FINANCIAL PLANNING
ASSOCIATION *of* AUSTRALIA

7 October 2022

Senator Jess Walsh
Chair
Senate Standing Committees on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

Email: economics.sen@aph.gov.au

Dear Senator Walsh,

Submission to the Senate Economics Legislation Committee Inquiry into Financial Services Compensation Scheme of Last Resort Levy Bill 2022 [Provisions] and Financial Services Compensation Scheme of Last Resort Levy (Collection) Bill 2022 [Provisions]

On behalf of the Financial Planning Association of Australia, may I thank you for the opportunity to provide our submission to the Committee on the package of Bills before the Parliament to establish a Compensation Scheme of Last Resort.

We would welcome the opportunity to discuss with the Committee any matters raised in our submission. If you have any questions, I can be contacted on (02) 9220 4500.

Yours sincerely,

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Head of Policy, Strategy and Innovation
Financial Planning Association of Australia

FINANCIAL PLANNING
ASSOCIATION of AUSTRALIA

SUBMISSION

Senate Economics Legislation Committee Inquiry into

the Financial Services Compensation Scheme of Last Resort Levy Bill 2022 [Provisions] and Financial Services Compensation Scheme of Last Resort Levy (Collection) Bill 2022 [Provisions]

OVERVIEW

The Financial Planning Association of Australia (FPA) is supportive of the Government's commitment to establish a compensation scheme of last resort (CSLR), which extends beyond personal advice failures, in line with recommendation 7.1 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission).

However, contrary to this recommendation, the scheme the Government recently announced is:

- too narrow in scope;
- provides inadequate coverage to consumers; and,
- does not address the underlying causes of unpaid determinations.

Simply put, the Government's scheme will leave consumers unprotected and financial planners footing the bill.

However, with certain amendments the Government's scheme can meet its intended purpose. That is why we believe the proposed scheme should be expanded to include all financial services providers that are within the jurisdiction of the Australia Financial Complaints Authority (AFCA). This change will provide protection to everyday Australians from uncompensated losses and ensure sustainable funding for the scheme.

When assessing claims, we acknowledge that AFCA seeks to appropriately apportion claims between inappropriate advice and product. However, the proposed scheme places a spotlight on advisers for the allocation of fault. In contrast, serious misconduct, misrepresentation or fraud of a product issuer or manufacturer, is ignored given their specific exclusion from the proposed scheme.

The current Bills would exclude significant segments of the financial industry, such as managed investment schemes (MIS) which will leave many consumers affected by financial misconduct without adequate protection or avenue for compensation. In essence, the proposed scheme will only apply to five financial products and services:

- personal advice on relevant financial products to retail clients,
- credit intermediation,
- securities dealing,

- credit provision, and
- insurance product distribution.

As such, it will mean that a large number of financial institutions and product providers will not be required to contribute to the costs of compensation.

Paying compensation must primarily be the responsibility of the party whose behaviour gave rise to the complaint. Holding financial services firms and practitioners responsible for their own behaviour is an essential component of professionalisation, necessary to improve standards and critical to raising trust levels of consumers in financial services.

As such, it is important that this scheme is fit for purpose from the outset, to give Australian consumers adequate protection and ensure responsibility for funding of the scheme can be shared equitably across the sector.

The FPA has joined with a diverse coalition of fifteen organisations, including consumer groups, professional financial advice associations, financial counsellors, professional accounting associations and community legal centres in calling for the expansion of the proposed CSLR, including:

- Association of Financial Advisers
- Boutique Financial Planning Principals Association
- Chartered Accountants Australia and New Zealand
- CHOICE
- Consumer Action Law Centre Consumer Credit Legal Service (WA) Inc
- Council of the Ageing (COTA)
- CPA Australia
- Financial Rights Legal Centre
- Financial Counselling Australia
- Financial Planning Association of Australia
- Institute of Public Accountants
- Super Consumers Australia
- SMSF Association
- Uniting Communities

We call on the Parliament to amend this suite of Bills to ensure that any established Compensation Scheme of Last Resort is broad-based, equitable and in the spirit of the recommendations of the Hayne Royal Commission.

BACKGROUND

The FPA believes that the first step in ensuring consumers are able to access compensation is to address the underlying causes of unpaid determinations.

The Government must address the role of professional indemnity (PI) insurance in the regulation of financial services. Financial services firms and practitioners are required to hold PI insurance as a condition of their license.

In part, PI insurance is intended to cover liabilities from financial services complaints and ensure that licensees are able to pay compensation when a complaint is made against them. In practice, failure to hold adequate and appropriate PI insurance is a major cause of licensees not paying compensation when it is due.

