30 November 2023

Mr Shail Singh

Lead Ombudsman

Investments and Advice

Australian Financial Complaints Authority

Via Email: consultation@afca.org.au

Private and Confidential

Dear Mr Singh

AFCA Approach to determining compensation in complaints involving Financial Advisers and Managed Investment Schemes

The FSC is pleased to provide **confidential** feedback on the draft *AFCA Approach to determining compensation in complaints involving Financial Advisers and Managed Investment Schemes (***Approach document***)*.

Summary

The FSC is concerned that AFCA's approach to apportion liability for claims brought against a financial advice firm to a managed investment scheme (**MIS**) conflicts with the policy intent of the Compensation Scheme of Last Resort (**CSLR**), which deliberately excludes MISs. In addition, it contemplates the apportionment by AFCA of claims (including for non-financial loss) that specifically have been legislated by statute as non-apportionable. This would mean AFCA would be acting contrary to legal principle. The FSC submits that this approach is inappropriate and should be expressly excluded by the Approach document.

Apportionable claims

As a general matter, the FSC is concerned that AFCA's approach to apportion claims conflicts with the policy intent of the CSLR. As you know, the CSLR is designed to be a targeted, limited safety net of last resort in respect of certain financial products and services, but expressly does not cover claims against MISs. However, this Approach document contemplates AFCA having the ability to require a MIS to pay compensation in respect of a claim relating to a breach of a legal obligation by a financial advice firm. Where a financial advice firm is the subject of a claim because it failed to comply with its legal obligations but is now insolvent and accordingly unable to provide redress to the complainant, the Approach document enables AFCA to effectively redirect the claim against a MIS. This would be possible even though the MIS is expressly excluded from the CSLR. In addition, on its face the Approach document does not unambiguously state that AFCA would not be able to do this where the MIS has not breached any law or had any causal connection to the loss in question.

The FSC submits that this is inappropriate and goes against the intention of Parliament in framing the CSLR to exclude MISs.

It is notable in this regard that the Approach document considers the treatment of complaints where the MIS is insolvent, and the advice firm is party to the complaint. However, it is unclear from the Approach document and the included case studies how AFCA would manage a similar complaint where *the advice firm* is insolvent and in what circumstances AFCA would redirect the claim against a solvent MIS. It would be useful to include a case study where an insolvent financial advice firm is the subject of a claim because it failed to comply with its legal obligations and the MIS has not itself breached any law or had any casual connection to the loss in question – in such a scenario the case study should make it clear that in such circumstances AFCA would not apportion loss to the MIS.

The FSC notes that operators of registered schemes must be public companies and must hold regulatory capital commensurate with the scale of their business, whereas there is no similar requirement placed on licensees that are authorised to provide financial advice, so in effect, it is more likely that the operator of the MIS and not the advice licensee will have the capacity to pay. An unintended consequence therefore might be that rather than having the CSLR pay out claims relating to determinations made against advice licensees, the cost is shifted to the MIS, which is neither fair nor reasonable if the RE has not caused the consumer to experience a loss or the claim is of a type that is not normally apportionable (see below) and should be borne by the advice licensee in the first instance and, if the advice licensee can't pay, the CSLR.

Non-apportionable claims

In addition, the FSC is concerned that not only does the Approach document contemplate the apportionment of claims between a financial advice firm and a MIS in respect of matters that have traditionally been apportionable under statute (such as misleading and deceptive conduct), but it goes much further and contemplates the apportionment by AFCA of claims that specifically have been legislated by statute as non-apportionable. By its own admission, AFCA notes that "this would mean that we would be acting contrary to legal principles".

The Approach document states (page 7) that "Even though breach of the best interests duty is a non-apportionable claim, where a MIS is solvent and is joined to the complaint, AFCA may, if it is fair in the circumstances, apportion loss between the RE and the financial advice firm. However, it would be rare for AFCA to do so, as this would mean that we would be acting contrary to legal principles."

The FSC submits that it is difficult to envisage any circumstances where it would be fair and reasonable for AFCA to go against legal principles and require a MIS to pay compensation in respect of a loss wholly caused by a financial advice firm in respect of a non-apportionable claim. The Approach document should clearly state this, and not leave the matter open to AFCA's discretion. As a general matter, If AFCA is of the view that legal principles concerned no longer serve a proper purpose, or that it should be exempted from following these, it is of course open to AFCA to advocate for legislative change.

The Approach document then lists several factors that AFCA will consider when determining whether it is fair and reasonable in the circumstances to apportion a non-apportionable claim, including "the extent of the respective wrongdoing of the parties, degree of respective culpability (that is, the degree of departure from the standard of behaviour required by law) and the proportion of respective causal contribution to the loss." (page 8). The FSC submits that where a MIS has not committed any wrongdoing or breached any legal requirement, it should not be required to

contribute to a claim (whether apportionable or non-apportionable). The reference to causal contribution should also be clarified so that it is clear that causation is only to be considered where there is a breach of a legal obligation that contributes to causing the loss.

In any event, regarding the factors that AFCA will consider when determining whether it is fair and reasonable in the circumstances to apportion a non-apportionable claim, the Approach document should include consideration of the capacity of the parties to pay a claim, including the solvency of the parties. If the financial advice provider is able to pay a non-apportionable claim, it is difficult to envisage any circumstances where it would be fair and reasonable to apportion an element of that claim.

Non-financial loss

The Approach document states that as a general matter (page 4) "if we assess that a financial firm has breached its obligations to the complainant, we may decide that the financial firm must compensate a consumer for direct financial loss, indirect financial loss or non-financial loss". However, it is not clear whether AFCA intends to apportion a claim for non-financial loss in the specific context of apportioning claim liability between financial advisers and managed investment schemes. Given that the proportionate liability statutes have historically not sought to apportion claims for non-financial loss, it does not seem appropriate for AFCA to apportion compensation for non-financial loss. It would seem to be particularly unfair to require a MIS that has not breached any law to pay compensation for non-financial loss caused by a financial advice firm in the context of a non-apportionable claim. The FSC submits this possibility should be clearly excluded in the Approach document.

If you would like to discuss our confidential feedback, please contact Ashley Davies in the first instance at adavies@fsc.org.au or 0421 062 327.

Yours sincerely,

Ashley Davies

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Financial Services Council