



**Consumer Credit
Law Centre SA**

Legal Advice and Services
Credit • Debt • Financial Counselling

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By email to: EDRreview@treasury.gov.au

EDR Review Secretariat
Financial System Division
Markets Group
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Manager

EDR Review – Supplementary Issues Paper

Thank you for the opportunity to comment on the *Review of the financial system external dispute resolution framework – Supplementary Issues Paper* (May 2017).

A compensation scheme of last resort (**LRCS**) must be established to prevent the well-documented harm caused by uncompensated losses, and to rebuild trust and confidence in Australia's financial system. A LRCS is the missing piece of our financial services regulatory architecture.

A series of financial scandals have left many Australians out of pocket and in some cases, resulted in the loss of the family home or a secure retirement. Scandals have not just occurred in relation to financial advice; many people have suffered uncompensated loss from the mis-selling of complicated investment products, collapse of managed investment schemes and predatory conduct by credit providers. When the loss goes uncompensated, the impact on individuals and families can be severe, with flow-on costs for the community, Government and trust in financial firms.

It is critical that the establishment and design of a last resort compensation scheme builds trust and confidence in the financial sector as a whole. To do so, the compensation scheme must be broad in its scope. It should apply to all financial service providers, including credit licensees and operators of managed investment schemes. The LRCS should be accessible to individuals and small businesses with unpaid external dispute resolution (**EDR**) determinations or a court or tribunal orders. Similarly, all legacy unpaid EDR determinations of the Financial Ombudsman Service (**FOS**) and Credit & Investments Ombudsman (**CIO**) must be paid, either as part of a LRCS or a separate one-off levy on industry.

Consumer Action Law Centre

Level 6, 179 Queen Street
Melbourne Victoria 3000

Telephone: 03 9670 5088
Facsimile: 03 9629 6898

info@consumeraction.org.au
www.consumeraction.org.au

Redress for past disputes is complex but achievable. We support a separate forum for past disputes, funded by industry with a contribution by Government, that is open for applications for a period of at least two years. The forum should consider disputes from at least the last 10 years to capture the harm suffered by victims of financial misconduct who could not recover from firms that collapsed during the Global Financial Crisis and other financial scandals. In the event that the forum is not able to fully compensate all affected consumers, a rationing approach on the basis of financial hardship should apply to ensure compensation for those who need it the most.

About this submission

The following consumer organisations have contributed to and endorsed this joint submission:

- Consumer Action Law Centre
- Financial Rights Legal Centre
- Care Inc Financial Counselling Service and the Consumer Law Centre of the ACT
- Consumer Credit Legal Service (WA) Inc
- Consumer Credit Law Centre SA

More information about the contributors is available at Appendix A.

Contents

Scope and principles.....	3
Existing compensation arrangements.....	3
Evaluation of a compensation scheme of last resort	4
Potential design of a compensation scheme of last resort	8
Claimants.....	10
Process.....	10
Compensation cap	11
Funding.....	11
Administrative arrangements	13
Time limits	13
Legacy unpaid EDR determinations	13
Redress for past disputes	14
Circumstances which have prevented access to redress	14
Approaches to providing access to redress for past matters.....	15
Design issues for providing access to redress for past disputes.....	15
Appendix A: About the Contributors	20

SCOPE AND PRINCIPLES

Question 1: Is the Panel's approach to the scope of these issues appropriate? Are there any additional issues that should be considered?

We support the Panel's approach to the scope of these issues.

Question 2: Do you agree with the way in which the Panel has defined the principles outlined in the Review's Terms of Reference? Are there other principles that should be considered?

We support the principles guiding the review. However, the Panel should be guided by a further principle: effective consumer protection and appropriate compensation.

Current government policy is that consumers should be compensated where there is loss or damage due to breaches of financial services or credit laws. This is implemented through financial services legislation that requires licensed businesses to have arrangements for compensating consumers and through compulsory membership of an external dispute resolution scheme as a licensing condition.¹ This is generally satisfied through the holding of adequate professional indemnity (PI) insurance cover.

Despite the existence of this policy goal, it is clear that the current compensation arrangements for consumers of financial services are inadequate and are not achieving this policy objective. An unknown number of additional consumers suffer loss that is likely to have been caused by misconduct but do not pursue a claim through the courts or EDR.

EXISTING COMPENSATION ARRANGEMENTS

Question 3: What are the strengths and weaknesses of the existing compensation arrangements contained in the Corporations Act 2001 and National Consumer Credit Protection Act 2009 (NCCPPA)?

We support the existing obligations on financial firms to maintain adequate compensation arrangements. However, these arrangements have significant limitations, particularly where the financial firm refuses to honour decisions, engages in phoenixing activity or is insolvent.

