Submission: Review of the financial system external dispute resolution framework – supplementary issues paper

Australian Timeshare and Holiday Ownership Council

The Australian Timeshare and Holiday Ownership Council (**ATHOC**, **we**, **our**, or **us**) is the industry body for the timeshare industry. ATHOC is a not-for-profit industry body established in 1994 to represent all interests involved in the Australian timeshare industry, and to work toward national industry best practice.

ATHOC operates nationally with an elected board representing a range of membership categories covering resorts, timeshare owners, developers and promoters, marketers, exchange companies and organisations providing professional advice to the timeshare industry.

ATHOC aims to foster a high standard of ethics and adherence to industry best practice amongst its members and to maintain good standing with all stakeholders (by requiring its members to abide by a code of ethics and a code of practice), to continually promote the benefits of the industry and to protect the goodwill of both members and consumers, and to assist members to achieve growth and profitability.

ATHOC's members include several AFS licensees, in particular responsible entities of timeshare schemes and sellers of timeshare and this submission is made on behalf of those members. These licensees are members of either the Financial Ombudsman Service (**FOS**) or the Credit and Investments Ombudsman (**CIO**).

Compensation scheme of last resort

1 The Panel is considering the premise of a compensation scheme of last resort which is to be considered in the context of a dispute which:

(a) has been the subject of a external dispute resolution (**EDR**) scheme decision; and

(b) has remained unsatisfied because, for example, the firm is insolvent, has ceased trading or otherwise has insufficient assets to pay the claim.

2 Though one of the questions posed by the Panel is how such scheme should be funded, ATHOC believes, if a compensation scheme was established, it would invariably be directly or indirectly funded by industry, being AFS licensees who are members of the EDR body. It is primarily because of an industry funded model (which ATHOC submits is the only method by which such scheme would be funded) that ATHOC does not support the proposal to establish a compensation scheme of last resort to the extent such scheme would apply to the timeshare industry.

3 Given ATHOC does not agree with the proposal, we have outlined our position and concerns below, rather than responding separately to each question posed in the supplementary issues paper.

4 ATHOC endorses the concerns with the establishment of a compensation scheme of last resort listed in paragraph 88 of the paper, particularly:

(a) it is inequitable to impose the costs associated with a compensation scheme of last resort on compliant financial firms;

(b) appropriate professional indemnity and capital requirements would reduce the likelihood of unpaid EDRS determinations in the first place and these should take priority; and

(c) any increase in levies or other funding would increase the costs for firms, with many of these costs ultimately borne by consumers.

5 The scope of financial services businesses operated by AFS licensees who are EDRS members is very broad and the risk of failure (and being unable to satisfy an EDR award) varies significantly between different types of AFS licensees and different industries within the financial services sector. Consequently, an industry funded compensation scheme will effectively require 'compliant' AFS licensees to underwrite and be liable for the actions of 'non-compliant' AFS licensees (being a licensee who is unable to satisfy and EDR scheme award) even though a 'non-compliant' licensee may operate a totally different, and potentially 'riskier', financial services business. ATHOC considers such position is unfair and unreasonable particularly for AFS licensees in the timeshare industry given the timeshare industry is significantly different and distinct from the vast majority of the financial services industry, though AFS licensees who operate timeshare schemes or sell timeshare products are regulated as financial services providers.

6 ATHOC reiterates the observations in paragraph 54 of the paper which highlights that ASIC recognises that the compensation and insurance requirements imposed on AFS licensees are not intended to cover all possible consumer losses (nor the other types of loss listed in paragraph 54). AFS licensees are not prudentially regulated and there is a risk that consumers may unfortunately suffer a loss for which they are entitled to be compensation (due to an EDR award) but are unable to recover such amount due to business failure and inadequate insurance. In our view, an industry funded compensation scheme effectively provides the same outcome which prudential regulation is intended to achieve (that consumers are not left with a loss for which they cannot recover compensation due to business failure) in a circumstance where ASIC, as the financial services regulator, does not (and is not intended to) have the same level of oversight and control as a prudential regulator, such as APRA, has over its regulated population. That is, an industry funded model requires 'compliant' AFS licensees to cover losses caused by 'non-compliant' licensees without any change in the regulation of AFS licensees which is intended to reduce the prevalence of 'non-compliant' licensees.

7 The Panel provides a number of examples of compensation schemes for specific losses in the financial system such as the National Guarantee Fund for ASX participants, the Financial Claims Schemes for ADIs and policy holders of APRA-regulated general insurance companies, and part 23 of the *Superannuation Industry (Supervision) Act 1993* which makes provision for the grant of financial assistance to APRA-regulated superannuation funds that have suffered a loss as a result of fraudulent conduct or theft. However, ATHOC notes that Financial Claims Schemes and part 23 of the SIS Act apply to prudentially-regulated participants who are at considerably lower risk of failure than non-prudentially regulated AFS licensees. Similarly, the market participants covered by the National Guarantee Fund are a broadly homogenous population and subject to capital adequacy and other financial conditions and are also subject to a lower risk of failure than AFS licensees, some of whom (such as licensees who are only authorised to provide financial product advice and dealing services) are subject to very minimal and basic financial conditions (e.g. to be solvent and have assets which exceed liabilities).

