SUPPLEMENTARY FINAL REPORT

Review of the financial system external dispute resolution and complaints framework

September 2017

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6 September 2017

The Hon Kelly O'Dwyer MP
Minister for Revenue and Financial Services
Parliament House
CANBERRA ACT 2600

Dear Minister

In accordance with the amended Terms of Reference, we are pleased to present the Supplementary Final Report of the Review of external dispute resolution and complaints arrangements in the financial system.

This Report makes four recommendations on the establishment of a limited and carefully targeted Compensation Scheme of Last Resort (CSLR) to cover future unpaid compensation in parts of the financial services sector where there is evidence of a significant problem of compensation not being paid.

This Report also makes six observations on the merits and issues involved in providing access to redress for past disputes.

The Panel received 63 submissions in response to its Supplementary Issues Paper. The Panel also met with many stakeholders representing a wide range of interests at each stage of the consultation process. Many organisations and individuals gave considerable time and resources to assist this Review, for which the Panel is grateful.

The Panel would also like to thank the individuals who in many cases shared their quite distressing personal experiences.

Finally, the Panel wishes to acknowledge the support of the members of the Secretariat.

Yours sincerely

Professor Ian Ramsay (Chair)

Julie Abramson

Alan Kirkland

FOREWORD

This Review is an important opportunity to ensure Australia's external dispute resolution (EDR) framework delivers effective outcomes for users in a rapidly changing and dynamic financial system.

On 20 April 2016, the Government announced this review of the financial system's EDR and complaints framework (EDR Review). On 8 August 2016, the Terms of Reference for the Review were released.

On 9 September 2016, the Panel released an Issues Paper and received 127 submissions from stakeholders. These submissions informed the Panel's Interim Report, which was released for consultation on 6 December 2016 and sought stakeholder views on 11 draft recommendations. Fifty-six submissions were received.

Among other issues, the Review's original Terms of Reference directed the Panel to make observations, but not recommendations, on the establishment of a statutory compensation scheme of last resort (CSLR). In their responses to the first Issues Paper, a number of stakeholders made submissions on this issue which informed the Panel's observation in the Interim Report that there is considerable merit in establishing an industry-funded CSLR.

On 2 February 2017, the Minister for Revenue and Financial Services amended the Review's Terms of Reference to include recommendations on the establishment, merits and potential design of a CSLR. The Panel was also asked to consider the merits and issues involved in providing access to redress for past disputes.

On 3 April 2017, the Panel provided to the Government its Final Report on matters covered by the original Terms of Reference (other than that relating to a CSLR).

On 31 May 2017, the Panel released a Supplementary Issues Paper in response to its amended Terms of Reference. The Panel received 63 submissions from stakeholders.

The Panel also met directly with a range of stakeholders individually and in Roundtable discussions prior to releasing the Supplementary Issues Paper, and while preparing this Report.

The high quality submissions received by the Panel, along with these stakeholder meetings, greatly assisted the Panel in preparing this Report.

MEMBERS OF THE EDR REVIEW PANEL

Professor Ian Ramsay (Chair)

Professor Ian Ramsay is the Harold Ford Professor of Commercial Law at Melbourne Law School, University of Melbourne, where he is the Director of the Centre for Corporate Law and Securities Regulation. He is a member of the Corporations Committee of the Law Council of Australia and the Government's ASIC Enforcement Review Taskforce.

Ian has practised law with firms in New York and Sydney. Former positions Ian has held include Dean of Melbourne Law School and Head of the Australian Government inquiry on auditor independence. He is a past member of the Takeovers Panel, the Government's Corporations and Markets Advisory Committee, the Auditors and Liquidators Disciplinary Board, ASIC's External Advisory Panel, the Audit Quality Review Board, the Law Committee of the Australian Institute of Company Directors, the International Federation of Accountants taskforce on rebuilding confidence in financial reporting, and consultant to the House of Representatives Standing Committee on Economics, Finance and Public Administration.

Ian has published extensively on corporate law, financial regulation and corporate governance issues both internationally and in Australia. He has extensive experience as an expert consultant to government reviews and as a member of government advisory committees.

Julie Abramson

Julie Abramson is a lawyer with over 20 years regulatory experience at both State and Federal levels. She was appointed a part-time Commissioner with the Productivity Commission in December 2015.

Her career in public policy includes working with Government, industry bodies, the private sector in a major financial institution and a regulatory agency. She has particular expertise and an interest in economic regulation. She was also a part-time Commissioner with the Essential Services Commission from 2014 to 2016 and a member of the Code Compliance Monitoring Committee from 2008 to 2011.

Alan Kirkland

Alan Kirkland has been CEO of CHOICE, Australia's largest consumer organisation, since 2012.

Alan has a background in the justice system, having previously worked as CEO of Legal Aid New South Wales and Executive Director of the Australian Law Reform Commission. He has also been a part-time member of a number of state and federal tribunals.

Alan has a long-term interest in redressing socio-economic disadvantage, which he has pursued through voluntary roles with organisations including the Australian Council of Social Service and the Public Interest Advocacy Centre.

ACKNOWLEDGMENTS

The Panel would like to thank the many consumer organisations, businesses and representative bodies who made submissions to this Review. The Panel would also like to thank the individuals who in many cases shared their quite distressing personal experiences.

The Panel is also grateful to the organisations and individuals who have met with it. The meetings have been very helpful in assisting the Panel in its deliberations.

Finally, the Panel wishes to acknowledge the outstanding professionalism, dedication and support of the members of the Secretariat: Kate Phipps (Head), Mohita Zaheed (Manager), Jacqueline Roessgen (Manager), Michael Denahy, Jackie Dixon, Joanna Orton and Julian Parise.

TERMS OF REFERENCE
(AS AMENDED ON 2 FEBRUARY 2017)

PURPOSE OF THE REVIEW

The Financial Ombudsman Service, Superannuation Complaints Tribunal and Credit and Investments Ombudsman help Australians to resolve disputes with financial services providers. The Government is committed to ensuring that these bodies are working effectively to meet the needs of users, including consumers and industry.

TERMS OF REFERENCE

1. The review will examine the following dispute resolution and complaints arrangements to consider whether changes to current dispute resolution and complaints bodies in the financial sector are necessary to deliver effective outcomes for users in a rapidly changing and dynamic financial system:

    1.1. the Financial Ombudsman Service (FOS);

    1.2. the Superannuation Complaints Tribunal; and

    1.3. the Credit and Investments Ombudsman.

2. The review will have regard to: efficiency; equity; complexity; transparency; accountability; comparability of outcomes; and regulatory costs.

3. The review will make recommendations on:

    3.1. the role, powers, governance and funding arrangements of the dispute resolution and complaints framework in providing effective complaints handling processes for users, including linkages with internal dispute resolution;

    3.2. the extent of gaps and overlaps between each of the bodies (including consideration of legislative limits on the matters each body can consider) and their impacts on the effectiveness, utility and comparability of outcomes for users;

    3.3. the role of the bodies in working with government, regulators, consumers, industry and other stakeholders to improve the legal and regulatory framework to deliver better outcomes for users;

    3.4. the relative merits, and any issues that would need to be considered (including implementation considerations), of different models in providing effective avenues for resolving disputes; and

    3.5. the establishment, merits and potential design of a compensation scheme of last resort.

4. In making its recommendations, the review will, to the extent relevant, take into account best practice developments in dispute resolution arrangements in overseas jurisdictions and other sectors.

TERMS OF REFERENCE (CONTINUED)

5. The review will take into consideration, and consult with ASIC, on the concurrent review of the FOS's small business jurisdiction.

6. The review will consider the merits and issues involved in providing access to redress for past disputes.

PROCESS

The review will be led by an independent expert panel, consisting of a Chair and two members, and be supported by a secretariat from Treasury.

A final report is to be provided to the Minister for Revenue and Financial Services by the end of March 2017 (with the exception of issues contained in clauses 3.5 and 6 which will be provided to the Minister by the end of June 2017).[1]

The review will invite submissions from the public and consult with a range of stakeholders, including consumers and industry.

1 On 9 May 2017, the Treasurer amended the date on which the Panel is to provide its report on the issues contained in clauses 3.5 and 6 from the end of June 2017 to the second half of 2017.

EXECUTIVE SUMMARY

ENSURING TRUST AND CONFIDENCE IN THE FINANCIAL SYSTEM

1. A well-functioning system for resolving disputes within the financial system is essential for safeguarding consumer trust and confidence and for ensuring the system is meeting the needs of its users.

2. This Report marks the second and final report of the Panel's review of the Australian financial system's external dispute resolution (EDR) framework. This Report should be read in conjunction with the Panel's earlier Report, *Review of the financial system external dispute resolution and complaints framework: Final Report*, which was provided to the Government in April 2017 (April 2017 Report).[2] The April 2017 Report responded to the matters covered by the original Terms of Reference for the Review (other than that dealing with a compensation scheme of last resort (CSLR)).

3. In its April 2017 Report, the Panel made 11 recommendations representing an integrated package of reforms to ensure that the EDR framework is well placed to address current problems and that it is designed to withstand the challenges of a rapidly changing financial system.

4. On 9 May 2017, the Government released the Panel's April 2017 Report and the Government's response to that Report. The Government accepted all 11 recommendations.[3]

5. The Panel's central recommendation was the establishment of a new single EDR body for all financial disputes (including superannuation disputes) to replace the Financial Ombudsman Service (FOS), the Credit and Investments Ombudsman (CIO) and the Superannuation Complaints Tribunal (SCT). This recommendation is to be implemented via the establishment of the new Australian Financial Complaints Authority (AFCA).

6. The Government has also commenced work to implement the Panel's recommendations that:

   - consumers and small businesses be provided with enhanced access to redress through higher monetary limits and compensation caps;
   - the single EDR body be subject to enhanced accountability measures, including an independent assessor to review complaints about its handling of disputes;

2 Commonwealth of Australia 2017, *Review of the financial system external dispute resolution and complaints framework: Final Report*.

3 Morrison, S (Treasurer) 9 May 2017, *Building an accountable and competitive banking system*, Media Release, <**http://sjm.ministers.treasury.gov.au/media-release/044-2017/**>.

- the Australian Securities and Investments Commission (ASIC) be provided with a general directions power to allow it to compel performance from the single EDR body if it does not comply with legislative and regulatory requirements; and
- improvements be made to increase the transparency and accountability of internal dispute resolution processes.

7. The Panel's view is that implementation of these recommendations will allow more people to have their disputes decided and will provide access to higher compensation for financial loss.

8. It is in this context that the Government amended the Review's Terms of Reference and asked the Panel to:

- make recommendations on the establishment, merits and potential design of a CSLR; and
- consider the merits and issues involved in providing access to redress for past disputes.

9. This Report addresses these Terms of Reference. This involves looking to the future, to ensure that consumers and small businesses can have confidence in receiving compensation awarded by AFCA, and to the past, to examine options for assisting consumers and small businesses that have not had access to redress.

THE PANEL'S APPROACH

10. In undertaking this Review, as required by its Terms of Reference, the Panel has had regard to the Review Principles of efficiency, equity, complexity, transparency, accountability, comparability of outcomes and regulatory costs.

11. Equity is a guiding principle for the Panel's work, and balancing the competing considerations in this area is challenging. While most financial firms behave reasonably and meet the obligations required of them in dealing with consumers and small businesses, the actions of a few firms have left some consumers and small businesses unable to access redress or compensation, with devastating consequences.

12. In its assessment and recommendations the Panel has been mindful of the need to balance the significant impact of financial losses on consumers and small businesses arising from the poor behaviour of some firms, with the recognition that in many of these cases the financial firm causing the wrong cannot provide compensation due to the fact that the firm is insolvent or otherwise unable (or, in some cases, unwilling) to pay. Therefore, the financial burden of providing compensation in these cases will fall upon the broader financial services industry or Australian taxpayers.

13. Comparability of outcomes is another important principle. Under current arrangements, some consumers or small businesses who have been customers of the same financial firm might receive compensation, while others in similar circumstances may not. These inconsistencies arise from matters beyond the control of the consumer or small business.

14. In considering these complex issues, the Panel has examined data provided by current EDR bodies and taken into consideration the evidence provided by a large number of stakeholders who have provided submissions and met with the Panel. The Panel has also looked to international approaches to resolving similar problems.

15. Like all complex policy problems, trade-offs need to be carefully weighed and balanced. The Panel has considered the likely costs and benefits, including whether any changes would be likely to make the financial system and the community as a whole better off.

THERE IS A NEED FOR A LIMITED AND CAREFULLY TARGETED COMPENSATION SCHEME OF LAST RESORT

16. The Review's Terms of Reference require the Panel to make recommendations on the establishment, merits and potential design of a CSLR. The Panel has made four recommendations in this area.

17. The Panel takes as its starting point that the *Corporations Act 2001* (Corporations Act) and the *National Consumer Credit Protection Act 2009* (National Consumer Credit Protection Act) impose an obligation on licensees to have arrangements for providing compensation where certain specified losses occur. As a result, consumers and small businesses have a reasonable expectation that they will receive compensation in these circumstances.

18. There is, however, clear evidence that current arrangements are failing to meet this expectation, with some consumers and small businesses not receiving compensation that has been awarded by an EDR body.

19. Some stakeholders have argued that this problem could be addressed through improvements to current arrangements, such as changes to professional indemnity (PI) insurance, financial resources requirements and ASIC's ability to take enforcement action in light of unpaid determinations. The Panel is firmly of the view that while these types of reforms are important, they will not solve the problem of uncompensated losses.

20. As the Panel has noted, the majority of financial firms comply with their legal obligations and compensate their customers where required.

21. Nevertheless, the Panel also recognises that while unpaid determinations represent a very small proportion of total EDR determinations the impact on consumers and small businesses can be significant and can erode confidence in the dispute resolution processes and the financial system more broadly.

22. To fill what the Panel regards as a gap in the dispute resolution framework, the Panel has recommended that a limited and carefully targeted CSLR be introduced for future unpaid compensation in parts of the financial services sector where there is evidence of a significant problem of compensation not being paid.

23. The evidence provided by FOS of unpaid EDR determinations in the past show that over 90 per cent of unpaid EDR determinations, by value, relate to financial advice. Therefore, the Panel recommends that a CSLR should initially be restricted to financial advice failures where a financial adviser4 has provided personal and/or general advice on 'relevant financial products'[5] to a consumer or small business. This means that only advice given by a 'relevant provider', as defined in section 910A of the Corporations Act, would be covered by a CSLR. Relevant financial products include, for example, financial advice on investments in managed investment schemes, superannuation and banking products that are not basic banking products.

24. The Panel also recommends that a CSLR should be designed to be scalable to cover other types of financial services should significant problems with unpaid compensation arise in the future. This should include a robust mechanism to ensure that the implications of future extensions are fully considered.

25. The Panel considers it essential that a CSLR be the last resort within the financial system's dispute resolution framework. That is, a CSLR should act as the final safety net to ensure consumers and small businesses are able to receive compensation after all other avenues have been exhausted.

26. The key design features of a CSLR recommended by the Panel are outlined below.

KEY DESIGN FEATURES OF A CSLR

- A CSLR should apply prospectively, which means that only unpaid decisions which arise after a CSLR is established will be eligible for compensation.
- Only consumers and small businesses (as defined by AFCA) should be eligible to lodge a claim with a CSLR.
- A CSLR should initially be restricted to financial advice failures where a financial adviser (relevant provider)[6] has provided personal and/or general advice on 'relevant financial products'[7] to a consumer or small business. This means that only advice given by a 'relevant provider', as defined in section 910A of the Corporations Act, would be covered by a CSLR.
- Consumers and small businesses must have a decision from AFCA, a court or a tribunal which remains unpaid after reasonable steps, as defined by a CSLR, have been taken.

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4 Financial adviser for the purposes of this Report refers to a 'relevant provider' as defined under section 910A of the *Corporations Act 2001*. A person is a relevant provider if the person: (a) is an individual; and (b) is (i) a financial services licensee; or (ii) an authorised representative of a financial services licensee; or (iii) an employee or director of a financial services licensee; or (iv) an employee or director of a related body corporate of a financial services licensee; and (c) is authorised to provide personal advice to retail clients, as the licensee or on behalf of the licensee, in relation to relevant financial products.

5 Section 910A of the *Corporations Act 2001* defines 'relevant financial products' as financial products other than: basic banking products; or general insurance products; or consumer credit insurance; or a combination of any of those products. The types of financial products which are considered 'relevant financial products' are similar, but not identical, to the financial products which are defined as Tier 1 financial products under the Australian Securities and Investment Commission's Regulatory Guide 146, *Licensing: Training of financial product advisers.*

6 Being a 'relevant provider' as defined in section 910A of the *Corporations Act 2001*.

7 As defined in section 910A of the *Corporations Act 2001*.

KEY DESIGN FEATURES OF A COMPENSATION SCHEME OF LAST RESORT (CONTINUED)

- A CSLR should only be able to receive a claim following a court judgment or tribunal award where the circumstances giving rise to that claim would have been eligible for consideration by AFCA.
- Applications must be lodged with a CSLR by a consumer or small business within 12 months of having completed specified reasonable steps to obtain compensation.
- A CSLR should not reassess the claims it receives; however, before paying a claim, a CSLR must be satisfied that the EDR determination, court judgment or tribunal award will not be paid by the financial firm to the consumer or small business.
- A cap should apply to the level of compensation that a CSLR is able to provide, which should be aligned with AFCA's compensation cap.
- A CSLR should have the ability to stand in the shoes of a consumer or small business and pursue the financial firm for the compensation amount.
- A CSLR should be funded by financial firms that provide the types of financial services covered by a CSLR.
- These financial firms should be required to be members and contribute to the funding of a CSLR as a condition of licensing.
- A CSLR should be governed by an independent board with an independent chair and equal numbers of directors with industry and consumer backgrounds.
- ASIC should have oversight of a CSLR to ensure it is fulfilling its objectives.
- A CSLR should be scalable, which means it can be expanded over time to cover other types of financial and credit services, should evidence of significant problems of uncompensated losses emerge.

27. In the context of a CSLR, the Panel considers it is imperative that effective regulatory requirements exist to ensure financial firms are able to meet their obligations to provide compensation to consumers and small businesses. While, as noted in paragraph 19, the Panel does not consider that strengthening the requirements imposed on financial firms in relation their levels of PI insurance and financial resources will solve the problem of uncompensated losses, there are some opportunities to improve regulatory requirements.

28. In addition to the recommendations made by the Panel on the establishment and design of a CSLR, the Panel recommends that firms that rely on PI insurance to meet their licensing obligations be required to provide additional data to ASIC on their PI arrangements, to improve ASIC's ability to undertake market surveillance and targeted regulatory action.

29. The Panel also recognises the importance of ASIC having appropriate enforcement powers to take action against firms that do not pay compensation awarded through EDR determinations. The Panel notes that the Government's ASIC Enforcement Review Taskforce is undertaking consultation on ASIC's power to ban senior officials in the financial sector. This consultation, amongst other matters, looks to provide ASIC with the power to take action against officers of financial firms that have failed to comply with a determination, as reported by AFCA.[8] The Panel strongly supports these proposals.

ADDRESSING LEGACY UNPAID EDR DETERMINATIONS IS IMPORTANT FOR FOSTERING CONFIDENCE IN THE FUTURE

30. The Panel has recommended that a CSLR should only operate prospectively. However, a number of consumers and small businesses have been awarded compensation through the current EDR framework that remains unpaid (legacy unpaid EDR determinations).

31. As at 30 June 2017, these legacy unpaid EDR determinations totalled $14,146,094 (excluding interest) and $399,862 (excluding interest) by FOS and CIO, respectively.

32. The Panel considers that there is a strong case for addressing these legacy unpaid EDR determinations as:

- the EDR framework is the primary mechanism for dispute resolution available to consumers and small businesses;
- these consumers and small businesses have fulfilled their obligations, undertaken the appropriate steps and received a decision from an independent EDR body that awarded compensation in their favour;
- these determinations remain unpaid through no fault of the consumer or small business or the lack of action by the EDR body to enforce the determination;
- the quantum of these determinations is known and therefore can be addressed without the risks associated with uncertainty of scale; and
- ensuring that this compensation is paid will foster confidence in the EDR framework by consumers and small businesses.

33. The Panel additionally sees merit in addressing these uncompensated losses as doing so will allow a CSLR to be established with a clear focus on ensuring that appropriate compensation awarded in the future is paid, without being clouded by concerns about legacy unpaid EDR determinations.

8 ASIC Enforcement Review September 2017, *Position and Consultation Paper 6, ASIC's power to ban senior officials in the financial sector*.

34. This approach also offers a level of equity and comparability of outcomes between consumers and small businesses that have experienced uncompensated losses in the past and those for whom compensation is awarded in the future, noting the Panel's recommendations in its April 2017 Report to strengthen the system overall.

35. The key challenge to addressing these legacy unpaid EDR determinations is the appropriate source of funding. The Panel recognises that in the majority of cases involving legacy unpaid EDR determinations, the financial firms that were ordered to pay compensation are insolvent or no longer operating, and are therefore unlikely to bear the costs. Accordingly, the Panel considered whether funding should be provided by other industry participants or government.

36. With reference to the Review Principle of equity, the Panel considers that it may not be either appropriate or desirable that current industry participants be required to contribute to pay for compensation arising from determinations against former industry participants.

37. In these difficult circumstances it would be a matter for government as to whether it is able to identify a funding source to address these legacy unpaid EDR determinations.

PROVIDING ACCESS TO REDRESS FOR PAST DISPUTES IS COMPLEX AND CHALLENGING

38. The Review's Terms of Reference require the Panel to consider the merits and issues involved in providing access to redress for past disputes but not to provide recommendations. The Panel accordingly makes a number of observations in this area.

39. In its April 2017 Report, the Panel noted that access to redress is critical. If consumers and small businesses are unable to access redress, this can lead to severe financial hardship and, more broadly, subsequent loss of trust and confidence in the EDR framework and the financial system.

40. However, the issue of providing access to redress for past disputes is challenging with no easy solutions. In many cases the financial firm whose misconduct has resulted in the loss is not available to bear the costs (for example, due to insolvency). As a result, in order to provide access to redress the costs of considering disputes and paying compensation arising from any misconduct will fall to the broader financial services industry or the Australian taxpayer.

41. Adding to this complexity is the lack of data on the scale and scope of these past disputes and the potential value of compensation that could be sought. Without an accurate quantification of the size, scale and nature of the potential claims it is not possible to fully assess the merits and issues in this area. Prior to determining the appropriate approach to providing access to redress the Panel considers that it is essential to obtain data on the scale of the problem.

Access to redress must be defined

42. As the first step in the Panel's consideration of past disputes, the Panel has had to define what is meant by providing access to redress in the context of this Review. In defining access to redress, the Panel notes that this is a complex area where the legal framework defines the boundary of what may be considered.

43. In particular, the Panel notes that there are substantial constitutional limitations on the ability of the Commonwealth (that is, the Government) to provide for the re-opening of matters where a final court judgment or a signed deed of settlement exists.[9] These limitations arise primarily from:

- the separation of powers, in that neither the Parliament nor the Executive may exercise or interfere with the exercise of judicial power. This could be the case if the Commonwealth conferred upon a non-judicial body the power to review matters that had previously been settled by a court;
- unjust acquisition of property (contrary to s 51(xxxi) of the Constitution), to the extent that the Commonwealth purported to interfere with the settled substantive rights of parties to their detriment; and
- interference with State laws, in that the legal rights and liabilities of parties would often have been decided in accordance with State laws and any law made by the Commonwealth which interfered with the operation of those laws would need to rely on a Commonwealth head of power.

44. The Panel also considers that consumers and small businesses who have had access to dispute resolution before an EDR body, court or tribunal, or who have reached a legally binding settlement, have had access to redress. The Panel does not consider that there would be merit in providing further access to redress in these situations, even if it was legally possible.

45. Some stakeholders argued that access to redress should not be based on legal principles or obligations. Rather, it should be based on broader notions of morality. The Panel's view is that it would be a significant departure from the Australian justice system to apply this type of approach to financial disputes. Some stakeholders also argued that in some circumstances the law that applies to their dispute is inadequate. The Panel considers that such circumstances are outside the scope of this Review and should be considered, if required, as part of future law reform processes.

46. Accordingly the Panel considers that, for the purposes of this Review, access to redress should only be considered for those disputes where, at the time of the dispute, a viable claim against a financial firm could have been brought to a court, tribunal or EDR body.

9 In relation to finalised deeds of settlement, the deed can generally only be challenged on the basis of its invalidity due to factors such as duress, mistake, fraud or bad faith, failure of consideration or illegality.

There is merit in considering providing access to redress for past disputes in certain circumstances

47. The Panel received evidence from a range of stakeholders, including in submissions from individuals, of a number of circumstances where consumers have been unable to access redress for disputes through the existing dispute resolution framework despite having taken all reasonable steps to do so.

48. These submissions involved a broad range of matters. Many involve losses resulting from inappropriate financial advice given to individuals, before reforms to the regulatory environment applying to financial advice were introduced. Some appeared to involve larger commercial disputes that would more appropriately be addressed through the courts rather than the EDR framework. In general, however, this evidence demonstrates that there have been situations where consumers or small businesses might have had access to redress, but for some reason this has not occurred.

49. The Panel's view, with regard to the Review Principles and the submissions received, is that there is merit in considering providing access to redress in the following circumstances, where at the time of the dispute:

- the financial firm was no longer operating, having ceased trading or, become insolvent or being otherwise uncontactable or unable to pay;
- the financial firm was not a member of an EDR body, because it was either trading while unlicensed or had been expelled by an EDR body;
- the monetary value of the dispute exceeded the EDR body's monetary limits and the consumer or small business lacked the resources to access the courts, tribunals or other dispute resolution bodies; and/or
- the consumer or small business was not in a position to pursue their dispute with the EDR body due to exceptional circumstances.

50. The Panel does not, however, consider that there is a case for access to redress for all types of losses suffered by consumers or small businesses. In a fair, well-functioning financial system, consumers should generally bear responsibility for their financial decisions, including the losses associated with market risk, investment performance and commercial decisions. While such events have a significant impact on consumers and small businesses, they do not reflect misconduct by financial firms and therefore are not circumstances requiring access to redress.

There are complex issues in considering providing access to redress

51. While the Panel has identified a range of circumstances where there may be merit in considering providing access to redress for past disputes, the Panel has also identified a number of issues that make this particularly challenging. As well as the need for data to enable the scale and scope of the problem to be quantified, there are issues associated with:

- who would fund a mechanism to provide access to redress for past disputes and any compensation that is awarded through such a mechanism;

- the need for a time limit within which disputes must be brought, and associated issues with the absence of documentation, evidence and/or personnel in relation to past disputes; and
- the risk of undermining the existing legal framework by applying regulatory requirements retrospectively.

52. The key issue with providing access to redress for past disputes is identifying appropriate funding for such mechanisms. The Panel notes that in many such disputes, the responsible firm may no longer be operating, may be insolvent or may otherwise be unable to pay compensation.

53. Consistent with the Panel's views on legacy unpaid EDR determinations, the Panel considers that it may be neither appropriate nor desirable that current industry participants be required to provide access to redress for disputes that relate to former industry participants.

54. Any mechanism for providing access to redress should be accessible for consumers and seek to minimise the impacts (including emotional distress and trauma) on them. It should provide consumers and small businesses with the appropriate support and timeframes to proceed with their claim.

55. The Panel has heard from many consumers and small businesses about the significant emotional and personal impact of a lack of access to redress. The Panel considers it important that appropriate support services, such as counselling, should be available to these consumers and small businesses to minimise, to the extent possible, the impact of emotional distress and trauma.

Four potential options to provide access to redress

56. The Panel has assessed four options to provide access to redress — three government-led and one industry-led. However, in the absence of reliable and complete information about the number of eligible past disputes and the quantum of the losses, it is difficult to fully assess the relative merits of each option or to identify all of the options that may be available.

57. For this reason, the Panel considers that before some of these options could be fully implemented, it would be necessary to undertake an information gathering exercise, where claims could be lodged within a set time period.

58. The four options considered by the Panel are outlined in the table below. These are not presented as alternatives but rather may operate together.

Options for providing access to redress for past disputes

Government-led

Government-supported legal case funding

Provide financial assistance for legal expenses to eligible consumers and small businesses that have a viable legal case but have not been able to access redress through the courts due to a lack of funds.

A new body to examine past financial sector disputes

Establish a new body to undertake a scoping exercise to quantify the pool of past disputes that may be eligible for access to redress and, following this, decide on the best way to finally resolve these cases.

A government-established compensation scheme for exceptional circumstances

Establish a scheme to make discretionary compensation payments by government to consumers and small businesses that have not had access to redress for past disputes in exceptional circumstances.

Industry-led

An industry-led forum to hear past disputes

Establish an independent forum to hear past disputes raised by consumers and small businesses in particular circumstances (for example, as proposed by Westpac, bank-related allegations relating to past poor financial advice or maladministration in lending which exceeded the value of the EDR schemes' monetary thresholds at the time the dispute arose).

TABLE OF RECOMMENDATIONS

RECOMMENDATION 1:

A LIMITED AND CAREFULLY TARGETED CSLR (SEE CHAPTER 3)

A CSLR should be established. A CSLR, if established, should be limited and carefully targeted at the areas of the financial sector with the greatest evidence of need.

RECOMMENDATION 2:

A CSLR RESTRICTED TO FINANCIAL ADVICE BUT FUTURE PROOFED (SEE CHAPTER 3)

A CSLR, if established, should initially be restricted to financial advice failures where a financial adviser (relevant provider) has provided personal and/or general advice on 'relevant financial products' to a consumer or small businesses.[10] This means that only advice given by a 'relevant provider', as defined in section 910A of the Corporations Act, would be covered by a CSLR. Relevant financial products include, for example, financial advice on investments in managed investment schemes, superannuation and banking products that are not basic banking products.

A CSLR should be designed for the future and accordingly be scalable, which means it can be expanded over time to cover other types of financial and credit services should evidence of significant problems of uncompensated losses emerge.

RECOMMENDATION 3:

DESIGN OF A CSLR (SEE CHAPTER 4)

If a CSLR is established, the following design features are recommended:

Prospective

- A CSLR should only apply to unpaid EDR determinations, court judgments and tribunal awards which are made after a CSLR is established.

Eligibility

- A CSLR should be restricted to consumers and small businesses (as defined by AFCA).

10 Section 910A of the *Corporations Act 2001* defines 'relevant financial products' as financial products other than: basic banking products; or general insurance products; or consumer credit insurance; or a combination of any of those products.

RECOMMENDATION 3 (CONTINUED):

DESIGN OF A CSLR (SEE CHAPTER 4)

Types of claims

- A CSLR should be limited to financial advice failures but scalable in the future subject to consultation and modelling.

Conditions for accessing a CSLR

- Consumers and small businesses must have a decision from AFCA, a court or a tribunal which remains unpaid after reasonable steps, as defined by a CSLR, have been taken.
- To allow consumers and small businesses to satisfy this condition, AFCA should determine a dispute and make a determination in circumstances where a financial firm is insolvent or has been expelled from AFCA.
- A CSLR should only be able to receive a claim following a court judgment or tribunal award where the circumstances giving rise to that claim would have been eligible for consideration by AFCA.

Time limits for making a claim to a CSLR

- Applications must be lodged with a CSLR by a consumer or small business within 12 months of the consumer or small business having completed specified reasonable steps to obtain compensation.
- Where an uncompensated loss arises from an unpaid EDR determination, AFCA should be required to provide certification that it has completed its processes to enforce the determination and that it does not consider that the determination will be paid, and then refer the consumer or small business to a CSLR.
- AFCA should ensure that consumers and small businesses are informed of their right to make a claim to a CSLR. This should be communicated as part of all key communications, such as when the initial determination is issued.

Functions and powers of a CSLR

- A CSLR should not independently reassess the merits of claims which it receives.
- Before paying a claim, a CSLR must be satisfied that the EDR determination, court judgment or tribunal award will not be paid by the financial firm to the consumer or small business.

The amount and types of compensation that can be paid through a CSLR

- A cap should apply to the level of compensation that a CSLR is able to provide. This compensation cap should be aligned with the compensation cap which AFCA applies.
- The compensation cap should be subject to review, from time to time, to ensure it remains fit for purpose and that a CSLR remains financially sustainable.
- A CSLR should set limits on the level and types of legal costs that are recoverable.
- A CSLR should consider issuing guidance on its treatment of compensation caps where litigation funding is involved, to ensure that access to a CSLR in matters involving private sector litigation funding does not undermine its financial sustainability.

RECOMMENDATION 3 (CONTINUED):

DESIGN OF A CSLR (SEE CHAPTER 4)

A CSLR's right to subrogation

- A CSLR should have the ability to stand in the shoes of a consumer or small business and pursue the financial firm for the compensation amount, where the firm is still in existence and a CSLR considers that it has reasonable prospects of success.

Funding of a CSLR

- A CSLR should be funded by financial firms engaged in the types of financial services covered by a CSLR (initially, specified types of financial advice).
- A CSLR should be ex-ante funded; that is, financial firms should be required to contribute to a CSLR from its outset. This ensures that those financial firms whose actions give rise to uncompensated losses are required to contribute to a CSLR.
- The Government should work with industry to develop an appropriate mechanism, such as a levy, to fund a CSLR.
- Comprehensive modelling should be undertaken to estimate the likely costs associated with a CSLR and the funding mechanism should reflect the outcome of this modelling exercise.
- The funding mechanism should be designed to minimise the volatility in funding requirements, that is, it should be designed to minimise the need for a CSLR to raise additional ad-hoc funding to meet its obligations.
- The funding mechanism should be designed in a manner that does not result in a substantial lessening of competition amongst financial firms, while ensuring that all firms providing the types of financial services covered by a CSLR make an appropriate level of contribution to a CSLR.
- A CSLR should be provided with sufficient funding to allow it to raise community awareness about its existence.

Administration of a CSLR

- Financial firms providing the types of financial services covered by a CSLR should be required to be members and contribute to the funding of a CSLR as a condition of licensing.
- A CSLR should be governed by an independent board with an independent chair and equal numbers of directors with industry and consumer backgrounds, consistent with the model in the EDR framework.
- ASIC should have oversight of a CSLR to ensure it is fulfilling its objectives, similar to the role envisaged for ASIC in respect of AFCA. This will require ASIC to have a general directions power to allow it to compel a CSLR to meet its regulatory and legislative requirements.
- A CSLR should operate independently of AFCA; however, these bodies will need to work together.

RECOMMENDATION 4:

STRENGTHENING REGULATORY REQUIREMENTS IS IMPORTANT (SEE CHAPTER 5)

- Firms that rely on PI insurance to meet their licensing obligations should be required to provide additional data to ASIC, to improve ASIC's ability to undertake market surveillance and targeted regulatory action.

TABLE OF OBSERVATIONS

LEGACY UNPAID EDR DETERMINATIONS

OBSERVATION 1:
THERE IS A STRONG CASE FOR PAYMENT OF LEGACY UNPAID EDR DETERMINATIONS (SEE CHAPTER 6)

There is a strong case for the payment of legacy unpaid EDR determinations. However, it may not be either appropriate or desirable that current industry participants be required to contribute to compensation arising from determinations against former industry participants. In these circumstances, it is, therefore, a matter for government as to whether it is able to identify a funding source to address these legacy unpaid determinations.

ACCESS TO REDRESS FOR PAST DISPUTES

OBSERVATION 2:
ACCESS TO REDRESS MUST BE DEFINED (SEE CHAPTER 7)

The Panel considers there is merit in considering providing access to redress to those consumers or small businesses that have not been able to receive a decision on a dispute through an EDR body, court or another dispute resolution mechanism for a viable claim, due to circumstances that are outside their control.

The Panel also considers that consumers and small businesses who have had access to dispute resolution before an EDR body, court or tribunal, or who have reached a legally binding settlement, have had access to redress. The Panel does not consider that there would be merit in providing further access to redress in these situations.

The Panel also notes there are substantial constitutional and other limitations to re-opening matters with final court judgments or signed deeds of settlement.

OBSERVATION 3:
THERE IS MERIT IN CONSIDERING PROVIDING ACCESS TO REDRESS FOR PAST DISPUTES IN CERTAIN CIRCUMSTANCES (SEE CHAPTER 7)

The Panel considers there is merit in considering providing access to redress in the following circumstances, where at the time of the dispute:

- the financial firm was no longer operating, having ceased trading, gone insolvent or being otherwise uncontactable or unable to pay;
- the financial firm was not a member of an EDR body, because it was either trading while unlicensed or had been expelled by an EDR body;

OBSERVATION 3 (CONTINUED):
THERE IS MERIT IN CONSIDERING PROVIDING ACCESS TO REDRESS FOR PAST DISPUTES IN CERTAIN CIRCUMSTANCES (SEE CHAPTER 7)

- the monetary value of the dispute exceeded the EDR body's monetary limits and the consumer or small business lacked the resources to access the courts, tribunals or other dispute resolution bodies; and/or
- the consumer or small business was not in a position to pursue their dispute with the EDR body due to exceptional circumstances.

The Panel does not consider that there is merit in providing access to redress for past disputes resulting from:

- losses arising from market risk and investment performance;
- losses arising from business decisions;
- allegations that the applicable law was deficient; and/or
- claims based solely on arguments about broader notions of morality rather than the requirements that apply under the law.

OBSERVATION 4:
THERE ARE COMPLEX ISSUES IN CONSIDERING PROVIDING ACCESS TO REDRESS FOR PAST DISPUTES (SEE CHAPTER 7)

There are a number of complex issues that arise in considering providing access to redress for past disputes. These include:

A need to quantify the issue

- Given the lack of comprehensive data on the number of consumers and small businesses with past disputes in the categories identified by the Panel, or the level of compensation that may be payable, an initial information gathering phase would be required before proceeding with committing to a mechanism to provide access to redress for past disputes.

Funding for redress for past disputes is the key challenge

- As a general principle the financial firm responsible for causing a loss should bear the cost of providing access to redress and compensation in the first instance but in many cases this will not be possible because the firm is insolvent or no longer operating. Where the financial firm responsible for causing the loss is no longer in operation, it may be neither appropriate nor desirable that current industry participants be required to contribute to providing access to redress for disputes that relate to former industry participants.

Mechanisms for access to redress must have clearly defined time limits

- Any mechanism for providing access to redress must clearly define time limits for past disputes that can be considered. There are significant issues and potential regulatory costs that may apply if time limits are established that go beyond the existing statute of limitations. The outer limit for the age of disputes should be no more than 10 years.

OBSERVATION 5:
OPTIONS FOR PROVIDING ACCESS TO REDRESS FOR PAST DISPUTES (SEE CHAPTER 8)

The Panel has proposed the following options for providing access to redress for past disputes. These options are not alternatives and may operate together.

The following three considerations are important in any mechanism designed to provide access to redress:

Simple and accessible

- Any mechanism providing access to redress should be simple and accessible for consumers and small businesses and provide them with the appropriate support and timeframes to proceed with their claim.

Seek to minimise costs for all stakeholders

- Any mechanism for providing access to redress should seek to minimise costs for all stakeholders, including using existing regulatory infrastructure where appropriate.

Adequate support for consumers and small businesses

- It is important that appropriate support services, such as counselling, are made available to these consumers and small business to minimise the impact of emotional distress and trauma.

GOVERNMENT-LED OPTIONS

- Government-supported legal case funding - provide financial assistance for legal expenses to eligible consumers and small businesses that have a viable legal case but have not been able to access redress through the courts (or a tribunal, where appropriate) due to a lack of funds.
- A new body to examine past disputes - establish a new independent, expert body to undertake a scoping exercise to quantify the pool of past disputes that may be eligible for access to redress. Following the quantification exercise, a decision will need to be made on how to resolve these cases.
- A government established compensation scheme for exceptional circumstances - government providing one-off, discretionary lump sum payments to consumers and small businesses that have not had access to redress for past disputes in exceptional circumstances.

INDUSTRY-LED OPTION

- An industry led forum to hear past disputes - Westpac proposed an independent expert panel being appointed to consider bank-related disputes relating to past poor financial advice or maladministration in lending which exceeded the value of the EDR body's monetary thresholds at the time the dispute arose.

OBSERVATION 6:
DESIGN PRINCIPLES FOR GOVERNMENT-LED MECHANISMS TO PROVIDE ACCESS TO REDRESS FOR PAST DISPUTES (SEE CHAPTER 8)

The Panel considers the following design principles to be relevant for government-led mechanisms to provide access to redress for past disputes:

Operate independently

The decision making function of any mechanism to provide access to redress for past disputes should be independent of AFCA.

Financial hardship should be taken into consideration

- Any funding that may be available to provide access to redress is likely to be limited. Therefore, careful consideration should be given to mechanisms for targeting available funds to those in greatest need. It would be appropriate, in this context, to take into account whether a claimant is in severe financial hardship:
  - Financial hardship should be taken into consideration in determining eligibility and/or priority in providing access to redress for past disputes.
  - Financial hardship should be taken into account when developing mechanisms to allocate available funds to those in greatest need.

Compensation caps may be necessary (not applicable to legal case funding)

Capping compensation consistent with compensation caps under the EDR framework is appropriate. However, funding constraints may require a lower compensation cap.

CHAPTER 1: CONTEXT FOR THE REVIEW AND REVIEW PRINCIPLES

1.1 The Terms of Reference require the Panel to review the existing dispute resolution and complaints arrangements in the financial system to consider whether changes are necessary to deliver effective outcomes for users in a rapidly changing and dynamic financial system.

1.2 This Report marks the second and final report of the review of the Australian financial system's external dispute resolution (EDR) framework. This Report should be read in conjunction with the Panel's earlier Report: *Review of the financial system external dispute resolution and complaints framework provided to the Government* in April 2017 (April 2017 Report).[1]

1.3 In its April 2017 Report, the Panel made 11 recommendations representing an integrated package of reforms to ensure that the EDR framework is well placed to address current problems and ensure that it is designed to withstand challenges of a rapidly changing financial system.

1.4 On 9 May 2017, the Government accepted all 11 recommendations announcing that it would introduce legislation to establish the Australian Financial Complaints Authority (AFCA) as a 'one stop shop' for financial disputes.

1.5 The Panel's view is that implementation of these recommendations will allow more people to have their disputes decided and provide access to higher compensation for financial loss.

1.6 In this Report, consistent with its Terms of Reference, the Panel:

- makes recommendations on the establishment, merits and potential design of a compensation scheme of last resort (CSLR); and
- considers the merits and issues involved in providing access to redress for past disputes.

1.7 This involves looking to the future to ensure consumers and small businesses can have confidence they will receive compensation where it is awarded by the Australian Financial Complaints Authority (AFCA), and to the past, to examine options for assisting consumers and small businesses that have not had access to redress.

1.8 The financial system plays a vital role in raising the living standards of all Australians, with its ultimate purpose being to facilitate sustainable economic growth by meeting the financial needs of its users.

1 Commonwealth of Australia 2017, *Review of the financial system external dispute resolution and complaints framework*: *Final Report*.

1.9 Its position in the economy and the lives of Australians has grown significantly in recent years. For individuals to participate in the modern economy, they are now expected to be able to make decisions about purchasing financial products and services, for example, services provided by financial advisers. This requirement will only increase as the superannuation system matures and individuals accumulate larger savings balances.[2]

1.10 However, these decisions can be particularly challenging for individuals given:

- many financial products are inherently complex and represent a form of 'credence good', where the performance and quality of the good is not apparent even after purchase;[3]
- their decision-making may be impacted by behavioural biases, they may have relatively low financial literacy and they are often confronted with complex documents and products;[4] and
- the potential for agency risks, for example, where a trusted party fails to act in the principal's best interest.[5]

1.11 The consequences of these challenges have been illustrated in recent years through many financial collapses, with a common theme in a number of these being poor financial advice.

1.12 The Panel has heard from a range of stakeholders about the significant financial and emotional impacts which result from these financial collapses.

1.13 The experiences presented to the Panel are further reflected in research undertaken by the Australian Securities and Investments Commission (ASIC) on the social impact of monetary loss. This research has highlighted the impact of losses on investors, including that some had:

- lost their homes and were living in caravans and motor vehicles;
- been seriously ill, either through a new illness or the aggravation of an existing one due to stress;
- gone without food, and heating or cooling; and
- been too ashamed to tell anyone of their plight and had isolated themselves from family and friends.[6]

2 Productivity Commission 2015, *Superannuation Policy for Post-Retirement Research Paper*, page 27.
3 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 4.
4 Australian Government 2017, *Review of the financial system external dispute resolution and complaints framework: Final Report*, page 20.
5 Australian Government 2004, *Study of financial system guarantees* (Davis Review), page 23.
6 Australian Securities and Investments Commission 2011, *Report 240 Compensation for retail investors: the social impact of monetary loss*, page 10.