The main weakness of the current compensation requirements is the overreliance on PI insurance. A primary reason for failing to pay compensation is that the licensee is insolvent (or missing) and lacks adequate PI insurance. Some of the factors as to why PI insurance cover may not result in consumers receiving compensation include:

- the total funds available under insurance may not cover the full award of compensation;
- insurance may not cover the conduct which is the subject of the award of compensation; and
- the amount of compensation awarded may be below the excess under the insurance policy.

It appears that a key reason for this outcome is a failure in the PI insurance market—the market is not able or willing to deliver affordable policies that cover the risk of all licensees being unable to pay compensation awards. In truth this is a small risk for insurers. However, it is also an unknown risk for insurers, and the response has been to provide only limited cover. For example, PI insurance will not cover some instances that cause consumer loss, such as fraud. Insufficient cover results in the risk of uncompensated loss.

¹ *National Consumer Credit Protection Act 2009* (Cth) s 48; *Corporations Act 2001* (Cth) s 912B. See also <http://asic.gov.au/regulatory-resources/credit/credit-general-conduct-obligations/rg-210-compensation-and-insurance-arrangements-for-credit-licensees>.

The compensation requirements in the credit industry are even weaker than in financial services. Not all credit providers are required to have a PI insurance policy. Unless a credit licensee provides 'credit assistance,' it is merely required to have 'adequate compensation requirements'.

Credit licensees are required to verify their compensation arrangements at the time they apply for their licence, which tends to be a multiple of their average expected loan or lease amount. However, ongoing compliance is only monitored by way of the annual compliance certificate, in which the credit provider self-certifies that they are compliant. The NCCPA requirement for a credit licensee to have 'adequate compensation requirements' is therefore meaningless from a consumer compensation perspective, as the regulator may not discover compensation arrangements are inadequate until after the business becomes insolvent.

Question 4: What are the strengths and weaknesses of the National Guarantee Fund, the Financial Claims Scheme and Part 23 of the Superannuation Industry (Supervision) Act 1993?

The Financial Claims Scheme aims to provide trust and confidence in the banking system. It is funded after the fact, which may be appropriate in a highly prudentially-regulated sector. However, this funding model would not be appropriate in areas like financial advice, managed investments and consumer credit.

Question 5: Are there examples of compensation schemes of last resort that the Panel should be considering?

Beyond those outlined in the Supplementary Issues Paper, we are not aware of any other compensation schemes of last resort that should be considered by the Panel.

EVALUATION OF A COMPENSATION SCHEME OF LAST RESORT

Question 6: What are the benefits and costs of establishing a compensation scheme of last resort?

The primary benefits of a LRCS are:

- to ensure that people who suffer loss due to misconduct by financial firms are justly compensated;
- the avoidance of the economic, social, and health costs of uncompensated losses; and
- improved trust and confidence in the financial system.

The impact of uncompensated losses has been well documented, including in previous consumer submissions to the EDR Review, consumer submissions to and the report of the Richard St John Review, and ASIC Report 240, *Compensation for retail investors: the social impact of monetary loss*.² Uncompensated losses arising from FSP misconduct can cause a range of financial and non-financial losses, including:

- the financial, emotional and social costs to the individual consumer and their family—for example, ASIC Report 240 found that 17% of people affected by uncompensated losses were living below the poverty line and had either lost their home or were perilously close to losing it;
- impact on the community generally, particularly for communities with a significant cluster of victims;

² See joint consumer submission, *Response to the St John Report on Compensation Arrangements for Consumers of Financial Services* (July 2012); Australian Securities and Investments Commission (ASIC), Report 240, *Compensation for retail investors: the social impact of monetary loss* (May 2011).

- costs to the government and community in increased welfare and health services, such as previously self-funded retirees become reliant on the aged pension.

The Murray Financial System Inquiry stated that ‘confidence and trust in the system are essential ingredients in building an efficient, resilient and fair financial system that facilitates economic growth and meets the financial needs of Australians.’³ Uncompensated loss damages this trust and confidence. The damage is exacerbated where the consumer has spent considerable time and energy pursuing a meritorious complaint through an EDR scheme—or worse, through the expensive court process—only to be left uncompensated.

The actual risk of uncompensated loss is small. Compared to the total number of consumers that purchase financial products, only a small number of consumers are affected by uncompensated loss. However, should the loss occur, the impact is generally very substantial. Any last resort compensation scheme would only be called on in a minority of cases—those where loss flows from proven misconduct by a licensee, the licensee then cannot meet the claim and the consumer cannot be compensated through other means.

The establishment of an industry funded LRCS will incentivise more responsible and better resourced firms to monitor other licensees’ behaviour and alert regulators or the LRCS to risks. Moreover, if the scheme is granted powers to assist it to mitigate risk (as we believe it should) then a LRCS will have the scope for further positive impacts on licensee behaviour including helping to avoid or minimise the impact of collapses of under-capitalised licensees. The LRCS could, for example, be empowered to take action to mitigate its risk by introducing soft “prudential measures,” for example by tweaking the capital adequacy requirements in the face of demonstrated problems. The Travel Compensation Fund had powers of this sort. The data and information that could be gathered from a LRCS may help inform regulators and assist in future regulation.