8 ATHOC notes the Australian Bankers' Association's (**ABA**) submission supports a compensation fund for individuals and small businesses who have received poor financial advice, specifically in relation to personal advice and general advice on Tier 1 products provided to retail clients. While ATHOC agrees such scheme may be appropriate where financial or investment advice has been provided, the application of such scheme to providers of personal financial product advice to retail clients would capture AFS licensees in the timeshare industry. This is because timeshare providers product financial product advice on timeshare schemes (a Tier 1 product), even though timeshare AFS licensees do not product financial or investment advice. Timeshare licensees provide financial product advice in relation to timeshare schemes only, which are a lifestyle product, and do not provide financial or investment advice.

9 ATHOC submits that requiring AFS licensees in the timeshare industry to, as a consequence of such AFS licensees providing financial product advice as defined in the Corporations Act, contribute to a compensation scheme to compensate consumers who have received poor financial and investment advice is unfair and unreasonable given the advice provided by timeshare AFS licensees is considerably different from the advice provided by financial planners and other providers of financial or investment advice.

10 Finally, paragraph 119 of the Panel's paper acknowledges that FOS members involved in non-compliance are not spread evenly throughout different sectors of the financial services industry and the top three categories of non-complaint financial firms are financial planners and advisors (53%), operators of managed investment schemes (13%) and credit providers (11%). ATHOC considers the higher prevalence of financial planners and advisors in part reflects the basic nature of the financial requirements applying to such licensees and consequently their higher risk of failure. ATHOC also believes none of the non-compliant members of FOS or CIO are licensees in the timeshare industry.

11 From ATHOC's perspective, a majority of timeshare industry AFS licensees are categorized as both 'financial advisors' (as they are licensed to provide financial product advice, even though they do not provide financial advice or investment advice and only provide advice in relation to timeshare products) and operators of managed investment schemes (as they are the responsible entities of registered timesharing schemes). As responsible entities, they are subject to net tangible asset and other financial requirements which results in them being in a stronger financial position, and less likely to fail or be unable to satisfy an EDRS award, than a financial adviser or financial planner who is not subject to such conditions.

12 However, if a compensation scheme of last resort applied to all licensees authorised to provide financial product advice, as per the ABA's proposal, it would also apply to AFS licensees who are responsible entities of timeshare schemes. ATHOC submits this would be an inappropriate, unfair and inequitable outcome as:

(a) timeshare licensees only provide advice on timeshare schemes and do not provide financial or investment advice;

(b) many responsible entities in other industries would not be caught as they are not authorised to provide financial product advice (as they do not need to be authorised to provide general advice on their own schemes);

(c) timeshare responsible entities are already subject to net tangible asset and other financial requirements which means they are less likely to be unable to comply with an EDR aware than licensees who are only authorised to provide advice and dealing services, meaning they would

contribute to the scheme but their clients are unlikely to benefit from the scheme though would indirectly bear the cost of contributing to the scheme (as a responsible entity will likely pass this cost to its clients).

Redress for past disputes

13 The Panel is considering the merits and issues involved in providing access to redress for past disputes and identified the following scenarios where such mechanism could apply:

(a) where a financial firm no longer exists (for example, due to insolvency) and therefore the dispute was either never lodged with an EDR scheme or was lodged but was unable to proceed to determination;

(b) the monetary value of the dispute exceeded the EDR scheme's monetary limits at the time but could potentially fall within monetary limits of the new Australian Financial Complaints Authority;

(c) the dispute was outside of the EDR scheme's time limits; or

(d) the consumer or small business did not pursue their dispute with the EDR scheme or for other unspecified reasons.

14 ATHOC does not support providing access to redress for past disputes for these, or other, circumstances. ATHOC considers that such proposal effectively amounts to retrospective regulation which is unfair and unreasonable for EDRS members who complied with the terms of reference of their EDR scheme applying at that time. Proposing a mechanism which enables a consumer to lodge a dispute with an EDR body which was outside the applicable EDR scheme's terms of reference creates uncertainty and undermines the confidence of licensees in the EDR system.

15 Further, a proposal to enable consumers to lodge disputes which are outside of the EDR scheme's time limits is unfair and may impose an unreasonable burden on licensees as they licensee may no longer have the necessary client records (if the records or files have been destroyed as the period of time for which the records are required to be maintained under the Corporations Act or as a condition of an AFSL has expired) or the representatives or staff who dealt with the consumer may cease to be employed with the licensee or may have a limited or no recollection of dealing with the consumer.

16 ATHOC is also concerned that proposal for allowing redress for past disputes may:

(a) increase current insurance premiums as insurers seeks to protect against claims which were not contemplated when premiums were calculated for policies in previous years (for example, as a result of enabling a consumer to lodge a dispute for an amount which was in excess of the monetary claim which applied when the dispute arose); and

(b) result in EDRS awards being made in relation to historical disputes which are not covered by a licensee's insurance due to the time which has elapsed since the dispute arose and consequently the licensee having to fund such payments even though it held the appropriate insurance at all times.

17 ATHOC submits these circumstances are unfair for licensees. While ATHOC agrees an EDR system must strike an appropriate balance between the interests of licensees and the interests of consumers, ATHOC considers providing redress for past disputes constitutes the interests of consumers being preferred to the interests of licensees in an unreasonable manner.