BOX 1: EXAMPLES OF RECENT FINANCIAL COLLAPSES

Entity	Description
Australian Property Custodian Holdings Ltd (APCHL) and Prime Retirement and Aged Care Property Trust	APCHL was the responsible entity of the Prime Retirement and Aged Care Property Trust (Prime Trust), a managed investment scheme that owned retirement villages in Queensland, New South Wales and Victoria; 9700 investors (predominantly retail) invested over $500 million in Prime Trust. It is estimated that unsecured creditors of Prime Trust were owed $23 million and secured creditors were owed $207 million.[7]
Timbercorp	Timbercorp Securities Ltd (TSL) was an Australian financial services licensee and the responsible entity of 33 registered managed investment schemes. The Timbercorp Group raised more than $2 billion from 18,500 investors since 1992 for investment in agribusiness projects.[8]
Great Southern	The Great Southern Group was a Perth based agri-business. Great Southern Limited (GSL), the parent company, was listed on the Australian Securities Exchange. Through its wholly owned subsidiary, Great Southern Managers Australia Ltd (GSMAL), it established, sold and managed approximately 43 agricultural managed investment schemes (MIS). Finance for the MIS was offered to investors via another wholly owned subsidiary, Great Southern Finance (GSF). According to the liquidator, the Great Southern Group had about 52,000 investors who contributed about $2.2 billion. Further, the group raised over $260 million in equity from shareholders, obtained over $200 million in unsecured convertible notes and raised over $600 million in secured funding.[9]
Trio Capital	Trio was a superannuation fund trustee and licensed responsible entity for 17 active managed investment schemes, including the Astarra (ASF) and ARP Growth (ARP) funds, which included investments in a number of overseas vehicles. Trio funds were promoted by a number of advisers to their clients. The following losses were associated with Trio funds: • $125 million: alleged misappropriation of ASF and Trio superannuation and other retail client money, with 6,048 investors; and • $69.5 million: assets of ARP Growth Fund, which had 79 investors (mostly SMSF investors).[10]

7 Australian Securities and Investments Commission 2014, *Submission to the Financial System Inquiry*, page 189 (Table 24: Major Collapses – Recent ASIC outcomes).

8 Australian Securities and Investments Commission, viewed 27 August, <**http://www.asic.gov.au/about-asic/media-centre/key-matters/information-for-timbercorp-growers**>.

9 Australian Securities and Investments Commission, viewed 27 August, <**http://www.asic.gov.au/about-asic/media-centre/key-matters/information-for-great-southern-growers**>.

10 Australian Securities and Investments Commission 2014, *Submission to the Financial System Inquiry*, page 189 (Table 24: Major Collapses – Recent ASIC outcomes).

BOX 1: EXAMPLES OF RECENT FINANCIAL COLLAPSES

Entity	Description
Storm Financial	Storm Financial provided financial services to clients across Australia, including operating a number of investment schemes for its customers. There are 2,780 investors or investor groups who ASIC assessed as having suffered loss. The estimated amount of loss was approximately $830 million.[11]
Westpoint	Westpoint was a property investment scheme. Intercompany loans were made between mezzanine companies and development companies which were guaranteed by Westpoint Corporation P/L. Unsecured investments procured by financial advisers were made on top of bank loans exposing investors to significant losses. The investors in Westpoint-related financial products had a total capital invested of $388 million outstanding as at January 2006 when the Group collapsed.[12]

1.14 While the impact of losses on consumers and small businesses can often be significant, the quantum of losses should be viewed in the context of the dispute resolution framework as a whole. For example, only a very small percentage of all Financial Ombudsman Service (FOS) members have been involved with uncompensated losses (FOS currently has over 13,500 members), and these unpaid determinations represent a small proportion of all FOS determinations that are in favour of and accepted by consumers (approximately 2.5 per cent).

1.15 It is, therefore, important to recognise that the majority of financial firms comply with their legal obligations and compensate their customers when required.

1.16 Nevertheless, the Panel also recognises that while uncompensated losses represent a very small proportion of total EDR determinations the impact on consumers and small businesses can be significant and can erode confidence in dispute resolution processes and the financial system more broadly.

1.17 The Panel's consideration of a CSLR looks to the future of the EDR framework. However, in line with the Terms of Reference, the Panel also assesses the merits and issues involved in providing access to redress for past disputes.

1.18 In its April 2017 Report, the Panel noted that access to redress is critical. If consumers and small businesses are unable to access redress, this can lead to severe financial hardship and, more broadly, subsequent loss of trust and confidence in the EDR framework and the financial system.

11 Australian Securities and Investments Commission, 2014, *Submission to the Financial System Inquiry*, page 189 (Table 24: Major Collapses – Recent ASIC outcomes).

12 Australian Securities and Investments Commission, viewed 27 August, <**http://www.asic.gov.au/about-asic/media-centre/key-matters/westpoint**>.

THE PANEL'S APPROACH

1.19 In undertaking its Review, as required by its Terms of Reference, the Panel has had regard to the Review Principles, set out below.

PRINCIPLES GUIDING THE REVIEW

EFFICIENCY

Any framework should provide outcomes in an efficient manner. This requires ensuring the framework possesses adequate coverage, powers, remedies, resources (that is, funding and skilled staff) to enable issues to be resolved quickly and with a minimum of resources.

EQUITY

Individuals should be treated fairly and be able to easily access any framework.

COMPLEXITY

Any framework should have minimal complexity. It must be easy to navigate and use, with a focus on informality.

TRANSPARENCY

Any framework should be transparent and open. Users should have access to appropriately tailored information, including about what outcomes they can reasonably expect from the process.

ACCOUNTABILITY

Relevant information should be made publicly available. There should also be scope for periodic independent reviews and responses to these reviews.

COMPARABILITY OF OUTCOMES

Any framework should ensure that individuals receive comparable outcomes, both procedurally and substantively.

REGULATORY COSTS

The regulatory settings should, as appropriate, utilise market forces and avoid creating moral hazards. The framework should impose the minimum amount of regulatory costs necessary to ensure effective user outcomes. These costs should, where appropriate, be borne by those who create the requirement for regulation, with incentives for costs to be minimised.

1.20 In applying the Review Principles, it is important to recognise that there will often be trade-offs in their implementation. For example, providing consumers and small businesses with additional mechanisms to access redress and receive compensation (which goes to equity) may increase costs in the system (regulatory costs) for financial firms. This is not an insubstantial consideration given the importance of ensuring there are sufficient firms to allow consumers to enjoy the benefits of competition.

1.21 The Panel considers that it is important to emphasise that its recommendations and discussion sit within a broader framework underpinned by fundamental principles, including that:

- consumers must bear responsibility for their financial decisions, including the losses associated with 'market risk',[13] but should be able to expect financial products and services to perform in the way they are led to believe;
- the EDR framework sits within a wider legal system that is underpinned by the rule of law, which, relevantly, prohibits arbitrary amendments to parties' legal rights; and
- the EDR framework is the primary mechanism for dispute resolution for consumers and small businesses and is intended to provide an efficient alternative to the courts, whereas larger disputes are more appropriately adjudicated by the courts.

1.22 The issues being considered by the Panel in this Report are complex and challenging, and many have been considered on a number of occasions in different forums. These have informed the Panel's deliberations and recommendations, and the Panel has given careful consideration to them. These include:

- the Parliamentary Joint Committee on Corporations and Financial Services Report, *Inquiry into financial products and services in Australia* (November 2009);
- Mr Richard St. John's Report, Compensation arrangements for consumers of financial services (April 2012);
- the Senate Economics References Committee Report, *Agribusiness managed investment schemes: Bitter harvest* (March 2016);
- the Parliamentary Joint Committee on Corporations and Financial Services Report, *Impairment of customer loans* (May 2016); and
- the Australian Small Business and Family Enterprise Ombudsman Report, *Inquiry into small business loans* (December 2016).

1.23 The Panel has also had regard to approaches internationally, in particular, the United Kingdom.

13 Market risk involves investors having exposure to fluctuations in the market value of financial assets or fluctuations in the earnings from those assets: see Australian Government 2004, *Study of financial system guarantees* (Davis Review), page 22.

STRUCTURE OF THE REPORT

1.24 The Report is structured in three parts:

- in Part 1, the Panel assesses and makes its recommendations on the establishment, merits and potential design of a CSLR;
- in Part 2, the Panel discusses and makes observations on legacy unpaid EDR determinations; and
- in Part 3, the Panel reviews the merits and issues and makes observations on providing access to redress for past disputes.

PART 1: A COMPENSATION SCHEME OF LAST RESORT

OVERVIEW OF PART 1

1. The Review's original Terms of Reference required the Panel to make observations, but not recommendations, on the establishment of a statutory compensation scheme of last resort (CSLR).

2. Consistent with these Terms of Reference, in its Interim Report 6 December 2016, the Panel observed that it was of the view that there was considerable merit in introducing an industry-funded CSLR.[1]

3. On 2 February 2017, the Minister for Revenue and Financial Services amended the Review's Terms of Reference to require the Panel to provide recommendations on the establishment, merits and potential design of a CSLR.

4. In Part 1 of this Report, the Panel assesses and makes its recommendations on the establishment, merits and potential design of a CSLR.

    - Chapter 2 provides a brief overview of the current regulatory framework which requires financial firms to have compensation arrangements and the Panel's analysis of whether strengthening these arrangements can prevent future uncompensated losses. It then provides an overview of the scale and impact of uncompensated losses, through reviewing existing legacy unpaid EDR determinations and outlining the circumstances that have resulted in these uncompensated losses.

    - Chapter 3 includes stakeholder submissions and the Panel's assessment of the merits of establishing a CSLR, with the Panel recommending the establishment of a limited and carefully targeted CSLR.

    - Chapter 4 outlines the Panel's recommendations on the potential design features of a CSLR.

    - Chapter 5 includes stakeholder submissions and the Panel's analysis on strengthening other parts of the regulatory framework, including the role of ASIC.

1 Commonwealth of Australia, *Review of the financial system external dispute resolution and complaints framework: Interim Report*, page 168.

CHAPTER 2: DEFINING THE PROBLEM

KEY POINTS

- The Corporations Act and the National Consumer Credit Protection Act impose an obligation on licensees to have arrangements for providing compensation where certain specified losses occur. As a result, consumers and small businesses have a reasonable expectation that they will receive compensation in these circumstances.
- There is clear evidence that current arrangements are failing to meet this expectation, with some consumers and small businesses not receiving compensation that has been awarded by an EDR body.
- Effective regulatory settings must exist to ensure that, to the maximum extent possible, financial firms can comply with any decision which requires them to provide compensation to a consumer or small business.
- Improvements to current arrangements, such as changes to professional indemnity insurance, financial resources requirements and the ability of the Australian Securities and Investments Commission to take enforcement action in light of unpaid EDR determinations will not solve the problem of uncompensated losses.

WHY CONSIDER A CSLR

2.1. The *Corporations Act 2001* (Corporations Act) and the *National Consumer Credit Protection Act 2009* (National Consumer Credit Protection Act) impose an obligation on licensees to have arrangements for providing compensation where certain losses are suffered.

2.2. As a result, where a consumer or small business suffers a recognised financial loss, they can seek compensation from the relevant financial firm.

2.3. In addition, targeted compensation schemes exist in some parts of the financial system. These schemes, which are considered in further detail in Appendix 2, cover losses associated with:

- market participants of the Australian Securities Exchange becoming insolvent and failing to meet their obligations to a person who had previously entrusted property to them;
- bank deposits and general insurance policies related to an Australian Prudential Regulation Authority (APRA) regulated entity in the event of insolvency; and
- fraudulent conduct or theft related to APRA-regulated superannuation funds.

2.4. There is, however, clear evidence that the current arrangements are failing to meet consumer and small business expectations concerning the compensation they will receive, with some consumers and small businesses experiencing uncompensated losses, that is, not receiving compensation that has been awarded by an EDR body.

2.5. It is the existence of these uncompensated losses that raises the need to consider whether a CSLR is necessary.

2.6. A number of industry stakeholders have commented that the issue of uncompensated losses is most appropriately addressed through improvements to the current regulatory arrangements, such as changes to professional indemnity insurance (PI insurance) and financial resource requirements, rather than a CSLR.

2.7. This Chapter provides a brief overview of the current regulatory arrangements and the Panel's analysis of whether strengthening these arrangements can sufficiently close the gap in the system that results in some consumers and small businesses experiencing uncompensated losses.

2.8. This was an area where a number of stakeholders provided views to the Panel. Stakeholder submissions on the appropriateness of existing regulatory arrangements and the Panel's analysis are considered more fully in Chapter 5.

2.9. This Chapter then examines the potential scale and impact of uncompensated losses, through reviewing data on existing legacy unpaid EDR determinations and outlining the circumstances that have resulted in compensation not being paid on these matters.

2.10. This analysis forms the basis of the Panel's discussion of the merits of a CSLR which follows in Chapter 3.

REGULATORY REQUIREMENT TO HAVE ARRANGEMENTS FOR PROVIDING COMPENSATION

2.11. The Corporations Act requires that if a financial services licensee provides a financial service to a person as a retail client, the licensee must have arrangements for compensating the person for loss or damage suffered because of breaches of the relevant obligations under Chapter 7 of the Corporations Act by the licensee or its representatives.[1]

2.12. Financial services cover a range of activities including:

- providing financial product advice;
- dealing in, or making a market for, a financial product;

1 Section 912B of the *Corporations Act 2001*. The obligation extends to all financial services covered by chapter 7 and losses caused by negligent, fraudulent or dishonest conduct that amounts to a breach of that chapter: see Australian Securities and Investments Commission, *Regulatory Guide 126: Compensation and insurance arrangements for AFS licensees*, page 14.

- providing custodial or depository services; and
- operating a registered managed investment scheme.[2]

2.13. Similarly, the National Consumer Credit Protection Act provides that a licensee must have adequate arrangements for compensating persons for loss or damage suffered because of a contravention of the Act by the licensee or its representatives.[3]

2.14. The *Corporations Regulations 2001* (Corporations Regulations) and the *National Consumer Credit Protection Regulations 2010* (NCCP Regulations) establish that the key regulatory requirement to ensure that financial firms have access to sufficient financial resources to pay compensation is the obligation to hold adequate PI insurance.[4]

2.15. Some licensees are exempt from this requirement. They include:

- a general insurance company regulated by APRA under the *Insurance Act 1973*;
- a life insurance company regulated by APRA under the *Life Insurance Act 1995*; and
- an authorised deposit-taking institution regulated by APRA under the *Banking Act 1959*.[5]

2.16. This exemption reflects that these firms are subject to APRA's prudential supervision framework and therefore subject to robust capital adequacy requirements.

2.17. The objective of these compensation arrangements has been stated as ensuring that retail consumers of financial services have appropriate remedies so that they maintain confidence in the market for financial services and continue to participate in it.[6]

2.18. The Australian Securities and Investments Commission (ASIC) oversees the PI insurance requirements in order to reduce the risk that retail clients go uncompensated where a licensee has insufficient financial resources to meet claims by retail clients.[7]

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2 See section 766A of the *Corporations Act 2001*. Section 9 of the *Corporations Act 2001* defines a managed investment scheme as a scheme with the following features: people contribute money or money's worth as consideration to acquire rights (interests) to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether they are enforceable or not; any of the contributions are to be pooled (trust based arrangement), or used in a common enterprise (contract based arrangement), to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the members) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders); and the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions).

3 Section 48 of the *National Consumer Credit Protection Act 2009*.

4 Regulation 7.6.02AAA(1) of the *Corporations Regulations 2001*; regulation 12 of the *National Consumer Credit Protection Regulations 2010*.

5 Regulation 7.6.02AAA(3) of the *Corporations Regulations 2001*.

6 Commonwealth of Australia 2002, *Compensation for loss in the financial services sector: Issues and options*, page 20, viewed 10 August, <**http://archive.treasury.gov.au/contentitem.asp?ContentID=402**>.

7 Australian Securities and Investments Commission, *Regulatory Guide 126: Compensation and insurance arrangements for AFS licensees*, pages 9-10.

2.19. In addition to PI insurance, financial firms are required to have appropriate financial resources to carry out their activities and are subject to other licensing conditions. These are discussed further in Chapter 5.

PROFESSIONAL INDEMNITY INSURANCE AS A COMPENSATION MECHANISM

2.20. In *Regulatory Guide 126: Compensation and insurance arrangements for AFS licensees*, ASIC notes:

> *"PI insurance is not designed to protect consumers directly and is not a guarantee that compensation will be paid. It is designed to protect the insured (that is, the licensee) against the risk of financial losses arising from poor quality services (for example, poor advice or execution of services) and other misconduct by a financial services provider (for example, fraud by its representatives)."*[8]

2.21. The Insurance Council of Australia commented in its submission that while it may appear to some consumers and small businesses that professional indemnity insurance is intended as a compensation mechanism for them, it is in fact designed for the benefit of the insured, that is, the financial firms themselves.[9]

2.22. The link to compensation for consumers arises from the idea that if a firm has access to an appropriate level of cover through PI insurance, then it will have the necessary financial resources required to pay EDR determinations. This proposition was contested in submissions to the Review.

2.23. A number of submissions identified factors explaining why PI insurance may not result in consumers receiving compensation from the financial firm, including that:

- the total funds available under the insurance contract may not cover the full award of compensation;[10]
- the insurance contract may not cover the conduct which is the subject of the award of compensation;[11]
- the amount of compensation awarded may be below the excess under the insurance policy;[12]

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8 Australian Securities and Investments Commission, *Regulatory Guide 126: Compensation and insurance arrangements for AFS licensees*, page 5.

9 Insurance Council of Australia, submission to the EDR Review Supplementary Issues Paper, page 3; Australian Securities and Investments Commission 2015, *Report 459: Professional indemnity insurance market for AFS licensees providing financial product advice*, pages 14-15.

10 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 3; Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 4.

11 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 3; Credit and Investments Ombudsman, submission to the EDR Review Supplementary Issues Paper, page 2. Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 3; Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 4.

12 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 3; Credit and Investments Ombudsman, submission to the EDR Review Supplementary Issues Paper, page 2.

- PI insurance policy premiums can be expensive for business and may lead to some businesses self-insuring;[13]
- complainants cannot make a claim directly on a financial firm's PI insurance policy, receive no information about why a firm's claim might be refused and have no standing to challenge that refusal;[14] and
- claims about a financial service might be made several years after the service is provided and a firm's policy may have expired by then in circumstances where 'run-off' cover was unavailable or prohibitively expensive.[15]

Panel analysis

2.24. As highlighted by ASIC and a range of other stakeholders, PI insurance exists for the benefit of the financial firm. Consumers and small businesses do not have direct recourse to payments made by the insurer to the financial firm under the insurance policy.

2.25. There are a range of additional challenges to relying on PI insurance to ensure that consumers and small businesses are able to receive compensation awarded. This includes the requirement to pay an excess on each claim made by the financial firm on its PI insurance policy and the potential misalignment between the types of claims covered by a PI insurance policy and the conduct that is subject to a decision of an EDR body, court or tribunal.

2.26. Therefore, the Panel is firmly of the view that while it is important to have an appropriate and effective PI insurance regime, no level of improvement to that regime will solve the problem of uncompensated losses.

2.27. Despite this, as a matter of general principle, effective regulatory settings must exist to ensure that, to the maximum extent possible, financial firms can comply with any decision which requires them to provide compensation to a consumer or small business.

2.28. Accordingly in Chapter 5, the Panel considers stakeholder views on the appropriateness of the existing regulatory arrangements applying to PI insurance and identifies opportunities to improve these arrangements.

13 Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 3; Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 4.

14 Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, pages 5-6.

15 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 8, citing Commonwealth of Australia (Richard St. John Report) 2012, *Compensation arrangements for consumers of financial services*, page 31.

UNCOMPENSATED LOSSES

2.29. Uncompensated losses arise where consumers and small businesses have been awarded compensation by an EDR body, court or tribunal, but due to, for example the inability of the financial firm to pay, they do not receive that compensation. That is, they arise in those cases where the existing framework for compensating losses proves ineffective.

2.30. While uncompensated losses arise in a very small proportion of financial disputes, their impact on consumers and small businesses can be significant.

Circumstances which lead to uncompensated losses

2.31. There are different circumstances which can lead to uncompensated losses. For example, FOS stated these include where a determination is made:

- in favour of the consumer, but it causes the financial firm to become insolvent;
- after the financial firm became insolvent; and/or
- in favour of a consumer, but the financial firm is unable or unwilling to make payment, and the financial firm has not entered into administration or liquidation.[16]

2.32. FOS takes a number of steps where its determinations remain unpaid while the firm is solvent. However, FOS notes that in many of these cases, the firm is showing signs of not being able to pay compensation, which suggests either the firm is in the process of entering insolvency or that it has significant cash flow issues.

2.33. FOS has pursued a number of financial firms through the courts for non-compliance with a FOS determination.[17] These unpaid determinations, therefore, are not a reflection of FOS's powers, or its capacity or willingness to enforce its determinations.

2.34. Similar circumstances can also exist where a consumer or small business pursues their claim through a court or tribunal.

Quantum of past uncompensated losses

2.35. Under the existing EDR framework, there are situations where an EDR body makes a determination requiring a financial firm to pay compensation to a consumer or small business, but that compensation is not paid.

2.36. As at 30 June 2017, $14,146,094 (excluding interest) and $399,862 (excluding interest) in determinations made in favour of complainants by FOS and the Credit and Investments Ombudsman (CIO), respectively, had not been paid.

16 Financial Ombudsman Service May 2017, supplementary information provided to the EDR Review Panel.
17 Financial Ombudsman Service August 2017, supplementary information provided to the EDR Review Panel.

2.37. The difference in unpaid determinations between FOS and CIO can largely be explained by the significantly higher volume of disputes received by FOS (34,095 disputes in 2015-16, representing 83 per cent of all EDR disputes in total) compared to CIO (4,760 disputes in 2015-16, representing 12 per cent of all EDR disputes in total).

2.38. According to information provided by FOS, its unpaid determinations can be broken down as follows:

- 154 determinations which involve 39 financial firms who are unable or unwilling to comply affecting 218 consumers;
- in 116 of these determinations, the consumer received no payment; and
- of the remaining 38 determinations, partial payment to consumers was usually the proceeds of insolvency proceedings and represented a minimal return on the dollar.[18]

2.39. Uncompensated losses also arise from situations where consumers have received court judgments or tribunal awards, and similarly the compensation is not paid. However, unlike the uncompensated losses within the EDR framework, there are no accessible data sources that enable the quantum of these losses to be estimated.

2.40. Additionally, there are a range of circumstances where individuals have not been able to have their case heard by an EDR body, court or tribunal and, therefore, have not been awarded compensation. If these cases had been heard, it is likely that the level of uncompensated losses would be higher.

2.41. FOS, in information provided to the Panel, identified three particular types of circumstances where this has occurred within the EDR framework:

- the financial firm is insolvent – FOS may determine that a dispute falls outside of its terms of reference due to the firm being insolvent; FOS has confirmed that, since 2010, approximately 206 disputes have been excluded due to the firm going into liquidation;
- the consumer discontinues the dispute – a consumer may decide to discontinue a dispute at FOS due to the firm becoming insolvent and the consumer believing that there is little prospect of obtaining redress; FOS has confirmed that 83 disputes have been discontinued by consumers at FOS due to an insolvent financial firm;[19] and

18 Financial Ombudsman Service, *Circular* Issue 30, viewed 30 August, <**http://www.fos.org.au/fos-circular-30-home/fos-news/unpaid-determinations-update.jsp**>.

19 The Financial Ombudsman Service advised that the reason for discontinuance of a dispute by a consumer was not always provided and therefore it was not possible to quantify the exact number of disputes discontinued by consumers and subsequently closed after the related financial firm had gone into liquidation or administration.

- the consumer does not lodge a dispute – a consumer may never lodge a dispute with FOS because they believe there is little prospect of receiving redress, for example, due to the financial firm's insolvency.

2.42. Alternatively, a consumer or small business may have had their case heard by a court or tribunal, or reached a settlement, but only received a portion of the compensation to which they were entitled.[20]

2.43. While the impact of these losses on consumers and small businesses will often be devastating, the quantum of losses should be viewed in the context of the dispute resolution framework as a whole. For example, only a very small percentage of all FOS members are involved with unpaid determinations (FOS currently has over 13,500 members), and these unpaid determinations represent a small proportion of all FOS determinations that are in favour of and accepted by consumers (approximately 2.5 per cent).

Uncompensated losses are mostly in the financial advice sector

2.44. The types of financial firms that are responsible for unpaid EDR determinations are spread unevenly across the different sectors of the financial services industry. The three leading categories of non-compliant financial firms at FOS are:

- financial planners and advisers (51 per cent);
- operators of managed investment schemes (13 per cent); and
- credit providers (10 per cent).

2.45. While these figures reflect the percentage of unpaid determinations by *type* of financial firm, in terms of the *value* of unpaid determinations, financial planners and advisers account for approximately 92 per cent of unpaid FOS determinations.

Impact of uncompensated losses

2.46. As identified in Chapter 1, the social impact of losses on consumers and small businesses can be devastating. The impact of these losses is not simply confined to the relevant individuals, although they experience the most significant impacts, but can also be transmitted through other parts of society and the economy. For example:

- costs may be imposed on the wider Australian community as individuals are forced to rely on other forms of support, including the social security system; and
- there is an undermining of trust and confidence in the dispute resolution framework and the financial services sector more generally.[21]

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20 Michael Legg, *A Comparison of Regulatory Enforcement, Class Actions and Alternative Dispute Resolution in Compensating Financial Consumers* [2016] SydLawRw 15; (2016) 38(3) Sydney Law Review 311.

21 Australian Securities and Investments Commission 2011, *Report 240: Compensation for retail investors: the social impact of monetary loss.*

CHAPTER 3: MERITS OF A COMPENSATION SCHEME OF LAST RESORT

KEY POINTS

- A limited and carefully targeted CSLR should be introduced for future unpaid compensation in parts of the financial services sector where there is evidence of a significant problem of compensation not being paid.
- A CSLR will:
  - ensure consumers and small businesses who have an EDR determination will receive compensation, consistent with the objectives of the current regulatory framework;
  - promote trust and confidence in the EDR framework and the financial services sector more broadly;
  - help to minimise the negative mental and physical health consequences of unpaid EDR determinations; and
  - reduce the costs imposed on Australian taxpayers where a consumer or small business is forced to rely on government support after they have lost their savings.
- Whilst a number of stakeholders raised concerns that the presence of a CSLR could result in moral hazard as participants in the financial system change their behaviour in response to a CSLR, the evidence presented to the Review did not substantiate this. Additionally, such problems if they do arise can be addressed through a carefully designed CSLR.
- A CSLR should act as the final safety net to ensure consumers and small businesses are able to receive compensation after all other avenues have been exhausted.

3.1. Chapter 2 outlined the circumstances which have resulted in uncompensated losses and the significant impact that such losses can have on consumers and small businesses.

3.2. In this Chapter, consistent with the Review's Terms of Reference, the Panel assesses the merit of a CSLR and recommends that a limited and carefully targeted CSLR be established.

3.3. The Panel's Supplementary Issues Paper sought comments on the merits of establishing a CSLR.

3.4. In response, stakeholders provided the Panel with a range of views on the merits of a CSLR and advanced a variety of reasons in support of those positions. These are set out below, along with the Panel's analysis.

ARGUMENTS MADE IN SUPPORT OF A CSLR

Stakeholder submissions

3.5. Stakeholders who supported the merits of a CSLR and recommended that one be established provided a number of reasons in support of their position.

Ensuring consumers and small business receive compensation

3.6. The Joint Consumer Group and Legal Aid NSW submitted that a key benefit of a CSLR would be to ensure that consumers and small businesses who suffered loss due to misconduct by financial firms were compensated.[1]

3.7. Similarly, FOS stated that a CSLR would meet the expectations of consumers and small businesses about the level of compensation they might receive, even in cases of insolvency.[2]

3.8. ASIC observed that the EDR framework possessed a significant structural gap in that there was no mechanism to ensure consumers received compensation where the licensee lacked the financial resources to pay a determination.[3]

Trust and confidence in the financial system

3.9. A number of stakeholders submitted that a CSLR would improve trust and confidence in financial firms, the dispute resolution framework and the financial system more generally.

3.10. The Australian Bankers' Association submitted that its advocacy for a CSLR was part of its support for the overall reform program to improve the quality of financial advice and rebuild trust and confidence in financial advisers. Through these reforms, trust and confidence should also be improved in the financial services industry more generally.[4]

3.11. ANZ said that a CSLR, which was limited to personal financial advice failures, would improve consumer confidence in the financial advice sector. It was also appropriate given the significant regulatory reform that has improved the quality of personal advice concerning more complex products.[5]

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1 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 4; Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 6.

2 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 17.

3 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 5.

4 Australian Bankers' Association, submission to the EDR Review Interim Report, page 16; see also Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 4.

5 ANZ, submission to the EDR Review Supplementary Issues Paper, page 1.

3.12. Legal Aid Queensland submitted that a CSLR was likely to increase consumer confidence in the financial services industry. This increased confidence would likely see consumers engage more with the industry and its participants, and this may lead to consumers making better financial decisions by choosing firms that are expert in financial matters.[6]

3.13. In relation to the dispute resolution framework, FOS submitted that the lack of a compensation mechanism and the continued problem of unpaid determinations directly undermined the effectiveness of the current EDR arrangements.[7] The Joint Consumer Group submitted that trust and confidence was damaged where the consumer had spent considerable time and energy pursuing a meritorious complaint through an EDR body - or worse, through the expensive court process - only to be left uncompensated.[8]

3.14. Both Legal Aid NSW and ASIC argued that a CSLR would help to restore public trust in dispute resolution and in the financial system more generally.[9]

Reducing costs on the community

3.15. A number of stakeholders argued that a CSLR would avoid a number of the costs associated with uncompensated losses.[10]

3.16. The Joint Consumer Group stated that a CSLR would avoid the economic, social and health costs of uncompensated losses.[11] ASIC and Legal Aid NSW also submitted that it would reduce the costs that are imposed on the wider Australian community. For example, individuals affected by uncompensated losses are often forced to rely on other forms of financial support, including the social security system.[12]

Other reasons in support of a CSLR

3.17. Other reasons put forward by stakeholders in support of a CSLR included:

- the limitations of PI insurance as a compensation mechanism;[13] and
- that the establishment of an industry funded CSLR would create incentives for more responsible and better resourced firms to monitor other firms' behaviour and alert regulators or a CSLR to any risks.[14]

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6 Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 4.
7 Financial Ombudsman Service, submission to the EDR Review Issues Paper, page 52.
8 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 5.
9 Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 6; Australian Securities and Investment Commission, submission to the EDR Review Supplementary Issues Paper, page 5.
10 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 1; Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 6.
11 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 4.
12 Australian Securities and Investment Commission, submission to the EDR Review Supplementary Issues Paper, page 5; Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 6.
13 Credit and Investments Ombudsman, submission to the EDR Review Supplementary Issues Paper, page 2.
14 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 4.

CONCERNS ABOUT ESTABLISHING A CSLR

Stakeholder submissions

3.18. The Panel also received a range of submissions from stakeholders who did not support a CSLR being established to deal with uncompensated losses within the financial services industry. A number of reasons were put forward for why a CSLR should not be established, or at least not established until other reforms to strengthen the compensation arrangements framework had been implemented.

Moral hazard

3.19. Moral hazard exists when people take risks because they know that someone else is protecting them against a financial loss.[15] Some stakeholders submitted that a CSLR could result in moral hazard as parties would change their behaviour in response to a CSLR.[16]

3.20. A number of examples of these behaviours were put forward by stakeholders and are set out in the following table.

Relevant actor	Behavioural change in response to a CSLR
Financial Firm	Smaller, less-capitalised financial firms could adopt less risk-averse approaches and behaviours in the expectation that if something goes wrong, a CSLR will compensate the client.[17]
	A financial firm in financial difficulty might worry less about trying to salvage its position if it knows that its customers will not be left entirely out-of-pocket.[18]
	A CSLR could reduce the incentive for compliance with existing compensation arrangements.[19]
Consumers	Consumers could become complacent about the fundamental risks of dealing in the market, which could incentivise riskier behaviour.[20]
	A consumer might be less diligent in checking compliance history or financial standing before choosing a financial firm.[21]
	An aggrieved customer may not pursue a defaulting financial firm as aggressively as they would otherwise.[22]

15 Commonwealth of Australia 2004, *Study of Financial System Guarantees* (Davis Review), page 41.
16 AMP, submission to the EDR Review Supplementary Issues Paper, page 1; Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 6.
17 Financial Services Council, submission to the EDR Review Supplementary Issues Paper, page 3.
18 Financial Services Council, submission to the EDR Review Interim Report attaching a note prepared by Professor Pamela Hanrahan, page 9.
19 Insurance Council of Australia, submission to the EDR Review Supplementary Issues Paper, page 4.
20 Insurance Council of Australia, submission to the EDR Review Supplementary Issues Paper, page 4.
21 Financial Services Council, submission to the EDR Review Interim Report attaching a note prepared by Professor Pamela Hanrahan, page 9.
22 Financial Services Council, submission to the EDR Review Interim Report attaching a note prepared by Professor Pamela Hanrahan, page 9.

Relevant actor	Behavioural change in response to a CSLR
Decision-makers	A decision-maker might be more inclined to award compensation to a customer knowing that a 'deep pocket' was available to cover the loss.[23]
ASIC	ASIC may decide to set lower thresholds or be less rigorous in enforcing financial firms' statutory obligations in relation to their compensation arrangements.[24]

3.21. The Panel considers the issue of moral hazard below at paragraphs 3.47-3.53.

Increased costs in the system for firms already complying with extensive obligations

3.22. A number of stakeholders submitted that the cost burden of a CSLR would be imposed on firms who held adequate PI insurance and financial resources, and had compensated their clients where that was required.[25]

3.23. The Financial Planning Association of Australia said that a CSLR would have significant implications for the cost of running a financial advice business, which would come at a time when regulatory costs were already set to increase significantly due to the ASIC industry funding levy and the Financial Adviser Standards and Ethics Authority.[26]

3.24. Stakeholders also argued that any additional costs imposed on financial firms would ultimately be passed on to consumers, either directly or indirectly.[27]

A negative impact on competition

3.25. These increased costs, it was submitted, would act as an inhibition to competition and innovation. That was because smaller entities and start-ups may be unwilling or unable to meet the cost of any CSLR levy and may be deterred from entering, or simply be unable to enter, the sector.[28]

3.26. Additionally, these increased costs may lead to poorer consumer outcomes as small businesses might no longer be able to afford to offer the same level of service to consumers.[29]

Other policy interventions should be considered before a CSLR

3.27. Some stakeholders submitted that a CSLR should not be established until the existing compensation arrangements were strengthened. For example, the Financial Services

23 Financial Services Council, submission to the EDR Review Interim Report attaching a note prepared by Professor Pamela Hanrahan, page 9.
24 Financial Services Council, submission to the EDR Review Interim Report attaching a note prepared by Professor Pamela Hanrahan, page 10.
25 AMP, submission to the EDR Review Supplementary Issues Paper, page 2; Australian Timeshare and Holiday Ownership Council, submission to the EDR Review Supplementary Issues Paper, page 2.
26 Financial Planning Association of Australia, submission to the EDR Review Issues Paper, page 7.
27 Financial Services Council, submission to the EDR Review Interim Report, page 14.
28 Financial Services Council, submission to the EDR Review Issues Paper, page 16.
29 Mortgage & Finance Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 3.

Council submitted that, while the case for a CSLR had not been established, if a CSLR was to be introduced, this should not occur until, relevantly:

- such time as the recommendations in the Richard St. John Report have been reviewed and measures introduced to address the issues that lead to licensees being unable to meet their consumer compensation obligations; and
- the reforms in progress to improve the competence and professionalism of advisers should be fully implemented and changes to the legislative breach reporting framework should be made to encourage and assist licensees to report and deal with those who engage in misconduct.[30]

3.28. AMP was of the view that arrangements should be put in place to ensure, as far as possible, that licensees have the proper financial resources and PI insurance before they commence providing financial advice to customers.[31]

3.29. These issues are discussed further in Chapter 5.

Sectors without uncompensated losses should be excluded

3.30. A number of stakeholders said they should not be included in a CSLR as their industry was not responsible for any uncompensated losses.

3.31. Stakeholders in the superannuation sector submitted that a CSLR was not required for APRA-regulated superannuation funds because:

- Part 23 of the *Superannuation Industry (Supervision) Act 1993* already effectively operated as a CSLR;[32] and
- APRA-regulated funds were prudentially supervised and regulated, already paid a significant levy for that supervision, as well as other levies, and have had a relatively low incidence of failure and a negligible incidence of non-payment of Superannuation Complaints Tribunal(SCT) determinations.[33]

30 Financial Services Council, submission to the EDR Review Issues Paper, page 2; see also Stockbrokers and Financial Advisers Association Limited, submission to the EDR Review Supplementary Issues Paper, page 3; Australian Timeshare and Holiday Ownership Council, submission to the EDR Review Supplementary Issues Paper, page 2.

31 AMP, submission to the EDR Review Supplementary Issues Paper, page 1.

32 The Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, page 4.

33 The Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, page 5; Australian Institute of Superannuation Trustees, submission to the EDR Review Supplementary Issues Paper, page 3.

3.32. The Mortgage & Finance Association of Australia and the National Insurance Brokers Association also submitted that there was no significant consumer harm or uncompensated losses in their sectors which would justify firms in those sectors being required to become members of a CSLR.[34]

CONSIDERATION OF THE MERITS OF A CSLR

Panel analysis

3.33. In considering the merits of a CSLR, in addition to the Review Principles, the Panel has had regard to the following matters.

Existing compensation obligations imposed on financial firms

3.34. The Corporations Act and the National Consumer Credit Protection Act impose an obligation on licensees to be a member of an ASIC approved EDR body and have arrangements for providing compensation where certain specified losses occur.

3.35. However, as the amount of uncompensated losses demonstrates, some consumers and small businesses are using the EDR framework, but are not receiving compensation after a determination is made in their favour.

3.36. This means the current arrangements are not delivering on the policy objective of ensuring that where compensation is awarded in the EDR system, it is paid. This is having a significant impact on those individuals who remain uncompensated.

3.37. While there are opportunities to improve regulatory requirements, the Panel does not consider that improvements to requirements in relation to PI insurance and financial resources held by firms will fix the problem of uncompensated loss.

Ensuring trust and confidence in the financial system

3.38. A CSLR will assist in promoting trust and confidence in the financial system. For example, consumers and small businesses will be able to have confidence that where a dispute is determined in their favour and compensation is awarded, this will be paid (subject to a CSLR's eligibility requirements).

3.39. Ensuring trust and confidence in the financial services industry, and particularly in the financial advice sector, will be important as more Australians enter retirement and begin drawing on their retirement savings. Given the mandatory nature of superannuation and that many consumers are entering retirement with substantial superannuation investments, financial advice is becoming increasingly important.[35]

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34 Mortgage & Finance Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 2; National Insurance Brokers Association, submission to the EDR Review Supplementary Issues Paper, pages 1-2.

35 Commonwealth of Australia 2014, *Financial System Inquiry Interim Report*, page 3-63.

Addressing the negative impact on individuals and the community

3.40. The negative economic and social impacts of uncompensated losses can be significant. The Panel was cognisant of the evidence provided by the many individuals who shared their stories with the Panel. This evidence detailed the long-term financial impacts of uncompensated losses, as well as the impact it has on individuals' mental and physical health.

3.41. This is consistent with ASIC's research on the social impact of monetary loss, which highlighted the impact of losses on investors, including that some had:

- lost their homes and were living in caravans and motor vehicles;
- been seriously ill, either through a new illness or the aggravation of an existing one due to stress;
- gone without food, and heating or cooling; and
- were too ashamed to tell anyone of their plight and had isolated themselves from family and friends.[36]

3.42. Additionally, where a consumer or small business has experienced an uncompensated loss, there is the potential for extra costs to be imposed on the wider Australian community. For example, investors who have lost their life savings will often be forced to rely on the pension for income in their retirement.[37]

Compensation schemes have operated effectively in other sectors

3.43. A number of compensation schemes, albeit limited schemes, already exist and function effectively in the financial services sector. These include the Financial Claims Scheme, the National Guarantee Fund and Part 23 of the *Superannuation Industry (Supervision) Act 1993*.

3.44. The Panel has been provided with evidence showing that these schemes are operating effectively. However, the existing Australian schemes are not comprehensive, which means there are gaps in the existing framework. The Panel considers that a CSLR can sit consistently with these schemes.

3.45. The Panel is also aware that a number of compensation schemes exist internationally in the financial services sector. In particular, the United Kingdom has a single, comprehensive compensation scheme covering a broad range of losses, including those not currently covered by Australia's targeted compensation schemes, such as losses associated with poor quality financial advice.

3.46. Further information on these schemes can be found in Appendix 2: Compensation schemes for specific losses in the financial system.

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36 Australian Securities and Investments Commission 2011, *Report 240: Compensation for retail investors: the social impact of monetary loss*, page 10.

37 Australian Securities and Investments Commission 2011, *Report 240: Compensation for retail investors: the social impact of monetary loss,* page 48.

Moral hazard concerns have not been substantiated

3.47. A number of stakeholders raised concerns that a CSLR could result in moral hazard as participants in the financial system change their behaviour in response to a CSLR.

3.48. Some stakeholders submitted that a CSLR could reduce a financial firm's incentive to comply with existing compensation arrangements and result in firms adopting less risk-averse approaches in the expectation that a CSLR would compensate a client.

3.49. The Panel considers this is a very small risk given:

- a firm which does not have compensation arrangements is in breach of the financial services laws and could be subject to regulatory and enforcement action by ASIC;
- before a client can access a CSLR, the firm's own financial resources and PI insurance must be exhausted; and
- there are a number of regulatory improvements underway or that have been undertaken in recent years to improve the professionalism and quality in financial advice. These are discussed further in paragraph 4.10.

3.50. It was also argued that a CSLR could encourage consumers to engage in riskier behaviour and become less diligent in checking a firm's compliance history.

3.51. Again, the Panel considers that this is a very small risk given:

- AFCA cannot make awards to compensate consumers for investment losses, which means losses arising from higher risk investments would not be compensable by a CSLR;[38]
- consumers are generally unable to assess a financial firm's compliance history or identify which firms are more likely to become insolvent;[39]
- if, as the Panel recommends, compensation caps apply, there will be limits to what a consumer or small business can recover from a CSLR;[40] and
- for a consumer or small business to access a CSLR, they need to first suffer a loss and then spend considerable time going through the dispute resolution process, which involves uncertainty for consumers and small businesses about whether they will be successful.

3.52. For these reasons, and based on the evidence presented to this Review, the Panel does not consider that the risks of moral hazard in the instance of establishing a CSLR have been substantiated.

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38 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 16.

39 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 16.

40 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 13.

3.53. However, bearing in mind concerns raised, the Panel also considers that any moral hazard, if it does arise, can be addressed through an appropriately designed CSLR, which is discussed in Chapter 4.

There are merits in a carefully targeted CSLR

3.54. Having regard to the Review Principles, along with the matters considered above, the Panel recommends the establishment of a CSLR in the financial services sector that is targeted to areas where there is clear evidence of recurrent problems with uncompensated losses.

3.55. A targeted CSLR will promote equity as consumers of firms engaged in the types of claims covered by a CSLR, and who have been found to have suffered loss from the misconduct of a financial firm, will receive compensation. It will also ensure that regulatory costs are minimised as those firms that do not provide services in those sectors where there is clear evidence of uncompensated losses will not be required to become members of a CSLR.

3.56. Additionally, it will support comparability of outcomes as all consumers and small businesses that have a decision in their favour will receive compensation. This outcome will no longer be determined by the solvency of the firm that engaged in the misconduct.

3.57. A CSLR will also promote efficiency as the resources expended when providing a decision to a consumer or small business will no longer be wasted where the financial firm is unable to pay compensation.

3.58. A CSLR also has the potential to increase accountability in the financial services industry as the costs associated with uncompensated losses will no longer be imposed on the broader community.