The final report of the Review of Compensation Arrangements for Consumers of Financial Services by Richard St. John[1] (the St John Review) considered these issues in 2012 and made recommendations to improve the effectiveness of PI insurance. These included addressing the quantum and coverage of PI insurance and recommending the Australian Securities and Investments Commission (ASIC) take a proactive role in monitoring whether licensees are complying with their PI insurance obligations.

Whilst we acknowledge the previous Government undertook to conduct a review into PI insurance, we are disappointed no action took place. Nor has there been any actions taken on this review by the new Government and problems with PI insurance continue to be a major cause of unpaid determinations. Further, ASIC have confirmed to the FPA that they do no proactive monitoring of PI insurance obligations or the PI market for financial advice more broadly.

Given the relatively narrow focus of the Government's proposed CSLR, and its limitation of the scheme to contributions from product distributors and financial planners, it is important to reflect on the recently released AFCA determination statistics. Of the 72,358 complaints AFCA received in the past financial year, those relating to financial advice showed a decline from 534 to 241 (down 54%) for complaints about inappropriate advice and from 525 to 281 (down 46%) for complaints about failure to act in clients' best interest. Further, the AFCA data cube demonstrates shows that in the most recent half year (1/7/2021 to 31/12/2021) that of the 636 complaints progressed, only 96 related to financial planners, of which only 25% were resolved in favour of the complainant.

These most recent statistics from AFCA indicate the number of advice related complaints to the authority is incredibly limited and further that less than a third of those complaints are actually upheld. It therefore appears incongruent for the Government to propose a CSLR that disproportionately targets financial advice for contributions to the scheme and which would leave consumers of products - relating to significantly higher numbers of complaints to AFCA - completely unprotected. It is also important the financial planning sector has undergone significant structural changes since the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*. The number of financial planners has firstly

[1] Final Report of the Review of Compensation Arrangements for Consumers and Financial Services, Richard St. John, 5 April 2012, https://treasury.gov.au/consultation/review-compensation-arrangements-consumers-financial-services-consultation-final.

dropped from just under 29,000 individuals to a current number below 16,000. Further, while 70% of financial planners at that time were licensed by the top 10 financial advice licensees (i.e. the banks and AMP), 60% of financial planners now run their own licensees and small financial planning businesses. These sole traders and small businesses cannot afford the continuing rising costs associated with increased complex regulation. The proposed scheme therefore risks making financial advice less affordable and accessible in an environment where increasing complexity in markets and Australia's ageing population mean that the need for advice continues to grow.

CONSIDERATIONS

In reviewing the proposed legislation to establish a CSLR, the FPA has had regard to the following parameters, which we believe are essential to the proper functioning of an effective scheme:

- A CSLR should have a broad coverage that reflects AFCA's jurisdiction to hear financial services complaints for multiple financial services classes and appropriately apportion responsibility between them. It should provide a holistic and integrated approach to external dispute resolution (EDR) which promotes consumer confidence in the financial services sector.
- The approach to funding a CSLR should reflect the broad risks of different financial services classes and the exposure that each class brings to the CSLR now, rather than based on history. However, it should balance this principle against the need to establish a broad and robust funding base for a CSLR, with all financial services classes contributing. A CSLR must be broader than just 'distributors' of financial products to include financial products.
- A CSLR should be a truly last resort scheme. There must be clear and reasonable steps established for AFCA to pursue compensation through the member firm; and an incentive for AFCA to pursue costs. It must not be allowed to become a compensation and cost recovery scheme rather than a compensation scheme of last resort.
- Reasonable compensation limits will ensure the funding model does not become cost prohibitive to the funding sectors.
- A CSLR should focus on maintaining a stable and predictable industry levy, with a focus on limiting the burden on firms and practitioners. An industry levy should have a maximum growth rate each year and the CSLR should seek to manage its cashflow with the available funding.
- Finally, the obligation to participate in a CSLR should be seen as an opportunity for all financial services participants to take responsibility for identifying and reporting misconduct and poor performance. Demanding higher standards throughout the financial services sector will reduce the number of consumer complaints that require compensation and the call on a CSLR to provide funding in the long term.

THE SCHEME PROPOSED BY THE PACKAGE OF BILLS

While changes have been made to the legislation since the consultation Exposure Draft released by the previous Government, the scheme proposed in the Bills has significant short comings. The Government's proposed CSLR is simply too narrow in scope, provides

inadequate coverage to consumers and does not address the underlying causes of unpaid determinations.