Over time, the additional discipline on the financial sector incentivised by a LRCS may in fact reduce the losses faced by PI insurers and allow premiums to fall.

Question 7: Are there any impediments in the existing regulatory framework to the introduction of a compensation scheme of last resort?

We are not aware of any major impediments. To the extent that any exist, presumably these could be overcome through legislation or by agreement.

Question 8: What potential impact would a compensation scheme of last resort have on consumer behaviour in selecting a financial firm or making decisions about financial products?

The Supplementary Issues Paper refers to the claim that a LRCS may encourage consumers to make riskier decisions in the knowledge that compensation will be available; that is, ‘moral hazard’ may arise.

We reject this concern. Few, if any, consumers understand the detail of regulatory arrangements and the scheme can be designed to minimise this risk. For example, there could be limits to the compensation available through the scheme. The scheme would also be ‘last resort’: a consumer who alleges liability against a licensee would first have to seek a compensation award from a court or external dispute resolution scheme, which involves a significant amount of time, effort and stress. Should the consumer’s behaviour contribute to their loss, the decision-maker will apportion liability accordingly.

³ Financial System Inquiry, Final Report (December 2014) page xv, see: http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf.

The establishment of a LRCS should be accompanied by a targeted communication strategy to consumers, especially marginalised communities and people experiencing vulnerability, to ensure they are properly informed about the scheme. This communication should include information about:

- the function and goals of the scheme;
- eligibility requirements;
- limitation periods; and
- how to access the scheme.

Question 9: What potential impact would a compensation scheme of last resort have on the operations of financial firms?

A further 'moral hazard' argument noted by the Supplementary Issues Paper is that a LRCS may encourage financial firms to engage in riskier behaviour leading to insolvency and, eventually, claims on the scheme.

This risk could be dealt with through a number of design measures. First, the scheme might only make compensation payments on the basis that the claimant assigns their rights against the licensee to the scheme. This would enable the LRCS to pursue recoveries against directors and managers where possible. Second, claiming against the scheme could trigger enforcement investigations against any relevant directors or managers that were involved in misconduct. ASIC's banning power could be used to prevent the possibility of businesses 'phoenixing'.

Rather than create 'moral hazard', the establishment of a LRCS would create both an important constituency for effective reform and a mechanism to identify and perhaps implement reform. More responsible and better capitalised firms (such as the large banks) will want to ensure that the scheme is called on as rarely as possible and will thus have an incentive to advocate for reforms that minimise misconduct. The scheme itself may have a role in monitoring and acting on problems that lead to claims on the scheme.

Question 10: Would the introduction of a compensation scheme of last resort impact on competition in the financial services industry? Would it favour one part of the industry over another?

The introduction of a compensation scheme of last resort will lead to increased consumer confidence in the financial system and therefore increased consumer participation in the market. This is likely to have a broader economic benefit to Australia's financial system.

Question 11: What flow-on implications might be associated with the introduction of a compensation scheme of last resort? How could these be addressed to ensure effective outcomes for users?

A concern has been raised that the establishment of a LRCS will increase the financial burden on industry, which may then be passed on to consumers. We submit that substantial costs should not be passed along to consumers of financial products and services. We consider that effective competition in the market and regulators will have a role in ensuring that financial products and services remain affordable for consumers.

The cost of a LRCS can be minimised by the proper regulation of the financial system. In particular, given that half of unpaid FOS determinations concern financial advice, there should be continued efforts to improve the professional and ethical standards of financial advisors. Government commitments to

enhance the regulatory framework for managed investments should also limit the likelihood of consumer detriment.⁴

Question 12: What other mechanisms are available to deal with uncompensated consumer losses?

Consumers can negotiate directly with a firm or commence court proceedings to recover uncompensated losses. Similarly, consumers who have legacy unpaid EDR determinations may be able to bring an action in court against the firm, provided their claim is within time and the firm is still operating. We note that the EDR scheme may also be able to pursue the firm for breach of contract in failing to pay the award. However, this is of no utility where the firm is insolvent. We refer to Carol's case study in the Joint Consumer Submission to Issues Paper,⁵ where FOS enforced three determinations against a rent-to-buy caryard at the Magistrates Court of Victoria that remain unpaid.

The Government could seek to specify mandatory levels of PI insurance cover to ensure it covered the risk of uncompensated loss. Another alternative is to require licensees to have more stringent capital adequacy requirements that could be called upon. However, both of these options are likely to impose significant costs on industry. Moreover, it is not clear that a private PI insurance market would be willing or able to provide this level of cover. There has been failure in other private last resort insurance markets such as home building warranty insurance in a number of states, where private providers have opted not to provide cover due to uncertainty in pricing for the risk. In comparison, a last resort compensation scheme can operate as an industry-wide insurance mechanism: a comparatively low cost arrangement that can provide cover for a small risk that, if it eventuates, has substantial impacts on individuals and families.