3.59. Accountability may also be enhanced as compliant firms monitor the behaviour of their competitors with a view to promoting better behaviours. This will create incentives for firms covered by a CSLR and their industry associations to work together to lift professional standards, which will in turn improve the efficiency of the system by reducing the number of cases in which a CSLR is required to cover losses that would otherwise be uncompensated.

3.60. While the discussion above outlines why a CSLR is necessary, the Panel acknowledges that the establishment of a CSLR increases the costs to industry participants that meet their obligations to provide compensation, through requiring these firms to contribute to the funding of a CSLR.

3.61. The Panel, therefore, considers that a CSLR must act as the final safety net in the compensation arrangements framework. That is, a CSLR should only be called on to provide compensation after a consumer or small business has exhausted all other avenues. The Panel has given effect to this objective through the potential design elements of a CSLR, which is discussed in Chapter 4.

RECOMMENDATION 1:

A LIMITED AND CAREFULLY TARGETED CSLR

A CSLR should be established. A CSLR, if established, should be limited and carefully targeted at the areas of the financial sector with the greatest evidence of need.

CHAPTER 4: POTENTIAL DESIGN OF A COMPENSATION SCHEME OF LAST RESORT

KEY POINTS

- A CSLR should apply prospectively, which means only unpaid decisions which arise after a CSLR is established will be eligible for compensation.
- Only consumers and small businesses (as defined by AFCA) should be eligible to lodge a claim with a CSLR.
- A CSLR should initially be restricted to financial advice failures where a financial adviser (relevant provider)[1] has provided personal and/or general advice on 'relevant financial products'[2] to a consumer or small businesses. This means that only advice given by a 'relevant provider', as defined in section 910A of the Corporations Act, would be covered by a CSLR.
- Consumers and small businesses must have a decision from AFCA, a court or tribunal which remains unpaid after reasonable steps, as defined by a CSLR, have been taken.
- A CSLR should only be able to receive a claim following a court judgment or tribunal award where the circumstances giving rise to the claim would have been eligible for consideration by AFCA.
- Applications must be lodged with a CSLR by a consumer or small business within 12 months of having completed specified reasonable steps to obtain compensation.
- A CSLR should not reassess the claims it receives; however, before paying a claim, a CSLR must be satisfied that the EDR determination, court judgment or tribunal award will not be paid by the financial firm to the consumer or small business.
- A cap should apply to the level of compensation that a CSLR is able to provide, which should be aligned with AFCA's compensation cap.
- A CSLR should have the ability to stand in the shoes of a consumer or small business and pursue the financial firm for the compensation amount.
- A CSLR should be funded by financial firms that provide the types of financial services covered by a CSLR.

1 Being a 'relevant provider' under section 910A of the *Corporations Act 2001*. A person is a relevant provider if the person: (a) is an individual; and (b)(i) a financial services licensee; or (ii) an authorised representative of a financial services licensee; or (iii) an employee or director of a financial services licensee; or (iv) an employee or director of a related body corporate of a financial services licensee; and (c) is authorised to provide personal advice to retail clients, as the licensee or on behalf of the licensee, in relation to relevant financial products.

2 Section 910A of the *Corporations Act 2001* defines a 'relevant financial product' as financial products other than: basic banking products; or general insurance products; or consumer credit insurance; or a combination of any of those products. The types of financial products which are considered 'relevant financial product' are similar, but not identical, to the financial products which are defined Tier 1 financial products under the Australian Securities and Investment Commission's *Regulatory Guide 146, Licensing: Training of financial product advisers.*

KEY DESIGN FEATURES OF A CSLR (CONTINUED)

- These financial firms should be required to be members and contribute to its funding as a condition of licensing.
- A CSLR should be governed by an independent board with an independent chair and equal numbers of directors with industry and consumer backgrounds.
- ASIC should have oversight of a CSLR to ensure it is fulfilling its objectives.
- A CSLR should be scalable, which means it can be expanded over time to cover other types of financial and credit services, should evidence of significant problems of uncompensated losses emerge.

4.1. In Chapter 3, the Panel recommended the establishment of a limited and carefully targeted CSLR. The Review's Terms of Reference also require the Panel to make recommendations on the potential design of a CSLR. In this chapter, the Panel makes recommendations on the following design elements:

- prospective application;
- who can access a CSLR;
- the types of claims that are eligible for compensation;
- conditions for accessing a CSLR;
- the functions and powers of a CSLR;
- the funding of a CSLR; and
- the administration of a CSLR.

4.2. The Panel would like to express its appreciation to stakeholders who provided detailed submissions on these issues, including those stakeholders who, whilst not supporting the establishment of a CSLR, nevertheless provided the Panel with relevant and helpful information on these issues.

1. A CSLR SHOULD BE PROSPECTIVE

Background

4.3. In establishing a CSLR it is important to consider whether, in addition to applying prospectively, it should also address uncompensated losses in the past, such as the legacy unpaid EDR determinations discussed in Chapter 2.

Stakeholder submissions

4.4. Industry stakeholders expressed significant concerns over any proposals that would require current industry participants to contribute to past uncompensated losses which relate primarily to financial firms that are no longer in the industry. This issue is discussed further in Part 2 of this Report.

4.5. The main concern expressed by these stakeholders was that applying a CSLR, funded by industry, to pay for past uncompensated losses would be inherently unfair as it would require compliant segments of the industry to bear the cost of the misconduct of other financial firms.[3]

4.6. It was also submitted that a prospective CSLR aligned with other improvements to consumer capability and decision-making about financial advice, for example, financial capability initiatives.[4]

Panel analysis

4.7. The Panel is firmly of the view that a CSLR that is industry funded should apply prospectively. That is, it should only apply to uncompensated losses that arise following a CSLR's establishment.

4.8. The Review Principle of equity applies in the Panel's consideration of this issue. A CSLR applying prospectively will result in those financial firms engaged in the types of financial services covered by a CSLR contributing to it. This will ensure that those financial firms that are responsible for uncompensated losses are also required to contribute to a CSLR. As the Panel notes above at paragraph 3.42, the current system is not without cost to the Australian taxpayer.

4.9. Restricting the application of a CSLR to prospective claims also enables financial firms to appropriately factor the cost of a CSLR into their operations.

4.10. The Panel has also taken into consideration recent reforms to strengthen the framework regulating the conduct and professional standards of financial advisers, including:

- the Future of Financial Advice reforms, which, relevantly, introduced a ban on conflicted remuneration structures for financial advisers and a duty for financial advisers to act in the best interests of their clients; and
- reforms to raise the professional, education and ethical standards of financial advisers.[5]

2. WHO CAN ACCESS A CSLR

Background

4.11. An important threshold issue for a CSLR is who should be able to access it. The requirement to have compensation arrangements, which is imposed on financial services licensees under the Corporations Act, and which was described in Chapter 2, applies to services provided to 'retail clients'.

3 See Financial Services Council, submission to the EDR Review Supplementary Issues Paper.
4 Australian Bankers' Association, submission to the EDR Review Interim Report, page 16.
5 *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017*.

4.12. Retail clients are individuals who satisfy certain product and wealth thresholds, and small businesses who employ less than 20 people, or if the business is or includes the manufacture of goods, less than 100 people.[6]

4.13. As identified in Chapter 2, the impact of uncompensated losses can be significant for consumers. It can also be particularly acute for small businesses. For example, where a small business does not receive the compensation to which it is entitled, this can impact on its financial viability and can result in an inability to pay employees and suppliers, the threat of bankruptcy, and personal stress and family breakdown.[7]

Stakeholder submissions

4.14. There was strong support from stakeholders for both consumers and small business having access to a CSLR.[8] However, stakeholders had diverging views on what types of firms should be categorised as a small business.

Defining 'small business'

4.15. FOS submitted that small businesses that have an unpaid decision from an EDR body, court or tribunal should be able to access a CSLR.[9] Under FOS's current Terms of Reference, a business is a small business if it has less than 20 employees, or if it includes the manufacture of goods, has less than 100 employees.[10]

4.16. The Australian Bankers' Association submitted that only some small businesses should be able to access a CSLR.[11] For the Australian Bankers' Association, a business was not a small business if one of the following conditions was met:

- the number of employees was 20 people or more, or 100 people or more if the business includes the manufacture of goods (full-time equivalent);
- the annual business turnover was $5 million or more;
- the size of loan for business purposes was $3 million or more; or
- the total credit exposure of the business group, including related entities, to all credit providers was $3-$5 million or more.[12]

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6 Section 761G of the *Corporations Act 2001*.

7 Commonwealth of Australia 2017, *Review of the financial system external dispute resolution and complaints framework: Final Report*, page 160.

8 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 10; Credit and Investments Ombudsman, submission to the EDR Review Supplementary Issues Paper, page 4; Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 12; Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 5.

9 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 19; see also Association of Financial Advisers, submission to the EDR Review Supplementary Issues Paper, page 9.

10 Financial Ombudsman Service 2015, *Terms of Reference (as amended 1 January 2015)*, page 41; ANZ had a similar position to FOS as it was of the view that that the 'retail client' definition used in the *Corporations Act 2001* should be used for determining who can access a compensation scheme of last resort.

11 Australian Bankers' Association, submission to the EDR Review Supplementary Issues Paper, page 3.

12 Australian Bankers' Association, submission to the EDR Review Interim Report, pages 4-5 and to the EDR Review Supplementary Issues Paper, page 3.

Panel analysis

Providing small business with access

4.17. In circumstances where it is a generally accepted policy objective that small business should be able to have their dispute heard,[13] it is a natural extension to ensure small businesses are provided with compensation where it is found they have suffered loss due to a financial firm's misconduct.

4.18. Providing small business with access to a CSLR will promote equity as it will ensure a larger number of individuals will be provided with compensation.

Defining 'small business'

4.19. In its April 2017 Report, the Panel did not consider that a change to how the EDR framework defined a 'small business' - less than 20 employees, or if it includes the manufacture of goods, less than 100 employees – was required. This was because under that definition, the vast majority of businesses could access the EDR system, as approximately 98 per cent of Australian businesses have less than 20 employees.[14]

4.20. The Government accepted this view in its response to the Panel's report. Consistent with this approach, the types of small businesses who can access a CSLR should be those who are able to access an EDR body. However, a CSLR should continue to engage with stakeholders to ensure that this definition remains fit-for-purpose.

3. TYPES OF CLAIMS ELIGIBLE UNDER A CSLR

Background

4.21. A critical design element of a CSLR is the types of claims that are eligible for compensation. Stakeholders provided a range of views on this issue, including on whether a CSLR should:

- be limited to financial advice failures;
- cover all types of financial services and credit claims; and
- where it is limited, have the potential for scalability so it can respond to future issues.

13 Commonwealth of Australia, *Review of the financial system external dispute resolution and complaints framework: Final Report*, page 169.

14 Australian Bureau of Statistics 2016, *8165.0 — Counts of Australian Businesses, including Entries and Exits*, June 2012 to June 2016, ABS, Canberra.

Stakeholder submissions

Support for a CSLR limited to financial advice failures

4.22. A number of industry stakeholders submitted that a CSLR should be limited to financial advice failures, although there were differing views on what types of advice should be captured.

4.23. The Australian Bankers' Association submitted that a CSLR should be limited to financial advice failures where personal advice on Tier 1 financial products,[15] and/or general advice on Tier 1 financial products was provided to retail customers, including some small businesses, by a financial adviser.[16]

AUSTRALIAN BANKERS' ASSOCIATION PROPOSAL

The CSLR should be limited to determinations on financial advice failures where personal advice on Tier 1 financial products, and / or general advice on Tier 1 financial products is provided to retail customers, including some small businesses, by a financial adviser. The financial advice failure could relate to Corporations Act breaches, fraud, negligence, misrepresentation and administrative errors in relation to the provision of financial advice.

The CSLR should cover general advice provided by financial advisers as well as personal advice to avoid market distortions and take account of the low level of consumer understanding of the difference between personal and general advice. The CSLR should not cover general advice provided by product issuers such as managed investment scheme operators, or retail bank staff providing retail banking services. The CSLR should not cover businesses that only provide dealing or arranging services, such as securities dealers or derivatives dealers, nor should it cover research houses that publish reports containing general advice.[17]

4.24. A narrower approach was proposed by ANZ, which submitted that a claim for compensation must involve personal advice, as defined by the Corporations Act, in respect of Tier 1 products. This was because if a CSLR were to cover losses arising from general advice, then it would capture many forms of financial service and go well beyond the historical core concern of compensation for poor personal financial advice.[18]

15 Tier 1 products are defined in Australian Securities and Investments Commission, *Regulatory Guide 146: Licensing: Training of financial product advisers* as follows: Tier 1 products are all financial products except those listed under Tier 2. Tier 2 products include: General insurance products, except for personal sickness and accident (as defined in regulation 7.1.14); consumer credit insurance (as defined in regulation 7.1.15); basic deposit products; non-cash payment products; first home saver deposit accounts.

16 Australian Bankers' Association, submission to the EDR Review Supplementary Issues Paper, page 3; Suncorp was broadly supportive of the model proposed by the Australian Banker's Association, see Suncorp, submission to the EDR Review Supplementary Issues Paper, page 2.

17 Australian Bankers' Association, submission to the EDR Review Supplementary Issues Paper, page 3.

18 ANZ, submission to the EDR Review Supplementary Issues Paper, page 2.

4.25. In seeking to limit a CSLR to financial advice failures, arguments made by stakeholders included that a broad approach would expose a CSLR to very large losses and that there was no justification for extending a CSLR beyond financial advice. Stakeholders also submitted that the financial advice sector was where the issue of uncompensated losses was most acute.

A CSLR should not be exposed to large losses

4.26. ANZ submitted that including claims in respect of financial services beyond personal advice would expose a CSLR to potentially large losses, in circumstances where otherwise legally compliant organisations would be required to pay for these. This risk would be crystallised in the event of an economic downturn or financial crisis that could see a large quantum of unpaid claims calling upon a CSLR.[19]

4.27. The Australian Bankers' Association stated that the scope of a CSLR's coverage should only extend to financial advice from a financial adviser and that it would be unacceptable from a prudential risk perspective to include other financial services and products, in particular, managed investment schemes.[20]

Managed Investment Schemes

4.28. A number of stakeholders submitted that disputes where the responsible entity of a managed investment scheme was required to pay compensation, but did not do so, should be included in a CSLR.

MANAGED INVESTMENT SCHEMES

In recent years, investors have suffered significant losses following the collapse of a number of managed investment schemes (MIS), particularly agribusiness schemes. The six most notable agribusiness MIS that collapsed between 2009 and 2012 managed $5.8 billion in funds raised.

Collapses of these agribusiness schemes have highlighted both the particular features of the schemes (for example, the uncertainty of the responsible entity's ability to fulfil its obligations to investors well after investments are initially made) and the role played by inappropriate financial advice.

In relation to the role of inappropriate financial advice, the Senate Economics References Committee's report, *Agribusiness managed investment schemes: Bitter harvest* found evidence which indicated that, in some cases, financial advisers:

- disregarded their clients' risk profiles;
- withheld important information, particularly about the speculative nature of the venture;
- failed to provide critical documents;
- wilfully downplayed risks and exaggerated the promised returns; and
- put their own interests above those of their clients, for example, by being more focused on selling a product to receive a commission rather than providing appropriate advice.[21]

19 ANZ, submission to the EDR Review Supplementary Issues Paper, page 1.

20 Australian Bankers' Association, submission to the EDR Review Supplementary Issues Paper, page 3.

21 Commonwealth of Australia, Senate Economics References Committee 2016, *Agribusiness managed investment schemes: Bitter harvest*, page xxiii.

MANAGED INVESTMENT SCHEMES (CONTINUED)

In its response to this report, the Government agreed that an enhanced regulatory framework for MIS was required and stated that the framework would be reviewed. The timing of the review of MIS framework has been discussed as part of the Government's broader prioritisation process. Having regard to the strong links to new collective investment vehicles (CIVs) regime (announced in the 2016-17 Budget and currently being introduced), the Government committed to the review of the MIS framework following the CIVs reforms. The Government has stated that this timing will better ensure policy consistency across investment fund frameworks from a retail investor perspective.

4.29. However, the Australian Bankers' Association identified a number of reasons why an EDR determination made against the responsible entity of a managed investment scheme should not be covered by a CSLR, including:

- There has been recent reform to increase the financial requirements for managed investment schemes and ASIC's recent consultation on risk management practices of responsible entities. However, the risk of managed investment schemes is primarily based on economic factors, not behavioural ones.
- Advice-based investor harm arises due to behavioural failures and these risks are being mitigated through the professionalisation of financial advice. In contrast, the financial risks arising from managed investment schemes are fundamentally different from advice-based financial harm and are likely to grow with the rise of non-bank financial activity utilising managed investment schemes (for example, peer-to-peer lending). These risks are largely related to the investment models of managed investment schemes and are difficult to mitigate.[22]

4.30. The Australian Bankers' Association also submitted that the narrow and clearly defined scope that it proposed for a CSLR would best promote its long-term success and viability, and appropriately manage risks for contributors.[23]

Lack of evidence to extend a CSLR beyond financial advice

4.31. Stakeholders also argued that financial advice issues and the related insolvency of advice firms were by far the biggest problem in terms of existing unpaid EDR determinations and therefore any scheme should be focussed on this area.[24] To do otherwise, it was submitted, would be inequitable for financial firms in other sectors who do not have the same scale of unpaid EDR determinations.[25]

22 Australian Bankers' Association, submission to the EDR Review Interim Report, page 20.
23 Australian Bankers' Association, submission to the EDR Review Supplementary Issues Paper, page 8.
24 Industry Super Australia, submission to the EDR Review Supplementary Issues Paper, page 9.
25 Credit and Investments Ombudsman, submission to the EDR Review Supplementary Issues Paper, page 7.

4.32. The Mortgage & Finance Association of Australia submitted that the non-payment of EDR determinations was not a large problem within the credit industry. It stated that the financial services and credit services industries are very different from one another, for example:

- most credit industry claims will involve a prudentially regulated credit provider;
- finance brokers rarely have access to customer funds so losses in this area are minimal; and
- finance brokers generally act to assist a customer to access lender finance for investment in real property, whereas financial services advisers tend to deal in products with higher levels of risk.[26]

Support for a CSLR covering all types of claims

4.33. A range of stakeholders submitted that a CSLR should apply to all types of claims and all financial licensees, including financial services providers, credit licensees and responsible entities of managed investment schemes.[27] A number of reasons were given supporting this position.

FINANCIAL OMBUDSMAN SERVICE PROPOSAL

FOS considers that the CSLR should cover providers of all forms of financial services, financial advice or financial products such as derivatives, foreign and payment products, foreign exchange contracts, general insurance, securities, managed investment schemes, life insurance products, superannuation, and other financial investment products in respect of which there has been a determination in favour of the claimant by an EDR body or court, or tribunal of competent jurisdiction.

FOS also considers that the CSLR should extend to the credit industry because the risk of non-payment of EDR determinations can arise in that industry.[28]

Access to compensation should not depend on receiving financial advice

4.34. The Joint Consumer Group submitted that access to effective redress for misconduct in the financial system should not depend on whether or not financial advice was involved.[29] In particular, credit providers and mortgage brokers should be included as these types of disputes could affect particularly vulnerable consumers. The Joint Consumer Group provided the Panel with examples of where these types of consumers had experienced uncompensated losses.[30]

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26 Mortgage & Finance Association of Australia, submission to the EDR Review Supplementary Issues Paper, pages 1-2.
27 See Maurice Blackburn, submission to the EDR Review Supplementary Issues Paper, page 4.
28 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, pages 9-10.
29 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 9.
30 Joint Consumer Group, submission to the EDR Review Issues Paper, pages 74-75.

4.35. Legal Aid NSW also commented that narrowing the scope of a CSLR appeared to prioritise the claims of those consumers with enough money to need advice about how to manage it, further entrenching disadvantage for vulnerable consumers and allowing some of the most egregious conduct to go uncompensated.[31]

4.36. Legal Aid Queensland submitted that it would be inequitable and unfair to consumers if losses caused by the financial planning industry were compensated by the scheme, but losses caused by other financial service providers were not.[32]

4.37. FOS submitted that a CSLR should cover all types of claims as the risk of non-payment of EDR determinations could arise in any sector.[33] It argued that EDR determinations made against the responsible entity of a managed investment scheme should be included because:

- there is potential for unpaid determinations and consumer detriment to flow from this sector;
- a broader range of financial firms are involved in the funding, distribution or other arrangements with managed investment schemes; and
- funding contributions to a scheme across the whole 'value chain' would support increased accountability of all participants.[34]

4.38. It also considered that credit providers and mortgage arrangers should be included because FOS disputes and awards for compensation in relation to credit can involve particularly vulnerable and disadvantaged consumers.[35]

4.39. The Holt Norman Ashman Baker Action Group (HNAB Action Group) said there was no valid reason to limit a CSLR to financial advice and every reason to include lenders, product issuers and liquidators. This was because these firms had significant resources and it was unfair for the average, financially and legally unsophisticated consumer who was often also in a state of deep despair and trauma.[36] Other submissions from individuals were of a similar view, stating that all claims made to an EDR body should have access to a CSLR if part or all of their determination was unpaid.[37]

31 Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 11.
32 Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 5.
33 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 9.
34 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 10.
35 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 10.
36 Holt Norman Ashman Baker Action Group, submission to the EDR Review Supplementary Issues Paper, page 46.
37 O'Reilly, S, submission to the EDR Review Supplementary Issues Paper, page 7.

Extending a CSLR would not burden industry

4.40. The Joint Consumer Group submitted that including credit disputes would be unlikely to place an undue burden on industry as a consumer who was successful in this type of dispute was generally provided with a contract variation or debt waiver, rather than an award of compensation.[38]

A CSLR with a wide scope would reduce consumer confusion

4.41. Legal Aid NSW argued that a wider scope had the benefit of reducing consumer confusion about eligibility to access a CSLR. Taking a broader approach to eligibility for compensation was also essential to building trust and confidence in the community towards the financial sector as a whole.

4.42. FOS submitted that difficulties would arise when trying to explain to consumers and small businesses why some determinations were eligible for compensation, but others were not.[39]

Challenges in scoping a limited CSLR

4.43. FOS argued that limiting a CSLR to providers of personal and general advice on financial products would pose challenges for defining who and what would be in scope. This was because the licence authorisations for Australian Financial Services Licensees and Credit Licensees have three dimensions which were used in establishing the Financial Advisers Register:

- type of financial services offered (for example, advice, dealing);
- types of products offered (for example, securities, managed investment schemes); and
- types of customers to be served (retail or wholesale).[40]

4.44. FOS noted that most Australian Financial Services (AFS) licensees carry authorisations for multiple and sometimes ancillary financial services. This means that for every unpaid award, a CSLR would need to make an assessment about the financial service type, the product type and the customer type.[41]

A scalable scheme

4.45. ASIC submitted that while it would be desirable to introduce a broad-based CSLR that addressed uncompensated losses across the EDR jurisdiction, it was essential to introduce a scheme that addressed, at least initially, the area of acute need; that is, unpaid determinations concerning financial advice.[42]

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38 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 9.
39 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, pages 10-11.
40 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 10.
41 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 10.
42 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 11.

4.46. ASIC stated that such a CSLR should be designed to be scalable so that its coverage, powers and operation could be effectively extended in the future to deal with broader types of losses and additional funding entities.[43]

Panel analysis

4.47. In determining the types of claims that a CSLR should consider, there are a number of considerations, in addition to the Panel's Review Principles, which the Panel has taken into account:

- where there is strongest evidence of uncompensated losses;
- the need to ensure a sustainable CSLR; and
- ensuring the scope of a CSLR provides certainty for industry and clarity for consumers.

Strongest evidence is in the financial advice sector

4.48. As identified in Chapter 2, as at 30 June 2017, $14,146,094 (excluding interest) and $399,862 (excluding interest) in determinations made in favour of complainants by FOS and CIO, respectively, had not been paid.

4.49. In relation to FOS's unpaid determinations, these are overwhelmingly in the financial advice sector with financial planners and advisers accounting for approximately 92 per cent of the value of unpaid FOS determinations.

4.50. When considering compensation in matters involving managed investment schemes, it is important to be clear about what has caused the loss. While there are some cases where the responsible entity of a managed investment scheme has been ordered by an EDR body to pay compensation, and this has not been paid, the value of these losses is relatively small. From the evidence presented to the Panel, the more significant category of cases involves those where a consumer received financial advice to invest in a managed investment scheme and this advice was not appropriate to the consumer's needs. Providing a CSLR that covers losses arising from inappropriate financial advice would target the core of this problem.

4.51. The Panel is conscious that there is evidence of unpaid EDR determinations in relation to credit providers, and that while these may represent small amounts, they often involve disadvantaged consumers for whom the amounts may be significant. The Panel is also aware of ASIC's report, *Review of mortgage broker remuneration,* which found there was scope to improve consumer outcomes in the mortgage broking sector.

43 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 11.

4.52. On balance, however, there is a relatively small number of cases of unpaid EDR determinations relating to credit providers, to date, and in balancing the Review Principles of equity and regulatory costs, the evidence is not sufficient for the Panel to recommend a CSLR extending to credit providers at this stage. The Panel is also aware of the complexity of including credit providers in a CSLR. As FOS identified, the diverse nature of credit provision and the variety of firms who offer credit gives rise to its own design challenges.[44] A CSLR that is scalable (as discussed below in paragraphs 4.63-4.66) will be able to respond in the future to any increase in unpaid EDR determinations involving credit providers if they should arise.

A sustainable CSLR

4.53. The long-term sustainability of a CSLR is an important factor which must be taken into account when determining which types of claims should be eligible for compensation.

4.54. The Panel's recommendation for the establishment of a CSLR and its recommendations on design elements are made without the benefit of comprehensive modelling and costing. In this context, moving immediately to a CSLR where all types of claims would be eligible for compensation could expose a CSLR to a significant financial liability which has the potential to undermine the sustainability of a CSLR, particularly where a large number of claims were made on it during its early stages. Further discussion on the importance of modelling is discussed below at paragraphs 4.246-4.249.

A clearly defined scope

4.55. An important consideration in determining the types of claims that should be eligible for compensation is the need to ensure that:

- industry has certainty around its funding exposure; and
- consumers have clarity about what types of claims are eligible for compensation.

4.56. A limited CSLR would provide industry with greater certainty about its potential financial exposure. The Panel notes that the Australian Bankers Association stated in its submission that APRA-regulated institutions are required to understand and manage prudential and financial system risks in accordance with standards set by APRA, and that clear and fixed funding arrangements were required, particularly for Authorised Deposit-taking Institutions that cannot provide unlimited guarantees.[45]

4.57. The Panel is conscious that one risk of a limited CSLR is that it may be difficult to explain to consumers and small business why they are not entitled to receive the same protections afforded to those whose dispute was with a financial adviser. However, this risk needs to be balanced against the costs of extending a CSLR to areas of the financial system where there is no evidence of significant problems with uncompensated losses.

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44 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 10.

45 Australian Bankers' Association, submission to the EDR review Supplementary Issues Paper, page 4.

A CSLR initially limited to financial advice

4.58. Having regard to the above considerations and applying the Review Principles, the case for a CSLR is strongest in relation to financial advice. The data provided to the Panel shows this is where the greatest problems with uncompensated losses exist.

4.59. The Panel, therefore, recommends that a CSLR should initially be restricted to financial advice failures where a financial adviser[46] has provided personal and/or general advice on 'relevant financial products'[47] to a consumer or small businesses. This means that only advice given by a 'relevant provider', as defined in section 910A of the Corporations Act, would be covered by a CSLR.

RELEVANT FINANCIAL PRODUCTS

Section 910A of the Corporations Act provides that 'relevant financial products' are financial products other than: basic banking products; or general insurance products; or consumer credit insurance; or a combination of any of those products.

This means that a financial adviser who provides financial advice in relation to, for example, a life insurance product, a managed investment scheme or a superannuation product would be providing advice on a 'relevant financial product'.

4.60. The Panel considers that as a matter of principle, the obligation to be a member of a CSLR should depend on the financial service provided (that is, providing financial advice), rather than the type of firm providing the service. This will target the activities which contribute to the uncompensated losses in an equitable way, while avoiding creating distortions in the system arising from incentives which could encourage firms to adopt particular structures in order to avoid being caught by a CSLR.

4.61. Under this approach, consumers and small businesses who receive personal and/or general advice on 'relevant financial products' from a financial adviser will have access to a CSLR (subject to the criteria of any CSLR), regardless of the type of financial firm for whom the adviser works. This means, for example, that financial advice provided by a financial adviser within the banking and superannuation sector will be covered by a CSLR.

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46 Being a 'relevant provider' under section 910A of the *Corporations Act 2001*. A person is a relevant provider if the person: (a) is an individual; and (b)(i) a financial services licensee; or (ii) an authorised representative of a financial services licensee; or (iii) an employee or director of a financial services licensee; or (iv) an employee or director of a related body corporate of a financial services licensee; and (c) is authorised to provide personal advice to retail clients, as the licensee or on behalf of the licensee, in relation to relevant financial products.

47 Section 910A of the *Corporations Act 2001* defines a 'relevant financial product' as financial products other than: basic banking products; or general insurance products; or consumer credit insurance; or a combination of any of those products. The types of financial products which are considered 'relevant financial product' are similar, but not identical, to the financial products which are defined Tier 1 financial products under the Australian Securities and Investment Commission's Regulatory Guide 146, *Licensing: Training of financial product advisers.*

4.62. Consumers and small businesses will also be able to access a CSLR where they have suffered losses associated with an investment in a managed investment scheme in circumstances where those losses were related to the failure of a financial adviser to provide appropriate financial advice.

4.63. Given the dynamic nature of the financial system, a CSLR should be future-proofed to ensure it can address significant problems of uncompensated losses should they emerge. It should have the ability to expand beyond financial advice and 'relevant financial products'. Additional discussion regarding the process for how a CSLR could be scaled is set out below in the section 'Administration of a CSLR'.

4.64. However, before a CSLR is introduced, and before any potential expansion occurs, it is critical that there is a comprehensive modelling and costing of a CSLR. This modelling will assist in developing an appropriate funding mechanism for a CSLR.

4.65. Having regard to the Panel's Review Principles, a CSLR which is initially limited to the financial advice sector, but which is scalable, will promote efficiency and minimise regulatory costs as a CSLR will be directed at the sector which has the overwhelming majority of uncompensated losses. Any concerns which exist around whether this limited CSLR is equitable, given that it will not cover losses associated with other financial services or products, can be addressed through the ability of a CSLR to expand the types of claims which it can receive.

4.66. While there are complexities with limiting a CSLR to financial advice, complexities also exist in designing a CSLR which captures other types of claims, as FOS identified in relation to the diverse nature of credit provision.

RECOMMENDATION 2:

A CSLR RESTRICTED TO FINANCIAL ADVICE BUT FUTURE PROOFED

A CSLR, if established, should initially be restricted to financial advice failures where a financial adviser (relevant provider) has provided personal and/or general advice on 'relevant financial products' to a consumer or small businesses.[48] This means that only advice given by a 'relevant provider', as defined in section 910A of the Corporations Act, would be covered by a CSLR. Relevant financial products include, for example, financial advice on investments in managed investment schemes, superannuation and banking products that are not basic banking products.

A CSLR should be designed for the future and accordingly be scalable, which means it can be expanded over time to cover other types of financial and credit services should evidence of significant problems of uncompensated losses emerge.

48 Section 910A of the Corporations Act *2001* defines 'relevant financial products' as financial products other than: basic banking products; or general insurance products; or consumer credit insurance; or a combination of any of those products.

4. CONDITIONS FOR ACCESSING A CSLR

4.67. It is necessary to determine the conditions that must be satisfied before a consumer or small business can make a claim on a CSLR. This has required the Panel to consider:

- the types of dispute resolution bodies whose decisions are covered;
- the steps a consumer or small business must take before lodging a claim with a CSLR; and
- the time period within which a claim must be lodged. These issues are considered below.

Types of bodies whose decisions are covered

4.68. An important access issue for a CSLR is whether it should only apply to unpaid EDR determinations, or also include unpaid court judgments and tribunal awards.

Stakeholder submissions

Support for a CSLR limited to EDR determinations

4.69. The Australian Bankers' Association did not support consumers with unpaid court judgments, including class action awards, being able to access a CSLR, for the following reasons:

- a CSLR should be an integrated part of the EDR framework;
- payments from a CSLR should be used to compensate consumers, rather than being used for legal and professional fees or court costs, which would be likely to form part of any unpaid court award;
- exclusion of court awards does not materially affect a consumer's access to redress, this can be readily sought through the EDR body;
- proposals to limit the eligibility of court awards to awards which would otherwise fit within the AFCA jurisdiction and/or exclude class actions would require the development of complex rules, compromising simplicity and undermining the link between a CSLR and the EDR framework; and
- the exposure to court awards is harder to quantify and may compromise the quality of financial modelling and ultimately the success of a CSLR.

4.70. The Association of Financial Advisers, the Financial Planning Association and Industry Super Australia did not support including court judgments and tribunal awards in a CSLR. Similar reasons were provided to those of the Australian Bankers Association, including that it could result in uncertainty in relation to costing, it could undermine the EDR process,[49] and that clients with legal decisions through the courts have the legal means to enforce a judgment.[50]

Support for a CSLR covering EDR determinations, court judgments and tribunal awards

4.71. There was support from a range of stakeholders for consumers and small businesses with unpaid EDR determinations, court judgments and tribunal awards being able to access a CSLR.

4.72. Consumer groups were in favour of including court judgments and tribunal awards, including class actions, arguing that it was important that consumers have access to the same potential remedies irrespective of the forum they choose.[51] The Joint Consumer Group said it was important that the design of a CSLR did not distort consumer choice about dispute resolution forums and that it was rare for a consumer to choose litigation instead of EDR, so the additional burden on a CSLR would be minimal.[52]

4.73. Legal Aid NSW stated that there would be circumstances where a court or tribunal was the most appropriate place for the matter to be heard, and there would be circumstances where a consumer would have no option but to take a financial services dispute to court because the firm was not a member of an EDR body when they should have been, or was trading without a licence.[53]

4.74. FOS submitted that if the ultimate policy goal was to restore trust and confidence in the financial system, consumer redress should not be limited to unpaid EDR determinations. FOS considered that there was merit in considering the inclusion of court judgments, but aligning the claims limit and compensation to the prevailing EDR jurisdictional limits and caps.[54]

Panel analysis

4.75. The current dispute resolution framework in the financial system is underpinned by the principle that consumers and small businesses should have a choice about whether to pursue their claim through an EDR body, a court or a tribunal.

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49 Industry Super Australia, submission to the EDR Review Supplementary Issues Paper, page 10.

50 Association of Financial Advisers, submission to the EDR Review Supplementary Issues Paper, page 10.

51 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, pages 9-10; Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, pages 12-15; Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, pages 6-7.

52 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 9; see also Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 13.

53 Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 12.

54 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 11.

4.76. Consistent with this principle, the Panel considers that consumers and small businesses that have an unpaid EDR determination, court judgment or tribunal award should be eligible to make a claim to a CSLR.

4.77. Allowing only consumers and small businesses with an unpaid EDR determination to make a claim with a CSLR may create an incentive for consumers or small businesses to use the EDR framework in circumstances where their interests could be better served through a different forum. For example, some consumers and small businesses may prefer to take their action to court because the court process is more transparent and based on formal rules of law and evidence. Additionally, as identified above, for some cases, a court may be the only forum in which they can have their dispute heard.

4.78. While the Panel is aware of concerns about a CSLR being able to receive claims relating to unpaid court judgments and tribunal awards, including following a class action (and with the support of litigation funders) the Panel considers that these concerns can be addressed through appropriate design mechanisms and are outweighed by the benefits of consumers and small businesses continuing to have a choice about which dispute resolution forum to use.

4.79. Additionally, for some consumers and small businesses, the only way they can have their case heard is by joining a class action or using the services of a litigation funder to underwrite their legal costs. The Panel does not believe that these consumers and small businesses should be disadvantaged because of where and how the loss is remedied.

4.80. However, the Panel is concerned to ensure that a CSLR is sustainable and is aware of the potential for a large number of class action claims to exhaust a CSLR. This issue is discussed in further detail below at paragraphs 4.183-4.187.

4.81. To ensure its financial sustainability and that it is only available for the types of disputes which can be heard by AFCA, a CSLR should only be able to receive a claim following a court judgment or tribunal award where that claim would have been eligible for consideration by an EDR body. For example, where the monetary limit at the EDR body for the type of matter under dispute was $1 million, a claim above that amount which was heard by a court should not be eligible for compensation at a CSLR.

4.82. Consistent with the Review Principles, a CSLR which applies to unpaid EDR determinations, court judgments and tribunal awards will promote equity and comparability of outcomes. For example, two consumers with similar causes of action against a financial firm, which is ultimately unable to pay compensation, will receive compensation irrespective of which forum hears their case.

4.83. The Panel's recommendation to allow consumers and small businesses with unpaid court judgment and tribunal awards to access a CSLR raises a number of important design issues. These include whether legal fees should be recoverable and what compensation a litigation funder should be able to receive. These issues are considered in detail below at paragraphs 4.176-4.187.

Disputes involving insolvent financial firms

4.84. As identified in Chapter 2, under the current EDR arrangements, there are circumstances where individuals have not been able to have their case heard by an EDR body and, therefore, have not received compensation to which they would have been entitled. The majority of these uncompensated losses relate to determinations made by FOS. These circumstances include where:

- FOS has determined that a dispute falls outside of its terms of reference due to the firm being insolvent;
- a consumer has decided to discontinue a dispute at FOS due to the firm becoming insolvent and the consumer believing there was little prospect of obtaining redress; and
- a consumer has never lodged a dispute with FOS because they believed there was little prospect of receiving redress, for example, due to the financial firm's insolvency.

4.85. FOS submitted to the Panel that the new single EDR body would need to have procedures under which these matters would progress to formal decision based on available information from the consumer, financial firm, liquidator/receiver and other sources as this would trigger a claim for payment by a CSLR.[55]

4.86. The Panel considers that AFCA should have the ability to issue a determination in circumstances where the financial firm is insolvent. This will ensure consumers are able to have their dispute heard, and where successful, receive compensation. This will promote equity and comparable outcomes as the level of compensation provided to a consumer or small business will not depend on the solvency of the financial firm, but the merits of the dispute.

Steps a claimant must take before lodging a claim

Background

4.87. Once a consumer or small business has received an EDR determination, court judgment or tribunal award, processes will need to be put in place to ensure that a CSLR is truly a 'last resort'. One way of ensuring that a CSLR is a last resort is to require consumers and small businesses to take certain steps before making a claim.

Stakeholder submissions

4.88. The Panel received a range of views on what steps a consumer or small business should take after they have received an EDR determination, court judgment or tribunal award in their favour and before they lodge a claim with a CSLR.

55 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 13.

A frictionless process for consumers and small business

4.89. The Joint Consumer Group submitted that the process should be as seamless as possible from the consumer's perspective. For example, where the firm is insolvent at the time of the determination or judgment, the consumer should proceed directly to a CSLR and only have to notify a CSLR that the compensation award remains unpaid. A CSLR itself should conduct the relevant checks to verify a firm's inability to pay.

4.90. Similarly, FOS said that consumers and small businesses should only have to provide the details of the existence of an unpaid eligible award of compensation from the EDR body or court/tribunal to a CSLR's administrators. It should be a CSLR itself that conducts relevant checks to verify a firm's inability to pay.[56]

4.91. ASIC submitted that AFCA could certify that the relevant firm was insolvent, stopped trading or has insufficient assets to meet the claim against it.[57]

Requiring consumers and small business to prove the financial firm cannot pay

4.92. In contrast, a number of stakeholders submitted that consumers and small businesses should take steps to prove that a financial firm could not pay an EDR determination, court judgment or tribunal award.

4.93. CIO said that a consumer or small business should demonstrate that the financial firm's professional indemnity insurance had failed to cover the claim, either as a result of the policy being exhausted or because the insurer relied on an exclusion clause to refuse indemnity.[58] Similarly, Legal Aid Queensland submitted that consumers should have exhausted all other redress avenues and confirmed that the business is insolvent or has been wound up before coming to a CSLR.[59]

4.94. Legal Aid NSW stated that once an EDR determination, court judgment or tribunal award was received, the next steps required of the consumer should depend on whether the firm is solvent and on the forum from which the award arises (these steps are set out in the below table).

Type of forum and status of firm	Next steps
EDR determination and solvent firm	The consumer should receive certification from the EDR body that the award remains unpaid after a reasonable period of time.
EDR determination and insolvent firm	The consumer should receive certification from the EDR body that the consumer is entitled to proceed directly to a CSLR.
Court or tribunal decision and solvent firm	The consumer should take reasonable steps to enforce the award, such as attempting to garnishee the bank account of the firm.
Court or tribunal decision and insolvent firm	The consumer should contact the administrator or liquidator requesting payment.

56 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, pages 19-20.
57 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 12.
58 Credit and Investments Ombudsman, submission to the EDR Review Supplementary Issues Paper, page 5.
59 Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 5.

Panel analysis

4.95. Determining the steps which a consumer or small business must take before lodging a claim with a CSLR requires balancing the burden imposed on claimants, particularly in circumstances where they have recently been through a dispute resolution process, against ensuring that a CSLR only pays compensation as a 'last resort'.

4.96. Therefore, a consumer or small business should take reasonable steps to receive payment from the financial firm before lodging a claim with a CSLR. What steps will be considered reasonable will depend on, for example, the forum which made the decision, the solvency of the financial firm and the consumer or small business's individual circumstances. For example, it may not be reasonable to require all consumers or small businesses to attempt to enforce a judgment against a director's personal assets.

4.97. The Panel expects that a CSLR will develop guidelines on what constitutes 'reasonable steps'. In doing so, the Panel has provided guidance which may be of benefit in a CSLR's considerations.

Qualifying conditions for unpaid EDR determinations

4.98. Regarding the steps that a consumer or small business should take to recover compensation, at a minimum, they should attempt to make contact with the financial firm.

4.99. However, AFCA will be best placed to enforce an EDR determination and evaluate whether a financial firm has the ability to compensate the consumer or small business. Therefore, where AFCA is satisfied that the EDR determination won't be paid by the financial firm to the consumer or small business, it should provide written certification to this effect.

4.100. The certification should include the steps undertaken by AFCA to enforce the determination and the circumstances, for example, the insolvency of the financial firm, which caused the unpaid EDR determination. The certification should also include information in plain English about how to lodge a claim with a CSLR. This certification should be sufficient for the consumer to access a CSLR.

4.101. The Panel also considers that AFCA should continue to enforce its determinations, consistent with the approach taken by existing EDR bodies. For example, as identified in Chapter 2, AFCA should:

- report non-compliance to ASIC;
- as appropriate, expel the financial firm from its membership; and
- consider pursuing compliance through the courts.

Qualifying conditions for unpaid court judgments and tribunal awards

4.102. Where compensation is awarded following a court or tribunal decision and remains unpaid, the consumer or small business should be required to provide evidence to a CSLR that they have taken all reasonable steps to recover the money from the relevant financial firm.

4.103. As identified above, this will depend on the circumstances of the case, but could involve:

- contacting the financial firm and, where relevant and the information is available, its professional indemnity insurer;
- instituting further proceedings to enforce the judgment or award; or
- contacting the administrator or liquidator to request payment.

4.104. However, ultimately a CSLR will need to undertake its own assessment of the financial firm's resources and decide whether the firm is in a position to compensate the consumer or small business. The role undertaken by a CSLR and the basis upon which it decides to pay compensation is discussed below at paragraphs 4.136-4.140.

Time period within which to make a claim

Background

4.105. After a consumer or small business has taken reasonable steps, as determined by a CSLR, to receive payment from the financial firm and has been unsuccessful, they should be entitled to lodge a claim with a CSLR for compensation. In these circumstances, a question arises about whether a claim must be lodged within a certain time limit.

4.106. Time limits exist in many dispute resolution processes, including in courts and EDR bodies, and serve a number of purposes, including:

- providing a level of certainty for parties regarding any liabilities they face, which enables them to arrange their affairs and utilise their resources on the basis that claims can no longer be made against them; and
- satisfying the public interest in seeing disputes are settled as quickly as possible.[60]

Stakeholder submissions

4.107. There was general agreement amongst stakeholders who provided submissions on this issue that time limits should apply to consumers and small businesses who lodge a claim with a CSLR.

60 *Brisbane South Regional Health Authority v Taylor* [1996] HCA 25; (1996) 186 CLR 541 at 552-553 per McHugh J.

