financial firm seeks to be released from being liable for its conduct beyond the scope of what was raised in the complaint or in settlement negotiations
- it does not reflect the preliminary assessment, determination or complaint resolution agreement that resolved the complaint
- it does not follow AFCA's governing principles (set out in Rule A.2.1)
- it prevents the complainant from referring a complaint to the relevant regulator(s)
- it is not a genuine and voluntarily agreement (for example, the complainant is entering it as a result of duress, misrepresentations, or unconscionable conduct).

## 2.2 Understanding our governing principles

### What should the terms of settlement cover?

The following governing principles should inform the terms of settlement to help prevent a future complaint from derailing the resolution agreed at AFCA:

- 1 The terms of settlement should finalise the complaint.
- 2 They should reflect the agreement between the financial firm and the complainant, and not introduce new terms.
- 3 They should expressly deal with the consequences of not complying with them. But this should not allow the financial firm to try to recover more than the agreed settlement amount plus recovery costs (except where a debt has not been disputed, or the complainant is free to defend the initial claim).
- 4 A financial firm should use plain English when drafting its own terms of settlement.

### How should the terms of settlement deal with defaults?

Some complaints are settled on terms which leave the complainant with obligations (for example, complaints about credit contracts). The terms of settlement should follow these principles for defaults on those obligations and legal proceedings:

- 1 The terms of settlement should generally give the complainant 7 days' notice to remedy a default before the financial firm takes action. If the financial firm then intends to reinstate legal proceedings, the notice should state that the financial firm may obtain judgment by default unless the complainant corrects the default or files a defence with the court.
- 2 They should not prevent the complainant from disputing whether either party complied with the terms of settlement.

- 3 They may allow discontinued legal proceedings to be restored or reinstated on default. If so, the proceedings might need amending to reflect that a settlement agreement was not met.
- 4 They should not require the complainant to consent to judgment.

### Are there special requirements for post-determination settlements?

A determination is AFCA's final decision on the merits of a complaint. It will take effect or become binding as set out in Rule A.15.

Rule A.15.4 allows a financial firm to ask the complainant to sign a settlement agreement or release from liability as a condition of the firm complying with a determination, provided:

- the complaint is not a superannuation complaint (because AFCA's determination of a superannuation complaint has immediate effect by law)
- the agreement meets AFCA's requirements under the Rules
- in addition to the general requirements listed in section 2.1 above, this includes:
- the agreement or release must be provided to the complainant within the time specified by AFCA
- it must be limited to the matters dealt with in the determination
- it must be consistent with the determination, and with the parties' rights and obligations under the Rules
- any release of the financial firm from liability may only take effect after the financial firm fulfils all its obligations under the determination.

## 2.3 Understanding the effect of a settlement agreement

### How is the settlement documented?

AFCA expects that when the complainant and the financial firm agree to resolve a complaint, it means the complaint will end. Documenting the terms of settlement is not a chance for either party to then change a mutually agreed resolution.

What regularly derails an agreement is when the terms of settlement do not include the consequences of either party not complying. It is important to include this in any agreement to resolve the complaint.

Generally, the terms of settlement:

- are binding
- effectively replace all previous contracts and arrangements to do with the complaint.

The usual remedy if a settlement agreement is breached is to sue the party for breaching it. See *McDermott v Black* (1940) 63 CLR 161, *Osborn and Bernotti v McDermott* [1998] 3 VR 1, and *Masters v Cameron* (1954) 91 CLR 353.

### **What if the complainant disputes the debt?**

Where the complaint is about a credit contract, a complainant who disputes liability will often agree to give up the complaint in exchange for paying the financial firm a smaller sum, rather than the sum owed under the disputed contract.

Where this occurs and the complainant does not make the required payments, the financial firm can only take legal action to recover the smaller sum agreed in the settlement plus recovery costs. If the financial firm recovers more than the agreed settlement sum and costs, it can contravene the doctrine of penalties.

The financial firm would be in breach, for instance, if it recovers the amount the complainant first owed under the original contract. This is because:

- the original, larger sum owing was not an accepted debt
- the complainant gave up rights in exchange for the financial firm agreeing to a smaller sum being paid.

For more on this, see *Zenith Engineering Pty Ltd v Queensland Crane & Machinery Pty Ltd* [2000] QCA 221, and *Duffy Bros Fruit Market (Campbelltown) Pty Ltd v Gumland Property Holdings Pty Ltd* [2007] NSWCA 7.

### **What if the complainant does not dispute the debt?**

By contrast, if the complainant does not dispute the debt, but instead seeks a revised payment plan, this is sometimes called an 'indulgence'. It often arises if the complainant faces financial difficulty in paying the owed sum.