Question 13: What relevant changes have occurred since the release of Richard St John's report, 'Compensation arrangements for consumers of financial services'?

The St John report concluded that the establishment of a statutory compensation scheme for financial services should not be established until other reforms were implemented. We refer to the joint consumer submission in response to the St John report, which disagreed with this conclusion.⁶ If a last resort compensation scheme was established in 2012, as we advocated, the impact of uncompensated losses that have arisen since that date could have been avoided.

Nevertheless, there have been significant changes to consumer protection laws and practice in financial services since the St John report in 2012. For example, the Future of Financial Advice (**FOFA**) reforms that came into effect during 2013 and 2015 had the objective of improving the trust and confidence of retail investors in the financial services sector, and ensure the availability, accessibility and affordability of financial advice.

Similarly, the NCCPA came into force in mid-2010 and placed responsible lending obligations on credit providers. Many of the benefits of these reforms, including improvements in industry practice, would not have crystallized during the St John inquiry. Further obligations were placed on small amount credit

⁴ Australian Government, *Improving Australia's financial system: Government Response to the Murray Financial System Inquiry*, Recommendation 42, available at: http://www.treasury.gov.au/~media/Treasury/Publications_and_Media/Publications/2015/Government_response_to_the_Financial_System_Inquiry/Downloads/PDF/Government_response_to_FSI_2015.ashx.

⁵ Joint consumer submission, *EDR Review – Issues Paper* (10 October 2016) p74, available at: <http://consumeraction.org.au/wp-content/uploads/2016/10/EDR-Review-Joint-consumer-submission-1.pdf>.

⁶ Joint consumer submission, *Response to the St John Report on Compensation Arrangements for Consumers of Financial Services* (July 2012) available at: <http://www.aph.gov.au/DocumentStore.ashx?id=7fffb243-03af-4fe8-8dd8-8ff089759e18&subId=351165>.

providers under the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth). This regulation has led to vast improvement in the behaviour of firms with regard to the provision of credit that is suitable for their clients' needs.

We support the recommendation of the St John report that existing compensation requirements of firms should be strengthened. In our view, this should be implemented alongside the establishment of a LRCS. We consider that the improvement in consumer protection laws, which provide strong rights to dispute resolution, will limit the number of potential claims to the scheme, therefore ensuring that it is financially viable and sustainable.

We also refer to our comments and case study in the joint consumer submission to the EDR Review Interim Report on the need for reforms to lending for investment purposes, including licensing, EDR membership and responsible lending obligations.⁷

POTENTIAL DESIGN OF A COMPENSATION SCHEME OF LAST RESORT

Question 14: What are the strengths and weaknesses of the ABA and FOS proposals?

While we warmly welcome the ABA's support for a compensation scheme of last resort, as outlined further below, the proposal made by FOS is stronger, particularly in respect of its wider scope and capacity to deal with existing uncompensated claims.

Types of claims

Questions 15 and 17: What are the arguments for and against extending any compensation scheme of last resort beyond financial advice? What types of claims should be covered by any compensation scheme of last resort?

The compensation scheme should apply to all licensees, including financial service providers, credit licensees and operators of managed investment schemes, in respect of which there has been a determination in favour of the complainant by an EDR scheme, tribunal or court.

Trust and confidence in the financial sector is low. Scandals have occurred not just in relation to financial advice; many people have suffered loss that remains unremedied from the mis-selling of complicated investment products, collapse of managed investment schemes and predatory credit provision. Indeed, the banking, finance and insurance sectors are perceived to be the least ethical sectors of our economy.⁸ It is critical that the establishment and design of a last resort compensation scheme builds trust and confidence in the financial sector as a whole. To do so, it must be broad in its scope and go beyond financial advice.

For the financial system to achieve its goals of meeting the financial needs of its users, consumers must be treated fairly. As the Panel observed in the Final Report:

Fundamental to fair treatment is the concept that while consumers should generally bear responsibility for their financial decisions and that some losses are inevitable in a market economy, consumers should be able to expect that financial products will perform in the way they are led to believe. To ensure consumers

⁷ Joint consumer submission, *EDR Review – Interim Report* (3 February 2017) p 20, available at: <http://consumeraction.org.au/wp-content/uploads/2017/02/Joint-Consumer-Submission-EDR-Review-Interim-Report.pdf>.

⁸ See Clancy Yeates, *Ethics survey: Banking, media and big business on the nose*, Sydney Morning Herald (20 July 2016) available at: <http://www.smh.com.au/business/banking-and-finance/ethics-survey-banking-media-and-bigbusiness-on-the-nose-20160719-gg9f5h.html>.

are treated fairly and can have confidence and trust in the financial system, they should have access to effective redress.⁹

Access to effective redress for misconduct in the financial system should not depend on whether or not financial advice was involved. From a consumer's perspective, it matters little whether their uncompensated loss arises out of financial advice or another financial product or service—what matters is that despite a meritorious complaint, their loss remains uncompensated.