4.108. Reasons put forward in support of imposing a time limit included that it would:

- give certainty to a CSLR in terms of its funding requirements;[61] and
- allow a CSLR to recover, to the greatest extend possible, funds from the non-compliant financial firm or their professional indemnity insurer.[62]

4.109. While there was general agreement on the need for time limits, stakeholders held a range of views on what this period should be, including:

- within two years of the financial firm being declared insolvent;[63]
- no later than 24 months after the consumer becomes aware or reasonably ought to have become aware that the amount was not recoverable, with a safeguard allowing a CSLR to waive compliance where appropriate;[64] and
- 6 years from the date of the EDR determination or court or tribunal order.[65]

4.110. The Joint Consumer Group also submitted that where time limits existed, it was essential that consumers knew about a CSLR, and the relevant time limits. To this end, the EDR body, tribunal or court should bring the existence of a CSLR and the relevant time limits to the attention of the consumer when the determination or court order is made. A CSLR should also engage in community outreach and education.[66]

Panel analysis

4.111. Ensuring the sustainability of a CSLR is a key principle informing the Panel's decisions on the design elements of a CSLR. Given this, the Panel considers that time limits should apply to consumers and small business that are eligible to lodge a claim with a CSLR.

4.112. A time limit provides a number of important benefits to a CSLR. For example, a time limit would ensure a CSLR could have a degree of certainty about what future claims could be made to it. In circumstances where AFCA and a CSLR are sharing information, such that a CSLR is aware of what unpaid EDR determinations exist, a time limit allows a CSLR to forecast what its potential future liabilities would be.

4.113. Additionally, where a CSLR has the ability to recover compensation from a financial firm that has an unpaid EDR determination, court judgment or tribunal award, which is discussed below at paragraphs 4.195-4.198, a time limit provides a CSLR with a greater ability to recover funds, for example from the liquidator, when compared to a situation where no time limit applies.

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61 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 13.
62 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 13.
63 Association of Financial Advisers, submission to the EDR Review Supplementary Issues Paper, page 12.
64 Financial Services Council, submission to the EDR Review Supplementary Issues Paper, pages 19-20.
65 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 13; Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, pages 16-17.
66 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 13.

4.114. In determining what the relevant time limit should be, the Panel has balanced the benefits which accrue to a CSLR, including greater equity and efficiency for CSLR members and their resources, with the requirement that consumers should be treated equitably.

4.115. As a result, the Panel considers that consumers and small businesses should bring their claim to a CSLR within 12 months of having completed the process which requires them to take all reasonable steps to receive payment from the financial firm (see discussion above at paragraph 4.96).

4.116. For unpaid EDR determinations, this means a consumer or small business will need to bring their claim to a CSLR within 12 months of AFCA certifying that it is satisfied that the EDR determination will not be paid by the financial firm to the consumer or small business.

4.117. For unpaid court judgments and tribunal awards, it means a consumer or small business will need to bring their claim to a CSLR within 12 months of completing all reasonable steps to receive payment from the financial firm. For example, contacting the financial firm and, where relevant and the information is available, their professional indemnity insurer. As discussed above at paragraph 4.97, the Panel expects that a CSLR will develop guidelines on what constitutes 'reasonable steps'.

4.118. It will be important for consumers and small businesses to be made aware of the possibility of lodging a claim with a CSLR. To ensure this, AFCA should include information on a CSLR in all written determinations, and when certifying that it is satisfied that the EDR determination will not be paid by the financial firm to the consumer or small business. It will also be necessary for the funding of a CSLR to be sufficient to allow a CSLR to raise community awareness of its existence.

4.119. Given the potential for unfairness to arise in certain circumstances, for example, where a consumer or small business only becomes aware of the existence of a CSLR after the time limit has expired, a CSLR should have the discretion to extend the time limit where there are extenuating circumstances.

5. THE FUNCTIONS AND POWERS OF A CSLR

4.120. Where a consumer or small business lodges a claim with a CSLR, and has complied with all necessary preconditions, consideration must be given to:

- the basis upon which a CSLR determines whether to pay compensation;
- the level of compensation it can pay to consumers and small businesses; and
- whether it should be able to seek recovery from the financial firm that failed to compensate the consumer or small business who lodged the claim.

The basis upon which a CSLR determines whether to pay compensation

Background

4.121. Where a consumer or small business has an unpaid EDR determination, court judgment or tribunal award and has lodged a claim with a CSLR, a question arises about the basis upon which a CSLR determines whether to pay compensation.

4.122. Two issues arise for consideration in this context:

- whether a CSLR should accept the decision of AFCA, a court or tribunal to award compensation, or whether it should independently review the merits of the case; and
- what inquiries need to be undertaken and what opinion a CSLR needs to form about the ability of the financial firm to pay compensation.

4.123. The Panel is aware that the rules of the United Kingdom's Financial Services Compensation Scheme (FSCS) state that, before paying compensation, the FSCS must be satisfied there is a specific civil liability owed by the firm in default. Accordingly, the FSCS's role is to examine each claim and any evidence provided and to determine for itself:

- whether there has been a breach of any contractual or other legal obligation owed by the firm in default; and
- where there has been such a breach, whether a court would make an award of damages.[67]

4.124. Additionally, before paying compensation, the FSCS must also be satisfied that the firm is in 'default'. That is, the firm is unable, or likely to be unable, to pay claims against it.[68]

Stakeholder submissions on a CSLR reviewing decisions

Submissions that did not support a CSLR reviewing decisions

4.125. Some stakeholders argued that a CSLR should not have the power to independently review the merits of a dispute.

4.126. Legal Aid NSW submitted that the process for applying and receiving compensation should be as streamlined and timely as possible for consumers, particularly as they may have already suffered considerable expense, hardship and delay in waiting for payment from the firm. In addition, the process involved in reaching a decision through an EDR process is independent, there is a full exchange of information, and an opportunity for all parties to participate.[69]

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67 Financial Services Compensation Scheme, viewed 9 August 2017, <**https://www.fscs.org.uk/what-we-cover/questions-and-answers/qas-about-keydata/cat1/**>.

68 Financial Services Compensation Scheme, viewed 9 August 2017 <**https://www.fscs.org.uk/what-we-cover/search-for-companies-in-default/**>.

69 Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 14.

4.127. Ballast Financial Management said a CSLR should not review EDR decisions as providing a full review was inefficient and would undermine the decision made by the EDR body.[70]

4.128. Legal Aid Queensland considered that it was unlikely that the introduction of a CSLR would see a reduction in the quality of EDR decision-making or in the internal quality assurance processes undertaken by an EDR body that might warrant a CSLR reviewing the merits of an EDR determination.[71] ASIC also identified that AFCA would be subject to accountability mechanisms, including the appointment of independent assessors to review complaints about dispute handling generally.[72]

4.129. Other reasons provided by stakeholders for not supporting any independent review, included that it would:

- result in delays for consumers receiving compensation;[73]
- increase administration costs and complexity, with no clear policy benefit;[74]
- undermine consumer confidence in the EDR system and may undermine confidence in the industry as a whole;[75]
- add time and stress to the consumer or small business that already has a valid claim for redress;[76] and
- add substantially to the costs of a CSLR, which would be borne by industry in the first instance.[77]

70 Ballast Financial Management, submission to the EDR Review Supplementary Issues Paper, page 2.
71 Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 6.
72 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 14.
73 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 11; NSW Legal Aid, submission to the EDR Review Supplementary Issues Paper, page 14.
74 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 11.
75 Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 6; Ballast Financial Management, submission to the EDR Review Supplementary Issues Paper, page 2.
76 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 20; Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 14.
77 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 14; Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 12.

Submissions supporting a CSLR reviewing decisions

4.130. Some stakeholders supported a CSLR having the power to consider the merits of a dispute and decide for itself whether a consumer or small business should receive compensation. For example, CIO submitted that like the UK's FSCS, a CSLR should independently review the EDR determination and decide for itself whether the consumer should be paid compensation, rather than simply accepting the EDR body's determination of the merits of the dispute.[78]

4.131. Maurice Blackburn Lawyers was also of the view that a claimant should have the right to raise any concerns regarding their EDR decision, particularly regarding disagreements about the quantification of losses. However, it stated that a CSLR should not need to be resourced to reinvestigate each matter in detail when the EDR body has already decided on it and the consumer accepts the decision.[79]

4.132. There was some support for review rights to exist in limited circumstances. The Association of Financial Advisers submitted that an EDR determination should not be reviewed in detail again unless new information becomes available about the matter, financial firm or adviser that is the subject of the complaint.[80]

Stakeholder submissions on a CSLR's role in determining a firm's ability to pay compensation

4.133. The Panel received a limited number of submissions on the inquiries which a CSLR would need to undertake, and the opinions it would need to form about the ability of the financial firm to pay the compensation, before making any compensation payment to the claimant.

4.134. ANZ submitted that a CSLR must be satisfied that:

- the financial firm against whom the determination had been made was insolvent; and
- there were no alternative avenues of recovery available to the claimant.[81]

4.135. FOS and the Joint Consumer Group both submitted that a CSLR should conduct the relevant checks to verify a firm's inability to pay.[82]

78 Credit and Investments Ombudsman, submission to the EDR Review Supplementary Issues Paper, page 5.
79 Maurice Blackburn Lawyers, submission to the EDR Review Supplementary Issues Paper, page 5.
80 Association of Financial Advisers, submission to the EDR Review Supplementary Issues Paper, page 10.
81 ANZ, submission to the EDR Review Supplementary Issues Paper, page 3.
82 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 10; Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper.

Panel analysis

A CSLR should not review the merits of a claim

4.136. For a consumer to be eligible for an award of compensation from a CSLR, they must have an unpaid EDR determination, court judgment or tribunal award in their favour. The Panel does not consider that it is the right policy outcome for consumers and small businesses, or an efficient use of resources, to require a rehearing of the merits of a dispute where a properly constituted and independent decision-maker has already decided the case.

4.137. Providing a CSLR with a review power will also increase regulatory costs as a CSLR will need to have its own expertise to determine the merits of a dispute. For complex cases, this process can take many months and involve the expenditure of significant resources. These costs will be borne by industry and ultimately passed on to consumers. The delays resulting from this approach will create further costs for consumers who are waiting for compensation.

4.138. It will also create complexity and has the potential to cause confusion for consumers and small businesses. For example, a consumer who has received a court judgment in their favour may not understand why they have to go through another process before receiving compensation.

4.139. A CSLR which can review the merits of a case has the potential to undermine comparability of outcomes. For example, a consumer may receive an EDR determination in their favour, but when they make a claim with a CSLR, it forms a different view about the merits of the dispute.

4.140. The Panel received compelling evidence from consumers who had suffered significant financial losses that requiring them to go through a process which reviews the merits again will compound the emotional distress they had already endured and raises issues of equity and fairness.

A CSLR should verify a financial firm's ability to pay compensation

4.141. Consistent with the Panel's approach of ensuring that a CSLR is truly a scheme of 'last resort', a CSLR should determine for itself whether a financial firm has the ability to pay the compensation awarded by an EDR body, court or tribunal.

4.142. Having regard to the Panel's Review Principles, this approach will:

- promote accountability as those firms who are responsible for the compensation awarded should be pursued to the maximum extent possible;
- ensure equity as funds provided by the members of a CSLR will only be paid as a 'last resort'; and
- promote transparency as this process will identify whether firms do have the ability to pay the compensation awarded.

4.143. What steps a CSLR should take to determine a firm's ability to pay will depend on the circumstances of the case. For example, the nature of the inquiries required where an EDR body has certified that the EDR determination will not be paid by the financial firm to the consumer or small business could be different from those where a consumer has a court judgment and may have had insufficient resources to enable them to fully pursue the financial firm for payment of the judgment.

4.144. However, the Panel does not consider that it is necessary for a firm to be insolvent before a CSLR pays compensation to a consumer or small business. The Panel received clear evidence of cases where it was extremely unlikely that compensation would be paid despite the lack of formal insolvency. For example, where there is still a legal entity, but in reality, the firm has ceased to exist in any practical sense.

The amount and types of compensation that can be paid

4.145. Where a consumer or small business has satisfied all the requirements for receiving compensation from a CSLR, there remains the question of:

- the amount of compensation a CSLR should be able to provide to the consumer or small business;
- the types of costs that should be recoverable; and
- the impact of private sector litigation funding.

The amount of compensation payable

4.146. It is common for a CSLR to apply caps to the amount of compensation that can be paid. For example:

- for banks, building societies and credit unions incorporated in Australia, the Financial Claims Scheme provides protection to depositors of up to $250,000 per account holder per Authorised Deposit-taking Institution; and
- the United Kingdom's Financial Services Compensation Scheme applies a range of compensation caps, which depends on the type of firm claimed against, for example, in relation to investments, there is a cap of £50,000 per customer.

4.147. However, that is not always the case. For example, under the National Guarantee Fund, there is no maximum amount that applies to any individual claim, although for claims for property entrusted to a dealer, the total available for all claims for any one insolvent dealer is 15 per cent of the minimum amount of the Fund.[83]

Stakeholder submissions

4.148. Stakeholders provided a range of views on the amount of compensation that consumers and small businesses should be eligible to receive.

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83 Australian Securities Exchange, submission to the EDR Review Supplementary Issues Paper, page 5.

4.149. A number of stakeholders submitted that consumers and small businesses should not receive the full amount of compensation awarded by an EDR body, court or tribunal, but only a percentage of that amount.[84]

4.150. The Financial Services Council stated that consideration needed to be given to a specified percentage, for example, 70 per cent of the lost amount being recoverable.[85] Similarly, the Financial Planning Association of Australia argued that compensation should be the lower of a prescribed percentage of the claim amount and a prescribed flat dollar amount.[86]

4.151. Other stakeholders put forward a position in which the compensation paid by a CSLR would be capped and not exceed the compensation caps that consumers and small businesses would be entitled to at an EDR body.[87]

4.152. The Joint Consumer Group submitted that as a general principle, a consumer should be able to recover their loss as awarded by the EDR determination or tribunal or court order. However, if a compensation cap was necessary, it should be no less than the compensation cap for the relevant EDR body.

Types of costs that should be recoverable

4.153. In addition to the amount of compensation payable, stakeholders provided the Panel with submissions on what types of costs should be recoverable, with a particular focus on legal costs.

4.154. Under the current EDR arrangements, there are limits to the costs that a consumer or small business can recover. For example, under FOS's Terms of Reference, it may decide that the financial firm should contribute to the legal or other professional costs or travel costs incurred by the applicant in the course of the dispute. However, unless exceptional circumstances apply, FOS will not require the firm to contribute more than $3,000 to these costs.

4.155. This is because it is considered that it is not usually necessary for either party to be legally represented.[88]

84 See Financial Services Council, submission to the EDR Review Supplementary Issues Paper, page 19; Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 10.

85 Financial Services Council, submission to the EDR Review Supplementary Issues Paper, page 19.

86 See also Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 13; Maurice Blackburn, submission to the EDR Review Supplementary Issues Paper, page 5.

87 Australian Bankers' Association, submission to the EDR Review Supplementary Issues Paper, page 7; Credit and Investments Ombudsman, submission to the EDR Review Supplementary Issues Paper, page 5; Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 20; Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 6.

88 Financial Ombudsman Service, *Operational Guidelines to the Terms of Reference (1 January 2015)*, page 99.

Legal costs

4.156. In circumstances where a consumer or small business is eligible to lodge a claim with a CSLR where they have a successful court judgment or tribunal award, there is a question whether they should be able to recover any legal costs incurred in obtaining that remedy. A range of views were put forward by stakeholders on this issue.

Submissions supporting legal costs being recoverable

4.157. A range of stakeholders supported consumers and small businesses being able to recover their legal costs, however, there were different views about the quantum of that recovery.

4.158. FOS stated that the criteria for awarding compensation should be the same as the prevailing EDR jurisdiction at the time of the court judgment, including the $3,000 cap on legal and professional costs.[89] Legal Aid Queensland supported consumers and small businesses being able to recover a percentage of their legal costs up to a fixed monetary cap.[90]

4.159. Legal Aid NSW considered that individuals with a court judgment should be able to recover their legal costs from a CSLR, otherwise they would be left considerably out of pocket.[91] The Joint Consumer Group also supported, as a general principle, a CSLR covering losses suffered by consumers and small businesses, including legal costs. However, if it was necessary to the viability of a CSLR, it would support legal costs being excluded.[92]

Submissions not supporting legal costs being recoverable

4.160. A number of stakeholders submitted that compensation should be limited to the losses caused directly by the financial firm and that legal costs should not be recoverable.[93]

4.161. Reasons given for this approach included that a CSLR would not have the ability to test the reasonableness of legal costs and it could make a CSLR vulnerable to claims for excessive legal costs.[94] Additionally, it was submitted that these costs could reduce the amount available for other claimants in respect of their actual losses and they would expose a CSLR to uncertainty in forecasting possible future funding requirements.[95]

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89 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 20.
90 Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 6.
91 Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 14.
92 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 10.
93 Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 12; Australian Bankers' Association, submission to the EDR Review Supplementary Issues Paper, page 5.
94 ANZ, submission to the EDR Review Supplementary Issues Paper, pages 4-5; see also Association of Financial Advisers, submission to the EDR Review Supplementary Issues Paper, page 11.
95 Industry Super Australia, submission to the EDR Review Supplementary Issues Paper, page 10.

4.162. It was also submitted that limiting the recovery of legal costs would help contain regulatory costs and, in turn, reduce the potential for the erosion of competition in the financial services industry.[96]

The impact of private sector litigation funding

4.163. A number of stakeholders provided submissions on whether litigation funders should be able to recover from a CSLR either directly or indirectly through their contracts with the class of claimants.

4.164. Litigation funding involves a contractual arrangement whereby a third party (the litigation funder) pays the cost of litigation and in return, if the case is successful, receives a percentage of the proceeds.[97]

4.165. The Association of Financial Advisers did not support the concept of a litigation funder having access to payments from a CSLR, as the intention of a CSLR should be to provide partial reimbursement to clients who have not received compensation.[98]

4.166. The Credit and Investments Ombudsman also considered that litigation funders should not be able to recover from a CSLR, either directly or indirectly through their contracts with the class of claimants. This was because of:

- the likely amount of compensation such funders typically expected to recover;
- the likelihood that it would open the floodgates to a large number of claims that would not otherwise be brought; and
- the fact that compliant financial firms would bear the entire cost of these claims.[99]

4.167. Legal Aid NSW considered that litigation funders should be able to recover from a CSLR, but only indirectly, through their contracts with the class of claimants. A CSLR that did not allow litigation funders to recover from class members might discourage class actions, to the detriment of consumers. On the other hand, Legal Aid NSW did not consider that litigation funders should take compensation directly from a CSLR before the consumer has had the opportunity to receive any benefit.[100]

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96 Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 12.

97 Australian Government 2015, Post-Implementation Review, *Litigation Funding, Corporations Amendment Regulation 2012 (No 6)*, viewed 22 August, <**http://ris.pmc.gov.au/sites/default/files/posts/2016/03/Litigation-Funding-PIR.pdf**>.

98 Association of Financial Advisers, submission to the EDR Review Supplementary Issues Paper, page 11.

99 Credit and Investments Ombudsman, submission to the EDR Review Supplementary Issues Paper, page 6; see also Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 20.

100 Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 15; see also Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 10.

Panel analysis

4.168. The amount of compensation a CSLR can pay to consumers and small businesses, and the types of costs that should be recoverable are critical issues for a CSLR. This is because if these parameters are not set correctly, it increases the risk that a CSLR will become financially unsustainable.

Compensation caps

4.169. Setting a compensation cap for a CSLR involves balancing the interests of consumers and small businesses in receiving compensation for the loss suffered against the interest of members of the scheme who are required to fund the compensation in circumstances where they have not been responsible for the conduct which caused the loss.

4.170. In balancing these interests, and applying the Review Principles, the Panel considers that a CSLR should have a compensation cap and it should be aligned with AFCA's compensation cap. This is particularly important where a CSLR has jurisdiction to receive claims from consumers and small business that have a court judgment or tribunal award.

4.171. Ensuring alignment between these two compensation caps will promote comparability of outcomes as consumers and small business will receive the same level of compensation irrespective of whether they take their dispute through the EDR framework or to a court or tribunal.

4.172. The Panel considers that the EDR framework provides consumers and small businesses with significant benefits and does not want to create incentives for these parties to pursue their claims through the courts with a view to receiving a higher compensation payment. For example, where a CSLR's compensation cap was higher than AFCA's compensation cap, this would create incentives for consumers to take their dispute to court as they could receive higher levels of compensation.

4.173. Capping the amount of compensation payable will also reduce regulatory costs and ensure the sustainability of a CSLR.

4.174. It is also important to note that requiring a CSLR to have a compensation cap is not a new concept. As identified above at paragraph 4.146, there are a number of precedents for a CSLR applying a compensation cap.

4.175. A CSLR should have the discretion to decide the level of its compensation cap. However, in the absence of special circumstances, the cap should be aligned with the compensation cap that applies to AFCA. A CSLR and AFCA should work together as compensation caps are periodically reviewed, to ensure these caps remained aligned wherever possible.

Recovering legal costs

4.176. As a general principle, the Panel considers that consumers and small businesses should be able to recover the legal costs incurred in having their dispute heard. This is because the EDR framework allows a consumer or small business to choose their dispute resolution forum and in some circumstances, a consumer or small business will not be able to have their case heard without incurring these costs.

4.177. However, the Panel is concerned that excessive legal costs could exhaust a CSLR's resources and undermine the overall purpose of the scheme, which is focused on providing compensation for loss or damage suffered because of breaches of the financial firm's relevant legal obligations.

4.178. Therefore, a CSLR should impose a cap on the amount of legal costs which a consumer or small business can recover from a CSLR. The Panel considers that this cap should allow consumers and small businesses to recover their reasonable legal costs.

4.179. The Panel is aware that there are a number of complexities in considering this issue, including:

- the types of costs that should be included, for example, solicitor and barrister costs, court fees; and
- how the amount of costs should be assessed and who should undertake this assessment.

4.180. There is also a risk that allowing consumers and small businesses to recover legal costs from a CSLR could create incentives for behaviour that ultimately undermines a CSLR's financial sustainability. While it is not possible to entirely foresee the types of behaviours that could emerge, they could include law firms pursuing class actions that might not be pursued in the absence of a CSLR.

4.181. Given the complexities associated with this issue and the uncertainty about what impact an ability to recover legal fees will have on the incentives of parties, a CSLR should be able to decide what expenses are reasonable and have the discretion to issue guidelines on this issue.

4.182. In developing these guidelines, a key consideration should be that the amount of legal fees which are recoverable should not undermine a CSLR's overall purpose and its financial sustainability.

Private sector litigation funding

4.183. Only consumers and small business should be able to access a CSLR. This means litigation funders are excluded from directly accessing a CSLR.

4.184. However, as discussed above at paragraphs 4.71-4.74, some consumers or small businesses may not be able to have their dispute heard without the support of a litigation funder. In these circumstances, as a matter of principle, the Panel considers that a consumer or small business should be able to use any compensation received to satisfy any obligations they have under a litigation funding agreement.

4.185. As with legal costs, in general, there is a risk that allowing consumers and small businesses to provide a litigation funder with part of the compensation paid by a CSLR could create incentives for behaviours that ultimately undermine the purpose and financial sustainability of a CSLR.

4.186. Given the complexities associated with this issue and the uncertainty about how the private sector litigation funding market could respond to a CSLR, a CSLR should have the discretion to issue clear guidelines on this issue.

4.187. In developing these guidelines, a key consideration should be that the role played by private sector litigation funding, which is an important one for some consumers and small businesses, should not undermine a CSLR's overall purpose and its financial sustainability.

A CSLR's ability to recover compensation from a financial firm

Background

4.188. After a CSLR pays compensation to a consumer or small business, a question arises about what rights it should have to recover funds from the firm that failed to pay, where the firm is still in existence. For example, a CSLR could stand in the shoes of the consumer or small business and assume its rights and duties, including its right to compensation (that is, exercise a right of subrogation).

4.189. An example of a compensation scheme where the operator has the ability to recover funds from a firm is the Fair Entitlements Guarantee (FEG). FEG is an Australian Government funded scheme of last resort that provides financial assistance for unpaid employee entitlements to eligible employees who lose their job due to the liquidation or bankruptcy of their employer.

4.190. Once entitlements are paid by FEG to an employee, the Government stands in the shoes of the employee as a subrogated creditor and is entitled to claim the amount paid, and is given priority over other unsecured creditors.

4.191. The Government may also provide funds to liquidators to enable recovery efforts of the Guarantee from entities, including initiating legal proceedings to recoup any funds paid.[101] Additional information on FEG is contained in Appendix 3.

101 On 17 May 2017, the Australian Government released a Consultation Paper on options for targeted law reform to address corporate misuse of the Fair Entitlements Guarantee scheme and to improve the recovery of Fair Entitlements Guarantee payments: see <**http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2017/Reforms-to-address-corporate-misuse-of-the-FEG-scheme**>.

Stakeholder submissions

4.192. There was strong support from stakeholders for a CSLR to be able to assume the rights of a consumer or small business who received compensation and seek recovery from the financial firm who failed to pay the EDR determination, court judgment or tribunal award.[102]

4.193. In addition to seeking recovery of the compensation paid, a number of stakeholders suggested specific powers or remedies which a CSLR should have, including:

- being given priority as a creditor in circumstances where the claims are paid before the financial firm is formally wound up, in case, through the winding up process, funds become available;[103]
- having the right to directly pursue the financial firm's professional indemnity insurer;[104]
- being able to also recover the costs of administering the payment to the consumer or small business from the firm that failed to pay.[105]

4.194. Legal Aid NSW also recommended that a CSLR be adequately funded to cover any enforcement actions, so that its compensation function is unaffected by costs related to enforcement.[106]

Panel analysis

4.195. The Panel considers that an important feature of a CSLR is its ability to assume the rights of a consumer or small business who received compensation from a CSLR and seek to recover funds from the financial firm that failed to pay the EDR determination, court judgment or tribunal award.

4.196. Providing a CSLR with a right to recover compensation will promote equity as it will ensure that the financial firm which engaged in misconduct is, to the maximum extent possible, required to make a contribution, albeit indirectly, to the compensation paid to the consumer or small business.

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102 Association of Financial Advisers, submission to the EDR Review Supplementary Issues Paper, page 12; Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 13; Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 15; The Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues, page 9; Credit and Investments Ombudsman, submission to the EDR Review Supplementary Issues Paper, page 6; Financial Services Council, submission to the EDR Review Supplementary Issues Paper, page 19; Industry Super Australia, submission to the EDR Review Supplementary Issues Paper, page 11; Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 12.

103 Australian Bankers' Association, submission to the EDR Review Supplementary Issues Paper, page 7.

104 Maurice Blackburn, submission to the EDR Review Supplementary Issues Paper, page 6.

105 Financial Ombudsman Scheme, submission to the EDR Review Supplementary Issues Paper, page 21.

106 Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 15.

4.197. It will also reduce regulatory costs and assist with a CSLR's sustainability as funds which are successfully recovered from financial firms will be returned to a CSLR to be used for other eligible claims for compensation.

4.198. It is important, however, to recognise that in many cases it will not be cost-effective to pursue these rights, so decisions about whether to do so will ultimately be a matter for a CSLR.

6. THE FUNDING OF A CSLR

Background

4.199. When establishing a CSLR, a number of important design issues exist in relation to how the scheme should be funded. These issues include who should fund a CSLR and any mechanism to facilitate funding.

4.200. A range of options exist for who should fund a CSLR. Internationally, compensation schemes of last resort in the financial sector are industry funded. For example, the United Kingdom's Financial Services Compensation Scheme adopts an industry funding model.

4.201. There is also the possibility of an industry funding model, but with government involvement in its administration. As discussed in Appendix 2, under the Financial Claims Scheme, where the liquidation proceeds of a firm are insufficient to recover the funds paid to deposit-holders, the Australian Government can place a levy on industry to recover the shortfall.[107]

4.202. Under an industry funding model, there are a variety of ways to allocate a CSLR's costs amongst contributors. For example, the United Kingdom's Financial Services Compensation Scheme adopts a funding class model to cover its compensation costs. Under this model, a participant firm's permissions to conduct activities determine to which class, or classes, it belongs. If a firm is a member of more than one funding class, they are required to contribute to both classes. Each of the relevant funding classes has a threshold to try to ensure that firms' contributions are affordable and sustainable. If compensation and specific costs in a funding class are so high that the threshold is breached, firms in other classes are called upon to contribute.

4.203. While grouping firms based on the types of activities they carry on can create incentives for firms to work together at an industry level to improve practices, it can result in levies being subject to high degrees of volatility where those activities are subject to a high number of claims.

4.204. By contrast, a single class funding model can reduce volatility, but it also raises issues around cross-subsidisation as firms in one sector who are operating consistent with their legal obligations are required to subsidise the actions of firms in other sectors who are not.

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107 Commonwealth of Australia 2014, *Financial System Inquiry Final Report,* page 82.

Stakeholder submissions

Who should fund a CSLR

4.205. A number of stakeholders supported a CSLR being funded by the financial services industry,[108] with those industry sectors that have clients who are eligible for compensation under a CSLR being required to make funding contributions.[109]

4.206. For example, the Australian Bankers' Association submitted, consistent with its proposed scope of a CSLR, that a levy should apply to all Australian Financial Services Licensees who offer financial advice to retail clients, including some small businesses.[110] The Joint Consumer Group and FOS said the costs of a CSLR should be spread across all financial firms, which was consistent with their proposed scope for a CSLR.[111]

4.207. Some other stakeholders considered that a CSLR should be government-funded,[112] or funded by investors as they would be the ultimate beneficiaries.[113]

Mechanism for funding a CSLR

4.208. Stakeholders provided the Panel with a range of ways that a levy could be designed as a mechanism for funding a CSLR.

Risk-based funding approach

4.209. A number of stakeholders suggested that one approach for designing a levy was to use a risk-based framework.[114]

4.210. The Australian Bankers' Association submitted that funding contributions would need to be calculated, taking into account different advice models, such as general advice representative models, product manufacturers that provide financial advice, and robo-advice businesses.

108 Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 13; Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 15.
109 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 15.
110 Australian Bankers' Association, submission to the EDR Review Supplementary Issues Paper, page 6.
111 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, pages 20-21; Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 11.
112 SR Group, submission to the EDR Review Supplementary Issues Paper, page 4.
113 Stockbrokers and Financial Advisers Association Limited, submission to the EDR Review Supplementary Issues Paper, page 5.
114 Industry Super Australia, submission to the EDR Review Supplementary Issues Paper, page 11.

4.211. In this regard, two options could be considered: contributions on a per adviser or licensee basis; or contributions could be appropriately risk weighted, taking into account:

- the risk profile of the firm's operating model;
- the scope of the firm's professional indemnity insurance, including exclusions; and
- other risk management arrangements that have been put in place.[115]

4.212. However, the Australian Bankers Association identified that there would be complexity and cost in designing and applying a risk-based calculation, and further investigation and a cost-benefit analysis would be required before considering such a system.[116]

4.213. The Financial Planning Association of Australia supported an approach whereby each firm's levy was based on their particular risk-level. It argued that risk-based funding would minimise the extent to which firms would increase their risk-level as they would be sharing compensation costs with other providers in their pool.[117]

Other levy design approaches

4.214. A number of stakeholders suggested different design approaches, including a levy:

- which raised funds in a tiered fashion, based on the type of advice provided and volume, with personal advice firms being in Tier 1 as they were the firms most likely to be claimed against;[118]
- which was proportionately based upon the historical record of unpaid determinations for the relevant sector in the previous year;[119]
- which applied a size threshold whereby only businesses above a certain size would be required to make a contribution;[120] and
- that adopted the ASIC industry funding model.[121]

A pre-vs post funded CSLR

4.215. The Panel received a limited number of submissions on the issue of whether a CSLR should be pre-funded or post-funded.

115 Australian Bankers' Association, submission to the EDR Review Supplementary Issues Paper, page 6.
116 Australian Bankers' Association, submission to the EDR Review Supplementary Issues Paper, page 7.
117 Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 13.
118 Ballast Financial Management, submission to the EDR Review Supplementary Issues Paper, pages 4-5.
119 Mortgage & Finance Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 2.
120 Association of Financial Advisers, submission to the EDR Review Supplementary Issues Paper, page 11.
121 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 12.

4.216. The Australian Bankers' Association submitted that it broadly supported a pre-funded levy structure comprising:

- a pre-funded establishment levy, based on borrowings from industry and repaid through future levies;
- pre-funded management levies to support the operation of a CSLR and repay establishment levies; and
- pre-funded compensation levies.

Avoiding cross-subsidisation

4.217. There was a concern raised by some stakeholders that a levy should not involve cross-subsidisation, that is, firms in sectors which have not contributed to a claim should not be required to fund the compensation related to that claim.[122]

4.218. Legal Aid Queensland supported the UK Financial Services Compensation Scheme's funding class model, discussed above at paragraphs 4.202-4.203, as it created an incentive for firms within an industry to collectively improve the industry practice. It did not support a single class funding model because it considered that this risked firms or industries who engaged in inappropriate practices being subsidised by firms who treated consumers appropriately.[123]

4.219. Suncorp was also of the view that if a scheme was implemented, it should be predominantly funded by those segments of the financial services industry that have licensees providing the services that are most likely to give rise to uncompensated consumer losses. By way of example, it stated that compensation for poor financial planning advice should not be cross-subsidised by general insurers operating no-advice or general-advice models.[124]

Modelling the costs of a CSLR

4.220. Designing an appropriate funding mechanism for a CSLR is a complex process which requires modelling of the potential costs of a CSLR.

4.221. The Panel was provided with economic modelling from FOS and the Financial Services Council on these potential costs.

4.222. FOS referred the Panel to its high level funding model which it prepared with the assistance of Grant Thornton in August 2014. The relevant parameters of that model included:

- it was focused on and funded by financial advisers/planners and managed investment schemes;
- APRA-regulated entities were excluded from being members of the scheme;

122 The Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, page 8.
123 Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 6.
124 Suncorp, submission to the EDR Review Supplementary Issues Paper, page 2.

- existing legacy unpaid determinations would be paid from the scheme; and
- the amount forecast as being paid out of the scheme each year was calculated using the data on the average value and frequency of previous unpaid determinations.[125]

4.223. Under the model developed by Grant Thornton, the scheme would raise approximately $10.8 million in upfront levies and have an ongoing combined annual levy of $3.3 million. For a financial adviser, they would be required to pay an upfront levy of $100, which would gradually decline to an ongoing levy of $20.

4.224. The modelling provided by the Financial Services Council predicted that a CSLR would impose significantly higher costs on industry. The relevant parameters used in that model included:

- the loss parameters are based on a 3 tier loss probability model of: business as usual; major loss (a recession or single event failure every 10 years); and a catastrophe (a GFC or major industry failure every 40 years);
- these parameters resulted in advice claims on a scheme of $3m, $400m and $2,400m, respectively for the loss parameters outlined above;
- 80 per cent of the total claims were below FOS's compensation cap; and
- costs would increase at a real rate of 4.5 per cent per annum over 20 years.[126]

4.225. As the foregoing demonstrates, these models use different assumptions and have very different cost estimates.

Panel analysis

4.226. Designing a funding mechanism for a CSLR is a complex task which raises a number of difficult issues, some of which will require further consultation between a CSLR and relevant stakeholders, including government. In these circumstances, the Panel has decided to set out a number of key principles which should guide the development of an appropriate funding mechanism.

Industry funding

4.227. A CSLR should be funded by financial firms engaged in the types of financial services covered by a CSLR.

125 Financial Ombudsman Service 2014, submission to the Financial System Inquiry Interim Report, Appendix 2.
126 Financial Services Council, submission to the EDR Review Supplementary Issues Paper.

4.228. As ASIC identified in its submission:

> *"The[re has been a] shift in regulatory philosophy towards industry funding, where industries pay for the regulation that they generate. The introduction of an industry-funded compensation scheme of last resort is consistent with this shift. That is, those sectors that generate unpaid determinations and will benefit from their resolution – in the form of enhanced consumer trust and confidence – should contribute to the payment of those determinations."*[127]

4.229. Requiring industry to fund a CSLR is also consistent with other compensation schemes in the financial services industry, including the Financial Claims Scheme, the National Guarantee Fund and Pt 23 of the *Superannuation Industry (Supervision) Act 1993*.

A risk-based approach to funding

4.230. Applying a risk-based approach to a funding mechanism has the potential to provide a CSLR with some benefits, including providing an incentive for members to maintain an appropriate risk-profile and ensuring those members who pose a higher risk make larger contributions.

4.231. However, a risk-based approach to funding will introduce considerable complexity, accompanied by significant regulatory costs for firms and a CSLR.

4.232. For these reasons, the Panel considers that applying a risk-based approach to funding should be considered as a future reform option, once a CSLR is established and has additional information which will allow the costs and benefits of this approach to be properly assessed.

Responding to large numbers of claims

4.233. In the future there could be circumstances where the number and amount of claims made on a CSLR exceed its funding levels. In this situation, a CSLR should have flexibility in how it responds. There are a range of approaches that could be used to deal with this issue, including:

- additional levies could be collected;
- levies could be set higher each year than is required to ensure there is a buffer for future events;
- payout caps could be introduced so that consumers receive their compensation over a period of years;
- a credit facility could be established to allow compensation to be paid when required, while recovering the necessary levies over a longer period of time.

127 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 6.

4.234. These approaches should be investigated as part of designing any funding mechanism.

Pre- vs post-funding

4.235. The Panel is aware of concerns which arise in relation to pre-funding a CSLR, including the costs associated with having a significant amount of funding sitting with a CSLR rather than being deployed into productive uses by member firms.

4.236. However, the Panel considers that these costs are outweighed by the benefits of pre-funding a CSLR. These benefits include:

- reducing the volatility of the funding contributions made by CSLR members; and
- ensuring that firms whose actions create the need for compensation to be paid by a CSLR make some contribution to a CSLR's costs.

4.237. Where pre-funding proves inadequate to meet the claims made on a CSLR, some form of post-funding may be required.

4.238. The UK Financial Conduct Authority is currently consulting on whether changes should be made to the Financial Services Compensation Scheme's funding mechanism. This consultation includes whether a pre-funded approach would be more appropriate than the current system whereby the Scheme can only charge for the amount they know or expect will be needed to meet expenses and pay compensation.[128]

Impact on competition

4.239. Given the importance of providing consumers with choice when deciding where to obtain financial advice, the funding mechanism should be designed in a manner that does not result in a substantial lessening of competition in this market.

4.240. For example, consideration should be given to indicators of scale, such as turnover from relevant activities and/or number of financial advisers employed by the firm, to ensure that the amount of any levy paid by a firm is proportionate to its level of involvement in the types of activities covered by a CSLR.

4.241. If effectively designed, the funding mechanism will ensure that all firms providing the types of financial services covered by a CSLR make an appropriate level of contribution without imposing such a high cost on smaller firms that they cannot continue to participate in, or are unable to enter, the market.

Cross-subsidisation

4.242. The Panel is aware of concerns by some stakeholders about the prospect of cross-subsidisation, that is, firms in sectors who have not contributed to a claim should not be required to fund the compensation related to that claim.

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128 Financial Conduct Authority 2016, *CP16/42: Reviewing the funding of the Financial Services Compensation Scheme (FSCS)*, page 17.

4.243. Under the Panel's proposed model of a CSLR, the issue of cross-subsidisation between sectors does not directly arise as a CSLR will be initially limited to financial advisers and will, therefore, be funded by firms who provide financial advice.

4.244. However, given the Panel's recommendation that a CSLR should also scalable, there is the potential for that issue to arise in the future. As discussed above at paragraphs 4.202-4.204, there are trade-offs with this issue. While grouping firms based on the types of activities they carry on can create incentives for firms to work together at an industry level to improve practices, it can result in levies being subject to high degrees of volatility where those activities are subject to a high number of claims.

4.245. The Panel would encourage any future decision on this issue to be informed by the relevant experiences of the United Kingdom's Financial Services Compensation Scheme, which is currently consulting on these issues.[129]

Comprehensive modelling

4.246. As discussed above at paragraph 4.64, comprehensive modelling should be undertaken to estimate the likely costs associated with a CSLR and the funding mechanism should reflect the outcome of this modelling exercise.

4.247. The Panel appreciates the modelling that stakeholders have provided on the potential costs of a CSLR. However, the benefits of these models are necessarily limited as they are based on a hypothetical model, not the features of a model which may ultimately be established or the model proposed by the Panel. For example, under the Panel's proposed model, a CSLR would:

- be limited to financial advice failures where a financial adviser provides personal and/or general advice on 'relevant financial products' (as defined), to a consumer or small business;
- impose a number of conditions on consumers and small businesses which need to be satisfied before they can access a CSLR; and
- be able to exercise the right of subrogation and recover funds from the financial firm that did not pay the compensation.

4.248. Additionally, the approach and assumptions which underpin this modelling provided to the Panel are open to challenge. For example, in the modelling provided by the Financial Services Council, the size of the claims made following a catastrophic event and the frequency of such an event are contestable. This is important as that scenario is a significant driver of the costs which it is claimed a CSLR will impose on industry.

129 Financial Conduct Authority 2016, *CP16/42: Reviewing the funding of the Financial Services Compensation Scheme (FSCS)*.

4.249. Another key aspect of any modelling is the approach to determining the amount of compensation that is likely to be awarded, and remain unpaid, in relation to financial advice. Given that the Panel's recommended model of a CSLR will only cover compensation arising from failures in financial advice, not market or investment losses in cases where the financial advice provided to a consumer or small business was appropriate it likely to cost less than the estimates provided by the FSC.

7. Administration of a CSLR

4.250. In circumstances where a CSLR is established, a number of important administrative decisions will need to be made. The Panel has considered some of the key matters in this area, however, further detailed consultations between government and stakeholders will be required.

4.251. Key areas of a CSLR's administration considered by the Panel in this section include:

- whether a CSLR should be independent or government administered;
- a CSLR's governance arrangements;
- accountability mechanisms for a CSLR; and
- a CSLR's relationship with AFCA.

An independent or government administered CSLR

4.252. There are a number of ways that a CSLR could be established and administered.

4.253. It could be an independent body, but supported by legislation and subject to regulatory oversight. This would be similar to the current EDR framework which involves an independent EDR body that is subject to regulatory approval, with membership of the body mandated by legislation.

4.254. Alternatively, a CSLR could be established and administered by government with appropriate legislative backing, similar to the Fair Entitlements Guarantee, as described in Appendix 3).

Stakeholder submissions

Support for a CSLR which is independent of government

4.255. A number of stakeholders submitted that a CSLR should be independent of government, but subject to regulatory oversight.[130]

130 See Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 13; Australian Bankers' Association, submission to the EDR Review Supplementary Issues Paper, page 5.

4.256. FOS submitted that to be successful, a CSLR which was independent of government would require sufficient broad based industry support with general agreement on key design features, such as coverage, funding and governance. FOS noted, however, that if industry was unable to agree on an appropriate model, then a statutory-based model would be the more viable approach.[131]

4.257. There was broad support amongst consumer groups for a CSLR which was independent of government, but subject to regulatory oversight. Legal Aid NSW said structuring a CSLR in this way would ensure that it had the necessary adaptability to change its processes as appropriate.[132]

4.258. The Australian Bankers Association was of the view that a CSLR should operate through industry-based terms of reference, however, it stated that there should be detailed enabling legislation which clearly sets out the scope of a CSLR, key elements of its terms of reference, and the mechanism to require financial firms to pay. For the Australian Bankers Association, this approach would promote certainty for industry and consumers.[133]

4.259. The Financial Planning Association of Australia stated that an industry-based CSLR was preferable because if industry was required to fund a CSLR, it should also control the costs of administering it. Further, financial firms would have an incentive to run a CSLR efficiently if they were paying for it.[134]

Support for a government administered CSLR

4.260. Some stakeholders expressed reservations about an industry-based CSLR, citing concerns around integrity and transparency.

4.261. Maurice Blackburn Lawyers commented that an industry-based scheme would represent a significant conflict of interest which would undermine public confidence in the new body.[135]

4.262. CIO submitted that consistent with other last resort schemes, a CSLR should ideally be established as a statutory scheme. It was argued that it would be inappropriate for a statutory levy which was imposed on industry to be collected, held and disbursed by a private body, such as an EDR body.[136]

4.263. The Association of Superannuation Funds of Australia considered it appropriate that if a CSLR was introduced, it should be independent of government and industry, established under statute, have a board of directors (appointed by the relevant minister) and report to ASIC.[137]

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131 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 21.
132 Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 16.
133 Australian Bankers' Association, submission to the EDR Review Supplementary Issues Paper, page 5.
134 Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 14.
135 Maurice Blackburn, submission to the EDR Review Supplementary Issues Paper, page 2.
136 Credit and Investments Ombudsman, submission to the EDR Review Supplementary Issues Paper, page 6.
137 Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, page 8.