Broad-based Scheme

The scope of the proposed CSLR in the Bills does not include all financial products – MIS, Real Estate Income Trusts (REITs) and other complex products are exempt. It is restricted to personal financial advice to retail clients, dealing in securities and engaging in credit activities. Therefore, the Bills should be amended to produce a CSLR that would have a broad coverage and include any financial services classes that are subject to AFCA's jurisdiction. This broad approach would achieve four things:

1. By mirroring AFCA's jurisdiction, it would complement a comprehensive EDR arrangement for financial services.

   This would ensure that compensation is available for any AFCA determination and consumers are not unfairly excluded from the CSLR based on the specific financial services class or classes to which their complaint relates. For example, there have been past examples of classes of consumer going uncompensated in relation to MIS and product failure based on the class of consumer they are.

   It would also reinforce AFCA's practice of looking at complaints holistically and apportioning responsibility between different financial services classes where a complaint covers multiple parties.

2. The proposed scheme is based on historic unpaid determinations data when product issuers were not required to be a member of an EDR scheme and complaints about financial products and providers fell outside the jurisdiction of AFCA's predecessor schemes.

   The recommendations of the final report of the Review of the Financial System External Dispute Resolution and Complaints Framework by Professor Ian Ramsay[2] (the Ramsay Review) in 2017 specifically surrounding the establishment of a CSLR that only covers financial advice, were made at a time when other types of complaints were excluded from EDR processes. Predecessor schemes assigned responsibility for a complaint to a single sector (generally where the complaint originated) and in the case of financial advice, prior to the introduction of the Future of Financial Advice (FOFA), Financial Adviser Standards and Ethics Authority (FASEA) and Hayne Royal Commission consumer protection regime. However, this is no longer the case. AFCA's jurisdiction covers a range of financial services classes reflecting the reality that a single complaint from a consumer can cover multiple licensees and responsible entities that are providing a variety of financial and credit advice and products.

   Matching the CSLR to AFCA's jurisdiction would ensure consistency in the treatment of unpaid EDR determinations and provide clarity for consumers seeking redress through EDR.

[2] Final Report of Financial System External Dispute Resolution and Complaints Framework, Professor Ian Ramsay, 3 April 2017, https://treasury.gov.au/sites/default/files/2019-03/R2016-002_EDR-Review-Final-report.pdf.

3. There is a further risk that clients who receive either ‘general’ or ‘wholesale’ financial product advice and suffer a financial loss may be deemed by AFCA to have in fact received ‘personal’ advice and therefore be eligible for compensation.

   It is then possible that if such a claim remains unpaid, that it could be paid from the licensed personal advice sub-sector, despite the fact that the unpaid claim was not from this sector.

   We do not believe that it is equitable that a sub-sector may have to fund such unpaid claims where this has no nexus to the advice provided from that sub-sector, while those who gave rise to the claim are not required to contribute in any manner to the levy.

4. A broad approach is necessary to ensure the sustainability of funding for the CSLR. To have the confidence of consumers, a CSLR must be credible and provide some assurance that funding will be available for unpaid determinations into the future.

   Limiting the CSLR to only “distributors” of financial services, such as financial advice and mortgage broking, narrows the funding model and makes it vulnerable to changes in the size of that class and its ability to pay.

5. By including a range of licensees across the financial services sector, a broader CSLR would provide an incentive for all participants to take responsibility for identifying and reporting misconduct and poor performance. This has been an area of failure in the past. Industry participants holding each other to account is an essential part of eliminating misconduct and necessary to restore the public’s trust in the financial services sector.

It is important to note that in its February 2020 submission in response to the Treasury Discussion Paper - Establishing a Compensation Scheme of Last Resort, AFCA also called for the expansion of the proposed CSLR based on the risks the EDR scheme sees to consumers. AFCA states:

> *The types of firms who have unpaid determinations extends past financial advisers who provide personal and general financial advice to include; credit providers; managed investment scheme operators; finance brokers; mortgage brokers; securities dealers and derivatives dealers. In our view, all firms are responsible for restoring trust in financial services and ensuring that their EDR obligations are met.*
>
> *In our view, it is important that the CSLR also covers managed investment schemes (MIS). This is due to:*
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> - *the potential for unpaid determinations and consumer detriment to flow from this group;*
> - *the involvement of other financial firms or their subsidiaries in the funding, distribution or other arrangements with MIS, and*

- *funding contributions to a scheme across the whole 'value chain' would support increased accountability of all participants, including MIS operators.*[3]

Since our commencement there have been more than 40 AFCA determinations awarding compensation to consumers that have not been paid due to the insolvency of the financial firms involved.