Only 53% of unpaid FOS determinations were against financial planners and advisors as at April 2017.⁵ If the LRCS is limited to financial advice, nearly half of affected consumers may go uncompensated.

In particular, credit providers and mortgage brokers must be included in the scheme as these types of disputes can often affect particularly vulnerable consumers. We refer to Carol's story in the joint consumer submission in response to the EDR Review Issues Paper.¹⁰ After misconduct by a rent-to-buy caryard, Carol was left without her car, which was sold by the FSP, and without any compensation.

The inclusion of credit disputes in the compensation scheme is unlikely to place an undue burden on industry. Successful credit disputes generally result in a change to the terms of the contract (for example, a hardship variation) or waiver of debt. It is far less common for a determination in a credit dispute to result in an award of compensation to the consumer. However, in circumstances where it does, and in the rare case that the credit provider becomes insolvent or is otherwise unable to pay, that consumer should be entitled to claim compensation from the last resort scheme.

It will also be important for the compensation scheme to be available in relation to other 'product' failures, not just where financial advice was deficient in relation to a product. For example, a dispute may arise where a particular investment product has defective or misleading disclosure and any loss is not caused by advice alone.

The LRCS must also include, or be established in conjunction with, redress for past disputes and existing unpaid determinations.

Question 18: Should any compensation scheme of last resort only cover claims relating to unpaid EDR determinations or should it include court judgments and tribunal decisions?

Access to effective redress should not depend on which forum heard a dispute. The LRCS should cover relevant unpaid compensation awards from EDR schemes, tribunals and courts, including class actions (subject to our comments below on legal costs and claims by litigation funders).

It is important that the design of the scheme does not distort consumer choice about dispute resolution forums. It is rare for a consumer to choose to take their dispute to court instead of the relevant EDR scheme, so the additional burden on a LRCS would be minimal. There are reasons why consumers may want to take their matter to a court. For example, it is a much more transparent forum. Moreover, consumers have a right to take their matter to a court should the EDR scheme not decide in their favour. It may be reasonable, however, to align the claims limit and compensation caps for court awards to that of the corresponding EDR jurisdictional claims and limits.

It might be argued that allowing court awards to be claimable on a compensation scheme of last resort would 'encourage' class actions. This is not a valid concern. First, an effective dispute resolution system should facilitate compensation for all losses. It does not matter whether this loss is remedied through

⁹ *Review of the financial system external dispute resolution and complaints framework: Final Report*, 20 (internal citations omitted).

¹⁰ Joint consumer submission, *EDR Review – Issues Paper*, above n 5, p 74.

an EDR scheme (including through any systemic investigation) or through courts (including through class actions). While an EDR scheme is most often preferable, because a consumer does not have to incur legal costs in obtaining a remedy, there will be occasions where courts are appropriate, including where it is an untested area of law and the EDR scheme refuses to investigate. Second, so as to avoid incentives for private lawyers to advance claims in courts, the scheme could ensure that legal costs are not claimable. In Victoria, the Motor Car Traders' Guarantee Fund does not allow claims for legal costs or loss of wages as a result of pursuing the matter against a licensed motor car trader.

Question 21: If a compensation scheme of last resort was established and it allowed individuals with a court judgment to access the scheme, what types of losses or costs (for example, legal costs) should they be able to recover?

As a general principle, the LRCS should cover the loss suffered, including legal costs. However, if it is necessary to the viability of the scheme, we would support legal costs being excluded. We refer to our response to Question 18.

Claimants

Question 16: Who should be able to access any compensation scheme of last resort? Should this include small business?

Our primary concern is that the LRCS provides access to affected individuals. However, there is no reason in principle for small businesses to be excluded. Financial counsellors often receive calls from people in financial difficulty that have a mix of personal and small business loans. In our experience, many people with small business loans:

- can be as unsophisticated in financial and legal matters as any individual consumer;
- hold very little bargaining power in negotiating products and services contracts; and
- are often asked to sign non-negotiable standard form contracts.

Careful consideration would need to be given to the definition of 'small business' to ensure that it is clear and appropriate.

Question 22: Should litigation funders be able to recover from any compensation scheme of last resort, either directly or indirectly through their contracts with the class of claimants?

If it is necessary to the viability of the scheme, we would support an approach that excludes litigation funders from claiming directly on a LRCS.

Process

Question 19: What steps should consumers and small businesses be required to take before accessing any compensation scheme of last resort?