Governance arrangements

4.264. ASIC and the Joint Consumer Group supported the governance arrangements of the existing EDR bodies with an independent chair and an equal number of directors with industry and consumer backgrounds.[138] Similarly, Legal Aid NSW said when appointing the board, the qualifications and experience of proposed directors should be taken into account.[139]

4.265. The Association of Superannuation Funds of Australia submitted that a CSLR should have an independent board of directors (appointed by the relevant minister). Clear mechanisms for accountability and transparency should also be provided, including detailed reporting of all contributions collected from industry and the amounts of compensation paid.[140]

Accountability mechanisms

4.266. The Panel received limited submissions on what mechanisms could be used to ensure accountability for a CSLR.

4.267. ASIC submitted that it should have an oversight role of a CSLR to ensure that it was functioning adequately to fulfil its objectives, similar to the role that is envisaged for ASIC in respect of AFCA.[141] Under AFCA, it is proposed that ASIC would have a general directions power to ensure AFCA complies with legislative and regulatory requirements.

A CSLR's relationship with AFCA

4.268. Any CSLR could form a part of the existing EDR framework, or operate as a stand-alone scheme.

4.269. Some stakeholders saw merit in a CSLR being administered by AFCA and pointed to the efficiencies and costs savings associated with this approach.[142] Industry Super Australia said a CSLR administered by AFCA would result in improved accountability and transparency because it would ensure direct feedback about the nature of non-payment issues that may subsequently be the subject of compensation claims.[143]

138 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 13; Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 14.
139 Legal Aid NSW, submission to the EDR Review Supplementary Issues paper, page 16.
140 Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, pages 8-9.
141 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 14.
142 Association of Financial Advisers, submission to the EDR Review Supplementary Issues Paper, page 12.
143 Industry Super Australia, submission to the EDR Review Supplementary Issues Paper, page 9.

4.270. ASIC submitted that a CSLR could achieve cost efficiencies by leveraging from AFCA's administration system and infrastructure.[144] The Association of Financial Advisers also saw merit in a CSLR being aligned with AFCA to enable it to leverage the existing resources.[145]

4.271. The Association of Superannuation Funds of Australia did not support a CSLR forming part of AFCA. It said this option may appear attractive from an administration and efficiency perspective. However, clear independence between the two bodies was critical, as the triggering of the compensation scheme may highlight deficiencies in the EDR framework which need to be comprehensively and independently reviewed.[146]

Panel analysis

4.272. In considering the administration and governance arrangements that should apply to a CSLR, the Panel has been guided by its Review Principles.

4.273. The Panel considers that a CSLR's administrative arrangements should be efficient and keep complexity to a minimum. However, in order for users and industry to have confidence in a CSLR, it is also important that it is, and is perceived to be, independent and that its administrative arrangements are sufficiently robust to ensure transparency and accountability. These competing considerations need to be balanced. The Panel's view on how this balancing should occur is set out below.

A strong and flexible CSLR

4.274. As the Panel identified in its April 2017 Report, a strength of the EDR framework has been the co-regulatory approach, which has provided independent EDR bodies with the flexibility to evolve in response to market changes, changing stakeholder expectations and the recommendations of independent reviews, while being subject to oversight by ASIC.[147]

4.275. The Panel considers that a model with strong industry engagement and appropriate legislative backing will deliver effective outcomes for the users of a CSLR, while keeping complexity and regulatory costs across the system to a minimum. A CSLR with specific legislative backing will also have the benefit of providing certainty for industry and consumers.

144 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues paper, page 14.

145 Association of Financial Advisers, submission to the EDR Supplementary Issues Paper, page 12.

146 Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, pages 8-9.

147 Commonwealth of Australia 2017, *Review of the financial system external dispute resolution and complaints framework: Final Report*, page 12.

Features of a CSLR requiring legislative backing

4.276. When designing a CSLR, legislative backing will be required for the following features:

- the requirement for financial firms who fall within the proposed scope of a CSLR to be a member of, and contribute to, a CSLR;
- the consequences of non-payment of a CSLR levy; and
- the oversight and accountability mechanisms of a CSLR (see below).

Scalability of a CSLR

4.277. As discussed in paragraphs 4.63-4.65, a CSLR should be scalable to allow it to expand to cover other sectors in the financial services industry where there is evidence of significant problems of uncompensated losses.

4.278. In circumstances where the requirement for financial firms to be a member of a CSLR is underpinned by legislation, the Panel considers that expanding the types of financial services covered by a CSLR should be able to happen in a timely manner. This may mean that a decision to expand the membership can be implemented through delegated legislation, rather than a statutory amendment. This approach will allow the government to ensure a CSLR can respond to significant change sin uncompensated losses, while still providing for parliamentary oversight.

4.279. Before any expansion takes place, there should be appropriate consultation with stakeholders and comprehensive modelling.

Governance

4.280. The Panel considers that the governance structure for a CSLR should comprise an independent chair and equal numbers of directors with industry and consumer backgrounds, who are appointed after consultation with stakeholders.

4.281. This governance model will allow a CSLR to operate independently of industry, despite being industry funded. It will provide flexibility whilst at the same time ensuring transparency and accountability. It will also allow a CSLR to make decisions in a timely fashion. For example, it could allow a CSLR to amend its compensation caps in response to any change in AFCA's caps.

Oversight and accountability mechanisms

4.282. Oversight and accountability mechanisms play an important role in promoting high-quality consumer outcomes and maintaining confidence amongst industry stakeholders in a CSLR's activities.

4.283. While primary oversight and governance responsibilities of a CSLR will rest with a CSLR's board, ASIC should have an oversight role of a CSLR to ensure it is fulfilling its objectives, similar to the role envisaged for ASIC in respect of AFCA.

4.284. In this regard, consideration should be given to ASIC:

- playing an important role in approving a CSLR's terms of reference;
- ensuring that a CSLR is subject to regular independent reviews of its operations; and
- having a general directions power to allow it to compel performance from a CSLR if it does not comply with legislative and regulatory requirements.

4.285. As the Panel identified in its April 2017 Report, a general directions power is more flexible and adaptable than a series of specific powers in terms of overseeing any new CSLR. However, these powers should only be used as a last resort and after consultation with a CSLR, and should be subject to merits review.[148]

Reviewing a CSLR's decision

4.286. A related consideration in terms of a CSLR's accountability is whether there should be any review mechanism in circumstances where a CSLR refuses to pay a claim for compensation.

4.287. Under the current EDR framework, consumers and small businesses can choose to have their dispute heard by an EDR body, court or tribunal. Where a consumer or small business chooses to go to EDR, if they are dissatisfied with a determination, they are not bound by the decision and are free to go to court or mediation. In contrast, financial firms are bound by the decision and are only able to appeal in limited circumstances.

4.288. The Panel considers that, to the extent a party should be able to challenge a CSLR's decision, the grounds for reviewing that decision should be narrow.

4.289. The type of review available to consumers and small businesses will depend on whether a CSLR is a statutory body or a company limited by guarantee. In the former case, there are established ways decisions can reviewed, such as through an application to the Administrative Appeals Tribunal.

4.290. However, if a CSLR is established as a company limited by guarantee, like FOS, then a useful model is provided by the grounds for reviewing an EDR determination. As an EDR body's authority with its members is contractual, an EDR body may be challenged in court for breach of contract (for example, if a financial firm did not believe that the body performed its services in accordance with its terms of reference).[149]

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148 Commonwealth of Australia 2017, *Review of the financial system external dispute resolution and complaints framework: Final Report*, page 184.

149 This can result in an appeal of a determination, but only on limited grounds and no party (either complainant or financial firm) has to date been successful in overturning a FOS determination in court. Additionally, there are informal and formal mechanisms available to financial firms, industry bodies or consumer organisations (but not complainants) to have the approach taken by FOS in determinations (as opposed to a particular decision) reviewed to assess whether the approach should be modified for future disputes.

A CSLR's relationship with AFCA

4.291. In terms of the relationship between a CSLR and AFCA, the Panel considers that, in the interests of transparency and accountability, a CSLR should be independent of AFCA. It should be a separate body with its own governance arrangements.

4.292. However, in line with the Review Principles of improving efficiency, reducing complexity and keeping regulatory costs to a minimum, a CSLR could share administrative costs and resources with AFCA.

4.293. There is also merit in AFCA and a CSLR sharing data to assist in the continuous evolution and improvement of the overall EDR framework. The sharing of data would also assist in the identification of systemic problems and non-payment issues that may be the subject of future compensation claims and enable a CSLR to plan and budget accordingly.

Vulnerable consumers

4.294. It is important that a CSLR is accessible for consumers and small businesses, both in terms of their awareness of it and how easy it is to use its service. In this regard, a CSLR should have a strong focus on consumer outreach and education, and ensuring that consumers, particularly vulnerable consumers, can easily access a CSLR.

4.295. The Panel is aware that the EDR bodies have undertaken a number of programs to improve outcomes for disadvantaged and vulnerable consumers. A CSLR should consider how it can work with AFCA to ensure positive consumer outcomes for these groups.[150]

RECOMMENDATION 3:

DESIGN OF A CSLR

If a CSLR is established, the following design features are recommended:

Prospective

- A CSLR should only apply to unpaid EDR determinations, court judgments and tribunal awards which are made after a CSLR is established.

Eligibility

- A CSLR should be restricted to consumers and small businesses (as defined by AFCA).

Types of claims

- A CSLR should be limited to financial advice failures but scalable in the future subject to consultation and modelling.

See Commonwealth of Australia 2017, *Review of the financial system external dispute resolution and complaints framework: Final Report*, page 54.

150 Commonwealth of Australia 2017, *Review of the financial system external dispute resolution and complaints framework: Final Report*, page 64.

RECOMMENDATION 3 (CONTINUED):

DESIGN OF A CSLR

Conditions for accessing a CSLR

- Consumers and small businesses must have a decision from AFCA, a court or a tribunal which remains unpaid after reasonable steps, as defined by a CSLR, have been taken.
- To allow consumers and small businesses to satisfy this condition, AFCA should determine a dispute and make a determination in circumstances where a financial firm is insolvent or has been expelled from AFCA.
- A CSLR should only be able to receive a claim following a court judgment or tribunal award where the circumstances giving rise to that claim would have been eligible for consideration by AFCA.

Time limits for making a claim to a CSLR

- Applications must be lodged with a CSLR by a consumer or small business within 12 months of the consumer or small business having completed specified reasonable steps to obtain compensation.
- Where an uncompensated loss arises from an unpaid EDR determination, AFCA should be required to provide certification that it has completed its processes to enforce the determination and that it does not consider that the determination will be paid, and then refer the consumer or small business to a CSLR.
- AFCA should ensure that consumers and small businesses are informed of their right to make a claim to a CSLR. This should be communicated as part of all key communications, such as when the initial determination is issued.

Functions and powers of a CSLR

- A CSLR should not independently reassess the merits of claims which it receives.
- Before paying a claim, a CSLR must be satisfied that the EDR determination, court judgment or tribunal award will not be paid by the financial firm to the consumer or small business.

The amount and types of compensation that can be paid through a CSLR

- A cap should apply to the level of compensation that a CSLR is able to provide. This compensation cap should be aligned with the compensation cap which AFCA applies.
- The compensation cap should be subject to review, from time to time, to ensure it remains fit for purpose and that a CSLR remains financially sustainable.
- A CSLR should set limits on the level and types of legal costs that are recoverable.
- A CSLR should consider issuing guidance on its treatment of compensation caps where litigation funding is involved, to ensure that access to a CSLR in matters involving private sector litigation funding does not undermine its financial sustainability.

A CSLR's right to subrogation

- A CSLR should have the ability to stand in the shoes of a consumer or small business and pursue the financial firm for the compensation amount, where the firm is still in existence and a CSLR considers that it has reasonable prospects of success.

RECOMMENDATION 3 (CONTINUED):

DESIGN OF A CSLR

Funding of a CSLR

- A CSLR should be funded by financial firms engaged in the types of financial services covered by a CSLR (initially, specified types of financial advice).
- A CSLR should be ex-ante funded; that is, financial firms should be required to contribute to a CSLR from its outset. This ensures that those financial firms whose actions give rise to uncompensated losses are required to contribute to a CSLR.
- The Government should work with industry to develop an appropriate mechanism, such as a levy, to fund a CSLR.
- Comprehensive modelling should be undertaken to estimate the likely costs associated with a CSLR and the funding mechanism should reflect the outcome of this modelling exercise.
- The funding mechanism should be designed to minimise the volatility in funding requirements, that is, it should be designed to minimise the need for a CSLR to raise additional ad-hoc funding to meet its obligations.
- The funding mechanism should be designed in a manner that does not result in a substantial lessening of competition amongst financial firms, while ensuring that all firms providing the types of financial services covered by a CSLR make an appropriate level of contribution to a CSLR.
- A CSLR should be provided with sufficient funding to allow it to raise community awareness about its existence.

Administration of a CSLR

- Financial firms providing the types of financial services covered by a CSLR should be required to be members and contribute to the funding of a CSLR as a condition of licensing.
- A CSLR should be governed by an independent board with an independent chair and equal numbers of directors with industry and consumer backgrounds, consistent with the model in the EDR framework.
- ASIC should have oversight of a CSLR to ensure it is fulfilling its objectives, similar to the role envisaged for ASIC in respect of AFCA. This will require ASIC to have a general directions power to allow it to compel a CSLR to meet its regulatory and legislative requirements.
- A CSLR should operate independently of AFCA; however, these bodies will need to work together.

CHAPTER 5: STRENGTHENING EXISTING REGULATORY REQUIREMENTS FOR FINANCIAL SERVICE AND CREDIT LICENSEES

KEY POINTS

- Changes to PI insurance, financial resources requirements and the ability of ASIC to take enforcement action in light of unpaid EDR determinations will not solve the problem of uncompensated losses.
- There is currently limited data about the PI insurance market. Additional data on PI insurance will increase ASIC's ability to undertake market surveillance in order to identify areas of risk, which can then be the subject of targeted regulatory action.
- If a CSLR is established, effective regulatory settings must exist to ensure that, to the maximum extent possible, financial firms can comply with any decision which requires them to provide compensation to a consumer or small business.
- It is important that ASIC has appropriate enforcement powers to take action against firms that do not pay compensation awarded by an EDR body.

5.1. In Chapter 2 of this Report, the Panel noted that a range of stakeholders provided submissions on the appropriateness of the regulatory arrangements that exist to ensure that financial firms are able to meet their obligations to provide compensation to consumers and small businesses. These comments focused primarily on:

- the current PI insurance arrangements;
- the requirement for financial firms to hold adequate financial resources;
- appropriate enforcement powers for ASIC; and
- the licensing criteria for financial firms.

5.2. A recurring theme through a number of these submissions was the recommendations made by Richard St. John concerning strengthening the current compensation arrangements in relation to PI insurance and financial resource requirements.[1]

5.3. In Chapter 2, the Panel stated that it did not consider that making changes to the existing regulatory framework, in the areas mentioned above, will fix the problem of uncompensated losses.

1 Australian Institute of Superannuation Trustees, submission to the EDR Review Supplementary Issues Paper, page 6; Maurice Blackburn, submission to the EDR Review Supplementary Issues Paper, page 2.

5.4. However, if a CSLR is established, in line with the Panel's recommendations, the Panel is firmly of the view that effective regulatory settings must exist to ensure that, to the maximum extent possible, financial firms can comply with any decision which requires them to provide compensation to a consumer or small business.

5.5. In this Chapter, the Panel more fully considers stakeholder submissions in this area and sets out its views on the need for further changes to the regulatory framework.

RICHARD ST. JOHN REPORT: *COMPENSATION ARRANGEMENTS FOR CONSUMERS OF FINANCIAL SERVICES*

In April 2010, Mr Richard St. John was asked by the Australian Government to consider the need for, and costs and benefits of, a statutory compensation scheme for financial services.

In April 2012, the report was published and it concluded that it would be inappropriate, and possibly counter-productive, to introduce a more comprehensive last resort compensation scheme to underpin the current relatively light compensation regime for financial advisers and other providers of financial services. Given the limited regulatory measures to protect retail clients from the risk of licensee insolvency, it was found that it would be inappropriate to require more responsible and financially secure licensees to underwrite the ability of other licensees to meet claims against them for compensation.

The report made a number of recommendations aimed at strengthening the existing compensation requirements, including:

- requiring licensees to provide ASIC with additional assurance that their professional indemnity insurance cover is current and is adequate to their business needs (rec 2.1);
- more attention being given, on a risk targeted basis and in conjunction with the level of their insurance cover, to the adequacy of licensees' financial resources to enable better management of risks and unexpected costs such as compensation liabilities (rec 2.2);
- ASIC taking a more pro-active approach in monitoring licensee compliance with the requirement to hold adequate professional indemnity insurance cover and any new requirement in regard to financial resources, and in targeting licensees who are most at risk (rec 2.3); and
- To assist ASIC in playing a more pro-active role in administering the licensing regime with respect to compensation arrangements, consideration should be given to clearer powers to enforce standards and to sanction licensees who do not comply through:
  - powers to deal with phoenix activity, both through licensees establishing new entities or by former directors who re-emerge in the industry as authorised representatives;
  - ability to deal with disreputable industry participants; and
  - access to an infringement notice regime (rec 2.4).

5.6. The Panel has considered the recommendations of the Richard St. John Report in the following sections of this Chapter.

PROFESSIONAL INDEMNITY INSURANCE

Regulatory requirements

5.7. The Corporations Act requires that if a financial services licensee provides a financial service to a person as a retail client, the licensee must have arrangements for compensating the person for loss or damage suffered because of breaches of the relevant obligations under Chapter 7 of the Act by the licensee or its representatives.[2]

5.8. Similarly, the NCCP Act provides that a licensee must have adequate arrangements for compensating persons for loss or damage suffered because of a contravention of the Act by the licensee or its representatives.[3]

5.9. When determining whether PI insurance coverage is adequate, the Corporations Regulations state that regard must be given to:

- the licensee's membership of an EDR body taking account of the maximum liability that has, realistically, some potential to arise in connection with:
  - any particular claim against the licensee; and
  - all claims in respect of which the licensee could be found to have liability; and
- relevant considerations in relation to the financial services business carried on by the licensee, including:
  - the volume of business;
  - the number and kind of clients;
  - the kind, or kinds, of business; and
  - the number of representatives of the licensee.[4]

2 Section 912B of the *Corporations Act 2001*. The obligation extends to all financial services covered by chapter 7 and losses caused by negligent, fraudulent or dishonest conduct that amounts to a breach of that chapter: see also Australian Securities and Investments Commission, *Regulatory Guide 126: Compensation and insurance arrangements for AFS licensees*, page 14.

3 Section 48 of the *National Consumer Credit Protection Act 2009*.

4 Regulation 7.6.02AAA(1) of the *Corporations Regulations 2001*.

ASIC's role in determining the adequacy of PI insurance arrangements

5.10. The factors set out in the Corporations Regulations are not exhaustive. ASIC also provides guidance to industry about when PI insurance arrangements will be adequate. It does this with reference to the policy objective underpinning the regulations, which is to reduce the risk that a retail client's losses cannot be compensated by the licensee due to the lack of financial resources.[5] Additional factors which ASIC requires licensees to take into account include:

- the amount and scope of cover;
- whether the terms and conditions of the cover undermine the objective of providing compensation; and
- whether the licensee has sufficient financial resources to enable the professional indemnity insurance policy to work in practice.[6]

5.11. ASIC provides guidance to licensees on the features a PI insurance policy should have for it to be adequate. A number of these features are set out in the below table.[7]

Policy feature	Minimum requirements and features to consider
Amount of cover	A PI insurance policy must have a limit of at least $2 million for any one claim and in the aggregate for licensees with total revenue from financial services provided to retail clients of $2 million or less. For licensees with total revenue from financial services provided to retail clients greater than $2 million, minimum cover should be approximately equal to actual or expected revenue from financial services provided to retail clients (up to a maximum limit of $20 million). Some licensees will require a higher limit of indemnity in order for the insurance cover to be adequate.
Scope of cover	The policy must indemnify the licensee against liability for loss or damage suffered by retail clients because of breaches of Chapter 7 of the Corporations Act by the licensee or its representatives. This includes liability: • for fraud or dishonesty by officers, employees and other representatives of the licensee (although fraud cover is not required, relevantly, for sole traders); and • under EDR body awards.

5 Australian Securities and Investments Commission, *Regulatory Guide 126: Compensation and insurance arrangements for AFS licensees*, page 10.

6 Australian Securities and Investments Commission, *Regulatory Guide 126: Compensation and insurance arrangements for AFS licensees*, page 13.

7 Australian Securities and Investments Commission, *Regulatory Guide 126: Compensation and insurance arrangements for AFS licensees*, Table 4 at pages 16-19.

Policy feature	Minimum requirements and features to consider
Exclusions	The policy must *not* have the effect of excluding: • EDR body awards; • loss caused by the conduct of representatives generally; • fraud and dishonesty by officers, employees and other representatives (although fraud cover is not required, relevantly, for sole traders); • claims for misrepresentations about services; and • claims arising from incidents that have been notified to ASIC.
Automatic reinstatement	The policy must include at least one automatic reinstatement.
Legal costs	Defence costs must be 'in addition' to the minimum limit or the level of cover must be sufficiently increased to take these costs into account.
Fraud/dishonesty	The policy must cover fraud/dishonesty/infidelity by officers, employees and other representatives of the licensee (although fraud cover is not required, relevantly, for sole traders).
'Run-off' cover	For the avoidance of doubt, the policy is not required to include automatic run-off cover as it is not currently available in the market. ASIC will continue to monitor the availability of automatic run-off cover and may reassess its position should automatic run-off cover become available.

Stakeholder submissions

5.12. This section focuses on stakeholder submissions on potential reforms to improve the regulatory arrangements for PI insurance. The Panel notes that paragraph 2.23 of Chapter 2 outlines submissions by stakeholders on the limitations of using PI insurance as a mechanism to provide compensation to consumers and small businesses.

5.13. ASIC submitted to the Panel that PI insurance must remain 'the first line of defence' so that a CSLR would truly be a 'last resort' for uncompensated losses. It stated that if a CSLR was introduced, there would be merit in considering whether those licensees that rely on PI insurance to meet their licensing obligations should provide ASIC with data about their PI insurance on an annual, ongoing basis.[8]

5.14. ASIC advised it would use this data to monitor the scope of professional indemnity insurance coverage and that more ASIC visibility of PI arrangements would enable ASIC to better target risk.[9]

8 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 9.

9 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 10.

5.15. ASIC currently only collects information about a licensee's PI insurance at the time of licence application. This enables ASIC to prevent an applicant from obtaining a licence where their PI insurance is manifestly inadequate.[10] However, aside from this initial information gathering, ASIC does not routinely collect information about licensees' PI insurance arrangements.

5.16. The Australian Bankers' Association, the Financial Planning Association of Australia and the Financial Services Council jointly submitted to the Panel that:

> *"industry should work with professional indemnity (PI) insurers and regulators to examine improving PI insurance and the regulatory setting regarding PI insurance. This would involve looking at the cost, availability and coverage of PI insurance, including minimum levels of cover, and how PI insurance can respond to insolvency, fraud and other misconduct."*[11]

5.17. They further proposed that ASIC should consult on requiring an annual assurance statement from AFS licensees and credit licensees that they are meeting their licence obligations to hold adequate PI insurance. This consultation should expressly take into account the coverage of PI insurance and the ability of the policy holder to meet the deductible and any reinstatement premiums.

Panel analysis

5.18. Consistent with the Review Principles, requiring firms to hold adequate PI insurance will promote equity and accountability in the financial services sector as those financial firms who engage in misconduct are responsible for compensating consumers. However, raising the requirement to hold a higher level of PI insurance cover will also increase costs for financial firms, particularly small firms, and may impact the level of competition in the market where consumer choice is an important consideration.

5.19. Given the inherent limitations in the ability of PI insurance to provide a source of funding for compensation to consumers and small businesses (as discussed in Chapter 2) and the risks to competition that would result from increasing the level of PI cover that firms are required to hold, the Panel has not recommended an increase in PI insurance requirements.

5.20. The Panel is, however, of the view that those licensees that rely on PI insurance to meet their licensing obligations should provide ASIC with data about their PI insurance arrangements on an annual, ongoing basis.

5.21. As the Panel observed in the Supplementary Issues Paper, there is currently limited data about the PI insurance market, in particular, the policies held by financial services licensees and credit licensees.

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10 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 10.

11 Australian Bankers' Association, Financial Services Council and Financial Planning Association of Australia, joint letter to the EDR Review Panel, page 2.

5.22. The Panel considers that access to additional data on PI insurance will increase ASIC's ability to undertake market surveillance in order to identify areas of risk, which can then be the subject of targeted regulatory action.[12]

RECOMMENDATION 4:

STRENGTHENING REGULATORY REQUIREMENTS IS IMPORTANT

Firms that rely on PI insurance to meet their licensing obligations should be required to provide additional data to ASIC, to improve ASIC's ability to undertake market surveillance and targeted regulatory action.

ADEQUACY OF FINANCIAL RESOURCES

5.23. AFS licensees, excluding those regulated by APRA,[13] have obligations under the Corporations Act to have available adequate financial resources to provide the financial services covered by the licence held and to carry out supervisory arrangements. ASIC explains these obligations (which some stakeholders refer to as 'capital adequacy requirements') in *Regulatory Guide 166: Licensing: Financial requirements*.[14]

5.24. In Regulatory Guide 166, ASIC states that the financial requirements are not designed to ensure that financial firms will be able to compensate clients where they breach a licensee obligation in Chapter 7 of the Corporations Act.[15]

5.25. Similar requirements apply to credit licensees, which are outlined in *Regulatory Guide 207: Credit licensing: Financial requirements*.

Stakeholder submissions

5.26. In their joint submission, the Australian Bankers' Association, the Financial Planning Association of Australia and the Financial Services Council stated that the Government should undertake a formal consultation, to consider whether the current financial requirements remain sufficient.

12 The Panel notes that the Australia Securities and Investments Commission recently reviewed the professional indemnity insurance policies held by a sample of 56 small Australian Financial Services Licensees to determine whether they complied with the defence costs and fraud and dishonesty requirements in Regulatory Guide 126. See Australian Securities and Investments Commission, Media Release, viewed 31 August, <**http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-286mr-professional-indemnity-insurance-review-completed/**>.

13 Registrable superannuation entity (RSE) licensees that are also authorised to operate registered managed investment schemes are required to meet these requirements.

14 Australian Securities and Investments Commission, *Regulatory Guide 166: Licensing: Financial requirements*.

15 Australian Securities and Investments Commission, *Regulatory Guide 166: Licensing: Financial requirements*, page 9.

5.27. This consultation, it was submitted, should consider whether having sufficient resources to compensate clients and being able to meet any insurance deductible payments or reinstatement premiums should form part of the financial resource licensing requirements.[16]

5.28. AMP submitted that arrangements should be put in place to ensure, as far as possible, that licensees have proper capital and PI insurance before they commence operations.

5.29. A number of submissions also referred the Panel to the recommendations made in the Richard St. John Report in relation to the adequacy of firms' financial resources.[17]

5.30. The Joint Consumer Group identified that government could require licensees to have more stringent capital adequacy requirements that could be called upon, however, this would likely impose significant costs on industry.[18]

Panel analysis

5.31. The Panel notes that while the financial resource requirement does not primarily operate to ensure that financial firms are able to pay compensation that has been awarded, there is a strong link between firms' access to adequate financial resources and their ability to pay compensation. These issues are noted in ASIC's Regulatory Guide 126 and include:

- Generally there is an excess that applies to PI insurance policies, in most cases this excess applies per claim. This means that the firm must have sufficient financial resources to meet the excess or multiples of the excess where compensation is due to multiple consumers.
- There may be gaps in the level of PI insurance cover due to the exclusions that apply to a policy. For example, a PI insurance policy may only cover certain types of misconduct and a firm may be required to pay compensation in respect of conduct that is not covered.

5.32. Adequate financial resources, that is, financial resources that enable a firm to cover any gaps in their PI insurance cover and excess payments, is a significant consideration in a firm's ability to meet the obligations to have adequate PI insurance.

16 Australian Bankers' Association, Financial Services Council and Financial Planning Association of Australia, joint letter to the EDR Review Panel, page 2.

17 AMP, submission to the EDR Review Supplementary Issues Paper; Financial Services Council, submission to the EDR Review Supplementary Issues Paper; Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper.

18 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 7.

5.33. The Panel, however, notes that there are a number of challenges in this area:

- Increasing the level of financial resources that are required to be held by firms will increase the regulatory costs across the sector (other than for those firms that are exempt licensees as they are subject to APRA's prudential capital requirements) and is likely to have an impact on the level of competition in these markets.
- In order for a firm to have adequate financial resources to meet its PI insurance obligations, a firm will need to accurately and consistently assess the probability and scope of future consumer claims and prospectively provide for these. These factors cannot be estimated easily or with a good degree of certainty. Therefore, it is not clear to the Panel that this approach will prevent uncompensated losses from arising.
- In cases where a financial firm is in distress, it is likely that its financial resources will be exhausted prior to paying the excess on a PI insurance policy or paying any compensation to a consumer or small business.

5.34. Increases to the financial resource requirements will impact regulatory costs across the sector, including on the majority of firms that currently meet their obligations to pay compensation. This, combined with the fact that the there is significant complexity in determining the necessary levels of financial resources to ensure that a firm is able to meet its compensation obligations in all cases, leads the Panel to consider there to be limited merit in seeking to address uncompensated losses through changes to the financial resource requirements.

5.35. The Panel notes that since the Richard St. John Report was delivered in 2012, a number of changes have been made to enhance the regulatory framework, in particular to professionalise the financial advice sector, which is where the overwhelming majority of uncompensated losses arise from. These reforms are discussed in Chapter 4 above.

APPROPRIATE ENFORCEMENT POWERS FOR ASIC

5.36. Oversight and accountability mechanisms play an important role in promoting high-quality consumer outcomes and maintaining confidence in both the EDR framework and the activities of a CSLR.

5.37. The role undertaken by ASIC in dealing with unpaid EDR determinations and its power to take enforcement action was raised by a number of stakeholders. In particular, stakeholders raised the issue of ASIC having the power to ban a director or officer of a firm where the firm had failed to comply with an EDR determination.

ASIC's current powers

5.38. Under the existing framework, if a financial firm fails to pay an EDR determination, the EDR body can terminate the firm's membership, and ASIC may then remove the firm's licence.[19] However, ASIC noted that this would effectively terminate the firm, and potentially any PI insurance policies held by the firm.

5.39. Where an EDR body does not terminate a financial firm's membership of a scheme for non-payment of a determination, ASIC *may* take action to cancel or suspend the firm's licence. However, to succeed in such a case ASIC would need to demonstrate that, for example:

- the firm had not complied with its obligation to do all things necessary to ensure the financial services covered by its licence are provided efficiently, honestly and fairly; and/or
- the firm had breached other financial services laws or licensing obligations; and/or
- ASIC was no longer satisfied that the firm's responsible officer/s were of good fame and character.[20]

5.40. ASIC informed the Panel that it had never brought administrative action solely on the basis of an unpaid EDR determination. It stated that a failure to pay an EDR determination was not a breach of a financial services law, and did not of itself allow licensing action to be taken.[21]

Stakeholder submissions

5.41. A number of stakeholders submitted that ASIC should have the power take banning action against directors and officers of a firm that has an unpaid EDR determination.[22]

5.42. Both the Joint Consumer Group and FOS submitted that ASIC should be able to take action against directors or managers of a firm that has an unpaid determination, including limiting their ability to be a director or officer of a new company.[23] The Joint Consumer Group stated this would provide an incentive for individuals to comply with the laws, and reduce phoenixing activity and calls on a CSLR.[24]

19 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 16.
20 Australian Securities and Investments Commission, additional submission to the EDR Review Supplementary Issues paper dated 10 August 2017, page 7.
21 Australian Securities and Investments Commission, additional submission to the EDR Review Supplementary Issues Paper, page 7.
22 Association of Financial Advisers, submission to the EDR Review Supplementary Issues Paper, page 12.
23 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 12; Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 21.
24 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 12.

5.43. The Australian Bankers' Association and the Financial Planning Association of Australia submitted that following non-compliance with an EDR determination, ASIC should, relevantly, have the power to:

- take enforcement action against persons responsible for the licensee's failure to comply (this may extend beyond the representatives of the licence to directors/managers in certain circumstances); and
- prevent those persons from establishing a new financial services or credit business".[25]

5.44. It was also submitted that ASIC's powers should be able to address the risk of licensees winding up their businesses with the intention of avoiding an EDR determination.[26]

5.45. ASIC submitted that it required more effective mechanisms to address the issue of unpaid EDR determinations. This included having the power to ban individuals from managing financial firms (as recommended by recommendation 24 of the Financial System Inquiry).[27]

CASE STUDY

Company A has 28 adverse determinations against it by FOS, 50 consumers are affected and there is currently $2,570,294.86 in outstanding compensation determinations against it.

A new company was established with the same name. There is no legal recourse available against this entity, despite it being owned and operated by the same people who were in control of Company A.[28]

Panel analysis

5.46. The Panel recognises the importance of ASIC having appropriate enforcement powers to take action against firms that do not pay compensation awarded by EDR determinations.

5.47. Providing ASIC with additional powers to ban senior officials has the potential to enhance accountability as those officials who are responsible for unpaid EDR determinations may be subject to regulatory enforcement action. It also has the potential to reduce regulatory costs as there may be fewer claims made on a CSLR where those individuals responsible for phoenixing behaviour and unpaid EDR determinations may be banned from managing a financial firm.

25 Australian Bankers' Association, Financial Services Council and Financial Planning Association of Australia, joint letter to the EDR Review Panel, pages 2-3.

26 Australian Bankers' Association, Financial Services Council and Financial Planning Association of Australia, joint letter to the EDR Review Panel, page 3.

27 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 16.

28 Financial Ombudsman Service August 2017, supplementary information provided to the EDR Review Panel.

5.48. The Panel notes the Government's ASIC Enforcement Review Taskforce is undertaking consultation on ASIC's power to ban senior officials in the financial sector. This consultation, amongst other matters, looks to provide ASIC with the power to take action against officers of financial firms that have failed to comply with a determination, as reported by AFCA.[29] The Panel strongly supports these proposals.

29 ASIC Enforcement Review September 2017, *Position and Consultation Paper 6, ASIC's power to ban senior officials in the financial sector*.

PART 2: LEGACY UNPAID EDR DETERMINATIONS

CHAPTER 6: LEGACY UNPAID EDR DETERMINATIONS

KEY POINTS

- In line with the Review Principle of equity there is a strong case for addressing legacy unpaid EDR determinations if funding is available, as:
  - the EDR framework is the primary mechanism for dispute resolution available to consumers and small businesses;
  - these consumers and small businesses have fulfilled their obligations, undertaken the appropriate steps and received a decision from an independent EDR body that awarded compensation in their favour;
  - these determinations remain unpaid through no fault of the consumer or small business or the lack of action by the EDR body to enforce the determination;
  - the outstanding values of these determinations are known and therefore can be addressed without the risks associated with uncertainty of scale; and
  - ensuring that this compensation is paid will foster confidence in the EDR framework by consumers and small businesses.
- The key challenge to addressing these legacy unpaid EDR determinations is the appropriate source of funding. It may not be either appropriate or desirable that current industry participants be required to contribute to compensation arising from determinations against former industry participants.
- In these circumstances it is a matter for government as to whether it is able to identify a funding source to address these legacy unpaid EDR determinations.

BACKGROUND

6.1. In Part 1 of this Report, the Panel considered the merits of establishing a CSLR and recommended that a limited and carefully targeted CSLR be established for future unpaid compensation in parts of the financial services sector where there is evidence of a significant problem of compensation not being paid.

6.2. In recommending the establishment of a CSLR, the Panel has recommended that a CSLR should operate prospectively. However, as discussed in Chapter 2, there are a number of individuals who have been awarded compensation through the current EDR framework and these remain unpaid (legacy unpaid EDR determinations).

6.3. As at 30 June 2017, these legacy unpaid determinations totalled $14,146,094 (excluding interest) and $399,862 (excluding interest) by FOS and CIO, respectively.

6.4. Having recommended the establishment of a CSLR to operate prospectively, the Panel in this Chapter engages with the merits and issues in addressing legacy unpaid EDR determinations.

STAKEHOLDER SUBMISSIONS

6.5. There was a range of views amongst stakeholders on the issue of whether there should be a mechanism to deal with legacy unpaid EDR determinations.

SUPPORT FOR A MECHANISM TO DEAL WITH LEGACY UNPAID EDR DETERMINATIONS

6.6. Consumer groups were supportive of a mechanism to deal with legacy unpaid EDR determinations.[1]

6.7. Legal Aid Queensland was concerned about equity, arguing that consumers who suffered loss before a potential CSLR should be treated in the same way as consumers who suffer a loss where a CSLR exists.[2]

6.8. The Joint Consumer Group submitted that it was essential that legacy unpaid EDR determinations are paid and that they should be funded via a levy on industry either as part of a CSLR or by a separate levy.

6.9. The Joint Consumer Group further commented that this was a key problem that continues to reduce trust and confidence in the EDR framework and the financial system generally, particularly where people have invested time, energy and money into dispute resolution that has been futile.[3]

6.10. FOS submitted that in considering past issues, as a minimum, compensation should be paid to consumers with legacy unpaid EDR determinations. It stated that the preferable course would be to treat these as a class of known and quantified claims as part of a past dispute redress mechanism.[4] This would allow a CSLR to be wholly prospective. If it was not viable to compensate all claimants, FOS submitted that a priority mechanism based on hardship would be appropriate.[5]

1 See the submissions of the Joint Consumer Group, Legal Aid Queensland, Legal Aid NSW and Maurice Blackburn Lawyers to the EDR Review Supplementary Issues Paper.
2 Legal Aid Queensland, submission to the EDR Supplementary Issues Paper, page 7.
3 Joint Consumer Group, submission to the EDR Supplementary Issues Paper, 4 July 2017, page 13.
4 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 14.
5 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 15.

CONCERN ABOUT A MECHANISM TO DEAL WITH LEGACY UNPAID EDR DETERMINATIONS

6.11. A number of industry stakeholders raised concerns about a mechanism to address legacy unpaid EDR determinations. However, these concerns related primarily to the notion that current industry participants would be required to bear the cost. Many industry stakeholders, while raising concerns about funding, supported addressing these determinations though a government funded mechanism.

6.12. ANZ submitted that requiring current industry participants to pay for these determinations would mean that currently solvent and compliant firms would be called upon to satisfy the debts of firms that had previously failed to meet their obligations.[6]

6.13. AMP questioned whether it would be legally possible to levy current industry participants for past issues, commenting that asking shareholders of licensees to pay for previous actions by firms over which they had no control was not a good public policy outcome.[7]

6.14. Some stakeholders also commented that along with the misconduct of the individual financial firms, these unpaid EDR determinations reflect a failure in the regulatory settings of the time.[8] These stakeholders expressed concern and questioned the principles of an approach which would require current industry participants to contribute to the payment of these legacy unpaid EDR determinations.

6.15. Similarly, the Financial Planning Association of Australia also raised concerns about the fairness of ethical financial firms bearing the cost for the misconduct of others, particularly where they had no opportunity to plan or budget for these costs. For these reasons, it submitted that any mechanism to compensate legacy unpaid EDR determinations should be taxpayer funded or subsidised.

6.16. Industry bodies representing the superannuation sector commented on this issue,[9] and were strongly opposed to APRA regulated funds subsidising the failings of others on the basis that it would be inequitable, noting that there are no unpaid SCT determinations.[10]

6.17. A number of stakeholders thought that legacy unpaid EDR determinations should be paid in-principle, but opposed an industry funding mechanism.[11]

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6 ANZ, submission to the EDR Review Supplementary Issues Paper, page 3.

7 AMP, submission to the EDR Review Supplementary Issues Paper, page 2.

8 Australian Bankers' Association, Financial Services Council and Financial Planning Association of Australia, joint letter to the EDR Review Panel, page 3.

9 Australian Institute of Superannuation Trustees, submission to the EDR Review Supplementary Issues Paper, page 4; and Industry Super Australia, submission to the EDR Review Supplementary Issues Paper, page 12;

10 Industry Super Australia, submission to the EDR Review Supplementary Issues Paper, page 12.

11 Finance and Mortgage Brokers Association of Australia; Ballast Financial Planning; the Stockbrokers and Financial Advisers Association Limited; and Industry Super Australia submission to the EDR Review Supplementary Issues Paper.

6.18. Industry Super Australia, for example, said that for those individuals who have suffered losses, it is without doubt that the effect on their lives can be devastating, and the non-payers should be brought to account, but not at the cost of superannuation retirement benefits.[12]

6.19. The Stockbrokers and Financial Advisers Association Limited said that if the government wished, in the interests of justice, to provide compensation for these legacy unpaid EDR determinations, it should consider funding the payment from consolidated revenue rather than from industry.[13]

CONSIDERATION OF A MECHANISM TO DEAL WITH LEGACY UNPAID EDR DETERMINATIONS

Panel analysis

6.20. EDR is the primary mechanism for dispute resolution available to consumers and small businesses. Consumers and small businesses should have reasonable confidence that if they pursue a claim through the EDR framework and are awarded compensation, this compensation will then be paid.

6.21. The Panel notes that these consumers and small businesses have fulfilled their obligations, undertaken the appropriate steps and received a decision from an independent EDR body that awarded compensation in their favour.

6.22. The Panel further recognises that, as outlined in Chapter 2, these EDR determinations remain unpaid through no fault of the consumer or small business or the lack of action by the EDR body to enforce the determination.

6.23. The Panel is of the view that in line with its Review Principle of equity, there is a strong case for addressing these legacy unpaid EDR determinations if funding is available.

6.24. The Panel notes that the quantum of these unpaid determinations is known providing certainty on the level of funding that will be necessary to address these determinations.

6.25. The Panel considers that addressing these legacy unpaid EDR determinations forms an important and necessary step in ensuring consumers and small business are able to have confidence in the EDR framework going forward.

6.26. The Panel additionally sees merit in addressing these legacy unpaid EDR determinations as it will allow a CSLR to be established with a clear focus on ensuring that appropriate compensation awarded in the future is paid, without being clouded by concerns about legacy unpaid EDR determinations.

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12 Industry Super Australia, submission to the EDR Review Supplementary Issues Paper, page 12.

13 Stockbrokers and Financial Advisers Association Limited, submission to the EDR Review Supplementary Issues Paper, page 9.

An appropriate funding mechanism

6.27. The key issue in addressing these legacy unpaid EDR determinations is the issue of who should bear the financial burden. There are two possible sources of funding: industry or government.

6.28. The Panel acknowledges that firms currently operating in the financial services sector are not the firms whose actions have led to these unpaid determinations. Therefore with reference to the review principle of equity, it may not be either appropriate or desirable that current industry participants be required to contribute to compensation arising from determinations made against former industry participants.

6.29. The Panel further notes that requiring current industry participants to bear the costs of these determinations could ultimately impact upon the consumers and/or shareholders of current industry participants.

6.30. In these difficult circumstances it would be a matter for government as to whether it is able to identify a funding source to address these unpaid determinations.

Unpaid court judgments and tribunal awards

6.31. The Panel also considered the issue of unpaid court judgments and tribunal awards.

6.32. Unlike the uncompensated losses within the EDR framework, there are no readily accessible data sources that enable the quantum of these losses to be estimated. This creates significant challenges in assessing the appropriate treatment for such cases and estimating the level of funding that would be necessary.

6.33. The focus of this review has been on the EDR framework recognising that it is the primary mechanism for resolving disputes about financial products and services available to consumers and small businesses.

6.34. The Panel's recommendation that legacy unpaid EDR determinations be paid is based on the view that this will build trust and confidence in the EDR framework in the future, to the benefit of all users.

6.35. The Panel's recommendation that court and tribunal-awarded compensation be included in a CSLR, is also based on a view that this will support an effective EDR system in the future, by ensuring that consumers continue to be able to exercise choice about the most appropriate forum for seeking resolution of a dispute.

6.36. The Panel did not receive evidence to indicate that failure to pay past court or tribunal decisions is likely to affect confidence in the EDR framework in the future.