In such cases, the complainant:

- accepts the amount the financial firm says is the owed debt
- has not given up any defences in exchange for paying a smaller sum.

In these complaints the terms of settlement can allow the complainant to pay the full debt (not just the smaller sum) if they default on the agreed settlement payments. If the settlement agreement does not specify a sum to be paid on default, the complainant must generally pay the full undisputed debt.

### **Can the parties agree that terms of settlement can be cancelled?**

The financial firm and the complainant can agree that the terms of settlement will not stay in place unless the complainant meets their obligations. This usually depends on the complainant making payments in line with the settlement terms.

If the complainant defaults on the payments, the settlement agreement remains incomplete and becomes ineffective. The financial firm and complainant then return to their original positions before they agreed to settle the complaint. The financial firm can seek to enforce its original rights and the complainant can again mount their initial defence.

## **2.4 Going to a judgment on default or restoring legal proceedings**

### **How can the financial firm pursue court action if the complainant defaults?**

If the complainant does not make the agreed payments in line with the terms of settlement, the financial firm can ask for a court judgment for a breach of the settlement agreement.

But the terms of settlement should not require the complainant to agree to judgment. A settlement agreement must allow the complainant to dispute that judgment if they claim that they did comply with it and did not breach the terms of settlement.

The financial firm should generally give the complainant at least 7 days' notice of a default on the terms of settlement.

### **Can the financial firm restart legal proceedings after settlement?**

Sometimes, a complaint is subject to legal proceedings that have been issued but not yet determined. Under our Rules, the financial firm must not pursue those proceedings while we consider that complaint.

Where proceedings have been discontinued and the complaint settled, but the complainant has then not complied with the terms of settlement, the financial firm can seek to restore or reinstate those proceedings.

However, the terms of settlement must include the financial firm's right to do this. We consider this acceptable because it saves in court costs that the complainant would ultimately need to pay if the proceedings have to be reissued.

But in such cases, the financial firm must give the complainant at least 7 days' notice of the default to give them the chance to raise any defence to that default.

## **2.5 Interpreting previous terms of settlement**

### **How can a previous settlement affect a new complaint?**

In some complaints, AFCA must review the previous terms of settlement agreed to by the complainant and the financial firm to determine whether a new complaint lodged with us has been previously dealt with.

This could be where the complainant has given the financial firm a release relating to a previous complaint in broad terms. For example, 'I release the financial firm from any claims and all liability to do with home loan XYZ'. The question we must address

is whether releasing the financial firm from 'all liability' stops the complainant from bringing a further complaint.

### Which principles of interpretation apply?

Principles for interpreting terms of settlement are summarised by J Santow in *Karam v ANZ Banking Group* [2001] NSWSC 709 at [406]. They are that:

- 1 The terms of settlement are to be interpreted as conveying the meaning that a reasonable person with the same background knowledge as both parties reasonably had when they signed it.
- 2 General words in the terms of settlement are limited to what the parties specifically considered the words to mean when they reached their agreement.
- 3 Generally, the parties did not intend to surrender rights and claims they were not aware of having when agreeing to the settlement.

This is why we interpret general words in terms of settlement that release the financial firm from all liability as a release only from liability for issues relating to the settled complaint. A general release does not apply to a further claim on a different matter.

## 2.6 Making third party settlements

### How are the complainant's rights affected in a third-party settlement?

An issue can occur where a third party is part of the complaint. For example, a mortgage broker may have misled the complainant about a loan interest rate. If the broker was the financial firm's agent, the complainant has a potential claim against both the financial firm, for the conduct of the broker, and the broker.

A third-party settlement agreement will often be in broad terms, such as the complainant agreeing not to bring any claim in any forum for that complaint.

If the complainant settles the complaint against the broker, it could affect their ability to also bring a complaint against the financial firm. We will interpret a settlement agreement as only settling the complainant's claims against the other party to that agreement – in this case, the broker. The complainant can make a further claim, but cannot be compensated for more than their full loss. If the complainant is fully compensated under a settlement with a third party, they cannot continue a complaint against the financial firm as there is no outstanding loss.

### What happens in family law settlements?

An issue often arises with family law settlements where partners in a relationship hold a joint account. If both need to agree to a withdrawal and the financial firm mistakenly allows one account holder to withdraw funds in breach of the account authority, the complainant can claim against both their partner and the financial firm.



If there are then legal proceedings over the partners' asset and liability allocations, it is often difficult to determine from the related settlement if the complainant was compensated for the loss caused by the financial firm's breach of mandate.