Limited data exists relating to unpaid AFCA determinations given that AFCA only started receiving complaints from 1 November 2018.[4]

Administration

The FPA has concerns with the proposed administration of the scheme. A compensation scheme of last resort should be truly last resort. There needs to be assurances for the contributors to the scheme that all possible actions to remediate consumers have been attempted before a compensation claim is paid by the scheme. Housing the CSLR in AFCA can create a potential conflict – where there may be little incentive for AFCA to assist consumers in attempting to obtain compensation, when it is administratively and more cost effective to rely on the backstop of the CSLR. This creates a moral hazard. Further, as AFCA is able to claim costs from the CSLR where costs have not been reimbursed to AFCA, the authority may have little incentive to chase these debts verses reimbursing themselves through the scheme, particularly as the scheme is proposed to have no right to reassess the merits of the claim.

A clear, reasonable and exhaustive process needs to be established and must be undertaken by AFCA, which must demonstrate this to the CSLR, prior to any compensation being paid from the scheme.

Consumers and contributors to the scheme need should be assured that it will truly be operated as a last resort for compensation and that those whose behaviour is responsible for determinations, are being made to pay as far as practical for the relevant compensation.

In summary, the FPA recommends that in order for consumers and industry to have confidence in the Compensation Scheme of Last Resort reforms, the Bills must be amended to achieve:

- **A broad-based scheme** - Consumers need protection through a CSLR covering the broad range of all financial services and products that are within the jurisdiction of AFCA.
- **A fair share** – Contributions to fund the CSLR should be made from every financial service and product within the jurisdiction of AFCA, based on that sector's current risk to the scheme.
- **An independent umpire** - AFCA as an independent umpire, should not also be in charge of the purse strings. Independent oversight and administration are key to ensuring those responsible for the complaints are the ones who pay.
- **An overdue lookover** - A CSLR isn't the only way to reduce unpaid AFCA determinations. To make sure the scheme truly is one of last resort, a long overdue

[3] AFCA submission in response to the Treasury Discussion Paper – Establishing a Compensation Scheme of Last Resort, February 2020, Page 3.
[4] AFCA submission in response to the Treasury Discussion Paper – Establishing a Compensation Scheme of Last Resort, February 2020, Page 4.

review of PI insurance coverage needs to be undertaken to ensure consumers are protected and industry has the security it needs. We acknowledge the Government's announcement of a Treasury led review into PI insurance and look forward to contributing to this important piece of work.

PROPOSED AMENDMENTS

The CSLR levy framework has been proposed to align with the ASIC Industry Funding Model[5] which currently applies to 48 listed sub-sectors, with the Minister able to exempt any of these sub-sectors as they see fit.

The Government has just commenced a review[6] that the Treasury is conducting which will review the ASIC Industry Funding Model to ensure it remains fit for purpose given the structural changes taking place in the advice industry. Further, the former Government recognised the problems specifically with the ASIC levy model for the financial advice sub-sector and announced temporary ASIC levy relief for financial planners over the last two financial years, which is assisting the profession to support Australians having access to affordable financial advice.

Given this review may result in structural changes to the current ASIC Industry Funding Model, the FPA has concerns with aligning the CSLR levy framework to this model.

It is also worth noting, the ASIC IFM sub-sector for advice does not align with AFCA's advice sub-sector which is broader that under the ASIC IFM model, again demonstrating that the ASIC IFM model is not fit for purpose.

The CSLR proposed in this package of Bills must be amended to include all financial products to ensure all consumers who engage with an ASIC regulated financial product, with or without seeking professional advice, will have access to adequate protection and compensation.

To remedy this and ensure that the CSLR that is implemented satisfies the recommendations of the Hayne Royal Commission, the FPA believes the scope of the CSLR should align with those licensees who are legally required to be a member of AFCA as a requirement of their license conditions, including:

- Australian Financial Services (AFS) licensees who provide financial services to a retail client must be a member of AFCA (a912A(1)(g) and s912A(2)(c) *Corporations Act 2001*); and,
- Australian Credit licensees (s47(1)(i) *National Consumer Credit Protection Act 2009*).

As the responsible entity for a registered MIS must hold an AFS licence, such an expansion of scope will ensure that when a body is authorised to operate such a scheme and provide financial services, they will be both covered by the CSLR as well as contribute to its funding. It will also ensure consumers are adequately protected by the CSLR and its funding obligation is fairly shared across the financial services industry.

[5] *ASIC Supervisory Cost Recovery Levy Regulations 2017 – Schedule 1*
[6] *Treasury Consultation: ASIC Industry Funding Model Review* https://treasury.gov.au/consultation/c2022-317130

Failing this, the FPA recommends that the mechanism by which all licensees contribute to the cost of the CSLR (in a similar way to AFCA membership) to ensure all participants have a role in improving the conduct and consumer outcomes for the profession more broadly. However, the graduated levy should be based on a risk-based approach where the larger the risk of consumers going uncompensated, the larger the levy. On this basis, the FPA recommends that the graduated levy be charged to licensees who have AFCA cases which progress past the merits assessment and have a finding in favour of the complainant.