Stockbrokers And Financial Advisers Association Limited

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INTERIM REPORT OF REVIEW PANEL – REVIEW OF THE FINANCIAL SYSTEM EXTERNAL DISPUTE RESOLUTION AND COMPLAINTS FRAMEWORK

We refer the Interim Report of the Review Panel on the Review of the Financial System External Dispute Resolution and Complaints Framework ("the Interim Report"). The Stockbrokers and Financial Advisers Association ("SAFAA") appreciates the opportunity to provide a submission on the Draft Conclusions and Recommendations in the Interim Report.

We also appreciate your consideration of this Submission after the due date noted in the Interim Report. This has allowed for our members to consider the Interim Report and provide us with their feedback.

SAFAA is the peak industry body representing institutional and retail stockbrokers and investment banks in Australia. Our membership includes stockbroking firms across the spectrum, ranging from the largest wholesale investment banks and retail broking firms to medium-sized firms and down to the smallest firms.

There are a number of issues that SAFAA members have with the Interim Report. These are set out below.

Monetary Limits for EDR Schemes

Draft Panel Finding/Draft Recommendation 2

The current monetary limits for consumers are inadequate.

The new industry ombudsman scheme for financial, credit and investment disputes should provide consumers with monetary limits and compensation caps that are higher than the current arrangements, and that are subject to regular indexation.

SAFAA members strongly disagree with the above Draft Panel finding and Draft Recommendation 2.

The heading of the relevant section of the Interim Report is "Outdated monetary limits for consumers", which clearly reflects the conclusions of the Review Panel.

We note that the Interim Report does not go so far as to propose what the new monetary limits should be. We note that the Consultation Paper sought views on the FOS proposal to increase monetary limits to $2 million, and there seems to be an implied level of support for an amount of this nature in the general wording of the Interim Report.

Whilst there may be grounds in some areas of financial services for monetary limits to be reviewed and potentially increased, **in relation to financial services provided in the stockbroking industry**:

1. Current monetary limits are **not inadequate.**

2. Monetary limits have been reviewed and increased periodically by FOS and could **not** be considered to be **outdated** at all.

3. Monetary limits **should not be increased** above the present level of $309,000 per claim set by FOS.

4. Any increase to an amount such as $2 million could be **highly damaging** to the firms providing stockbroking services.

We note at para. 5.49, the Interim Report states "While there was broad agreement that the limits and caps should be increased, there were diverging views about what the new thresholds should be."

This finding does not reflect the strong submission made by SAFAA (under its former name Stockbrokers Association of Australia) in relation to the Consultation Paper issued by the Panel.

In SAFAA's previous submission, the Association stated quite strongly that it **did not agree** with the FOS proposal, on which the Panel sought views, to increase the monetary limits to $2 million. It did not support the monetary limits being raised above the existing levels.

SAFAA is most disappointed that its views have not been acknowledged in the Interim Report. The statement that there was broad support for an increase in monetary limits is incorrect.

The following matters should be taken into account in relation to any consideration of monetary limits in respect of EDR awards:

1. **The nature of External Dispute Resolution**. Membership of an EDR scheme is a license condition applying to the holder of an AFS License. Hence, it is a mandatory condition of being able to carry on business.

   The AFSL holder has no choice about being subject to the EDR scheme, and is bound by the decision of the EDR scheme. The firm has no right to challenge or appeal a determination made by an EDR scheme.

   The proceedings at an EDR tribunal are informal. The decision maker is a Tribunal member, and not a member of the judiciary. The laws of evidence do not apply, and there is no right to compel production of documents.

   The nature of an EDR scheme is that it is a compulsory means of providing consumers with expedited low-cost way of lodging a claim, without the AFSL holder having any of the safeguards that apply in formal legal proceedings. However the trade-off in subjecting an AFSL holder to this was meant to be that there be a "reasonable" limit on the size of claims that could be dealt with in this way.

   Larger claims should more properly be brought in the courts, where claims of a more significant amount could be dealt with and tested according to the normal safeguards afforded to both sides by legal proceedings.

We note that the District Court of NSW has a jurisdictional limit of $750,000 on claims. Similar limits apply in other states. It would be entirely anomalous for there to be a monetary limit of even similar size applied to an EDR scheme, let alone limits in the order of $2 million.

A financial firm who was the subject of a $2 million award by an EDR scheme would be unable to challenge the decision. As mentioned above, an award of such an amount would be highly damaging if not fatal to all but the largest of institutional firms in the stockbroking sector.

There are a number of other reasons why a Court is the more appropriate body to hear claims of a significant size, apart from the rights of appeal. These include:

(a) the inability of an EDR scheme to determine third party liability for indemnity or contribution in respect of claims;
(b) the inability to prevent non-parties to the EDR proceedings maintaining a claim for contribution of indemnity if the claimant pursues them after obtaining a decision at EDR (even if the member has paid an award of compensation); and
(c) the inability to compel third parties to provide documents relevant to the dispute and which may have the ability to alter the EDR Tribunal's determination
(d) the ability of EDR schemes such as FOS to award sums of money, even under the current monetary caps, for "loss of opportunity" without recourse to the legal principles that govern the award of such damages at law.