6.37. Given the above factors, including the critical factor that there is no quantification of unpaid court judgments and tribunal awards as there is for legacy unpaid EDR determinations and that the focus of this review has been on the EDR framework, the Panel considers that the strongest and most immediate case exists for the payment of legacy unpaid determinations.

Transitional issues

6.38. While the number and value of current legacy unpaid EDR determinations is known, some additional unpaid determinations may arise prior to the establishment of a CSLR. If these are consistent with past trends, the monetary value is likely to be small. Taking into account the Review Principles of equity and comparability of outcomes, if the currently known legacy unpaid determinations are paid, it may also be appropriate to consider payment of any further unpaid determinations that exist at the point that a CSLR is established.

OBSERVATION 1:

THERE IS A STRONG CASE FOR PAYMENT OF LEGACY UNPAID EDR DETERMINATIONS

There is a strong case for the payment of legacy unpaid EDR determinations. However, it may not be either appropriate or desirable that current industry participants be required to contribute to compensation arising from determinations against former industry participants. In these circumstances, it is, therefore, a matter for government as to whether it is able to identify a funding source to address these legacy unpaid determinations.

PART 3: PROVIDING ACCESS TO REDRESS FOR PAST DISPUTES

OVERVIEW OF PART 3

1. On 2 February 2017, the Minister for Revenue and Financial Services amended the Review's Terms of Reference to require the Panel to consider the merits and issues involved in providing access to redress for past disputes.

2. In Part 1 of this Report, the Panel has assessed and made recommendations on the establishment and design of a CSLR that will operate prospectively to address uncompensated losses in relation to financial advice failures.

3. In Part 2 of this Report, the Panel reviewed the legacy EDR unpaid determinations and noted that the Panel considers there is a strong case for the payment of these legacy unpaid EDR determinations, subject to appropriate funding.

4. In this final part of the Report, the Panel looks to the past, to those cases where consumers and small businesses have not had access to redress and, in line with the Terms of Reference, considers the issues and merits in this complex area.

5. Chapter 7 defines what access to redress means, for the purposes of this Report, followed by an assessment of the circumstances where the Panel considers there is merit in providing access to redress, and finally the issues that arise in seeking to provide access to redress.

6. Chapter 8 then sets out four options that the Panel has considered for providing access to redress for past disputes.

CHAPTER 7: MERITS AND ISSUES OF PROVIDING ACCESS TO REDRESS

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; and/or
  - the financial firm was not a member of an EDR body, because it was either trading while unlicensed or had been expelled by an EDR body; and/or
  - the monetary value of the dispute exceeded the EDR body's monetary limits and the consumer or small business lacked the resources to access the courts, tribunals or other dispute resolution bodies; and/or
  - the consumer or small business was not in a position to pursue their dispute with the EDR body due to exceptional circumstances.
- Consumers and small businesses who have had access to dispute resolution before an EDR body, court or tribunal, or who have reached a legally binding settlement, have had access to redress. The Panel does not consider that there would be merit in providing further access to redress in these situations.
- There are complex issues in considering providing access to redress and these include:
  - the lack of complete, reliable data to enable the scale and scope of the problem to be quantified;
  - determining appropriate sources of funding;
  - the need for a time limit on disputes eligible for consideration for access to redress;
  - indirect costs to industry; and
  - the risk of undermining the existing legal framework by applying regulatory requirements retrospectively.
- Prior to determining any government-led approach to providing access to redress it is essential to obtain data on the scale of the problem.

ACCESS TO REDRESS IS CRITICAL

7.1. The Review's Terms of Reference require the Panel to consider the merits and issues involved in providing access to redress for past disputes but not to provide recommendations.

7.2. As the Panel noted in its April 2017 Report, access to redress is a critical feature of Australia's consumer protection system. While the majority of financial firms comply with their legal obligations and compensate their customers where required, there have been instances where, through circumstances outside of their control, consumers and small businesses have been deprived of access to redress for their financial dispute.

7.3. A range of government inquiries, reviews and reports have identified a number of past disputes where consumers or small businesses have been unable to access redress.[1] These inquiries, as well as the public debate surrounding them, highlight the importance of this issue for many Australians.

7.4. Lack of access to redress for disputes can have a significant impact on individuals and families. These impacts are not confined to the costs of resolving the individual dispute, such as legal fees, or the financial loss itself, but extend to emotional stress and opportunity costs. These opportunity costs include the economic and social opportunities which consumers and small businesses could have pursued had they not been dealing with the effects of an unresolved dispute or uncompensated loss.

7.5. Where a small business is faced with a dispute, this can impact on its financial viability and can result in an inability to pay employees and suppliers, the threat of bankruptcy, and personal stress and family breakdowns.[2] In the case of credit facilities, the small business owner may have provided a mortgage over assets, such as the family home, and there may be guarantees from other family members.

7.6. In addition to the significant impact on consumers and small businesses, failure to provide access to redress may also impose costs on other firms operating in the sector, who, despite meeting their obligations to their customers, suffer losses due to reputational damage or loss of consumer confidence created by the poor conduct of other firms.

7.7. If consumers and small businesses are unable to access redress, this can lead to severe financial hardship and subsequent loss of consumer trust and confidence in the financial dispute resolution framework, industry sectors and the financial system more generally.[3]

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1 Parliamentary Joint Committee on Corporations and Financial Services Report, *Inquiry into financial products and services in Australia* (November 2009); Commonwealth of Australia (Richard St. John Report), *Compensation arrangements for consumers of financial services* (2012); the Senate Economics References Committee Report, *Agribusiness managed investment schemes: Bitter harvest* (March 2016); the Parliamentary Joint Committee on Corporations and Financial Services Report, *Impairment of customer loans* (May 2016); and the Australian Small Business and Family Enterprise Ombudsman Report, *Inquiry into small business loans* (December 2016).

2 Western Australian Small Business Development Corporation 2016, submission to the Australian Consumer Law Review Issues Paper, page 5.

3 Australian Securities and Investments Commission 2011, *Report 240 Compensation for retail investors: the social impact of monetary loss*, page 8. ASIC notes the loss experience can have a corrosive effect on trust in the financial system; See also Commonwealth of Australia 2014, *Financial System Inquiry Final Report*.

WHY NOW?

7.8. The *Future of Financial Advice* reforms and the *Financial System Inquiry* (FSI) recognised that consumer protection in some areas of the financial system has been inadequate. As the Government's response to the FSI notes, 'recent history provides a number of examples of product and advice failures. While the circumstances of each case differ, problems have arisen when commercial incentives have overridden consumer interests.'[4] A number of reforms have subsequently been announced or implemented to address these weaknesses.

7.9. The Panel's April 2017 Report whilst finding that the existing EDR framework has many strengths, recommended some important changes, including increasing the EDR monetary limits, which the Panel found to be no longer fit-for-purpose and bearing little relationship to the value of some financial products.[5]

7.10. In Part 1 of this Report, the Panel has recommended the establishment of a limited and carefully targeted CSLR to close an important gap in the dispute resolution framework for consumers who use it to seek redress in the future. While action has and continues to be taken to improve the dispute resolution framework and the regulatory landscape for financial services, there remains the complex issue of addressing the past, where a number of consumers and small businesses may not have had access to redress.

7.11. The issue of providing access to redress is challenging with no easy solutions. Many examples of past disputes where consumers or small businesses have not had access to redress involve situations where the financial firm whose misconduct has resulted in the loss being not able or likely to pay compensation (for example, due to insolvency). As a result, any costs of providing redress to consumers and small business in these circumstances will fall to the broader financial sector or the Australian taxpayer.

7.12. Adding to this complexity is the lack of data on the scale and scope of these past disputes and the potential value of compensation that could be sought. Without an accurate quantification of the size, scale and nature of the issues it is not possible to fully assess the merits and issues in this area.

A PRINCIPLED APPROACH

7.13. In considering this difficult issue, the Panel has had regard to the Review Principles of efficiency, equity, transparency, accountability, comparability of outcomes and regulatory costs as outlined in Chapter 1.

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4 Australian Government October 2015, *Improving Australia's Financial System - Government response to the Financial System Inquiry.*

5 Australian Government April 2017, *Review of the financial system external dispute resolution and complaints framework.*

7.14. Of particular significance to the consideration of access to redress is the principle of equity. There are a number of circumstances where consumers or small businesses have been unable to access redress for disputes through the existing dispute resolution framework, even where they have taken all reasonable steps to do so.

7.15. Comparability of outcomes is another important principle. Under current arrangements, some consumers or small businesses who have been customers of the same financial firm might receive compensation, while others in similar circumstances may not. These inconsistencies arise from matters beyond the control of the consumer or small business—such as the fact that the firm is insolvent or otherwise unable or unwilling to pay.

7.16. While equity and comparability of outcomes are considerations, it is equally as important to be mindful of regulatory costs, especially when considering the difficulty in fully scoping or quantifying the problem.

7.17. When considering possible options for providing access to redress, efficiency, complexity, accountability and transparency are also important.

7.18. The Panel notes, however, that the objective of the Review is not to address access to redress for all types of losses suffered by consumers or small businesses. In a fair, well-functioning financial system, consumers should generally bear responsibility for their financial decisions, including the losses associated with market risk, investment performance and commercial decisions. While such events have a significant impact on consumers, they do not reflect misconduct by financial firms and therefore are not circumstances requiring access to redress.

DEFINING ACCESS TO REDRESS

Access to redress should be restricted to consumers and small businesses

7.19. The Panel has undertaken its analysis in this area within the context of the broader scope of this Review which focuses on the EDR framework. Accordingly, in looking at past disputes the Panel considers that it is appropriate to focus its assessment on consumers and small businesses (as defined for the purposes of the EDR framework).

7.20. The Panel has received submissions from stakeholders who fall outside of this definition and involve businesses of considerable scale. These are matters that are more appropriately pursued through the court system. Where a matter involving a larger business has merit but the proprietor lacks the resources to pursue litigation, there may be other avenues for seeking redress; for example, litigation funding through the private sector or contingent costs agreements.

A viable claim is the threshold condition for access to redress

7.21. A threshold issue for the Panel's Review is what is meant by access to redress. The Panel received a number of different views from stakeholders on this issue.

Stakeholder submissions

7.22. Some stakeholders argued that access to redress should not be based on legal principles or obligations. Rather, it should be based on broader notions of morality.[6] One representative group for individuals submitted that 'ethical and moral considerations must underpin the approach to avoid the problems of legal loopholes, limitations of the letter of the law or lack of legislation regarding aspects of disputes'.[7]

7.23. In contrast, ASIC submitted that access to redress should exclude consumers and small businesses with disputes that, under the law that existed at the time of the dispute, a legal entitlement to a remedy did not exist.[8]

7.24. Some individual consumers also had concerns in relation to whether the law at the time of the dispute was adequate.[9]

Panel Analysis

7.25. The Panel recognises that there have been examples of conduct which have resulted in loss to financial participants but have not been found to breach legal obligations. However, the Panel's view is that it would be a significant departure from the Australian justice system to ignore legal principles and obligations and instead apply broader notions of morality in any approach that seeks to provide redress.

7.26. Where there is a question relating to the adequacy of a particular law that regulates dealings between parties, such as the law of contracts, then this is not a matter for this Panel and is a matter for consideration by the government.

7.27. The Panel, therefore, is of the view that the threshold condition for providing access to redress is the existence of a viable legal or EDR claim against a financial firm at the time of the dispute.

7.28. Viable in the context of this Report refers to disputes of a nature that would ordinarily be able to be considered by an EDR body, court or other dispute resolution body. Viability also includes an element of merit. That is, based on the facts, the dispute had reasonable prospects of success.

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6 Holt Norman Ashman Baker Action Group, submission to the Supplementary Issues Paper, page 7; the Panel also heard from stakeholders in confidential submissions to the Review and during consultation.

7 Holt Norman Ashman Baker Action Group, submission to the Supplementary Issues Paper, page 7.

8 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 8.

9 McNamee, Peter, submission to the EDR Review Supplementary Issues Paper, page 3; Roy and Alma Lavis, submission to the EDR Review Supplementary Issues Paper, page 6.

7.29. Some scenarios that the Panel considers could be possible indicators of a viable claim include where:

- other consumers or small businesses with similar circumstances were successful in obtaining EDR determinations or court judgments against the firm for similar conduct;
- regulatory action was taken against the firm for the same, or similar conduct; or
- the claim is one that could normally be brought before a court or EDR body but was not for extenuating circumstances (for example, insolvency).

7.30. The Panel also considers it critical that the claim was viable at the time the dispute occurred. In other words, subsequent changes to the law should not apply to a past dispute.

ACCESS TO REDRESS INCLUDES REDRESS THROUGH THE COURTS AND OTHER DISPUTE RESOLUTION BODIES

7.31. In its Supplementary Issues Paper, the Panel sought views from stakeholders on its preliminary view that access to redress should be limited to the EDR framework and should not include disputes where redress could have been sought through the courts, tribunals or other dispute resolution bodies.

Stakeholder submissions

7.32. During the Review, the Panel heard from individuals and consumer groups who submitted that the scope of this Review should be broader than just considering disputes through the EDR framework and should also include access to redress through other dispute resolution processes, such as the courts.[10] It was submitted by individuals affected by financial loss that there were instances of a lack of redress within the court system and that these should be considered by the Review.[11]

Panel analysis

7.33. It is the view of the Panel that a full examination of the circumstances where there has been a lack of access to redress for EDR disputes is difficult to undertake without taking a holistic approach that also considers disputes that might not have met the criteria for access to an EDR body at the time of the dispute, where the consumer or small business lacked resources to access the courts.

10 McNamee, Peter, submission to the EDR Review Supplementary Issues Paper, pages 5 and 6; the Panel also heard from stakeholders in confidential submissions to the Review and during consultation roundtables.

11 McNamee, Peter, submission to the EDR Review Supplementary Issues Paper, pages 5 and 6.

7.34. Therefore, having regard to the Review Principles of equity, comparability of outcomes and regulatory cost, the Panel's views is that there is merit in considering access to redress for past disputes through both EDR and other dispute resolution processes.

CIRCUMSTANCES WHERE THERE IS MERIT IN PROVIDING ACCESS TO REDRESS

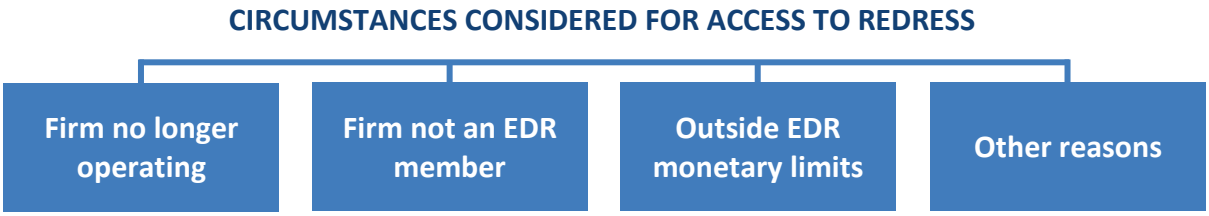
7.35. In its Supplementary Issues Paper, the Panel identified a range of circumstances that have resulted in consumers or small businesses being unable to access redress.

7.36. The Panel invited stakeholders to comment on the appropriateness of these identified circumstances.

7.37. Stakeholders mostly agreed with the circumstances the Panel identified in the Supplementary Issues Paper. Several consumer representatives identified additional categories of circumstances that could have led to a lack of redress.[12] These included where a financial firm was not a member of an EDR body when it ought to be (for example, the firm was expelled from the scheme or was trading unlicensed) and where a firm is otherwise uncontactable.[13]

7.38. A common theme across these circumstances is that consumers and small businesses were unable to gain access to redress due to circumstances outside of their control.

7.39. Key circumstances considered in this section include:



- the financial firm was no longer operating, having ceased trading, gone insolvent or being otherwise uncontactable or unable to pay;
- the financial firm was not a member of an EDR body, either trading unlicensed or being expelled by the EDR body;
- the monetary value of the dispute exceeded the EDR body's monetary limits and the consumer or small business lacked the resources to access the courts; and

12 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 14; Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 18; Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper; Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper.

13 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 14; Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 18.

- the consumer or small business did not pursue their dispute with the EDR body for other unspecified reasons (for example, because of personal circumstances, cost involved, lack of documentation, dispute fatigue or emotional distress).

Financial firm was no longer operating

7.40. Some disputes may not have been resolved because, at the time the dispute was lodged either with an EDR body or other dispute resolution body, the financial firm:

- was insolvent or had entered into administration;
- had ceased trading; or
- was otherwise uncontactable or unable to pay.

7.41. For example, the financial firm's PI insurance may have failed to cover claims, either as a result of the policy being exhausted or the policy not covering the type of misconduct. Alternatively, following a large financial collapse, a firm may have experienced a number of claims and exhausted all its resources before all claims could be paid. As a result, the consumer who was last in line, for no reason of their own, was left without access to redress.

7.42. This may have occurred before the consumer could lodge their dispute with an EDR body or court meaning the dispute was never heard. Alternatively, the EDR body or court may have closed the dispute after its lodgement because the financial firm either ceased trading or became insolvent before a determination or judgment could be made.

7.43. Ultimately, the consumer was unable to access redress because the financial firm no longer existed in a form that could allow a dispute to be brought to EDR or another dispute resolution body.

Stakeholder submissions

7.44. A number of stakeholders supported providing access to redress to consumers and small businesses in these circumstances.[14] This was on the basis that the lack of redress did not arise from the conduct of a consumer and may simply have resulted as a matter of timing regarding the lodgement of their dispute.[15]

7.45. However, some stakeholders submitted that consumers and small businesses in these circumstances should not be provided with access to redress, as there is no merit in revisiting past disputes where the firm responsible no longer exists and is therefore unable to provide compensation.[16]

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14 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 16; Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 17; Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 8; Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper; Holt Norman Ashman Baker Action Group, submission to the EDR Review Supplementary Issues Paper, page 67.

15 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 14.

16 Finance Broker Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 7.

7.46. In addition, significant practical issues in providing access to redress for consumers and small businesses in these circumstances were also raised by stakeholders. One stakeholder submitted that these practical considerations would include how a claim could be brought where the financial firm is insolvent, that there would be challenges with access to records and documentation, and how the eligibility criteria to access the arrangements, including scope of issues and timeframes, could be fairly developed'.[17]

Panel analysis

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.

Financial firm was not a member of an EDR body

7.50. In some circumstances, a financial firm may not have been a member of an EDR body. This could have occurred because a firm was trading while unlicensed, was in breach of a licensing requirement to be a member of an EDR body, or had been expelled from the EDR body for non-compliance.

7.51. In these circumstances, some consumers and small businesses were unable to access EDR and were left with few other low cost avenues through which to seek redress.

EXAMPLE – HOUSEHOLD RENTALS

Legal Aid NSW has a group of Aboriginal clients who have been unable to obtain redress through the EDR process. These clients live in a remote town and Aboriginal mission with a high Aboriginal population and a high incidence of economic disadvantage. The clients include a single parent with young children, several large families wholly dependent on Centrelink, and an older Aboriginal man. Most of the clients have never worked, remain reliant on Centrelink income, have low levels of literacy and extensive family carer responsibilities.

These consumers were targeted by a small business (that is now trading under a new business name) selling rental contracts for household goods. Many of the clients received unsolicited home visits to sign them up for contracts. Legal Aid NSW considered that the business may have engaged in unconscionable conduct and multiple breaches of consumer protection laws. Due to the failure of the trader to engage in internal dispute resolution, Legal Aid NSW assisted clients to lodge disputes with an EDR body.

17 Australian Bankers' Association, additional submission to EDR Review Supplementary Issues Paper, page 2.

EXAMPLE – HOUSEHOLD RENTALS (CONTINUED)

The EDR body subsequently failed to advance or determine the matters in a timely manner, or take action against the trader for failing to meet deadlines. Due to lack of engagement, the trader was expelled from the scheme and is not currently a member of any ASIC-approved EDR body.

As the EDR body did not determine the matter prior to the member's expulsion, this dispute remains unresolved and many of the time limits for alternative legal claims have now expired. The clients now have little or no prospects of obtaining financial or legal redress. The clients were seeking a modest refund of approximately $15,000 in total for their combined loss, which would be of significant benefit, given their vulnerability and disadvantage.[18]

Stakeholder submissions

7.52. Consumer representatives submitted this was an important category that should also be considered for access to redress. The Joint Consumer Group submission notes:

> *"Where the firm was not an EDR member but ought to have been (for example, where the firm was unlicensed, was excluded from EDR or let its membership lapse), the consumer's only recourse was legal action in a court or tribunal. To put consumers in the position that they would have been but for the firm's misconduct, these consumers and small businesses should have access to a past disputes forum if they have uncompensated losses."*[19]

Panel analysis

7.53. In circumstances where a firm should have been a member of an EDR body (as a consequence of the type of financial services it was providing) but was not, it is unlikely that a consumer or small business would have been aware of this fact and able to consider it when deciding to engage with the firm. Where a firm was expelled from an EDR body, this may have occurred after a consumer or small business became a customer of the firm, and the customer or business may never have been made aware of the expulsion.

7.54. In these types of situations, a consumer or business should have had access to an EDR body but this was not possible due to factors beyond the control of the consumer or small business.

7.55. As with the circumstances described above in paragraphs 7.40-7.49, this raises concerns about equity and comparability of outcomes. The Panel, therefore, considers that there is merit in providing access to redress where the firm should have been a member of an EDR body but was not.

18 Legal Aid NSW, submission to the Supplementary Issues Paper, page 19.

19 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 17.

Outside EDR monetary limits and unable to access the courts

7.56. A dispute may have fallen outside of an EDR body's jurisdiction if the value of the dispute was above the body's monetary limits. In these circumstances, consumers and small businesses would have been unable to access EDR and have been left with few, if any, avenues through which to seek redress.

Stakeholder submissions

7.57. Industry representatives and some consumer representatives submitted that it was not appropriate to consider providing access to redress for consumers and small businesses with past disputes that were outside the monetary limits of EDR bodies as they could have accessed redress through the courts. Further, some stakeholders submitted there are sound policy reasons for monetary limits and compensation caps and that retrospectively changing monetary limits for past disputes, would undermine the policy in place at the time of the past dispute.

7.58. One stakeholder noted that 'EDR thresholds are set with the policy objective of providing free access to dispute resolution for small, consumer disputes. Point in time EDR thresholds reflect the prevailing economic and financial conditions at the time.'[20]

7.59. Another industry representative submitted that allowing consumers and small businesses under this circumstance to access redress would be moving the goalposts and runs counter to providing the certainty that all stakeholders should be entitled to expect from EDR arrangements'.[21]

7.60. Other stakeholders, primarily individuals and consumer representatives, submitted that there was merit in providing consumers and small businesses in these circumstances with access to redress as those affected lack sufficient resources to access the courts and, are as such, left with few other avenues of redress. As a result, access to redress should be considered on the grounds of fairness, equity and access to justice.

7.61. One industry representative submitted that while there are often significant costs involved in taking legal action, there are a range of legal firms that are publicly offering to assist clients in taking action.[22] Given the access to such legal firms are on a 'no win no fees' basis, there is no merit in providing access to redress to this circumstance as consumers already have sufficient access to the legal system.[23] However, one individual who suffered a financial loss and had sought access to redress through the assistance of such a legal firm noted that they had to assign the proceeds of their case, should damages be awarded to a third party.[24]

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20 Australian Bankers Association, submission to the EDR Review Supplementary Issues Paper, page 9.

21 Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, page 12.

22 Association of Financial Advisers, submission to the EDR Review Supplementary Issues Paper, page 13.

23 Association of Financial Advisers, submission to the EDR Review Supplementary Issues Paper, page 13.

24 Bone, David, submission to the EDR Review Supplementary Issues Paper, page 2.

7.62. Other stakeholders saw merit in providing a mechanism for redress in these circumstances in exceptional situations such as where the consumer is experiencing financial hardship.[25]

Panel analysis

7.63. Given that the Panel and the Government have identified that the current EDR monetary limits are inadequate, and this is being addressed as part of the establishment of AFCA, the Panel considers that there may be merit in allowing consumers or small businesses with past disputes that were outside those limits but lacked the resources to access the courts to have access to some form of redress.

7.64. The Panel recognises that monetary limits are an important element of the EDR framework and that some disputes are more appropriately handled through the courts but as the Productivity Commission's Access to Justice Arrangements report notes 'while these disputes are small in number, many individuals are poorly placed to access the courts'.[26]

7.65. The Panel notes that in litigation there are often imbalances in power, information and resources between consumers or small businesses and larger financial firms. This can lead to situations where consumers and small businesses are left with few, if any, low cost and practicable avenues through which to seek redress.

7.66. The Panel, therefore, considers that there may be merit in considering providing access to redress for consumers or small businesses that fall outside of EDR monetary limits but are also unable to access the courts.

Providing access to redress in other exceptional circumstances

7.67. In its Supplementary Issues Paper, the Panel noted there may be other situations which create the circumstances whereby a consumer or small business does not bring their dispute to an EDR body for resolution.

7.68. For example, this category might cover disputes that were not pursued because of exceptional personal circumstances (such as a significant debilitating illness), a lack of knowledge about the legal and EDR processes or the perceived complexity, difficulty or costs involved (dispute fatigue).

7.69. In some cases the Panel was told that consumers were unable to take action because of exceptional personal circumstances or because the complexity of the issues meant that they were unable to pursue a dispute without professional assistance, which may have been unaffordable. Complicating this further were cases of incomplete or missing documentation that had made it even harder for consumers to progress their claim.

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25 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 16.

26 Productivity Commission 2014, *Access to Justice Arrangements* (Inquiry Report), 3 December 2014, available at: <**http://www.pc.gov.au/inquiries/completed/access-justice/report**>, Overview, page 2.

Stakeholder submissions

7.70. During the course of this Review, the Panel heard directly from individuals and groups of the significant impacts on their lives as a result of being unable to gain access to redress. In many cases participants advised the Panel that having to take a matter through a claims process could potentially add to the traumatic experiences associated with the dispute. A number of scenarios were also raised during consultations where consumers had failed to access redress due to exceptional circumstances.

7.71. Some industry representatives argued that providing access to redress to consumers and small businesses in these circumstances was particularly problematic given that the existing EDR arrangements are free to consumers and easy to access, and there are many free sources of information available to assist consumers. [27]

7.72. Some industry stakeholders also submitted that providing access to redress for where a claim of emotional distress or dispute fatigue formed the eligibility criteria could raise issues as it may incentive consumers to claim dispute fatigue in order to gain access to such a scheme. It was also submitted that extending access to a broader range of situations, for example, where a consumer failed to take action where it was reasonably practicable for them to do so, would undermine the principle of the accountability of the consumer.[28]

7.73. Some consumer and industry representatives submitted that redress should only be provided for this circumstance where the consumer or small business could demonstrate exceptional circumstances, such as where the consumer is experiencing severe financial hardship.[29] Ultimately, the dispute would need to not have been heard by a court, tribunal or EDR body through no fault of the consumer.[30]

Panel analysis

7.74. As a general principle in the Panel's analysis of the merits in providing access to redress for past disputes, the Panel considers that a consumer or small business must have taken reasonable action to obtain redress at the time they became aware of the dispute. The Panel also notes that the EDR framework has been designed specifically to provide access to redress in a manner that seeks to minimise costs for consumer and small businesses.

7.75. However, with regard to the Review Principle of equity, the Panel considers that there is merit in considering providing access to redress outside of the circumstances outlined earlier in this section in certain exceptional circumstances, such as where a severe and debilitating illness or hardship prevented a consumer from taking action.

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27 Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, page 12.

28 Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 18.

29 Legal Aid New South Wales, submission to the EDR Review Supplementary Issues Paper, page 26.

30 Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 18.

7.76. The Panel notes that it would expect that only a limited number of consumers or small businesses would be eligible based on these criteria alone.

Circumstances where there is no merit in providing access to redress

7.77. The Panel also considered whether there was merit in providing access to redress in the following circumstances:

- losses arising from market risk and investment performance or business decisions; and
- consumers with a final EDR determination, court decision or deed of settlement who are unsatisfied with the outcome.

Losses arising from market risk, investment performance and business decisions

7.78. The Panel did not receive any stakeholder submission specifically on this issue. However, the Panel considers this an important consideration and therefore provides the following analysis. This issue was also noted in Chapter 4 in the Panel's discussion in relation to a CSLR.

Panel analysis

7.79. A fair, well-functioning financial system 'allows consumers to take on risk to make a return. Inevitably, this means consumers will incur gains and losses from market movements'.[31]

7.80. The Panel, accordingly, does not consider that there is merit in providing access to redress for all types of losses suffered by consumers or small businesses. Where the system is functioning effectively, consumers should generally bear responsibility for their financial decisions, including the losses associated with market risk, investment performance and business decisions. While such events have a significant impact on consumers, they do not reflect misconduct by financial firms and therefore are not circumstances requiring access to redress.

7.81. Similarly, the Panel does not consider there to be merit in providing access to redress in circumstances where a business decision or market risk and investment performance were ultimately responsible for a loss incurred by a small business as these losses do not reflect misconduct by a financial firm.

31 Commonwealth of Australia 2014, *Financial System Inquiry Final Report*, page 197.

7.82. More broadly, the Panel notes that seeking to provide access to redress for past disputes should not seek to de-risk the system and distort investment returns or market outcomes. Some losses are inevitable in a market economy and there is inherent risk in any financial investment or enterprise. If a consumer received inappropriate financial advice that resulted in a loss, there is merit in providing access to redress, but where a consumer received financial advice that was appropriate to their needs and incurred a loss as the result of a change in market conditions, then the Panel is of the view that such claims should not be considered.

Who has already received access to redress?

Stakeholder submissions

7.83. Some stakeholders advocated that consumers and small businesses should have further consideration of their dispute even where they have received a final decision from an EDR body, court or tribunal. It was suggested that the imbalance of power and available resources between consumers and large financial firms meant that consumers may have been unable to receive redress because the consumer was unable to effectively pursue their case.[32]

7.84. Similarly, some representatives for individuals impacted by financial loss proposed that legal settlements between financial firms and consumers should be overturned and re-examined, on the basis of the imbalances in bargaining power and knowledge that can often occur between large financial firms and consumers.[33] Some stakeholders also argued that the capacity of some consumers or small businesses to understand settlement agreements can be limited.

Panel analysis

7.85. As a general principle, a consumer or small business who has received a determination or decision from an EDR body, court or tribunal has had access to redress. Even where the consumer or small business is unhappy with the outcome, there would need to be compelling reasons for providing access to further redress in these circumstances. Any legal or constitutional barriers would also need to be overcome.

7.86. The Panel notes there are significant legal and other limitations on reopening past disputes with a finalised deed of settlement or a final court judgment (which has no further avenues of appeal).[34] Essentially, if the rights between two parties to a dispute have been finally determined (including appeals) it is difficult to revisit or reopen a decision. To allow otherwise would undermine certainty in legal process and the meaning of the law.[35]

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32 McNamee, Peter, submission to the EDR Review Supplementary Issues Paper, pages 5-6.

33 O'Brien, Rory, submission to the EDR Review Supplementary Issues Paper, page 1.

34 *Bailey v Marinoff* (1971) 125 CLR 529, where the High Court held that '[o]nce an order of the court has been passed, entered into or otherwise perfected in a form which correctly expresses the intention with which it was made, the court has no jurisdiction to alter it.'

35 This was the contention in *NSW v Kable* (2013) 252 CLR 118 at 135 where it was held that there must come a time where decisions made in the exercise of judicial power must be given effect in order to give effect to rights and liabilities.

7.87. In the case of finalised deeds of settlement, deeds can generally only be challenged on the basis of its invalidity due to factors such as duress, mistake, fraud or bad faith, failure of consideration or illegality.[36] Mere dissatisfaction with the terms, or a perceived inadequate settlement amount, would not be sufficient for a party to have legal grounds to reopen or overturn the settlement.

7.88. The Panel also notes there are likely to be substantial constitutional limitations for the Government to re-open finalised matters (either a final court judgment or a signed deed of settlement). These limitations arise primarily from:

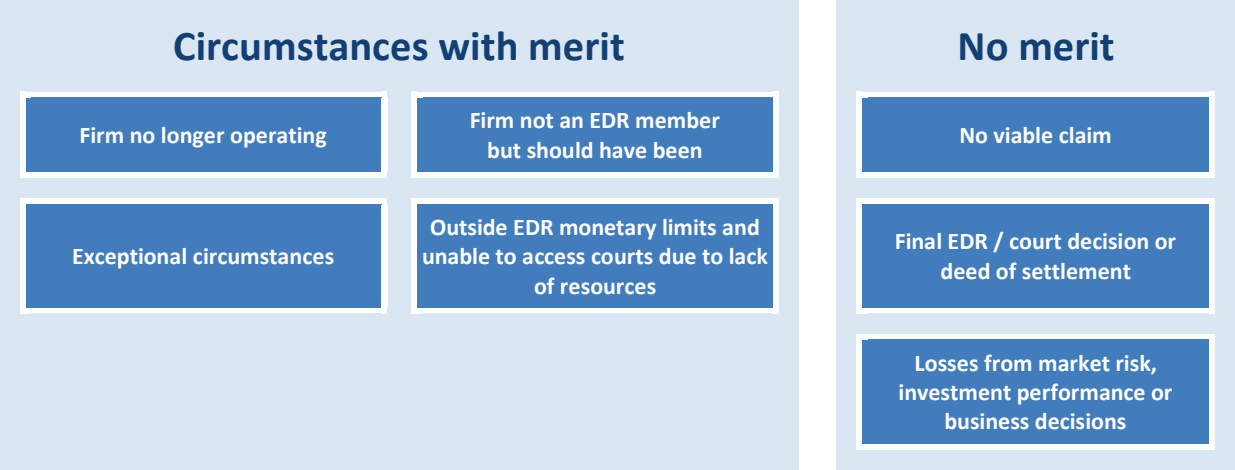
- The separation of powers, in that neither the Parliament nor the Executive may exercise or interfere with the exercise of judicial power. This could be the case if the Government conferred upon a non-judicial body, such as AFCA, the power to review matters that had previously been settled by a court.
- The unjust acquisition of property (contrary to s 51(xxxi) of the Constitution), to the extent that the Government purported to interfere with the settled substantive rights of parties to their detriment.
- Interference with State laws, in that the legal rights and liabilities of parties would often have been decided in accordance with State laws and any law made by the Commonwealth Government which interfered with the operation of those laws would need to rely on a Commonwealth head of power.

7.89. The Panel also considers that consumers and small businesses who have received a decision from an EDR body, court or tribunal, or who have reached a legally binding settlement, have had access to redress. The Panel does not consider that there would be merit in providing further access to redress in these situations, even if it was legally possible.

7.90. However, in circumstances where an EDR body, when determining jurisdiction, refused to hear a dispute on a preliminary basis, (for example because the consumer was outside of the monetary limits or the financial firm had gone into administration) it is the view of the Panel that a consumer may not necessarily have had access to redress and there may be merit in these circumstance in providing access to redress.

36 *National Australia Bank Ltd v Koller* [2011] VSC 228.

7.91. The Panel's views on the merit of the various types of circumstances described in this section are illustrated below:



OBSERVATION 2:

ACCESS TO REDRESS MUST BE DEFINED

The Panel considers there is merit in considering providing access to redress to those consumers or small businesses that have not been able to receive a decision on a dispute through an EDR body, court or another dispute resolution mechanism for a viable claim, due to circumstances that are outside their control.

The Panel also considers that consumers and small businesses who have had access to dispute resolution before an EDR body, court or tribunal, or who have reached a legally binding settlement, have had access to redress. The Panel does not consider that there would be merit in providing further access to redress in these situations.

The Panel also notes there are substantial constitutional and other limitations to re-opening matters with final court judgments or signed deeds of settlement.

OBSERVATION 3:

THERE IS MERIT IN CONSIDERING PROVIDING ACCESS TO REDRESS FOR PAST DISPUTES IN CERTAIN CIRCUMSTANCES

The Panel considers there is merit in considering providing access to redress in the following circumstances, where at the time of the dispute:

- the financial firm was no longer operating, having ceased trading, gone insolvent or being otherwise uncontactable or unable to pay;
- the financial firm was not a member of an EDR body, because it was either trading while unlicensed or had been expelled by an EDR body;
- the monetary value of the dispute exceeded the EDR body's monetary limits and the consumer or small business lacked the resources to access the courts, tribunals or other dispute resolution bodies; and/or

OBSERVATION 3 (CONTINUED)

- the consumer or small business was not in a position to pursue their dispute with the EDR body due to exceptional circumstances.

The Panel does not consider that there is merit in providing access to redress for past disputes resulting from:

- losses arising from market risk and investment performance;
- losses arising from business decisions;
- allegations that the applicable law was deficient; and/or
- claims based solely on arguments about broader notions of morality rather than the requirements that apply under the law.

ISSUES IN PROVIDING ACCESS TO REDRESS FOR PAST DISPUTES

7.92. In the previous sections of this Chapter, the Panel has assessed the merits of providing access to redress for consumers and small businesses in certain circumstances. While the Panel acknowledges that there is merit in providing access to redress, the Panel has also considered the significant issues that arise in examining this question.

7.93. In particular, there are issues associated with:

- the lack of complete, reliable data to enable the scale and scope of the problem to be quantified;
- determining appropriate sources of funding;
- the need for a time limit on disputes eligible for consideration for access to redress;
- indirect costs to industry; and
- the risk of undermining the existing legal framework by applying regulatory requirements retrospectively.

7.94. The remainder of this Chapter discusses these issues within the framework of the Panel's Review Principles.

Essential to identify the pool of eligible consumers and small businesses and the value of losses

7.95. In order to design any mechanism to provide access to redress for past disputes, including the detailed eligibility criteria, processes for assessing claims and any caps or prioritisation criteria that may apply, it is necessary for the Government to be able to reliably estimate both the number of potential claims and the level of compensation that may be payable.

Stakeholder submissions

Views on the lack of information about the scope of the problem

7.96. A number of stakeholder submissions acknowledged the fact that the number of disputes is currently unquantified and that therefore the scope of the problem is unclear.

7.97. Consumer groups acknowledged the 'large and unknown number of disputes [which] may need to be handled'.[37] Likewise, industry organisations referred to redress for an 'unknown quantum' of potential claims[38] and 'subjecting providers […] to unquantifiable and potentially open-ended liability'[39] and stated that it is not known how many old or dormant claims might be raised as a result of the establishment of a mechanism to provide redress to past disputes.[40]

7.98. Stakeholders recognised that a clear understanding of the significance of the problem is required before proceeding with the development of a mechanism to provide redress. For example, the Australian Institute of Superannuation Trustees submitted that evidence of the issues must be available before a suitable response can be developed if one is necessary,[41] and FOS identified that compiling the data to assist in assessing the likely amount of compensation (and therefore funding) required will be a key challenge.[42] Similarly, ANZ noted the importance of undertaking work to estimate the value of claims that could be eligible for a redress mechanism.[43]

Views on an application 'window'

7.99. Some stakeholders indicated that there would need to be a limited window within which potential claimants can come forward to register or lodge their dispute. This is particularly important where there is a limited source of funding for compensation and an approach is needed to allocate this limited funding across consumers and small businesses with eligible past disputes.[44]

37 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 15; Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, pages 21-22.
38 Mortgage & Finance Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 3.
39 Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, page 1.
40 Australian Institute of Superannuation Trustees, submission to the EDR Review Supplementary Issues Paper, page 8.
41 Australian Institute of Superannuation Trustees, submission to the EDR Review Supplementary Issues Paper, page 8.
42 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 26.
43 ANZ, submission to the EDR Review Supplementary Issues Paper, page 7.
44 Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, page 14.

7.100. Consumer groups suggested that a period of at least two years would be appropriate and that an extensive community education, outreach and advertising campaign would be required to ensure accessibility.[45]

Panel analysis

7.101. The Principles guiding this Review include that the framework should be transparent, with users having access to appropriate information, and efficient, which requires the framework to possess, amongst other things, adequate coverage, remedies and resources to resolve matters promptly.

7.102. This Chapter identifies the circumstances where the Panel considers that there may be merit in providing access to redress for consumers and small businesses who have not had such access. The Panel has found that there is a lack of comprehensive of data on:

- the number of affected consumers/small businesses (that is the number of disputes at stake); and
- the value of losses.

7.103. This is a threshold issue as this lack of data creates significant risks and challenges in determining:

- the scale of the problem;
- how best to provide access to redress for past disputes in a manner that is consistent with the Review Principles of equity, complexity, comparability of outcomes and regulatory costs;
- the value of the losses in question, and therefore the value of compensation that may be sought;
- potential implementation costs of a mechanism to provide access to redress for past disputes; and
- the appropriate approach to funding for administration and compensation.

7.104. Past disputes cannot be resolved efficiently if the number of disputes falling within the categories identified by the Panel and value of potential awards of compensation are unquantified. Further data is required before it is possible to design mechanisms that ensure that outcomes are provided in an efficient manner, with adequate resources to enable claims to be resolved quickly.

7.105. Providing transparency to users includes giving users information about what outcomes they can reasonably expect from the process. Until the value of eligible claims is known, it is not possible to provide clarity on any compensation arrangements that may be available in respect of particular claims.

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45 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 17; Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 26.

7.106. In light of this, the first step prior to any further consideration of providing access to redress must be to establish an appropriate approach to gather data. This will allow a full and thorough examination of the merits and issues and analysis of the possible options to provide access to redress for past disputes.

7.107. The Panel considers that an appropriate way to quantify the number and potential value of claims is to call for consumers and small businesses to come forward during a specified application window. This will provide a clear indication of the pool of affected consumers and small businesses with potential claims, which will in turn assist in defining the size and scope of any mechanism.

7.108. In setting the appropriate application window, the Panel notes the concerns raised by consumer groups in needing to ensure that it is sufficiently long to enable potentially vulnerable consumers to come forward. This is also balanced by the need to ensure that the process occurs in a timely manner. Therefore, the Panel is of the view that 12 months may represent an appropriate window for consumers and small businesses with an eligible past dispute to come forward.

7.109. That said, the Panel is cognisant that calling for consumers and small businesses to come forward may falsely increase expectations of redress or compensation, expectations which may ultimately remain unsatisfied if claims end up not being eligible.

7.110. Once a call is made for applications, claims will need to be subject to initial assessment, to inform further decisions about the detailed design of any redress and compensation mechanisms. While this could commence during the application window, it will need to continue for a period of time after that window closes as it is likely that a large number of disputes will be submitted at or just prior to the closing date.

7.111. The Panel notes that any means of gathering complete and reliable information about past disputes is not, itself, without substantial cost, and that a source of funding will be required for this exercise.

The sources of funding

7.112. A significant issue in considering whether to provide access to redress for past disputes is the question of who will fund any mechanism. A funding source will need to be identified for both the payment of compensation and the administration of any mechanism, and this has the potential to have significant consequences for financial firms.

7.113. Within the EDR framework, the financial firm against which a claim is brought is required to pay the compensation awarded by an EDR body. This arrangement arises by virtue of the contract that an EDR body has with its members (or, in the case of superannuation, by operation of the law). Similarly, where a judgment involving an award of compensation is made against a financial firm in a court or tribunal the financial firm is legally required to pay. In each case, those at fault bear the cost of compensation. With EDR, the costs of administering an EDR body are borne by its members.

7.114. However, in a number of the circumstances where the Panel considers that there is merit in providing access to redress for past disputes, the financial firm whose misconduct has resulted in the loss is not available to bear the costs (for example, due to insolvency). As a result, in order to provide access to redress, the costs of considering disputes and paying compensation arising from any misconduct, will fall to the broader financial services industry or the Australian taxpayer.

7.115. Additionally, in some circumstances considered for access to redress outlined earlier, there may not be a legal or contractual obligation for the financial firm that is the source of the misconduct to bear the costs of any compensation awarded. For example, where the matter is outside of statutory time limits for an EDR, court or tribunal decision.

7.116. Any question of funding which could involve costs for industry or other users naturally also increases regulatory costs.

Stakeholder submissions

Support for industry funding

7.117. Broadly, consumer groups supported redress for past disputes being funded by industry. Legal Aid Queensland indicated that industry should fund a mechanism to provide redress for past disputes to provide consistency with an industry funded CSLR,[46] while Legal Aid NSW did not consider that the Government has any role in funding such a mechanism.[47]

7.118. Other submissions noted that, for example in the case of small business disputes with banks, it is fitting that banks be held to account for their conduct and fund the redress process.[48]

7.119. While supporting an industry funded solution some stakeholders suggested there also needs to be a role for government.