The process should be as seamless as possible from the consumer perspective. Where the firm is insolvent at the time of the determination or award, the consumer should proceed directly to the compensation scheme. The consumer should only have to notify the scheme that the compensation award remains unpaid. The scheme itself should conduct the relevant checks to verify a firm's inability to pay.

The LRCS should not require, as a precondition of compensation, that the EDR scheme has taken legal action to enforce its determination. Any such requirement would simply delay compensation for the consumer and add further cost for the EDR scheme and, in turn, industry. However, the EDR scheme's

right to take legal action under the tripartite agreement to enforce its determination could be transferred to the last resort compensation scheme after the consumer has been compensated. That is, the LRCS could recover from the financial firm on a subrogated basis.

The LRCS should have the right to identify PI insurers and recover monies from them when an insured financial firm fails to pay and the LRCS has to compensate the complainant.

Since our last submission to the EDR Review, we have become aware of the direct recourse provisions that apply in New South Wales, which allow a court to order that the PI insurer pay the benefit of a claim to the consumer complainant. Under section 1(a) of the *Civil Liability (Third Party Claims Against Insurers) Act 2017* (NSW), if an insured person has an insured liability to a person (the claimant), the claimant may recover the amount of the insured liability from the insurer in proceedings before a court. This provision was implemented following the NSW Law Reform Commission's Report 143, *Third Party Claims on Insurance Money*.¹¹

This approach is preferable for two reasons. First, it will assist the LRCS to recover directly from the relevant PI insurer the compensation that the scheme has paid out to the consumer, which will reduce the cost of the scheme. Secondly, it will streamline the process for consumers and ensure the process is as timely and stress-free as possible. It can often be very challenging for consumers to pursue a PI claim, or even ascertain the relevant PI insurer.

Alternatively, the EDR scheme could require the firm to disclose its PI insurer prior to a determination being made or even join the PI insurer to the dispute.

Question 20: Where an individual has received an EDR determination in their favour, should any compensation scheme of last resort be able to independently review the EDR determination or should it simply accept the EDR scheme's determination of the merits of the dispute?

No. Any independent review of an EDR determination by a LRCS will only increase delay, administration costs and complexity, with no clear policy benefit. Consumer advocates strongly support the existing decision-making criteria of the FOS and CIO.

Compensation cap

Question 23: What compensation caps should apply to claims under any compensation scheme of last resort?

As a general principle, a consumer should be able to recover their loss as awarded by the EDR determination or tribunal or court order. However, if a compensation cap is necessary, then it should be no less than the compensation cap for the relevant EDR scheme.

Funding

Question 24: Who should fund any compensation scheme of last resort?

A LRCS should be funded by industry. All industry participants should contribute to the funding of the scheme.

¹¹ NSW Law Reform Commission, *Third Party Claims on Insurance Money: Review of s 6 of the Law Reform (Miscellaneous Provisions) Act 1946* (Report 143) available at: <http://www.lawreform.justice.nsw.gov.au/Documents/Publications/Reports/Report%20143.pdf>.

We recognise that the funding mechanism is perhaps the most controversial part of a new scheme. In particular, some large institutions may argue that they should not contribute to the cost of the scheme, as they are able to compensate their customers for any loss. There are a number of reasons that the industry broadly should contribute to the cost of the scheme.

First, it must be acknowledged that many of the financial advice scandals have been the result not only of poor financial advice, but also financial products that have not been appropriate to the needs of consumers. Those products are, for the most part, designed and/or distributed by larger better capitalised industry participants. Large participants also benefit from the sales activities of smaller financial advisers when they provide finance to investors. Given the integrated nature of the financial services sector, it makes sense that all levels of the supply chain should contribute, including product issuers.

Second, large product manufacturers have not experienced significant penalties as a result of their involvement in financial advice misconduct. The Murray Financial System Inquiry recognised that the penalty regime is low in Australia comparatively to other jurisdictions, and that it should be reviewed. In the United Kingdom, for example, penalties available to the Financial Conduct Authority are unlimited, and in recent years that have been a number of instances of multi-million pound penalties. In this context, it is not unreasonable to expect all licensees in Australia to contribute to compensating uncompensated loss caused by financial misconduct.

Question 25: Where any compensation scheme of last resort is industry funded, how should the levies be designed?

The levies should be financially sustainable, provide stability to the scheme and ensure adequate coverage. One model that could be adopted is the ASIC Industry Funding Model.

Question 26: Following the payment of compensation to an individual, what rights should a compensation scheme of last resort have against the firm who failed to pay the EDR determination?

The LRCS should have full rights of subrogation against the financial firm, like the Travel Compensation Fund. We refer to our comments in response to Question 19 in relation to PI insurance.

Question 27: What actions should ASIC take against a firm that fails to pay an EDR determination or its directors or officers?

The LRCS should be required to notify ASIC when a firm fails to pay a determination or tribunal or court award. The LRCS could also be required to report systemic issues and serious misconduct to ASIC.

