SUBMISSION TO THE REVIEW OF THE FINANCIAL SYSTEM EXTERNAL DISPUTE RESOLUTION FRAMEWORK

CONSULTATION ON THE ESTABLISHMENT, MERITS AND POTENTIAL DESIGN OF A COMPENSATION SCHEME OF LAST RESORT AND THE MERITS AND ISSUES ASSOCIATED WITH PROVIDING ACCESS TO REDRESS FOR PAST DISPUTES

July 2017

SUMMARY

1. ANZ thanks the EDR Review Panel for the opportunity to respond to its supplemental issues paper.

2. ANZ supports a last resort compensation scheme (**LRCS**) that covers unpaid determinations awarded to retail clients in respect of personal financial advice concerning Tier 1 financial products. We would see this scheme operating on a prospective basis.

3. Such a scheme would improve consumer confidence in the financial advice sector. It is appropriate given the significant regulatory reform that has improved the quality of personal advice concerning more complex products.

4. There are issues with extending the LRCS beyond this that we believe the EDR Review Panel should consider.

5. Primarily, we are concerned that including claims in respect of financial services beyond personal advice would expose the LRCS to potentially large losses that could be mutualised across otherwise legally compliant organisations. 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 LRCS, turning the LRCS into a risk transmission mechanism.

6. In respect of the supplemental issues paper's second topic of access to redress, ANZ acknowledges that there are customers who have been affected by this issue. For its part, ANZ takes action to compensate customers who have been disadvantaged as a result of its behaviour or failures.

7. As the supplemental issues paper identifies, designing a redress mechanism raises a number of design issues. We agree that such a mechanism, if it were established, would need to consider achieving fairness in funding and access.

A. CONSUMERS WITH A DECISION BUT NOT COMPENSATED FOR FINANCIAL LOSS

Design of a Last Resort Compensation Scheme

8. ANZ supports a LRCS with the following features.

- **First**, the individual seeking compensation through the LRCS (**claimant**) must be a retail client as defined by the *Corporations Act 2001* (Cth).
- **Second**, the determination that the claimant seeks payment for must concern personal advice as defined by the *Corporations Act 2001* (Cth) in respect Tier 1 products.[1]
    - If the LRCS were to cover determinations for losses arising from general advice (or, even broader, acts by licence holders with a general advice authorisation), then the LRCS would capture many forms of financial service and go well beyond the historical core concern of compensation for poor personal financial advice.
    - We believe the scheme should only cover Tier 1 financial products as customers benefit from the best interests duty when receiving personal advice in respect of these (see section 961B of the *Corporations Act 2001* (Cth)). The duty helps reduce the risk of the LRCS being called upon to satisfy unpaid determinations.
- **Third**, the covered determination must be against an Australian Financial Services licensee that has agreed to pay levies to the LRCS.
    - This would exclude claims for determinations against firms that were insolvent prior to the inception of the LRCS.
- **Fourth**, the claim against the LRCS must be in respect of a determination by an external dispute resolution (**EDR**) scheme.
    - We are open to the scheme covering determinations by courts or tribunals provided that (a) class actions are excluded and (b) the claim is otherwise limited to what could have been recovered under the EDR.
- **Fifth**, the determination must be handed down after the commencement date of the LRCS.

[1] Tier 1 products are defined in ASIC *Regulatory Guide 146 Licensing: Training of Financial Product Advisors* (July 2012) para 146.38 as more complex financial products.

- We do not think it appropriate that the LRCS operate retrospectively to satisfy determinations that have been awarded prior to its inception. Such operation would mean that currently solvent and compliant firms would be called upon to satisfy the debts of firms that never contributed to the LRCS.

- **Sixth**, the LRCS must be satisfied that (a) the AFS licensee against whom the determination has been made is insolvent and (b) there are no alternative avenues of recovery available to the claimant.

We expand on our views on some of these points below.

Class actions

9. The risk of the LRCS acting as a risk transmission mechanism would become acute if successful class action claimants could access the fund. Class actions are effective mechanisms for dealing with large scale issues but, by that virtue, also typically involve large scale claims.

10. We ask that, in giving consideration to this risk, the Panel think of class actions in broad terms to include a series of claims that are in respect of the same or similar circumstances and give rise to a common issue of law or fact. This definition should apply whether the claims are bought through a court or in multiple individual claims within an EDR.

11. Under the Financial Ombudsman Service's (**FOS**) existing terms of reference (**TOR**), FOS can exclude some class actions via provisions which require it to exclude disputes which relate to the management of a fund or scheme as a whole or disputes about decisions of the trustees of approved deposit funds and of regulated superannuation funds.[2]

12. The TOR for the new Australian Financial Complaints Authority (**AFCA**) have not been released and it is unclear how they will deal with class actions. In addition, it is not clear if these TOR would form the basis for a proposal for an LRCS.