In such cases, AFCA will not be able to determine the complaint about the alleged breach of mandate, as we cannot calculate the loss. We only consider complaints where:

- the other party received notice in writing that the complainant intended to separately make a future claim against the financial firm for the loss, or
- the complainant expressly reserved the right to make a future claim against the financial firm in the property settlement, or
- the complainant was not, and could not have been, aware of the error at the time of the settlement, or
- we can determine from the terms of the settlement that the complainant was not fully compensated, but we will not go beyond the settlement document to do so (see case study 1).

### Superannuation and family law settlements

AFCA does not resolve disputes about the allocation of superannuation interests between parties to a marriage for family law purposes. AFCA's superannuation jurisdiction is limited to reviewing the decisions (and related conduct) of superannuation providers in:

- implementing agreements or court orders that deal with a party's superannuation
- dealing with requests for information from a person who wishes to make an agreement or seek a court order dealing with a party's superannuation.

Under AFCA's superannuation jurisdiction if, for family law purposes, a person's spouse or former spouse is party to an agreement or subject to an order relating to that person's superannuation interest or someone is eligible to request information about that person's superannuation interest, they can complain to AFCA that a decision or related conduct of the superannuation provider about the agreement, order or information request was unfair or unreasonable.

## 3 Context

The case studies below are based on determinations by one of AFCA's predecessor schemes, the Financial Ombudsman Service. While previous determinations (by AFCA or by its predecessor schemes) are not binding precedents, where relevant they will inform AFCA's approach to an issue.

### 3.1 Case studies

#### Case 1: Unclear third-party settlement payment prevents a claim

The complainant had a joint account with her husband and either could make withdrawals. Their relationship assets were:

- the home, valued at \$500,000 (each had a 50% share)
- \$100,000 in the joint account.

Before her husband died:

- he changed his will, leaving all his assets, including his share of the house, to her step-daughter rather than to her, as had been the case
- she transferred \$50,000 from their joint account into an account in her name only
- he then transferred that \$50,000 into an account in his name only.

After her husband died, the complainant made two claims against both his estate and her stepdaughter:

- that his new will had been made under duress and was not valid
- for the return of the \$50,000 he had transferred from her account.

She settled this claim in exchange for a lump sum of \$100,000. But the settlement did not apportion that payment between her two claims.

She then lodged a claim with us against the financial firm for the \$50,000 it had allowed her husband to withdraw from her account without authority.

We took the view that:

- the financial firm had breached its obligations to the complainant by allowing the unauthorised withdrawal
- settling the claim with the estate and her step-daughter did not prevent a further claim against the financial firm because it was not a party to that settlement.

However, we could not determine if the complainant had been fully compensated for \$50,000 taken from her account because her lump sum payment had not been apportioned. We could not consider the complaint.

We could have done so, for instance, if the previous terms of settlement had specified that in the settlement sum:

- \$80,000 was for her claim the will was invalid
- \$20,000 was for her claim about wrongful access to her account.

She then could have made a claim against the financial firm for the remaining \$30,000 for wrongful account access.

### Case 2: Broad settlement terms allowed a further claim

The complainant had a home loan with the financial firm and fell into default after losing his job. After unsuccessfully negotiating with the financial firm to vary the loan repayments due to financial difficulty, the complainant lodged a claim with us.

The complaint was settled with an agreement the complainant could make lower monthly repayments for three years. The terms of settlement were broadly in satisfaction of 'all claims' against the financial firm.

One year later, the complainant lodged a further claim against the financial firm about being misled over the home loan interest rate. The financial firm argued we could not consider the complaint as the complainant had previously settled 'all claims' against it.

We took the view that despite this broad expression in the previous terms of settlement, it applied only to complainant's initial complaint with the financial firm over the lowering of the loan repayments.

We accepted that the complainant could make the further claim against the financial firm.

## 3.2 References

### Definitions

Term	Definition
AFCA	the Australian Financial Complaints Authority
complainant	individual or small business that has lodged a complaint with AFCA
financial firm	a bank or credit provider who is a Member of AFCA
Rules	The rules which along with the Corporations Act govern AFCA's jurisdiction, powers and procedures

### Useful links

Document type	Title / Link
<a href="#">Rules</a>	<a href="http://afca.org.au/rules">afca.org.au/rules</a>
Case law	McDermott v Black (1940) 63 CLR 161.
Case law	Osborn and Bernotti v McDermott [1998] 3 VR 1.
Case law	Masters v Cameron (1954) 91 CLR 353.

Document type	Title / Link
Case law	Zenith Engineering Pty Ltd v Queensland Crane & Machinery Pty Ltd [2000] QCA 221.
Case law	Duffy Bros. Fruit Market (Campbelltown) Pty Ltd v Gumland Property Holdings Pty Ltd [2007] NSWCA 7.
Case law	Karam v ANZ Banking Group [2001] NSWSC 709 at [406].