When ASIC becomes aware of the failure to pay a determination, it should promptly investigate the matter. The firm will not be compliant with the terms of its EDR membership and should be expelled from the scheme. Where the firm is required to be a member of the EDR scheme as a condition of its licence, its licence should be revoked.

There should be clear triggers for ASIC to take action against all directors or managers of firms that have unpaid determinations, including curtailing their ability to be a director or officer of a new company. This would incentivise compliance with the laws, reduce the incidence of phoenixing activity and ultimately reduce calls on a LRCS.

We recommend that the regulators be adequately resourced to investigate and enforce breaches of the obligations in the NCCPA and *Corporations Act 2001*. Licensees with questionable business models or practices are likely to end up insolvent or deregistered, with consumers left with no access to

compensation. Earlier intervention by the regulator can reduce the number of people ultimately affected by systemic misconduct, and thus reduce calls on a LRCS.

Administrative arrangements

Question 28: Should any compensation scheme of last resort be administered by government or industry? What other administrative arrangements should apply?

A LRCS should be administered by industry with regulatory oversight. We support the governance framework of the existing EDR schemes in financial services, with an independent chair and an equal number of directors from industry and consumer backgrounds. We agree with the findings of the EDR Review Final Report on the benefits of this model, which allows flexibility and deep engagement by the board. Alternatively, if the scheme is to be administered by Government, it should ensure that suitably qualified people with industry and consumer backgrounds are equally involved in the governance.

Time limits

Question 29: Should time limits apply to any compensation scheme of last resort?

Time limits should apply to give certainty to the scheme and allow it to recover, where possible, from the non-compliant financial firm or PI insurer.

We consider that the appropriate time limit for applications to the LRCS is 6 years from the date of the EDR determination or court or tribunal order.

It is essential that consumers know about the existence of the scheme, and the relevant time limit. The EDR scheme, tribunal or court should bring the existence of the LRCS and the relevant time limit to the attention of the consumer at the time of the determination or court order. The LRCS should also engage in community outreach and education.

Question 30: How should any compensation scheme of last resort interact with other compensation schemes?

In the unlikely event that a consumer has a claim for which they are able to access two or more compensation schemes, the consumer should only be able to recover their loss from one scheme. The LRCS should provide information for consumers about what other schemes are available, to help consumers identify the appropriate compensation scheme for their dispute.

LEGACY UNPAID EDR DETERMINATIONS

Question 33: Is there a need for an additional mechanism for those with legacy unpaid EDR determinations to receive compensation? If so, who should fund the payment of the legacy unpaid EDR determinations?

It's essential that legacy unpaid EDR determinations are paid. This is a key problem that continues to reduce trust and confidence in the EDR framework and the financial system generally, particularly where people have invested time, energy and money into dispute resolution process that has been futile.

We support the proposal made by FOS for all unpaid determinations and decisions made since the establishment of the FOS on 1 July 2008 to be included in any scheme of redress.

Legacy unpaid EDR determinations should be paid by industry, either as part of a LRCS or by a separate levy on industry. We also refer to our comments in response to Question 24.

One option is to use some of the proceeds from the Major Bank Levy. This levy applied from 1 July 2017 and is estimated by Treasury to raise \$6.2 billion over the next four years.¹²

EDR schemes and the LRCS should take active steps to advise all consumers with a legacy unpaid EDR determination about the availability of, process to obtain, compensation.

REDRESS FOR PAST DISPUTES

Circumstances which have prevented access to redress

Question 34: Other than circumstances that may be covered by a compensation scheme of last resort (such as outstanding unpaid determinations), what kinds of circumstances have given rise to past disputes for which there has not been redress? Are there any other classes besides those identified by the Panel?

Additional circumstances leading to consumers being unable to seek redress include:

- where a firm is trading while unregistered or unlicensed, and is therefore not required to be a member of an EDR scheme;
- where a firm has been expelled from an EDR scheme and has not become a member of the alternative scheme;
- where a consumer has commenced a dispute in EDR, but the EDR scheme did not make a determination prior to the member leaving or being expelled from the EDR scheme;
- where a firm has closed down (not necessarily becoming insolvent) and is uncontactable; and
- where predatory business models emerge to exploit gaps in the regulatory framework, such as debt management firms. We refer to our comments in previous submissions to the EDR Review on the lack of effective redress for misconduct by debt management firms and debt agreement administrators, which are very poorly regulated by the *Bankruptcy Act 1966* (Cth).¹³

Question 35: What evidence is there about the extent to which lack of access to redress for past disputes is a major problem?

The problem of uncompensated losses has been known for a long time, and is well documented in many reviews, inquiries, and reports that have examined this issue. From the perspective of the people affected, the impact of uncompensated losses due to financial misconduct is a major problem.