2. **There is no "one financial sector".** Some large institutions could absorb an award of $2 million. Most could not. It is incorrect to characterize all service providers in the financial sector as being the same.

The amounts involved in some financial sectors are large, and may justify an increase in the monetary limits in relation to those products. We note that the Report states that monetary limits are "*no longer in line with the values of some financial products (such as mortgage balances) that may give rise to disputes, resulting in a gap in EDR coverage.*"

However, applying a "one size fits all" approach to EDR, as the Interim Report has done, does not reflect the different amounts involved in different sectors, and as a result, does not consider the need for there to be sensible and reasonable caps in other areas of financial advice where large limits are not appropriate.

In the Association's Submission on the consultation Paper, we noted that claims lodged with FOS in relation to stockbrokers are at the lower end of the scale. Furthermore, FOS figures in respect of stockbrokers show a consistently low and falling level of complaints lodged with FOS.

Quite simply, there is no reason why there should not be different classes of limits applying to different financial sectors. It seems to the Association that the Panel has been heavily influenced by issues that may pertain to banking and insurance, and has not adequately considered the nature of other sectors, such as stockbroking.

If there are some areas of the financial sector where a larger monetary limit is considered appropriate, then the approach should be that there be different monetary limits applied to claims brought in those sectors.

3. **Access to EDR schemes.** The Interim Report cites at 5.47 that consumer organisations had "submitted that they regularly meet with people who have disputes which fall well outside of the schemes/ jurisdiction". We are not aware of any claims by clients of stockbrokers or consumer groups that investors have been unable to access FOS in relation to stockbroking claims. It is our understanding that the number of claims in relation to stockbrokers which could not be brought in FOS due to jurisdictional limits is low, although we cannot locate those statistics from FOS Reports. We submit that this justification for considering higher limits simply does not apply to the stockbroking sector.

   In any event, we note that FOS has effectively expanded its monetary limits through its treatment of actions as consisting of **multiple separate claims** (as discussed in parag. [4.40] of the Interim Report.

4. **PI Insurance.** Increasing the monetary limits to levels in the order of $2 million would result in major increases in the cost of obtaining Professional Indemnity (PI) insurance and/or potential difficulties in obtaining insurance cover. For stockbroking firms, this would be an unnecessary additional cost, in view of the low $ levels of EDR claims that are actually brought against stockbrokers.

5. **Comparison with other schemes globally.** We note that at 2.24, the Interim Report notes that the Panel considered ombudsman-type schemes in the financial services sector in a number of other jurisdictions, including New Zealand, the UK, Singapore and Canada.

   We note from the material in Appendix 1 of the Interim Report that the monetary limits in the overseas EDR Schemes are Canada (CAN$350,000), Singapore (SIN$50,000), New Zealand (NZ$200,000) and UK (£150,000).

Compared with the overseas equivalents, the existing monetary limit of $309,000 in relation to FOS claims does not look at all inadequate, at least in relation to financial advice provided in the stockbroking sector.

In SAFAA's submission, the international comparison is further evidence that the approach of other jurisdictions is in line with our characterization of the nature of EDR schemes discussed in paragraph 1 above.

6. **Anti-competitive impact**. As mentioned above, the impact of large awards by an EDR scheme, and even the threat of such an award, will have the potential to lead to small to medium-size firms to exit the financial advice market.

   We note at paragraph 5.49 that the Australian Bankers Association has called for EDR schemes to be empowered to make awards of up to $1 million. It may be that large banks are in a position to finance awards of that nature, in view of their size and profit levels. However small and medium sized firms are not in that position.

   Any hollowing out of the market of small to medium firms will have an impact on the accessibility of investors to stockbroking advice from a range of competing service providers. Service levels and investor satisfaction in small to medium sized firms is high. It would be a bad outcome if the only choice that investors were left with was the choice between the very largest financial service houses.

Conclusions. For the above reasons, SAFAA strongly argues that:

(a) there is no basis for the conclusion that monetary limits are inadequate or should be increased, at least in so far as the stockbroking industry is concerned;
(b) there is no basis for any conclusion that there needs to be one set of limits applicable across all financial sectors; and
(c) if there are to be any substantial increases in the monetary limits applicable to stockbroking, then SAFAA argues that safeguards must be introduced to give rights to licensees to challenge EDR decisions in appropriate cases.

Consolidation of EDR Schemes

Draft Recommendation 1

There should be a single industry ombudsman scheme for financial, credit and investment disputes (other than superannuation disputes) to replace FOS and CIO.

SAFAA does not support any intervention by Government to change the existing framework for EDR schemes.