7.120. The Joint Consumer Group stated that, while generally redress should be provided by industry, there may be a role for the Government to contribute to funding where the regulatory framework enabled the collapse of forestry managed investment schemes.[49] It noted that the Senate Economics Committee found that the tax advantage for these schemes 'was a factor and certainly a major plank in the marketing strategy for these products' and that regulators and government must share responsibility for the harm caused by these failed schemes, given their lack of decisive action in monitoring the marketing and performance of the schemes.[50]

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46 Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 10.
47 Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 27.
48 McNamee, Peter, submission to the EDR Review Supplementary Issues Paper, page 7.
49 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 18.
50 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 18, citing the Senate, Economics References Committee, *Agribusiness Managed Investment Schemes: Bitter Harvest*, pages xxii and xxiv.

7.121. The Financial Planning Association of Australia shared the view that there is a role for government, stating that a mechanism to provide redress for past disputes should at the very least be subsidised by government because the problem being addressed arises, in part, from regulatory limitations.[51]

7.122. The Joint Consumer Group submission also suggested that a mechanism which provides redress for past disputes could provide a wider benefit to the community in reduced reliance on social security, health and other welfare services. It identified as an option using some of the proceeds from the Major Bank Levy to fund a mechanism to provide access to redress for past disputes.[52]

Concerns about industry funding

7.123. Industry stakeholders expressed strong concerns about any mechanism funded by industry. ANZ, while broadly supportive of a CSLR, noted that 'having today's solvent firms pay the claims against yesterday's (insolvent) firms raises issues of equity to the formers' stakeholders (customers, shareholders, employees)'.[53]

7.124. The Association of Financial Advisers submitted that any scheme to address the mistakes of past market participants should not be funded by current participants and that the only viable source of funding is the Government.[54] It noted that, because industry funding would have a substantial impact upon the cost of providing financial advice, this approach could reduce both the access to and the affordability of financial advice.[55]

7.125. The Financial Planning Association of Australia indicated that requiring industry to fund a redress mechanism would divert funds from business operations and may impact on client service offerings and the cost of advice, particularly for small to medium financial firms which have less capacity to absorb additional, unexpected cost. It also stated that broadening eligibility for redress increases the magnitude of the inequity, where those funding the redress mechanism did not cause the loss being compensated.[56]

7.126. Superannuation industry bodies raised concerns about any funding arrangement which would require the financial services industry, including superannuation funds, to provide compensation in respect of past disputes.

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51 Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 19.
52 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 18.
53 ANZ, submission to the EDR Review Supplementary Issues Paper, page 6.
54 Association of Financial Advisers, submission to the EDR Review Supplementary Issues Paper, page 16.
55 Association of Financial Advisers, submission to the EDR Review Supplementary Issues Paper, page 14.
56 Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 17.

7.127. The Association of Superannuation Funds of Australia stated that: 'It is clearly inappropriate that such a liability be imposed in relation to the APRA-regulated superannuation sector, where monies are held on trust and the funding of such compensation would impact adversely on the outcomes provided to all superannuants.'[57]

7.128. The Australian Institute of Superannuation Trustees suggested that there would be risks to members' financial interests, indicating that funds may need to use trust monies to pay a claim, which would erode retirement savings.[58] Industry Super Australia also stated that paying compensation for past disputes 'may be inconsistent with the existing fiduciary obligations of trustees to act in the best interests of members as a whole.'[59]

Panel analysis

7.129. Careful consideration needs to be given to the appropriate arrangements for funding any redress for past disputes and the need to preserve equity, maximise efficiency and transparency and minimise regulatory costs.

7.130. There are two elements to the funding: administrative/operating costs of the mechanism established to quantify and potentially assess past disputes, and costs of any compensation.

7.131. The Panel acknowledges the different views among stakeholders: support by some consumer advocates and legal aid services for industry funding, tempered by the recognition that there may be some role for government; and significant industry concerns about any mechanism where current participants fund losses created by past participants.

7.132. As a matter of general principle, the financial firm responsible for causing a loss should bear the cost of providing redress and compensation. This means that where an eligible claim is made within specified time limits and the financial firm is still in operation, then that financial firm should be responsible for the funding.

7.133. However, in many cases, the cost of providing redress for past disputes is not practically able to be borne by the financial firms at fault. For example, in many cases, access to redress may be provided in relation to disputes where the financial firm is insolvent and does not have assets to fund redress or is uncontactable.

7.134. In these cases, if access to redress and, ultimately, compensation are provided the burden will fall on current industry participants or on the wider taxpaying community.

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57 Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, page 10.

58 Australian Institute of Superannuation Trustees, submission to the EDR Review Supplementary Issues Paper, page 8.

59 Industry Super Australia, submission to the EDR Review Supplementary Issues Paper, page 5.

7.135. The Panel has considered the issue of current industry participants being required to contribute to the cost of misconduct by former financial firms in the industry in Chapter 6 in its discussion on funding to address legacy unpaid EDR determinations. The principles outlined by the Panel in Chapter 6 apply equally to this discussion of past disputes.

7.136. That is, the Panel is of the view that it may not be either appropriate or desirable that current industry participants be required to contribute to provide access to redress for disputes that relate to former industry participants. Therefore, it is a matter for government as to whether it is able to identify a funding source to provide access to redress for past disputes.

7.137. In considering what the source of funding should be, the Panel notes that the current situation of some consumers and owners of small business lacking access to redress is not without cost to the taxpayer. A lack of access to redress may result in financial hardship and require consumers or owners of small businesses to rely on social security arrangements, for example, the age pension, which are funded though taxation.

There may be indirect costs to industry in providing access to redress for past disputes

7.138. In considering whether to implement any mechanism to provide access to redress for past disputes, it is necessary to consider the potential impacts on affected consumers and small businesses as well financial firms.

7.139. Implementing a mechanism to provide access to redress for past disputes has the potential to impose indirect costs on financial firms, which are discussed below.

Administrative and other costs borne by financial firms

7.140. Establishing a mechanism to provide access to redress for past disputes may increase administrative and compliance costs for financial firms, irrespective of who pays the direct costs associated with the operation of a mechanism and the payment of compensation awards.

Stakeholder submissions

7.141. A number of stakeholders, particularly those in the superannuation sector, raised concerns about the administrative and other costs that would be borne by financial firms if access to redress is provided for past disputes. One stakeholder indicated that the administrative burden and costs for financial firms 'should not be underestimated'.[60]

60 Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, page 11.

7.142. Another elaborated on the types of costs that would be borne, indicating that superannuation funds will need to develop new work streams dedicated to dealing with past disputes, and that associated costs would include:

- administrative: the fund will be required to gather and retain evidence about each decision made by the trustee;
- operational: the fund will be required to develop operational procedures and processes to address old complaint procedures and processes; and
- compliance: the fund will need to comply with EDR decisions relating to old complaints.[61]

7.143. It was submitted that these costs are likely to be ultimately borne by superannuation fund members.[62]

Panel analysis

7.144. The Panel agrees that providing access to redress for past disputes may impose some indirect costs on financial firms, however, the scale of any such costs will depend on the mechanism adopted.

7.145. The Panel notes that the financial services sector is a dynamic industry with a range of firms entering and, exiting or merging. In reviewing certain past disputes, in particular disputes that occurred a considerable time in the past, there may be significant complexity in identifying the firm who is legally liable.

7.146. The Panel considers that clearly defining the circumstances in which a dispute may be brought to any mechanism providing access to redress for past disputes, as well as defining how the mechanism will operate, will help to scope the possible administrative and other indirect costs.

7.147. In designing any mechanism to provide access to redress for past disputes, following an initial information gathering phase, care should be taken to ensure that any costs on financial firms are minimised.

There is a need for a time limit for past disputes to be considered for access to redress

7.148. The matter on which the Panel received significant stakeholder views was in relation to the need to apply time limits on past disputes that are eligible to be considered for access to redress.

61 Australian Institute of Superannuation Trustees, submission to the EDR Review Supplementary Issues Paper, page 10.

62 Industry Super Australia, submission to the EDR Review Supplementary Issues Paper, page 13; Australian Institute of Superannuation Trustees, submission to the EDR Review Supplementary Issues Paper, page 10.

Stakeholder submissions

Absence of documentation, evidence and/or personnel

7.149. Stakeholders raised concerns about the evidentiary issues with providing access to redress for past disputes, where a claim was not previously possible under prevailing settings at the time.

7.150. The Association of Superannuation Funds of Australia indicated that crucial evidence may no longer be available, either because prescribed record-keeping periods have expired or because, in the absence of an 'active' dispute, it was not considered necessary to obtain particular types of evidence (for example, regarding the health of a member/product holder).[63] It also submitted that:

> "The unavailability of contemporaneous evidence will have a significant impact on the resolution of past disputes, as it will require assumptions to be made and will inevitably lead to suggestions of bias in favour of either the consumer or the provider."[64]

Time limits within which to bring a claim (the age of disputes)

7.151. Stakeholders had a range of views on the age of disputes that should fall within the scope of the meaning of past disputes, in the context of considering providing access to redress for past disputes. These views are summarised in the table below.

Age	Reason
Up to 6 years	Consistency with the current court and EDR time limits applying to past disputes.[65]
More than 6 years	Longer than the EDR 6 year time limit because there are unpaid determinations that have fallen outside the limitation period within which recovery can be made.[66]
Between 6 years and 10 years only	Matters within time for EDR should be lodged with FOS or CIO (or in future AFCA) in the usual way.[67] Matters outside the time limit for EDR should be eligible but only where the cause of action arose within the last 10 years (and provided they meet other eligibility criteria).[68]

63 Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, page 11.
64 Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, page 11.
65 Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 9.
66 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 15.
67 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 17; Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 26.
68 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 17; Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 26.

Age	Reason
Up to 10 years	To provide justice to victims of financial misconduct, and to restore the lost trust and confidence in the financial system, given that many of the losses caused by financial misconduct went uncompensated when firms collapsed during the global financial crisis in 2007-08.[69] To provide consistency with the payment of legacy unpaid EDR determinations dating back to 2008.[70] Consistency is important for people who did not or could not pursue action at the time because they were advised (for example, by lawyers or an EDR body) that any claim would be futile. These people should not be in a worse position than those who pursued an (ultimately unpaid) EDR determination against the same firm.[71]
No time limit	Ethical behaviour is not time dependent and imposing a time limit would disadvantage some consumers.[72]

7.152. Industry stakeholders expressed concern over an approach to providing access to redress that did not specify a time limit.

7.153. A number of stakeholders referred to the uncertainty created in considering providing access to redress for past disputes that are outside time limits that apply to the current dispute resolution frameworks. For example, the Association of Superannuation Funds of Australia indicated that creating special rules for past disputes is inconsistent with 'the need for all stakeholders to have certainty, with clear timeframes and criteria applying to the resolution of financial system disputes',[73] noting that a key aspect of certainty is time limits.

7.154. Industry Super Australia stated that long-dormant claims may result in an unreasonable burden on the defendant as it is accepted that firms should be able to arrange affairs and utilise their resources without concern of a potential action from such claims.[74]

7.155. One stakeholder indicated that consideration of access to redress for past disputes creates uncertainty and undermines financial firms' confidence in the EDR system,[75] while another indicated that an important part of the existing EDR arrangements is certainty and consistency and that these are indicators of a fair process.[76]

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69 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 17.

70 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 17.

71 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 17; Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 15, also considers that the timeframe should be longer than the EDR six-year time limit given there are unpaid determinations that have fallen outside the limitation period within which recovery can be made.

72 McNamee, Peter, submission to the EDR Review Supplementary Issues Paper, page 7; Holt Norman Ashman Baker Action Group, submission to the EDR Review Supplementary Issues Paper, pages 108-9.

73 Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, page 1.

74 Industry Super Australia, submission to the EDR Review Supplementary Issues Paper, page 13.

75 Australian Timeshare and Holiday Ownership Council, submission to the EDR Review Supplementary Issues Paper, page 4.

76 Ballast Financial Management, submission to the EDR Review Supplementary Issues Paper, page 3.

Panel analysis

7.156. The Panel acknowledges that time limits serve important functions and that there are compelling policy and legal reasons for limiting the age of disputes that could be eligible for any mechanism to provide access to redress. Imposing a time limit provides certainty to financial firms. It provides finality for all participants in the financial system; it assists with ensuring procedural fairness, a fair hearing and natural justice; and is consistent with the concept of the rule of law.

7.157. There are also practical considerations that make it difficult to pursue claims which relate to events that have occurred a considerable time in the past. For example, the firm may no longer be operating or its records may no longer be available, other relevant evidence or witnesses may no longer be available or recollections of events may not be as accurate as they once were. Considerations such as these are the underlying policy rationale for limitations imposed on bringing legal action by a statute of limitations.

7.158. The Panel is also mindful that some firms subject to prudential supervision by APRA are required to hold regulatory capital in respect of contingent liabilities.[77] For such prudentially regulated firms, uncertainty has a direct impact on regulatory costs. This adds further strength to the need to minimise uncertainty by defining time limits and other eligibility criteria.

7.159. The Panel, therefore, considers an appropriately defined time limit as an essential means of minimising regulatory costs, both direct and indirect, on industry and ensuring fairness to consumers and small businesses as well as financial firms.

7.160. In terms of what the age or time limit should be, on balance the Panel considers a starting point to be a time limit of six years from the date that the consumer or small business became aware of the dispute. Six years is consistent with the time limits applied by EDR bodies more generally and also broadly consistent with the state statutes of limitations, where issues of public policy have been carefully considered. This approach will assist in promoting procedural fairness and natural justice. It also aligns with the Review Principle of minimising regulatory costs.

77 Contingent liabilities are possible obligations only payable contingent upon a future event not wholly in the entity's control or a present obligation not currently deemed to be probable or not measurable with sufficient reliability: AASB **http://www.johnwiley.com.au/highered/aas2e/content029/fact_sheets/AASB137_ch05.pdf**.

7.161. That said, because of the nature of the losses sustained, it may be justifiable to allow disputes which are older than six years to access a mechanism to provide access to redress for past disputes. Options that could be considered include:

- a time limit of seven years, which would align with existing record keeping requirements for financial firms;[78] or
- a time limit of the last 10 years to cover those disputes arising during the GFC (when a number of disputes arose).

7.162. It is a matter for government as to what option would be most appropriate, but in the Panel's view, it would be difficult and problematic to go beyond a maximum of 10 years and therefore this should be the outer limit.

7.163. Any time limit that extends further than six years would need to be carefully considered to ensure the trade-offs are appropriate and that risks, for example of inadequate records being available, are sufficiently minimised.

7.164. There are also funding considerations that would need to be considered (as discussed earlier in this Chapter in paragraphs 7.129–7.132).

Current regulatory requirements should not apply to the past and statutes of limitation should not be disregarded

Stakeholder submissions

7.165. Some stakeholders argued that new regulatory requirements that have been introduced in recent years should be applied retrospectively, when considering past disputes that have not had access to redress.

7.166. Some stakeholders submitted that there are significant legal impediments, including constitutional ones, to providing access to redress for past disputes. Legal Aid New South Wales and FOS noted that there would potentially be legal limitations with respect to time limits and eligibility of a consumer, especially where the financial firm was insolvent.[79] At the same time, consumer groups submitted that to the extent that such legal impediments exist, presumably these can be overcome through the passage of legislation or agreement by industry.[80]

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78 ASIC Class Order [CO 14/923] *Record-keeping obligations for Australian financial services licensees when giving personal advice* inserts a notional section 912G into *Part 7.6 Licensing of providers of financial services* of the *Corporations Act 2001*. Section 912G requires financial firms to retain records that demonstrate compliance with the best interests duty and related obligations for a period of seven years after the day the personal advice is provided to the client; see **https://www.legislation.gov.au/Details/F2016C00928**. Record keeping requirements under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (which apply to some financial firms) are also generally seven years; see **http://www.austrac.gov.au/chapter-8-amlctf-record-keeping-obligations#retention**.

79 Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 22; Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, pages 23-24.

80 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 15.

Panel analysis

7.167. The Panel considers that applying current regulatory requirements to the past, where these requirements may not have existed or may have been different, is problematic within the existing legal framework.

7.168. The Panel notes that there are constitutional limitations on applying laws retrospectively where it relates to the acquisition of property.[81] This means that laws cannot impose liabilities or otherwise negatively affect a person's existing property, while conferring some resulting benefit on another party, without providing just compensation. In the context of past disputes this means the Government cannot make a law which would require financial firms to make payments to consumers where they had no liability to do so at the time of the dispute, or one which affected the existing rights and liabilities of parties to a past dispute (for example, under contract), without adequate compensation.

7.169. Where financial firms have complied with the legal and regulatory requirements that applied at the time of the dispute the Panel considers that it would be inequitable and outside the boundary of the legal framework to require these firms to provide compensation based on current laws.

7.170. Equally the Panel considers that where disputes are outside of statutory limitation periods it would be inequitable and outside the legal framework to require financial firms to provide compensation.

OBSERVATION 4:

THERE ARE COMPLEX ISSUES IN CONSIDERING PROVIDING ACCESS TO REDRESS FOR PAST DISPUTES

There are a number of complex issues that arise in considering providing access to redress for past disputes. These include:

A need to quantify the issue

- Given the lack of comprehensive data on the number of consumers and small businesses with past disputes in the categories identified by the Panel, or the level of compensation that may be payable, an initial information gathering phase would be required before proceeding with committing to a mechanism to provide access to redress for past disputes.

Funding for redress for past disputes is the key challenge

- As a general principle the financial firm responsible for causing a loss should bear the cost of providing access to redress and compensation in the first instance but in many cases this will not be possible because the firm is insolvent or no longer operating. Where the financial firm responsible for causing the loss is no longer in operation, it may be neither appropriate nor desirable that current industry participants be required to contribute to providing access to redress for disputes that relate to former industry participants.

81 Property in this context is a broad concept that extends to 'every species of valuable right and interest'; see *Minister for Army v Dalziel* (1944) 68 CLR 261, 290 per Starke J.

OBSERVATION 4 (CONTINUED):

THERE ARE COMPLEX ISSUES IN CONSIDERING PROVIDING ACCESS TO REDRESS FOR PAST DISPUTES

Mechanisms for access to redress must have clearly defined time limits

- Any mechanism for providing access to redress must clearly define time limits for past disputes that can be considered. There are significant issues and potential regulatory costs that may apply if time limits are established that go beyond the existing statute of limitations. The outer limit for the age of disputes should be no more than 10 years.

CHAPTER 8: OPTIONS FOR PROVIDING ACCESS TO REDRESS FOR PAST DISPUTES IN THE FINANCIAL SYSTEM

KEY POINTS:

Four options are proposed for providing access to redress for past disputes:

GOVERNMENT-LED OPTIONS

- Government-supported legal case funding - provide financial assistance for legal expenses to eligible consumers and small businesses that have a viable legal case but have not been able to access redress through the courts (or a tribunal, where appropriate) due to a lack of funds.
- A new body to examine past disputes - establish a new independent, expert body to undertake a scoping exercise to quantify the pool of past disputes that may be eligible for access to redress. Following the quantification exercise, a decision will need to be made on how to resolve these cases.
- A government established compensation scheme for exceptional circumstances - establish a scheme to make discretionary compensation payments by government to consumers and small businesses in exceptional circumstances that have not had access to redress for past disputes.

INDUSTRY-LED OPTION

- An industry-led forum to hear past disputes - Westpac proposed an independent expert panel being appointed to consider bank-related disputes relating to past poor financial advice or maladministration in lending which exceeded the value of the EDR bodies' monetary thresholds at the time the dispute arose.
- Appropriate support services, such as counselling should be made available to consumers and small businesses that have lacked access to redress to minimise the impact of emotional distress or trauma.
- For government-led options, to provide access to redress consideration should be given to:
  - independence of the mechanism;
  - financial hardship as a relevant criterion; and
  - the need for compensation caps (not relevant to the legal case funding option).

8.1. Having considered the merits and issues involved in providing access to redress for past disputes in Chapter 7, the Panel, in this Chapter, now considers a number of options for mechanisms to provide access to redress for those circumstances that the Panel has identified as having merit.

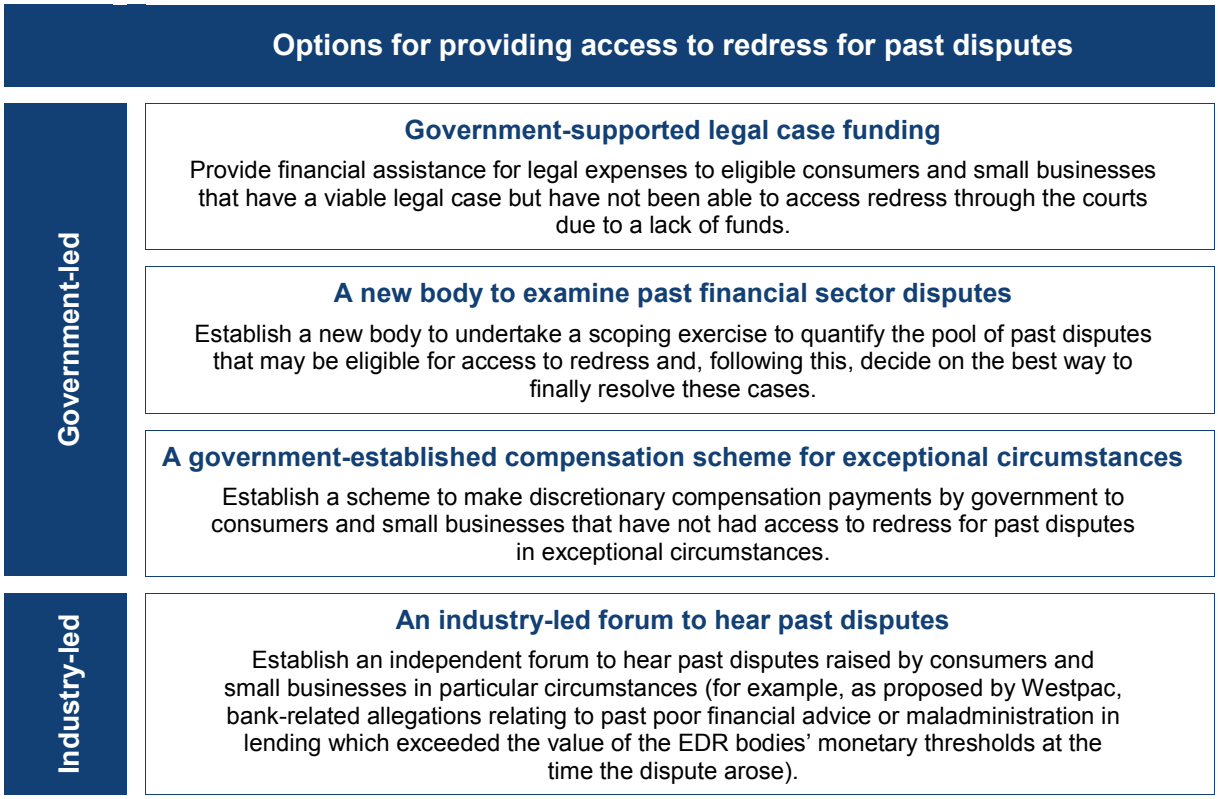
8.2. In considering these options, the Panel has also taken into consideration the issues identified in Chapter 7, in particular issues in relation to funding.

8.3. The Terms of Reference do not require the Panel to make recommendations in this area but the Panel has made a number of observations which may assist further consideration of these matters.

8.4. The Panel notes that, as highlighted in paragraph 7.104, the scale and nature of past disputes where consumers and small businesses have not had access to redress remains unquantified.

8.5. In the absence of an accurate quantification of the size, scale and nature of the potential claims, it is not possible to fully assess the merits and issues in this area. Prior to determining the appropriate approach to providing access to redress, the Panel considers that it is essential to obtain data on the scale of the potential claims.

8.6. In presenting the options outlined in this Chapter, the Panel notes that these options are not presented as alternatives but may operate together and, it has not endorsed any particular option as relative to another.



8.7. Having regard to stakeholder submissions and the experiences of individuals and groups who have suffered significant impacts from a lack of access to redress, the Panel considers it essential that any mechanism providing access to redress should be simple and accessible for consumers and small businesses and seek to minimise the impacts (including emotional) on them.

8.8. The Panel considers that any mechanism to provide access to redress for past disputes should provide consumers and small businesses with the appropriate support and timeframes to make their claims. In addition, it is important that appropriate support services, such as counselling, are made available to these consumers and small business to minimise the impact of emotional distress and trauma.

8.9. The Panel anticipates that, once the existing past disputes with merit are resolved, it is unlikely that there will be an ongoing need for a mechanism to be operating into the future. There are a number of recent developments which strengthen and update regulatory requirements. These will address a number of the circumstances that have, in the past, prevented consumers and small businesses from being able gain access to redress. They include:

- monetary limits (as well as compensation caps) will be increased significantly with the establishment of AFCA;
- if the Panel's recommendation is accepted, a CSLR will be operating to ensure that decisions in favour of consumers and small businesses awarding compensation are paid;
- as discussed in Chapter 4 of this Report, if a CSLR is established, insolvency of the financial firm will not be a barrier to a consumer or small business receiving a determination by AFCA; and
- a number of regulatory improvements are underway or have been undertaken in recent years, including the professionalisation of the provision of financial advice and reforms stemming from the Future of Financial Advice reforms, including a ban on conflicted remuneration structures, a duty for financial advisers to act in the best interests of their clients and enhanced licensing and banning powers for ASIC.

8.10. In developing these options, the Panel has had regard to schemes currently operating in the financial sector or in other segments of the Australian economy. These are detailed in Appendix 4.

8.11. The remainder of this Chapter provides an overview of each of the options identified by the Panel, with a broader discussion of the merits and issues that the Panel has identified, incorporating where appropriate feedback from stakeholder submissions.

GOVERNMENT-LED OPTIONS FOR PROVIDING ACCESS TO REDRESS

Legal case funding scheme — financial assistance to pursue litigation for past disputes

8.12. A funding scheme that would provide financial assistance for legal expenses to eligible consumers and small businesses that have a viable legal case but have not been able to access redress through the courts due to a lack of funds.

Legal case funding — financial assistance to pursue litigation for past disputes

Objective

Provide access to redress for past disputes by providing funding for legal expenses for consumers and small businesses that have a viable legal case but have not been able to access redress through the courts due to a lack of funds.

Funding

- Funding for legal expenses paid by government.
- Compensation paid by the financial firm (or counterparty) to the case.
- Any legal costs awarded to the consumer or small business paid to the legal case funding scheme.

Eligibility

Include:

- A defendant must be identified for legal action to take place – that is, the financial firm would need to still be in operation, or if appropriate the relevant directors or partners would need to be available to defend the case and pay any compensation awarded.
- Only cases which are within the statute of limitations.

Exclude:

- Cases which are eligible for consideration within the EDR framework.
- Cases which have already received a court ruling, tribunal judgment or EDR determination (whether or not in favor of the consumer or small business) as these cases have already had access to redress.

Additional considerations

A mechanism will be necessary to undertake an initial impartial, expert assessment of applications to assess:

- Cases which have a reasonable prospect of success in the court system and are therefore suitable candidates for funding for legal expenses.
- Cases which do not have legal merit and are therefore not suitable for funding but which may highlight systemic issues or areas in which law reform or regulatory action should be considered.
- The resources and capacity of a financial firm to defend a claim in court and pay compensation. In order to have each dispute properly heard and protect the right to natural justice, it may be necessary to provide funding for legal assistance to small business defendants in certain circumstances.

There may be merit in a progressive roll out to ensure that the scheme is not overburdened at the outset. Options may be to:

- Only address disputes involving allegations of misconduct or unconscionable conduct by a large financial firm. This would reduce the complexity associated with assessing whether the financial firm has the necessary resources to defend the case and pay any compensation awarded.
- Provide funding only for those circumstances involving particular hardship.
- Potential to extend funding to include disputes by some businesses that fall outside the definition of small business under a set of specific circumstances (for example, lack of resources due to financial hardship) once fully implemented and subject to funding constraints.

Stakeholder submissions

8.13. A number of submissions identified that some consumers and small businesses have not been able to access redress for past disputes due to a lack of resources to pursue their dispute through the court system. In these cases, access was not available via the EDR framework because of circumstances such as, the value of the dispute exceeded the EDR monetary limit applicable at the time, or the firm was not a member of an EDR body.

8.14. As noted in Chapter 7, a lack of resources to pursue legal action, as well as potential information, power and resourcing imbalances between the parties to a dispute can make it difficult for consumers and small businesses to access redress.

8.15. The potential establishment of a legal case funding scheme, was not canvassed in the Supplementary Issues Paper and has not been the subject of direct comment from stakeholders.

Panel analysis

Potential advantages of legal case funding

8.16. A number of stakeholders have indicated that a lack of access to funds for legal assistance has prevented some consumers and small businesses from seeking access to redress through the courts.

8.17. Existing avenues for redress, which are funded by government, include legal aid for consumers, test case funding to establish legal precedents, and funding for regulators to pursue cases involving systemic failures. Legal aid is not generally available to small businesses and is only available for civil litigation by consumers in very limited circumstances, and only in some states and territories. A legal case funding scheme could assist in closing this gap.

8.18. Most importantly, consistent with the Review Principle of equity, this option will result in those financial firms that have caused the losses bearing the costs of any compensation.

8.19. This process could also assist in collecting intelligence about areas of the law that may need reform in the future.

Potential issues in providing legal case funding

8.20. This option would not deliver access to redress for past disputes where the financial firm, or an otherwise relevant party, is not available to defend the case and pay any compensation awarded.

8.21. Cases eligible for funding will be subject to strict time restrictions that apply under the current legal framework. The Panel recognises that some of the losses suffered have occurred outside of this time frame.

8.22. It is difficult to estimate the potential costs of the scheme. Funding will be required for each case (some of which may involve very complex legal issues) and for the administration of the scheme (including remuneration of scheme decision makers).

8.23. While the costs of administration of a legal case funding scheme can be estimated and managed within appropriate constraints, the costs associated with obtaining a preliminary legal assessment of the merits of each case and the costs of litigation itself can be significant and difficult to assess at the outset.

8.24. A favourable decision by the court could be subject to further appeal by the financial firm. This will increase the funding costs and also prolong the process of redress and the associated emotional impacts.

8.25. Where an action is unsuccessful the consumer or small business could be required to pay the legal costs of the financial firm, which could have a significant impact on the consumer or small business and might deter some from pursuing this option. Alternatively, if the fund were to cover any costs orders, this would add to the cost of this option.

8.26. To ensure natural justice for both parties to a dispute, it may be necessary to provide funding for the defendant in certain circumstances (or to find another mechanism for the resolution of past disputes where neither party has the resources to go to court). Providing funding for defendants will place an additional burden on the funding of the scheme, as well as risking that funding is not being expended efficiently.

Other observations

8.27. It is the Panel's expectation that a legal case funding scheme for past disputes in the financial sector will be similar in principle to the existing Commonwealth legal financial assistance schemes administered by the Attorney-General's Department. Information about these schemes is provided in Appendix 4.

A NEW BODY TO EXAMINE PAST FINANCIAL SECTOR DISPUTES

8.28. A new body could be established to initially undertake a scoping exercise to quantify the pool of past disputes that may be eligible for access to redress, consistent with those circumstances that the Panel has identified as having merit in Chapter 7.

8.29. Following the data gathering stage, it will be necessary for the Government to make a decision on the best way to finally resolve these cases, including considering:

- whether sufficient information has been gathered to determine the merit of cases;
- whether there is a need for a more formal consideration of some cases; and
- how cases may be compensated.

8.30. Subject to the outcome of the data gathering stage, further work may be necessary to provide advice on the final resolution of these cases.

A new body to examine financial sector past disputes

Objective

- Gather data to scope the scale and nature of past disputes that have lacked access to redress as this is currently unquantified.
- Following the quantification exercise, government to consider how to finally resolve the cases.

Funding

- Appropriate funding mechanism will need to be determined for administration and initial quantification exercise.
- If compensation is to be awarded, additional funding will be necessary. Mechanisms could include payment by responsible financial firms (if solvent) or a government funded compensation scheme.

Eligibility

Include:

- Consumers and small businesses that have not had access to redress for past disputes across the financial services sector and fall within the circumstances determined by the Panel as having merit.

Exclude:

- Disputes outside a pre-determined reasonable timeframe to provide certainty and practicality, as well as ensuring that parties to the dispute are given natural justice and a fair hearing. In cases of exceptional circumstances (for example, long term, debilitating illness), time limits may be waived or extended.
- Cases which are eligible for EDR.
- Cases which have already received a court ruling, tribunal judgment or EDR determination (whether or not in favor of the consumer or small business).

Additional considerations

- Currently there are no reliable estimates of the scale of past disputes. The first and foremost consideration to design and implement any broad mechanism to examine past disputes is to carry out an exercise to quantify the potential claims. This exercise is likely to be complex and resource intensive.
- An appropriate mechanism will be necessary to administer the scheme. While there are efficiency benefits of leveraging existing regulatory or EDR infrastructure this would need to be carefully weighed against the benefits of having the body operating independently to mitigate risks of conflicts of interest.
- The body must be accessible for consumers and small businesses and ensure that it minimises any further emotional or financial stress on them.
- Where funding is limited, consideration should be given to ways in which to allocate compensation, such as the application of a 'hardship' criterion and/or compensation caps.

Stakeholder submissions

8.31. Submissions identified a range of circumstances which have led to some consumers and small businesses being unable to access redress for past disputes (as discussed in Chapter 7). Of particular relevance to the option of establishing a new body to examine past disputes is the situation where the financial firm is insolvent: for example, the Joint Consumer Group submission indicated that disputes against Holt Norman Ashman Baker are 'but one example' of where claims exceeding the EDR monetary limit were unable to be taken to court because the financial firm was insolvent.[1]

8.32. A number of stakeholder submissions in this area focused on the importance of any mechanism to address past disputes operating independently. These submissions and the Panel's analysis of the issue are considered below in paragraphs 8.54-8.60.

8.33. Additionally, stakeholders raised a number of concerns requiring current industry participants to fund the cost of such a body. These stakeholder submissions and the Panel's analysis were discussed in Chapter 7.

Panel analysis

Funding for a body to examine past disputes

8.34. Funding of a new body will need to seek to preserve equity, maximise efficiency and transparency and minimise regulatory costs. As noted above, there are two elements to the funding: administrative/operating costs of the mechanism established to quantify and potentially examine past disputes, and the costs of compensation.

8.35. An appropriate funding mechanism will need to be determined for the initial quantification exercise and the administration of the new body (operating costs, including the assessment of disputes and remuneration of decision makers).

8.36. While in principle the financial firm responsible for causing the loss should pay any compensation awarded by the body, in practice in many cases the firm may be insolvent. The Panel notes that in many such disputes, the responsible firm may no longer be operating, may be insolvent or may otherwise be unable to pay compensation.

8.37. Consistent with the Panel's views on legacy unpaid EDR determinations (discussed in Chapter 6), the Panel considers that it may not be either appropriate or desirable that current industry participants be required to provide access to redress for disputes that relate to former industry participants.

1 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 14.

Potential advantages of a new body to examine financial sector past disputes

8.38. The body could be designed to allow consumers and small businesses to make claims in all or any of the circumstances that the Panel has determined have merit. This means that, if funding for the administration of the mechanism permitted, the body could provide a mechanism for access to redress for potentially all meritorious past disputes. Creation of a single mechanism will provide greatest simplicity for consumers and small businesses wishing to access the mechanism.

8.39. A key advantage of this option, as compared to the legal case funding scheme option, is that it can provide access to redress for consumers and small businesses with claims against insolvent financial firms (provided a funding source is identified to pay awarded compensation in those cases).

Potential issues with a new body to examine financial sector past disputes

8.40. The scale of the issue in the area of past disputes currently remains unquantified and could potentially be significant. Therefore, the establishment of any mechanism to deal with the issue where the firms themselves may no longer be in operation creates significant risks and potentially an unreasonable level of costs for government (and the broader taxpaying community) or the rest of the industry.

8.41. The Panel acknowledges that, while gathering data to quantify the scale of these past disputes is an essential first step, this process itself is likely to have relatively high administration costs and will be resource intensive to implement.

8.42. These past disputes may be of a complex nature and therefore considerable resources could be required to assess each dispute. Depending on the volume of disputes, this could also result in disputes being unable to be assessed quickly and in a cost effective manner.

A GOVERNMENT ESTABLISHED COMPENSATION SCHEME FOR EXCEPTIONAL CIRCUMSTANCES

8.43. A scheme could be established to make discretionary compensation payments by government, to consumers and small businesses that have not had access to redress for past disputes, in exceptional circumstances.

A government established compensation scheme for exceptional circumstances	
Objective	• In exceptional circumstances such as cases of severe financial hardship, provide compensation to consumers and small businesses that have not had access to redress for past disputes.
Funding	• Compensation to be allocated by government subject to a compensation allocation mechanism and funding.
Eligibility	Include: • Consumers and small businesses that have been unable to gain access to redress in the circumstances identified by the Panel as having merit in Chapter 7 and are experiencing financial hardship. Exclude: • Cases which are eligible for EDR. • Cases which have already received a court judgment, tribunal decision or EDR determination (whether or not in favor of the consumer or small business).
Additional considerations	• Currently there are no reliable estimates of the scale of past disputes and therefore the quantum of compensation. • May require legislation to implement and decisions will need to be made regarding the administration of the scheme. If a body is established to examine past disputes, as outlined above, it could be appropriate to include administration of this scheme within its terms of reference.

Stakeholder submissions

8.44. As noted in Chapter 7, numerous stakeholders, particularly industry participants and industry bodies, expressed views that any access to redress for past disputes should be funded by government.

Panel analysis

Observations on the payment of compensation by government

8.45. Given the circumstances, anticipated scope and value of past disputes, the Panel does not consider this as a viable option to provide access to redress for all circumstances that the Panel has determined may have merit.

8.46. Rather, there will need to be strict limitations around the eligibility of consumers and small business to access a government established compensation scheme. One means of narrowing the application of the option may be to make it available only:

- in cases of severe financial hardship; and
- where an independent decision maker has made a determination in favor of a consumer or small business but the financial firm is unable to pay.

8.47. Legislation may be required for a government established compensation scheme.

Potential advantages of a government established compensation scheme

8.48. A government established compensation scheme could operate as a compensation payment mechanism in conjunction with, for example, a new body to examine past disputes in cases where a financial firm is unable to pay awarded compensation.

Potential disadvantages of a government-funded compensation scheme

8.49. The scale of the potential claims in the area of past disputes currently remains unquantified and could potentially be significant. Therefore, the call on funds necessary to award compensation could prove challenging.

8.50. There are a broad range of circumstances and cases where access to redress may not have been available. Designing an appropriate and fair mechanism to distribute a finite pool of compensation across such a diverse range of circumstances is likely to be challenging.

PRACTICAL DESIGN CONSIDERATIONS FOR GOVERNMENT-LED OPTIONS TO PROVIDE ACCESS TO REDRESS

8.51. The Panel notes that for the three government-led options (legal case funding, a body to examine past disputes, and a government established scheme for exceptional circumstances), there are a range of additional considerations. These include:

- independence of the mechanism from AFCA;
- consideration of financial hardship as a criterion for access and/or basis for allocating compensation; and
- the need for compensation caps (not relevant to the legal case funding option).

A mechanism to provide access to redress must operate independently of AFCA

8.52. If a government-led mechanism to provide redress for past disputes is to be implemented, it will need to work effectively with the existing dispute resolution arrangements. This raises an issue with whether any scheme should be integrated with the EDR framework, namely AFCA, or form part of a separate mechanism specifically established for the purpose of addressing past disputes.

8.53. A number of stakeholders provided views on this issue. While many of these views relate specifically to the creation of a new body to address past disputes, these stakeholder views are discussed in this section as the Panel considers this to be an issue that applies more broadly across all options.

Stakeholder submissions

Views on integration of a mechanism with AFCA

8.54. Stakeholder views on whether a mechanism should be integrated with AFCA or be constituted or administered separately from that body were mixed. In providing these views stakeholders focused primarily on the establishment of a mechanism.

8.55. Some stakeholders consider that independence can be best achieved by creating a new body to hear past disputes.

8.56. For example, Legal Aid Queensland suggested that an expert panel consisting of an industry representative, a consumer representative and an independent member could be appointed by AFCA but thereafter operate independently.[2] Operating separately from AFCA, it claimed, would avoid any confusion that might arise concerning the scope of AFCA's jurisdiction to hear disputes.

8.57. The Joint Consumer Group expressed a preference that a forum for past disputes be an independent body,[3] while the Association of Superannuation Funds of Australia was of the view that any scheme should be administered entirely separately from the EDR framework (in particular, AFCA) for reasons of independence.[4]

8.58. Likewise, FOS considered that access to redress for past disputes can best be provided by a scheme independent of both a prospective CSLR and AFCA, with its own funding arrangements and administration.[5]

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2 Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, pages 9 and 10.

3 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 18.

4 Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, page 13.

5 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, pages 15 and 25. Note that one stakeholder (Association of Superannuation Funds of Australia, submission to the EDR Review Supplementary Issues Paper, page 13), while opposed to any integration with AFCA, saw 'synergies for integration with any compensation scheme of last resort, should one be implemented, as similar considerations around independence, transparency and accountability will apply to each scheme.'

8.59. Other submissions also suggested that requiring AFCA to consider past disputes will make the dispute resolution process slower and less efficient because it will shift the focus of AFCA away from its primary function (considering current claims within its terms of reference) and will 'likely have the effect of clogging the dispute resolution pipeline'.[6]

8.60. However, some stakeholders supported a mechanism to provide access to redress for past disputes being established as a separate division or unit within AFCA.[7] The division would only need to operate temporarily until all existing past claims are finalised. This approach would:

- encourage consistency in decision making processes;
- ensure efficient use of resources by leveraging the experience of the existing EDR bodies;
- avoid duplication; and
- promote the cost effective and speedy resolution of past disputes.[8]

Views on skills/expertise of decision maker

8.61. Additionally, some submissions referred to the need for particular skills or expertise of decision makers. FOS indicated that the scheme would require specialist expertise to determine the merits of a claim, particularly given that no clear legal claim for compensation exists in relation to past disputes that have not been through EDR or a court or tribunal.[9]

8.62. Legal Aid NSW suggested that '[i]t would be helpful to have specialists […] providing expertise about particular products, such as financial advice, and particular perspectives, such as consumer advocates.'[10]

Panel analysis

8.63. The Panel agrees that the decision making function of any mechanism to provide access to redress for past disputes should be independent of AFCA. Ensuring an independent decision maker mitigates any risk of conflict of interest and promotes confidence that decisions made are objective and equitable.

8.64. Further, keeping any mechanism to provide access to redress for past disputes independent of AFCA will better enable AFCA to remain focused on the challenging task of transitioning the existing EDR arrangements into the single new EDR body.

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6 Australian Institute of Superannuation Trustees, submission to the EDR Review Supplementary Issues Paper, page 9.

7 Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 26; and Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 18.

8 Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, pages 25 and 26.

9 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 15.

10 Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 25.

8.65. That said, the Panel considers it important to leverage any opportunities to minimise costs and take advantage of existing efficiencies, provided doing so does not detract from the independence of a past disputes mechanism or AFCA's establishment. Therefore, synergies in back office should be taken advantage of where appropriate or possible.

8.66. The extent to which a mechanism to provide access to redress for past disputes interacts with AFCA will depend ultimately on the nature and scope of the particular option. If a mechanism is to operate successfully as part of the financial system EDR framework, even if only temporarily, it will need to have a productive relationship with a variety of organisations.

8.67. As outlined in the Panel's April 2017 Report, it is important that decision makers are appropriately qualified. Specialist expertise is likely to be required to determine the merits of a claim.

Financial hardship criterion for access

8.68. The Panel recognises that it may not be possible to provide access to redress for all disputes within the circumstances identified by the Panel as having merit in Chapter 7 when taking into consideration the challenges in identifying appropriate funding for the government-led mechanisms. Depending on the number of disputes and the amount of any funding that might be available, this may require further eligibility criteria and mechanisms for allocating compensation to those in greatest need.

8.69. In such circumstances, the Panel has considered whether it may be appropriate and necessary to take into consideration whether a consumer or small business is in severe financial hardship.

8.70. Financial hardship or difficulty is a familiar concept within the financial services industry. Indeed there are a number of different contexts in which such a concept applies, along with a number of existing definitions. For example:

- FOS describes 'financial difficulty' as a situation that an individual or a small business can experience where they are unable to meet their repayments under a credit facility due to circumstances such as sickness, natural disaster, unemployment or over commitment.[11] FOS uses this as a criterion in deciding whether to put a dispute through a modified dispute resolution process.