Type of claims

13. In the absence of AFCA's TOR and a clear definition of LRCS scope, it is also necessary to draw the Panel's attention to the risks posed by claims relating to the provision of general advice and, in particular, managed investment schemes (**MIS**).[3]

14. ANZ is particularly concerned about exposing banking sector to losses flowing from less regulated parts of the financial services industry, such as peer-to-peer lenders that are

[2] Clause 5.1(i) and clause 5.1(h) of the FOS Terms of Reference.
[3] In order for a MIS to promote itself to retail clients, it must obtain an AFS licence enabling the fund manager to operate a MIS, deal in a financial product and **provide advice** (although section 766A(2) of the Corporations Regulations provides exemptions in some circumstances).

not subject to banking-type regulatory and prudential requirements. Peer-to-peer lenders are typically structured as MIS.

15. Under our preferred approach above, the LRCS could be exposed to losses arising in MIS structures to the extent that retail clients suffered the loss as a result of personal advice in respect of Tier 1 products. We believe this risk is adequately ameliorated by the regulatory framework which surrounds the provision of personal financial advice concerning such products.

16. Until the AFCA TOR are finalised, misplaced expectations may arise that consumers who are disadvantaged through misconduct in a large scale financial failure would be covered by a future LRCS (even though it is probable that under the existing FOS TOR those consumers would be excluded).

Court decisions

17. We believe there are good reasons for allowing claimants to recover from the LRCS amounts awarded in court and tribunal decisions. These include not elevating EDR decisions, in terms of recovery, above those of a court or tribunal and supporting the ongoing development of retail banking case law (rather than the soft law developed by EDR schemes).

18. However, allowing claimants to recover court awards from the LRCS would require the LRCS to analyse court decisions to determine the extent the court matches the EDR eligibility criteria. This would include considering whether the heads of damage fall within the remit of the LRCS and the extent to which awarded compensation is within EDR's limits.

19. Such steps will introduce complexity and cost into the LRCS processes and create some uncertainty for claimants.

Legal expenses

20. The issue of court actions also raises the issue of legal fees and the right of claimants to recover their legal costs, including costs imposed by litigation funders, from the LRCS.

21. ANZ questions whether it is appropriate for a LRCS to pay out additional compensation to cover legal expenses or fees charged by lawyers and litigation funders. Paying such expenses and fees could reduce the amount available for other claimants in respect of their actual losses.

22. We are also concerned that the LRCS does not have the ability to test the reasonableness of legal fees and permitting claims for legal expenses could make it vulnerable to claims for excessive legal costs.

23. It's important to note that legal representation for EDR claimants is not required. Accordingly legal costs are rarely awarded and, where they are awarded, a cap of $3,000 applies.[4]

Way forward

24. In light of the above issues, we believe there are three gaps in the current consideration of a LRCS that need to be filled before further conclusions about its design can be reached.

    - First, the classes of financial services, customers and events covered by an LRCS need to be specified.
    - Second, a quantitative risk assessment based on this specification needs to be undertaken of the potential liability to the LRCS under different market conditions.
    - Third, in the event that there is a significant potential liability, mechanisms to limit the impact of the LRCS on the financial system and its funders need to be considered e.g. explicitly capping LRCS liabilities, reinsurance or public underwriting.

B. CONSUMERS WHO HAVE BEEN UNABLE TO ACCESS REDRESS OR OBTAIN A DECISION

25. The Panel has raised concerns about claimants who have been unable to access an EDR scheme and, for various reasons, have not pursued a dispute through a court or tribunal. It has flagged potential mechanisms for providing redress to these claimants.

26. The distress of claimants who have been unable to access redress is understandable. We are, however, mindful that retrospective payments could create precedents and raise issues of fairness.

27. Some of the issues posed by retrospective redress mechanisms are:

    - **Which claims would be permitted** – as the supplemental issues paper notes, individuals may not have had access to redress for a variety of reasons, including FOS's terms of reference, time limits, insolvency of the financial service provider and voluntary decisions to not pursue a claim.
    - **How to adjudicate claims** – as the relevant claims have not been previously adjudicated, there would need to be a mechanism to assess the claim. This would include both a decisional body and a set of standards (or law) that should apply.

[4] See clause 9.3 of FOS' TOR.

- **Who pays** – careful consideration would need to be given to who pays for retrospective redress. Unlike the LRCS, where contribution across the industry can be seen as a legitimate cost of doing business today, having today's solvent firms pay the claims against yesterday's (insolvent) firms raises issues of equity to the formers' stakeholders (customers, shareholders, employees).

28. ANZ looks forward to working with the EDR Panel on resolving some of these issues as their dimensions and implications become clearer. In particular, we believe it is important that work is done to estimate the dollar amount of claims that are likely to arise through a redress mechanism.

ENDS