We note that, as mentioned above, the Corporations Act imposes a requirement for an AFS License holder to be a member of **an** approved EDR scheme as a condition of doing business.

It is evident that the underlying philosophy behind the legislation was that AFSL holders be required to offer a low-cost expedited dispute handling facility to clients, however Government did not mandate a particular EDR scheme. AFSL holders were to be free to choose the EDR scheme.

As a matter of practical reality, there have not been competing EDR scheme providers that have set up to offer their services. Different schemes have operated in different financial sectors, however there have not been any competitors to FOS.

Nevertheless, it was clearly not Parliament's intention to dictate a particular EDR scheme to AFSL holders.

It is noted that this philosophy has recently been once again evident in the Professional Standards legislation introduced into Federal Parliament late last year. The legislation has mandated that financial advisers must be subject to a Code of Ethics which is monitored by a Code Monitoring Body approved by ASIC, however it is up to financial advisers to choose which Code Monitoring Body will apply to them. The Government has not mandated choice of any particular Code Monitoring Body or any professional association.

SAFAA submits that it is not in line with Government philosophy to mandate that EDR schemes be required to amalgamate, or that there should be just one EDR scheme applicable to financial services.

Whether or not there are economies and efficiencies to be gained by EDR schemes merging should be entirely a matter for the EDR schemes themselves. If they choose to amalgamate, that should be a matter for them.

Likewise, it should also be a matter for AFSL Holders to choose a different EDR scheme if they believe that an EDR scheme is not offering the facility efficiently or effectively, and that another EDR scheme will offer a better choice.

This ability to choose is potentially of equal importance to any financial efficiency to be gained from EDR scheme mergers. It is worth noting that history does not tend to offer many examples, whether it be in trade or commerce or politics, where establishing a single monopoly without competition has led to better or more efficient outcomes in the long run.

In fact, the danger of a "one size fits all" approach, such as we have already highlighted in relation to monetary limits above, is greater where a single monopoly structure is created.

Whilst on this subject of EDR choice, we note the reasons at parag. [5.27] of the Interim Report which the Panel puts forward for not supporting potential competition between EDR schemes. The paragraph is quoted below:

5.27. In the current EDR framework, it is the financial firms and not consumers that have the choice of which industry ombudsman scheme to belong to. In general terms, this means that there could be the potential for a scheme to provide a service which is valued by the firms, but which does not align with what is in the consumer's best interests. Alternatively, it is possible that efforts to attract financial firms to an EDR scheme may also have benefits for consumers (for example, by creating pressure on the schemes to provide value for money EDR services which benefit consumers to the extent lower EDR costs flows through to the pricing of financial services). However, this is not guaranteed and competition between schemes could, for example, result in a reluctance for schemes to accept disputes that go beyond the minimum jurisdiction, an outcome not beneficial to consumers.

In SAFAA's submission, the experience with the operation of External Dispute Resolution in the financial sector in Australia does not provide any evidence for the comments in the above paragraph. In the experience of SAFAA members, the service offered by **FOS is highly aligned with consumers**.

There is no evidence of which we are aware that any pressure has been put on FOS by financial firms for it to operate any differently, or that financial firms have sought to promote a competing EDR scheme that does not align with consumer interests. We are certainly not aware that FOS has ever made any of these suggestions.

Internal Dispute Resolution

Draft Recommendation 9

Financial Firms should be required to publish information and report to ASIC on their IDR activity and the outcomes consumers receive in relation to IDR complaints. ASIC should have the power to determine the content and format of IDR reporting.

SAFAA members do not support Draft Recommendation 9. In our submission, this requirement is a case of unnecessary over-engineering of process, and adding unnecessary cost and administrative red tape to business.

In relation to Internal Dispute Resolution, the client is either satisfied with the outcome or they are not. If the client is satisfied, then the IDR has achieved the desired outcome and nothing further should be required.

If the client is unhappy, then there is a low cost option of complaining to FOS. This results in information which is easily measured and reported (which it currently is on an annual basis by FOS).

In our view, a further requirement for a reporting regime by financial firms to ASIC adds cost and red tape that ultimately must be recovered by increasing the cost of providing financial services to investors.

ASIC already has all the powers it needs to compel AFSL holders to provide it with such information that ASIC requires in the form that it specifies in relation to compliance with the license holder's obligations, including its license conditions.

ASIC can and already does require firms to provide information to satisfy ASIC that the ASFL holder is complying with its license obligation to have in place a complaints handling process that meets Australian Standards. It is our understanding that ASIC routinely looks into complaints handling as part of its licensee surveillance program.

Draft Recommendation 9 would merely result in a duplication of process.

CONCLUSION

We would be happy to discuss any issues arising from these comments, or to provide any further material that may assist. Should you require any further information, please contact Peter Stepek, Policy Executive, on (02) 8080 3200 or email pstepek@stockbrokers.org.au.

Yours sincerely,

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