11 Financial Ombudsman Service, *Financial difficulty*, viewed 24 August, <**https://www.fos.org.au/consumers/financial-difficulty/**>.

- Section 72 of the National Credit Code allows a debtor (for example, a consumer or small business) to request a change to the terms of their credit contract on the grounds of financial hardship if they consider that they are or will be unable to meet their obligations under a credit contract. Credit providers have an obligation to consider changes to a contract where a debtor is experiencing financial hardship.[12] Where the credit provider agrees to change the terms of the credit contract, they must provide a notice setting out the particulars of the change within 30 days – failure to comply is a criminal offence. Should the debtor not be satisfied, there are provisions to seek changes to the contract through the court system.[13]

Stakeholder submissions

8.71. A small number of stakeholders commented on the notion of applying a hardship criterion to any mechanism to provide access to redress for past disputes.[14]

8.72. Stakeholders who commented on compensation were generally supportive of an approach based on the financial hardship of consumers and small businesses. One stakeholder indicated that a priority mechanism based on a hardship assessment would be appropriate.[15] Other stakeholders supported a compensation mechanism based on financial hardship.[16]

8.73. Concerns raised with the proposition of a compensation mechanism based on hardship were that it could put consumers in competition with each other, and that it would involve subjective judgments.[17]

Panel analysis

8.74. The Panel is particularly mindful of the examples it has heard through the course of this Review, of situations involving severe financial hardship. The Panel, therefore, recognises the importance of ensuring that these circumstances are taken into consideration in mechanisms to provide access to redress through applying a financial hardship criterion.

8.75. As noted above, the concept of financial hardship is not new. On the contrary, it is used in many contexts across the financial system to provide a degree of relief or assistance to consumers and small businesses experiencing particular difficulty in meeting their contractual obligations.

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12 Schedule 1 to the *National Consumer Credit Protection Act 2009*.

13 Clause 28 of the voluntary Code of Banking Practice, which deals with financial difficulties with credit facilities, provides additional operational guidance and expands on the requirements contained in section 72 of the *National Credit Code*.

14 The Supplementary Issues Paper canvassed a 'financial hardship' criterion applying to compensation in the event rationing is required. It did not explicitly seek responses regarding hardship applying in other contexts, such as a criterion for access to any mechanism.

15 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 26.

16 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 18; Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 28.

17 Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 19.

8.76. Given the very distressing circumstances that some consumers and small business owners are in as a result of unresolved past disputes, the Panel sees a strong case for prioritising access to redress for past disputes which have merit where financial hardship is being experienced. This approach will ensure that access to redress is provided most quickly to those who arguably need it the most.

8.77. The Panel considers that a financial hardship criterion can apply in the following ways:

- Financial hardship can be a threshold eligibility criterion for access to redress for past disputes. That is, only those consumers and small businesses that meet a prescribed definition of financial hardship might be considered eligible for mechanisms to provide access to redress.
- Financial hardship may determine priority of access to redress. This will result in disputes of consumers and small businesses that meet the prescribed definition of financial hardship being provided with access to redress prior to others. Financial hardship may determine the basis of any compensation received, for example, by applying a higher compensation cap than that applying to other disputes.

8.78. If financial hardship is adopted as a consideration in providing access to redress, the Panel notes that an appropriate definition of financial hardship will need to be developed. The Panel considers that in the first instance, this definition should be aligned to that of AFCA to be consistent across the EDR framework.

8.79. Likewise in the case of a Government established compensation scheme for exceptional circumstances, a definition of severe financial hardship will need to be developed (amongst other criteria).

8.80. For consistency with the Review Principle of transparency, any application of a financial hardship criterion should be clearly disclosed so that consumers and small businesses have adequate information about what outcomes they can reasonably expect from the redress mechanism.

Compensation caps

8.81. Another consideration in establishing a government-led mechanism to provide access to redress for past disputes is the amount of compensation that may be awarded by or through the mechanism. This issue does not, however, arise in considering the option for legal case funding as any compensation would be paid by the financial firm.

8.82. A general compensation cap of $309,000 currently applies at the EDR bodies.[18] In line with Government's response to the recommendations of the Panel's April 2017 Report, this compensation cap will increase to a minimum of $500,000 for non-superannuation disputes when AFCA is established.

18 However, superannuation disputes resolved through the Superannuation Complaints Tribunal are not subject to a compensation cap.

Stakeholder submissions

8.83. In terms of the amount of a compensation cap, a small number of stakeholders expressed a view. One stakeholder indicated that any compensation cap should be significantly less than the cap put in place for AFCA and that compensation should be set at a level where it is only a partial reimbursement for larger claims.[19]

8.84. Another stakeholder commented that compensation caps in EDR were established specifically to exclude claims which are more appropriately resolved through the court, suggesting that caps comparable to the EDR caps might be appropriate.[20]

8.85. One stakeholder also submitted that where all claimants cannot be compensated fully, compensation should be rationed on a pro rata basis with reference to the loss suffered.[21]

Panel analysis

8.86. The Panel recognises that depending on funding arrangements, it is unlikely that any government-led mechanism (excluding legal case funding) to provide access to redress for past disputes will be able to fully compensate all eligible claimants. Therefore, a mechanism will be necessary to allocate available funds to those in greatest need.

8.87. The Panel notes that the approaches to compensation will differ depending on the design of any mechanism to provide access to redress for past disputes and how it is to be funded and the number of eligible claims.

8.88. In line with the Review Principles of equity and comparability of outcomes, the Panel considers that capping compensation consistent with the EDR framework is appropriate. However, the Panel recognises that funding constraints may require a lower compensation cap.

INDUSTRY-LED OPTION

Industry-led forum to hear past disputes

8.89. An industry-led forum could be established to hear past disputes raised by consumers and small businesses in particular circumstances.

8.90. The features described in the following table and discussed in this section are features described by Westpac in its proposal for a 'past issues forum' led by the banking sector.[22]

19 Association of Financial Advisers, submission to the EDR Review Supplementary Issues Paper, page 16.
20 Ballast Financial Management, submission to the EDR Review Supplementary Issues Paper, page 4.
21 Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 10.
22 This proposal was included in the EDR Review Supplementary Issues Paper at pages 44-5.

8.91. The 'past issues forum' would consist of an independent expert panel being appointed to consider bank-related allegations relating to past poor financial advice or maladministration in lending which exceeded the value of the EDR bodies' monetary thresholds at the time the dispute arose.[23]

Industry-led forum to hear past disputes	
Objective	• Provide access to redress for bank-related disputes related to poor financial advice or maladministration in lending which exceeded the EDR bodies' monetary limits and were therefore not eligible for consideration under the EDR framework. • The decision maker (an independent, expert panel) would operate in parallel to the banks' remediation schemes and be funded by the banking sector.
Funding	• Compensation paid by the relevant bank. • Costs associated with the administration of the forum to be funded by bank participants with industry determining appropriate apportionment across members.
Eligibility	Eligibility would be determined by bank participants but could include: • Consumers and small businesses whose dispute has come within certain time limits which would be determined at the outset by the forum. • Disputes that have not been previously heard or compensated (for example, by FOS or a court). • Some businesses outside the definition of small business that, due to financial hardship, do not have recourse to the courts. Exclude: • Cases which were inside the existing Terms of Reference of an EDR body (monetary limits). • Disputes which have already received a court judgment, tribunal decision or EDR determination. • Non-bank related matters for example superannuation or insurance, including cases where these matters relate to bank-owned financial institutions.
Additional considerations	Westpac has proposed the following additional features that would require consideration: • Expert panel to be an ad-hoc panel – that is, an approved list of panel members would be compiled and an expert panel would be constituted for each matter based on the nature of the disputes and the requisite commercial, legal and technical expertise. • Expert panel appointed by AFCA. • Decisions by the expert panel would be eligible for appeal to the courts by either consumers and small businesses or the banks.

23 In this section, 'banks' is used to mean authorised deposit-taking institutions as defined under the *Banking Act 1959* or a subset of these such as the major banks.

Stakeholder submissions

8.92. The Panel sought stakeholder views in its Supplementary Issues Paper on the strengths and weaknesses of the proposal put forward by Westpac. Stakeholders (such as consumer groups and ASIC) welcomed the proposal, saying, for example, that 'we support any effort by industry to compensate victims of misconduct'.[24]

Strengths of the Westpac proposal

8.93. Stakeholders submitted that the key strengths of the proposal are:

- the fact that the decision maker is independent and has relevant expertise.[25] Stakeholders noted that an independent forum would ensure the claims assessment process would be independent. In addition, using an expert panel would facilitate having the relevant technical legal and commercial expertise applied to the consideration of disputes;
- the simplicity of the funding model, including a 'user pays' element, which would impose a levy on firms which have determinations made against them;[26]
- the relative simplicity and accessibility of the forum for consumers;[27] and
- that it includes consideration of both poor financial advice and maladministration in lending, thereby acknowledging that matters beyond merely financial advice need to be addressed.[28]

Weaknesses of the Westpac proposal

8.94. Stakeholders raised a number of concerns with the proposal. The key limitations raised relate to the narrow scope failing to provide access to redress for many consumers and small businesses with past disputes. In particular, concerns were that, in its current form, the proposal only covers:

- disputes with banks rather than disputes across the financial sector more broadly (for example, those with financial advisors and non-bank credit providers);[29] and

24 Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, page 15.

25 Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 18; Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 9.

26 Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 9; Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 18.

27 Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 9.

28 Association of Financial Advisers, submission to the EDR Review Supplementary Issues Paper, page 15.

29 Financial Ombudsman Service, submission to the EDR Review Supplementary Issues Paper, page 24; Joint Consumer Group, submission to the EDR Review Supplementary Issues Paper, pages 15-16; Financial Planning Association of Australia, submission to the EDR Review Supplementary Issues Paper, page 18.

- disputes relating to poor financial advice and maladministration in lending.[30] It would not include small amount credit contracts, consumer leases and insurance (particularly life and home and contents insurance), among other disputes. Legal Aid NSW submitted that the full range of claims need to be included to 'build consumer trust and ensure consistency in financial services dispute resolution'.[31]

8.95. Another weakness identified is the capacity for appeals of the decision of the expert panel to the Supreme or Federal Court. An appeal mechanism, Legal Aid Queensland indicated, would reduce confidence in the expert panel as its decision will not be final, and restrict consumers' access to redress due to the resources required to fund court action or appeals.[32]

General comments about an industry-led mechanism

8.96. ASIC noted that part of the complexity about providing access to redress for past disputes arises because of the significant variation in the nature and scale of past disputes against financial firms. In that context, it supports the notion of individual entities or sectors developing their own approach to providing access to redress for past disputes.[33]

8.97. It noted that financial firms 'have effectively done this in the past by permitting access to remediation schemes and to EDR bodies, through waiving jurisdictional limits (including time and monetary limits).' Further, the current industry-based EDR body rules expressly permit parties to a dispute to agree to waive jurisdictional limits to enable the EDR body to hear the dispute.[34]

Panel analysis

Potential advantages of an industry-led forum to hear past banking disputes

8.98. This option requires the banks to fund the administration of the forum and the financial firm that is party to a particular dispute to pay compensation if awarded. This is consistent with the principle identified by the Panel in Chapter 7 that the financial firm responsible for causing the loss should bear the cost of providing access to redress (including access to compensation).

30 Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, pages 22-3.
31 Legal Aid NSW, submission to the EDR Review Supplementary Issues Paper, page 23.
32 Legal Aid Queensland, submission to the EDR Review Supplementary Issues Paper, page 9.
33 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 8.
34 Australian Securities and Investments Commission, submission to the EDR Review Supplementary Issues Paper, page 8.

8.99. Being industry-led, industry will have ownership of and buy-in to the forum. The mechanism could be regarded as an extension of the banks' existing remediation schemes or IDR processes (albeit a more independent decision-making process). An industry initiated forum could send a positive message to consumers as well as help restore consumer trust and the reputations of financial firms and the financial sector more generally.

8.100. The forum, being industry-led, could mean that a broader subset of disputes are considered as eligible to access the forum. That is, while the Panel has determined that past disputes arising in certain circumstances have merit for access to redress, the banks (or broader industry) may determine that other, additional circumstances may be eligible, where such circumstances are key issues for industry (for example, allegations of unfair contract terms in small business lending).

8.101. The Panel notes that Westpac's proposal requires decision makers to have appropriate expertise to hear the range of disputes that might come before the forum, and agrees that, given the range of issues and complexities of past disputes, having a panel of experts to draw from will provide maximum flexibility to ensure necessary expertise is applied to each case.

Potential issues with an industry-led forum to hear past banking disputes

8.102. While Westpac's proposal has merit, in its current form it is limited in scope. It will not provide access to redress for a number of consumers and small businesses with past disputes who are faced with circumstances that the Panel has determined have merit. The proposal covers disputes with banks relating to poor financial advice and maladministration in lending. It does not include non-bank-related disputes. It includes maladministration in providing credit to consumers who invested in a MIS and financial advice about an MIS by a financial adviser that works for a bank, but does not include disputes relating to advice about the appropriateness of investing in an MIS where the advice is not provided by an adviser employed by a bank. As stakeholders identified, small amount credit contracts, consumer leases and insurance, among other disputes, are also excluded from the scope of the proposed forum.

8.103. There is currently a lack of consensus across the industry on Westpac's proposal. For an industry-led approach to be viable and effective, there must be sufficient buy-in from across the industry.

8.104. The Panel also notes that Westpac proposes that decisions from an industry-led forum be able to be 'appealed' in the court system. The Panel considers that it would be preferable for decisions from any such forum to be binding on financial firms, with no appeal mechanism available. Permitting appeals to a court will not provide an appropriate course for redress as it will lead to further delays for consumers and small businesses and increase complexity and uncertainty. In addition, allowing a bank to appeal a decision which has been made in favour of a claimant who has limited financial resources to contest an appeal is inconsistent with the purposes and principles of EDR.

Other observations

8.105. From the evidence presented to both this Review and other inquiries, there is a body of consumers and small businesses that are bank customers with past disputes, and there is a degree of interest within industry to create a 'past issues forum'. Therefore, the Panel considers that the proposal has merit, despite its limited scope. Indeed, any effort by industry to take a lead on this complex and difficult issue should be encouraged.

8.106. That said, the Panel notes that the banks have not initiated a forum for redress on this basis, despite some of the issues considered to fall within the scope of the Westpac proposal having occurred several years ago. In the absence of industry consensus it is also difficult to see how this proposal could have wider application. For these reasons, the model proposed by Westpac is best seen as a potential complement to, rather than substitute for, the other options considered above.

8.107. The Panel considers that it is appropriate for participants of any industry led forum for past disputes to have regard to ASIC's *Regulatory Guide 256 Client review and remediation conducted by advice licensees* (RG 256).

OBSERVATION 5:

OPTIONS FOR PROVIDING ACCESS TO REDRESS FOR PAST DISPUTES

The Panel has proposed the following options for providing access to redress for past disputes. These options are not alternatives and may operate together.

The following three considerations are important in any mechanism designed to provide access to redress:

Simple and accessible

- Any mechanism providing access to redress should be simple and accessible for consumers and small businesses and provide them with the appropriate support and timeframes to proceed with their claim.

Seek to minimise costs for all stakeholders

- Any mechanism for providing access to redress should seek to minimise costs for all stakeholders, including using existing regulatory infrastructure where appropriate.

Adequate support for consumers and small businesses

- It is important that appropriate support services, such as counselling, are made available to these consumers and small business to minimise the impact of emotional distress and trauma.

OBSERVATION 5 (CONTINUED):

OPTIONS FOR PROVIDING ACCESS TO REDRESS FOR PAST DISPUTES

Government-led options

- Government-supported legal case funding - provide financial assistance for legal expenses to eligible consumers and small businesses that have a viable legal case but have not been able to access redress through the courts (or a tribunal, where appropriate) due to a lack of funds.
- A new body to examine past disputes - establish a new independent, expert body to undertake a scoping exercise to quantify the pool of past disputes that may be eligible for access to redress. Following the quantification exercise, a decision will need to be made on how to resolve these cases.
- A government established compensation scheme for exceptional circumstances - government providing one-off, discretionary lump sum payments to consumers and small businesses that have not had access to redress for past disputes in exceptional circumstances.

Industry-led option

- An industry-led forum to hear past disputes - Westpac proposed an independent expert panel being appointed to consider bank-related disputes relating to past poor financial advice or maladministration in lending which exceeded the value of the EDR body's monetary thresholds at the time the dispute arose.

OBSERVATION 6:

DESIGN PRINCIPLES FOR GOVERNMENT-LED MECHANISMS TO PROVIDE ACCESS TO REDRESS FOR PAST DISPUTES

The Panel considers the following design principles to be relevant for government-led mechanisms to provide access to redress for post disputes:

Operate independently

- The decision making function of any mechanism to provide access to redress for past disputes should be independent of AFCA.

Financial hardship should be taken into consideration

- Any funding that may be available to provide access to redress is likely to be limited. Therefore, careful consideration should be given to mechanisms for targeting available funds to those in greatest need. It would be appropriate, in this context, to take into account whether a claimant is in severe financial hardship.
  - Financial hardship should be taken into consideration in determining eligibility and/or priority in providing access to redress for past disputes.
  - Financial hardship should be taken into account when developing mechanisms to allocate available funds to those in greatest need.

Compensation caps may be necessary (not applicable to legal case funding)

- Capping compensation consistent with compensation caps under the EDR framework is appropriate. However, funding constraints may require a lower compensation cap.

Appendices

APPENDIX 1: THE UNITED KINGDOM FINANCIAL SERVICES COMPENSATION SCHEME

OVERVIEW

A1.1. The Financial Services Compensation Scheme (FSCS) is the United Kingdom's statutory compensation scheme of last resort for customers of financial services firms. It is an independent body established under the *Financial Services and Markets Act 2000* (UK).

A1.2. Individuals and small business are eligible to make claims to the FSCS.[1] Products covered by the FSCS include:

- investments (including investment advice);
- insurance policies and insurance broking services; and
- deposits and mortgage advice.

COMPENSATION

A1.3. The FSCS can pay compensation when it is satisfied that a firm is unable, or likely to be unable, to pay claims against it and therefore deemed to be in 'default'.[2] The FSCS will carry out an investigation to determine whether or not a firm is in default.

A1.4. The level of compensation payable to consumers and small business depends on the type of claim made.[3] For example, in relation to investments, the maximum compensation payable is £50,000 per person, per firm.

A1.5. After compensation is paid to a consumer or small business, the FSCS has the power to step into the shoes of the consumer or small business and seek recovery of compensation that would have been paid in winding-up proceedings.[4]

1 United Kingdom Financial Services Compensation Scheme, *Questions & Answers about claiming compensation*, viewed 12 August, <**https://www.fscs.org.uk/what-we-cover/questions-and-answers/qas-about-claiming-compensation/ item 11 for small company criteria**>.

2 United Kingdom Financial Services Compensation Scheme, *Questions and* Answers, viewed 12 August <**https://www.fscs.org.uk/what-we-cover/questions-and-answers/, Item 2**>.

3 United Kingdom Financial Services Compensation Scheme, *What we cover, Compensation Limits*, viewed 12 August <**https://www.fscs.org.uk/what-we-cover/compensation-limits/**>.

4 Section 215(1)(b) of the United Kingdom *Financial Services and Markets Act 2000*.

FUNDING

A1.6. Funding for the FSCS is provided by the financial services industry via levies on firms authorised by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).[5]

A1.7. Levies to fund the FSCS are raised each year based on known or anticipated claims, however, the FSCS can make additional levies during the year, if necessary.[6] The FCA is currently reviewing the FSCS's funding arrangements.[7,]

SCHEME ADMINISTRATION

A1.8. The FSCS is governed by a board of directors who are appointed by the FCA and the PRA. The board is made up of executive and non-executive directors with a mix of consumer and industry backgrounds. The Chairman's appointment and removal is subject to Treasury approval.

A1.9. The FSCS is independent from the UK regulators but accountable to them and ultimately to the Treasury.[8]

5 United Kingdom Financial Services Compensation Scheme, *A guide to making a claim with FSCS. How FSCS protects your money*, viewed 19 August, <**https://www.fscs.org.uk/globalassets/disclosure-materials-2017/201610-fscs_awareness_jan2017_web-int-1.pdf**>.

6 United Kingdom Financial Services Compensation Scheme, *A guide to making a claim with FSCS. How FSCS protects your money*, viewed 19 August, <**https://www.fscs.org.uk/globalassets/disclosure-materials-2017/201610-fscs_awareness_jan2017_web-int-1.pdf**>.

7 United Kingdom Financial Conduct Authority 2016, *Consultation Paper CP16/42 – Reviewing the funding of the Financial Services Compensation Scheme (FSCS)*.

8 United Kingdom Financial Services Compensation Scheme, *Organisational structure*, viewed 24 August, **https://www.fscs.org.uk/industry/about-fscs/organisational-information/organisational-structure/**.

APPENDIX 2: COMPENSATION SCHEMES FOR SPECIFIC LOSSES IN THE FINANCIAL SYSTEM

A2.1. A number of targeted compensation schemes currently operate in the financial system to protect consumers from specific types of losses.

NATIONAL GUARANTEE FUND

A2.2. The National Guarantee Fund (NGF) is a compensation fund available to meet certain claims which arise from dealings with participants of the Australian Securities Exchange (ASX) and, in limited circumstances, participants of ASX Clear Pty Limited, which provides clearing and settlement services. A range of claims can be paid under the NGF, including claims relating to compensation for loss that results if a market participant becomes insolvent and fails to meet its obligations to a person who had previously entrusted property to it.

A2.3. The NGF is open to both wholesale and retail clients. There is no cap on claims of compensation for loss arising where a market participant fails to complete a sale or purchase of securities, makes an unauthorised transfer of securities, or cancels or fails to cancel a certificate of title to quoted securities. The scheme is funded by ASX participants.

FINANCIAL CLAIMS SCHEME

A2.4. The Financial Claims Scheme (the Scheme) is an Australian Government scheme that protects retail clients of authorised deposit-taking institutions (ADIs) and policy holders of APRA-regulated general insurance companies from potential loss due to the failure of these institutions.

A2.5. For banks, building societies and credit unions incorporated in Australia, the Scheme provides protection to depositors up to $250,000 per account holder, per ADI. The Scheme seeks to provide depositors with timely access to their protected deposits in the unlikely event of the failure of their ADI.

A2.6. For general insurers, the Scheme provides compensation to eligible policyholders with valid claims against a failed general insurer. Under the Scheme, most policyholders with the affected general insurer are covered for valid claims up to $5,000. For any valid claims of $5,000 and over, the policyholder or claimant must be eligible under certain criteria.

A2.7. The Scheme is funded by recovery action through insolvency proceedings, and if the assets are insufficient, through an industry levy on other ADIs or general insurers.

PART 23 OF THE *SUPERANNUATION INDUSTRY (SUPERVISION) ACT* 1993

A2.8. Part 23 of the *Superannuation Industry (Supervision) Act 1993* makes provision for the grant of financial assistance to APRA-regulated superannuation funds that have suffered loss as a result of fraudulent conduct or theft. The loss must also have caused a substantial diminution of the superannuation fund leading to difficulties in the payment of benefits.

A2.9. Compensation limits are at the Minister's discretion with previous grants ranging from 90 to 100 per cent of the eligible loss. If the Minister, after seeking the advice of APRA, is satisfied that the loss has caused a substantial diminution of the superannuation fund and that the public interest requires action, a financial grant may be made by government to the fund. The scheme is industry funded through a levy on APRA-regulated superannuation funds and approved deposit funds.

APPENDIX 3: COMPENSATION ARRANGEMENTS IN OTHER SECTORS

A3.1. Compensation schemes for particular types of losses have also been established from time to time in other sectors. Several examples are described below.

FAIR ENTITLEMENTS GUARANTEE

A3.2. The Fair Entitlements Guarantee (the Guarantee) is an Australian Government funded scheme of last resort that provides financial assistance for unpaid employee entitlements to eligible employees who lose their job due to the liquidation or bankruptcy of their employer. To be eligible, employees need to lodge a claim with the Government within either 12 months of losing their job or the liquidation or bankruptcy of their former employer, whichever is later. Directors of companies (and their spouses or relatives) and contractors are excluded.

A3.3. Once entitlements are paid to an employee under the Guarantee, the Government stands in the shoes of the employee as a subrogated creditor and is entitled to claim the amount paid, and is given priority over other unsecured creditors. The Government may also provide funds to liquidators to enable recovery efforts of the Guarantee from entities, including initiating legal proceedings to recoup any funds paid.[1]

TRAVEL COMPENSATION FUND

A3.4. The national licensing rules for travel agents, which were in place until 30 June 2014, required participation in the Travel Compensation Fund (TCF) as a precondition for being licensed. The TCF's purposes were to:

- ensure that only persons who had sufficient financial resources could join, or continue to participate in, the Fund and therefore carry on business as a travel agent; and
- provide compensation to eligible consumers who had suffered financial loss as a result of the bankruptcy or insolvency of a registered travel agent.

A3.5. The TCF, which closed at the end of 2015, provided for compensation to be paid to consumers in circumstances where they had paid a licensed travel agent for travel or travel-related services, and that agent subsequently failed to arrange the services requested by the consumer.

1 On 17 May 2017, the Australian Government released a Consultation Paper on options for targeted law reform to address corporate misuse of the Fair Entitlements Guarantee scheme and to improve the recovery of Fair Entitlements Guarantee payments: see <**https://treasury.gov.au/consultation/reforms-to-address-corporate-misuse-of-the-feg-scheme/**>.

A3.6. The TCF was funded, relevantly, through: initial contributions by new participants; initial administration fees by new participants; and ongoing annual renewal fees.[2]

NSW LAW SOCIETY FIDELITY FUND

A3.7. Administered by the NSW Law Society, the Fidelity Fund receives annual contributions from solicitors as part of their Practising Certificate requirements. The money received is used to pay compensation to members of the public who successfully claim financial loss due to a solicitor's or firm's dishonest failure to pay or deliver trust money or property.

A3.8. Upon receipt of a claim, the Law Society may make further enquiries. The Fidelity Fund Management Committee decides the claim and it can allow, disallow, compromise or settle it. For almost all claims, there is a limit on payments of a total of $1,000,000 for claims against a particular solicitor or firm. The Law Society may increase this amount, but is not obliged to do so.

MOTOR CAR TRADERS GUARANTEE FUND

A3.9. The Motor Car Traders Guarantee Fund operates in Victoria to, relevantly, meet the cost of successful claims made by consumers who have suffered a loss after purchasing a car, motorcycle or commercial vehicle, as a result of the trader failing to comply with certain conditions of the *Motor Car Traders Act 1986* (Vic) (such as compliance with warranty provisions or transferring title to the car).[3]

A3.10. Claims for compensation from the Fund are heard by the Motor Car Traders Claims Committee. Attempts must have first been made to resolve the complaint directly with the motor car trader. Making a claim is free of charge, with the maximum amount awarded being $40,000. The Fund is funded through motor car traders' licensing fees and penalties paid for breaches of the *Motor Car Traders Act 1986* (Vic). The Fund seeks to recover amounts paid out against the licensee.[4]

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2 PricewaterhouseCoopers (November 2010), *Review of consumer protection in the travel and travel related services market*, viewed 26 July, <**http://consumerlaw.gov.au/files/2011/03/review_protection_in_travel_industry.pdf**>.

3 State Government of Victoria, Consumer Affairs Victoria, *Motor Car Traders Guarantee Fund*, viewed 1 August, <**https://www.consumer.vic.gov.au/about-us/who-we-are-and-what-we-do/funds-we-administer/motor-car-traders-guarantee-fund**>.

4 State Government of Victoria, Consumer Affairs Victoria, *Motor Car Traders Guarantee Fund*, viewed 6 September, **https://www.consumer.vic.gov.au/about%20us/who%20we%20are%20and%20what%20we%20do/funds%20we%20administer/%20motor%20car%20traders%20guarantee%20fund**.

APPENDIX 4: SCHEMES FOR ACCESS TO REDRESS FOR PAST MATTERS

COMMONWEALTH LEGAL FINANCIAL ASSISTANCE

A4.1. The Commonwealth Attorney-General's Department administers a number of statutory and non-statutory legal financial assistance schemes.[1] The purpose of each scheme is to assist people who could not otherwise afford to pay for their legal costs. Depending on the scheme, funding may be provided for costs of legal representation and disbursements or disbursements only.

A4.2. The schemes assist with legal matters under Commonwealth laws other than matters involving criminal charges. They do not assist with legal matters under state or territory laws.

A4.3. One example of a Commonwealth legal financial assistance scheme is the Commonwealth public interest and test cases scheme.[2] This provides financial assistance (for legal fees and other expenses) associated with Commonwealth cases that are of public significance or importance. The funding is not generally available to people who can meet the costs without incurring serious financial difficulty.

A4.4. Commonwealth Guidelines for Legal Financial Assistance 2012 outline when and how such schemes may be established and run, including the application process, decisions on applications, types of financial assistance available, administration of the assistance provided and review of decisions.[3]

A4.5. One example of a test case, as reported in the media, for which legal financial assistance was made available is the Great Southern test case.[4]

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1 Commonwealth of Australia, Attorney-General's Department, *Commonwealth legal financial assistance*; viewed 8 August, <**https://www.ag.gov.au/LegalSystem/Legalaidprogrammes/Commonwealthlegalfinancialassistance/Pages/home.aspx**>.

2 Commonwealth of Australia, Attorney-General's Department, *Commonwealth public interest and test cases*, viewed 11 August, **https://www.ag.gov.au/LegalSystem/Legalaidprogrammes/Commonwealthlegalfinancialassistance/Pages/Commonwealthpublicinterestandtestcases.aspx**.

3 Commonwealth of Australia, Attorney-General's Department, *Commonwealth Guidelines for legal financial Assistance*, <**https://www.ag.gov.au/LegalSystem/Legalaidprogrammes/Commonwealthlegalfinancialassistance/Documents/Commonwealth%20Guidelines%20for%20Legal%20Financial%20Assistance%202012.PDF**>.

4 As reported in *The West Australian*, 8 June 2017, article by John Rolfe entitled *Couple takes on Bendigo and Adelaide Bank over loan demands from failed investment*; viewed 4 August, <**https://thewest.com.au/business/banking/couple-takes-on-bendigo-and-adelaide-bank-over-loan-demands-from-failed-investment-ng-b88501203z**>.

EXAMPLES OF SCHEMES OUTSIDE THE FINANCIAL SYSTEM

A4.6. Some examples of schemes in other sectors which have been (or are proposed to be) established to provide redress for past matters include: [5]

a) the Asbestos Injuries Compensation Fund (also known as the 'James Hardie fund');

b) the redress scheme being delivered in response to the Royal Commission into Institutional Responses to Child Sexual Abuse;

c) 'stolen wages' schemes for Aboriginal and Torres Strait Islander communities;

d) the Forde Foundation, established in response to the Commission of Inquiry into Abuse of Children in Queensland Institutions; and

e) reparation schemes for the Stolen Generations, which operate (or have been announced) in Tasmania, South Australia and New South Wales.

A4.7. While some of these approaches have typically focused on redress for past wrongs rather than necessarily past disputes, they may possess features worthy of consideration in the context of providing redress for past disputes in the financial system.

Asbestos Injuries Compensation Fund ('the James Hardie fund')

A4.8. The Asbestos Injuries Compensation Fund (AICF) was created in February 2007 as an independent, special purpose vehicle to provide compensation for Australian asbestos related claims against former subsidiaries of the James Hardie Group.[6] James Hardie provides funding for the AICF in accordance with an agreement entered into with the NSW Government. The AICF operates as the trustee for two trust funds.

A4.9. James Hardie's former subsidiaries are insolvent and regulated by the *James Hardie Former Subsidiaries (Winding up and Administration) Act 2005* (NSW). This legislation also governs the proceedings which can be taken against the former subsidiaries and the payments which can be made by the AICF trust on behalf of the former subsidiaries.[7]

5 These examples were contained in Appendix B in the EDR Review Supplementary Issues Paper.

6 James Hardie, Asbestos Compensation, Factsheet – *How is James Hardie supporting asbestos education, medical research and contributing to asbestos disease related compensation?* viewed 20 July <**http://www.ir.jameshardie.com.au/jh/asbestos_compensation.jsp**>.

7 Asbestos Injuries Compensation Fund, *About Amaca, Amaba and ABN 60*, viewed 27 July <**https://www.aicf.org.au/about_sub.php**>.

A4.10. The primary activities of the AICF are to: receive and assess claims against James Hardie's former subsidiaries and pay those claims using company funds or AICF trust funds as appropriate; pursue insurance and other recoveries on behalf of James Hardie's former subsidiaries; receive and manage the funding paid into the AICF by James Hardie; and manage and administer the role of trustee.[8]

A4.11. James Hardie paid initial funding of $184.3 million into the AICF in 2007. Additional annual contributions are made on 1 July each year based on relevant financial information. Total contributions to 1 July 2015 are $799.238 million.[9]

A4.12. The Fund received 577 claims in the year ending 31 March 2016 (665 in the prior year), and made gross payments of $146.749 million ($142.014 million in the prior year) in respect of asbestos claims.[10]

A4.13. According to James Hardie, no proven compensation claim against it or its former subsidiaries has been unpaid.[11] Since 2010, the State of New South Wales has provided 'financial accommodation' to the AICF to assist in paying liabilities (an AICF Loan Facility agreement).[12]

Royal Commission into Institutional Responses to Child Sexual Abuse — providing a redress scheme

A4.14. The Royal Commission published its 'Redress and civil litigation' Report in 2015.[13] The Report states that monetary payments as a tangible means of recognising the wrongs suffered is one element of appropriate redress for survivors, as is funding for unlimited counselling and psychological care throughout survivors' lives (recommendations 2 and 9). The redress scheme should have no fixed closing date (recommendation 48) and applications should not be subject to usual limitation periods (recommendation 85).

A4.15. The Report states that the purpose of monetary payments should be to provide a tangible recognition of the seriousness of the hurt and injury suffered by survivors (recommendation 15) and payments should be provided based on the severity and impact of abuse (recommendation 16). Monetary payments under redress should be a minimum payment of $10,000, a maximum payment of $200,000 and an average payment of $65,000 (recommendation 19).

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8 Asbestos Injuries Compensation Fund, About us, <**https://www.aicf.org.au/about.php**>.

9 Asbestos Injuries Compensation Fund, General Purpose Financial Report for the year ended 31 March 2016, page 5 <**https://www.aicf.org.au/docs/AICFL%202016%20Financial%20Accounts.pdf**>.

10 Asbestos Injuries Compensation Fund, General Purpose Financial Report for the year ended 31 March 2016, page 5, <**https://www.aicf.org.au/docs/AICFL%202016%20Financial%20Accounts.pdf**>.

11 James Hardie, Asbestos Compensation, Factsheet – *How is James Hardie supporting asbestos education, medical research and contributing to asbestos disease related compensation?* viewed 12 July, <**http://www.ir.jameshardie.com.au/jh/asbestos_compensation.jsp**>.

12 Asbestos Injuries Compensation Fund, Key Documents, <**https://www.aicf.org.au/key_docs.php**>.

13 Commonwealth of Australia 2015, Royal Commission into Institutional Responses to Child Sexual Abuse, *Redress and civil litigation report*, 14 September 2015, <**http://childabuseroyalcommission.gov.au/about-us/our-reports**>.

A4.16. Counselling and psychological care should be provided to survivors, both through increasing access to Medicare funded services and providing for other gaps in care, funded by the Government. A trust fund should be established to receive funding for counselling and psychological care (recommendation 40).

A4.17. The redress scheme should be established as a single national scheme by the Australian Government (recommendation 26) but funded by the institutions in which the abuse is alleged to have occurred, with the Australian Government and State and Territory Governments being 'funders of last resort' (recommendations 35 and 36).

A4.18. On 9 May 2017, as part of the Federal Budget, the Commonwealth Government announced that it will establish a Commonwealth Redress Scheme for survivors of institutional child sexual abuse. The Scheme will provide redress to survivors who were sexually abused as children in Commonwealth institutions. Survivors will be able to claim a monetary payment of up to $150,000, based on the severity and impact of the abuse experienced. Survivors will also be able to access psychological counselling. The Scheme will accept claims from 1 July 2018 and will end on 30 June 2028.[14]

'Stolen wages' scheme for Aboriginal and Torres Strait Islander communities

A4.19. The Aboriginal Trust Fund Repayment Scheme (ATFRS) was established in 2004 by the New South Wales Government to provide a mechanism for Aboriginal people in NSW to recover 'stolen wages': wages, allowances and pensions held in trust by the NSW Government between 1900 and 1969 but never paid out.

A4.20. Reparation schemes also operated in Queensland under the Underpayment of Award Wages Process which was introduced in 1999. One-off payments of $7,000 were provided to workers employed on Aboriginal reserves. The Indigenous Wages and Savings Reparations Offer introduced in 2002 provided for payments of $2,000 or $4,000, depending on the date of birth of the Indigenous worker.[15]

14 Commonwealth of Australia, Department of Human Services, Commonwealth Redress Scheme for Survivors of Institutional Child Sexual Abuse, *Budget 2017-18*, <**https://www.humanservices.gov.au/organisations/about-us/budget/budget-2017-18/improving-services/commonwealth-redress-scheme-survivors-institutional-child-sexual-abuse**>.

15 Parliament of Australia, *Unfinished business: Indigenous stolen wages* (7 December 2006), Chapter 7: Repayment of monies by Governments, <**http://www.aph.gov.au/parliamentary_business/committees/senate/legal_and_constitutional_affairs/completed_inquiries/2004-07/stolen_wages/report/index**>; Parliament of New South Wales, Questions & Answers Papers No. 13 and 25, 0048 – Aboriginal Trust Fund Repayment Scheme, <**https://www.parliament.nsw.gov.au/lc/papers/Pages/qanda-tracking-details. aspx?pk=181823**>.

The Forde Foundation: response to the Commission of Inquiry into Abuse of Children in Queensland Institutions

A4.21. The Forde Foundation was established in August 2000 'for the relief of poverty, for the advancement of education, training or development, personal and social support, relief of sickness, suffering distress, general enhancement of social and economic wellbeing or for any other purposes beneficial to persons who have been wards of the State or under guardianship of the State or have been resident, as a child, in a Queensland institution.' The Foundation was established in response to the 1999 report of the Commission of Inquiry into Abuse of Children in Queensland Institutions (the Forde Inquiry), which recommended that '[t]he Queensland Government and responsible religious authorities establish principles of compensation in dialogue with victims of institutional abuse and strike a balance between individual monetary compensation and provision of services' (recommendation 39).

A4.22. The Queensland Government has contributed $4.15 million to the Forde Foundation since its establishment. Income generated by the investment of these monies is distributed via a grants process to both individuals and to certain non-government organisations. Grant monies must be used within six months.[16]

Reparation for members of the Stolen Generations

A4.23. Reparation schemes for members of the Stolen Generations operate in some States. The provision of monetary compensation was a key recommendation of the Human Rights and Equal Opportunities Commission's 1997 Report, *Bringing Them Home*. These schemes provide one-off lump sum compensation to eligible individuals for the pain and suffering endured as a result of government policy.

A4.24. The first Stolen Generation reparation scheme (the Stolen Generations Fund) was established by legislation in 2006 by the Tasmanian Government, with $5 million allocated for ex gratia payments, administered by the Department of Premier and Cabinet. Applications were accepted for a period of six months in 2007 and applicant eligibility was assessed by an independent assessor in accordance with legislation.

16 The Forde Foundation 2013, *About the Forde Foundation*, <**http://fordefoundation.org.au/about/forde-foundation**>.

A4.25. In March 2016, the South Australian Government set up a similar scheme providing a total of $11 million, $6 million of which is to be distributed as ex gratia payments of up to $50,000 to members of South Australia's Aboriginal communities who were forcibly removed from their families. The scheme provided an 'application window' of 12 months.[17]

A4.26. On 2 December 2016, the NSW Government announced a $73.8 million package offering compensation of up to $75,000 for each claimant 'without the need for a lengthy and arduous legal process'. This program is to operate separately from the Aboriginal Trust Fund Repayment Scheme.[18]

17 Government of South Australia, Department of State Development 2016, and Maher, K, Ministerial Statement, dated 18 November 2015, <**https://statedevelopment.sa.gov.au/aboriginal-affairs/stolen-generations-reparations-scheme**>. An ABC News report of 31 March 2017 by Tom Fedorowytsch, *Stolen Generations: South Australia's compensation scheme attracts more applications than expected,* indicated that the scheme was oversubscribed with over 350 applicants, which would reduce the value of each payout. See <**http://www.abc.net.au/news/2017-03-31/sa-stolen-generations-compensation-payment-will-be-a-bonus/8401836**>.

18 ABC News, article of 2 December 2016 by Brooke Boney, *Stolen Generations: Victims to get $73 million compensation*, NSW Government says, <**http://www.abc.net.au/news/2016-12-02/stolen-generations-to-get-$73-million-compensation-package-nsw/8086126**>.

APPENDIX 5: CONSULTATION

OVERVIEW

A5.1. In the course of the Review, the Panel undertook the following consultation processes which relate to the matters covered by the amendments to the Terms of Reference:

- The EDR Review Issues Paper was released for public consultation for a period of four weeks from 9 September 2016 to 7 October 2016.
- The EDR Review Interim Report, which contained findings and observations on the merits of the establishment of a compensation scheme of last resort, was released for public consultation for a period of seven weeks from 6 December 2016 to 27 January 2017.
- The EDR Review Supplementary Issues Paper was released for public consultation for a period of four weeks from 31 May 2017 to 28 June 2017.

A5.2. The Panel held numerous roundtables and meetings with individual stakeholders as part of these consultation processes. Details of the roundtables and meetings conducted since the Panel provided its Final Report of 3 April 2017 to the Government are provided below.

CONSULTATION ON THE SUPPLEMENTARY ISSUES PAPER

Submissions

A5.3. The Panel received 63 submissions to the EDR Review Supplementary Issues Paper, six of which were marked as confidential. Stakeholders who made non-confidential submissions are listed below.

AMP
ANZ
Australian Bankers' Association
Australian Securities and Investments Commission
Association of Financial Advisers
ASX
Association of Superannuation Funds of Australia
Australian Institute of Superannuation Trustees
Australian Timeshare Holiday Ownership Council

Azzi, Tom
Ballast Financial Management
Barker, Debbie
Bibo, David
Bone, David
Burge, Suzi
Caulfield, Craig and Moeroa
Credit and Investments Ombudsman
De Michiel, Gilbert and Sylvia
Digwood, Terrence
Eriksson, Trevor
Finance Brokers Association of Australia
Financial Ombudsman Service
Financial Planning Association of Australia
Financial Services Council
Goldrick, Guy
Hargraves, Tanya
Harwood, Peter and Anne
Holt Norman Ashman Baker (HNAB) Action Group
Industry Super Australia
Freeman, Lynton
Insurance Council of Australia
Joint Consumer Group (Consumer Action Law Centre, Financial Rights Legal Centre, Care Inc Financial Counselling Service and the Consumer Law Centre of the ACT, Consumer Credit Legal Service (WA) Inc and Consumer Credit Law Centre SA)
Kelepecz, George
Krepp, Selwyn

Lavis, Roy
Legal Aid NSW
Legal Aid Queensland
Lock, Max and Diane
Mathews, Rose
Maurice Blackburn
McCathy, Ron
McNamee, Peter
Mortgage & Finance Association of Australia
Myttonwatson, Sidney
National Credit Providers Association
National Insurance Brokers Association
O'Brien, Rory
O'Reilly, Steve
Power, Colin
Sgargetta, Elliot
SR Group
Stockbrokers and Financial Advisers Association
Styles, Wayne
Suncorp
Topping, Paul
Walton, Alexander
Wilde, Milton and Leanne

Roundtables

A5.4. The Panel held roundtables as outlined below.

Event	Date held	Venue
Consumer roundtable	4 May	Sydney, Melbourne, Canberra
Industry roundtable	5 May	Sydney, Melbourne, Canberra
Roundtable with individuals and representatives of individuals that have suffered financial loss	5 May, 27 July	Sydney, Melbourne, Canberra
Two consumer and industry roundtables	28 July	Sydney, Melbourne, Canberra

Meetings

A5.5. The Panel members held a range of meetings, which are summarised below.[1]

Stakeholder category	No. of meetings
EDR bodies	4
Government	4
Other	12

1 The majority of meetings were attended by all three Panel members.