It is clear that there have been barriers to effective redress for financial misconduct in the past. The Panel's Final Report found that the monetary limits of the existing EDR schemes have been too low for far too long, preventing redress. For people with claims exceeding the monetary limits of EDR scheme, generally the only other option was to take their dispute to court. But where the financial firm was insolvent, this avenue was futile, and likely to incur further loss for no gain. Disputes against Holt Norman Ashman Baker are but one example.

Unpaid EDR determinations are further evidence of barriers to effective redress. Even in the short time since the commencement of this Review, more firms have failed to comply with EDR determinations.

¹² The Hon Scott Morrison MP, Media release: *Turnbull Government delivers on Major Bank Levy* (20 June 2017) available at: <http://sjm.ministers.treasury.gov.au/media-release/055-2017/>.

¹³ Joint consumer submission, *EDR Review – Issues Paper*, above n 5, p 59; Joint consumer submission, *EDR Review – Interim Report*, above n 7, p 22-3.

For the period January to March 2017, three new financial service providers have been added to FOS's list of non-compliant firms for failing to comply with eight determinations.¹⁴

Approaches to providing access to redress for past matters

Questions 37, 39, 41: What are the benefits and costs associated with providing access to redress for past disputes? What impact would providing access to redress for past disputes have on the operations of financial firms? Would there be any flow-on implications associated with providing access to redress for past disputes? How could these be addressed in order to ensure effective outcomes for users?

On the necessity and benefits of providing redress for uncompensated losses, we refer to our response to Question 6.

We note the concerns outlined in the Supplementary Issues Paper about introducing a process of redress for past disputes. A key issue is that a large and unknown number of disputes may need to be handled in a relatively short period of time. This can be managed by properly designing and funding the past disputes forum at the outset to ensure a significant number of disputes can be progressed simultaneously. Another issue is the potential cost of a large number of determinations and how this interacts with the compensation scheme of last resort. These concerns can be managed by:

- an application window of at least two years which will ensure an end date for past disputes to be ventilated;
- clear eligibility criteria that enables industry to gauge the size of potential claims;
- capping the value of disputes and rationing claims, with a focus on providing redress to those who are or have experiencing financial hardship; and
- properly resourcing the compensation scheme of last resort at the outset so that a spike in determinations for past disputes can be paid, if required.

Ensuring the scheme is not overwhelmed with inappropriate past disputes can be managed by:

- community education and plain language information about eligibility and process;
- a warm referral process from consumer advocates; and
- a system to check the eligibility of disputes up front.

Other considerations may arise depending on the types of past disputes made eligible for redress. For example, where the firm is insolvent, consideration will need to be given to how these matters will be determined in light of limited documentary evidence.

Question 38: Are there any legal impediments to providing access to redress for past disputes?

To the extent that legal impediments exist, presumably these can be overcome through the passage of legislation or agreement by industry.

Design issues for providing access to redress for past disputes

Question 42: What are the strengths and weaknesses of the Westpac proposal?

Broadly, we support any effort by industry to compensate victims of misconduct. The major limitation of the Westpac proposal is that it appears to be related to misconduct by banks. This would appear to

¹⁴ FOS, *The FOS Circular – Unpaid determinations update*, Issue 29 (April 2017) available at: <http://www.fos.org.au/fos-circular-29-home/fos-news/unpaid-determinations-update.jsp>.

exclude uncompensated victims of misconduct by financial advisors, non-bank credit providers and others from redress. We refer to our comments on the need for a broad scheme in response to Questions 15 and 17.

Question 43: What range of parties should be provided with access to redress for past disputes? Should all of the circumstances described in paragraphs 133-144 be included?

As a guiding principle, to the extent that it is not possible to fully compensate all claimants, we strongly recommend that claims be prioritised on the basis of hardship.

Circumstance	Comments
Financial firm insolvent or otherwise unable to pay	<p>The past disputes forum should provide redress in this circumstance. Where the matter is within time, it should be resolved through the ordinary EDR process, not the past disputes forum. In light of the proposed compensation scheme of last resort, EDR schemes should consider disputes even where the firm is insolvent, is not participating in the dispute resolution process or is otherwise unable to pay.</p>
Monetary value too large	<p>The past disputes forum should provide redress in this circumstance. It may be appropriate to cap the amount of compensation at the relevant EDR compensation cap that applied at the time the cause of action arose. This would ensure that consumers in this category are in no better position than consumers who compromised the value of their claim to go to EDR (i.e. to bring their claim within the relevant EDR limits).</p> <p>Alternatively, the forum should have a discretion to allow redress in exceptional circumstances, such as where the person is experiencing financial hardship.</p>
Monetary value too high but within the limits of the new Australian Financial Complaints Authority (Question 49)	<p>The past disputes forum should provide redress in this circumstance. It may be appropriate to cap the amount of compensation at the relevant EDR compensation cap that applied at the time the cause of action arose. This would ensure that consumers in this category are in no better position than consumers who compromised the value of their claim to go to EDR (i.e. to bring their claim within the relevant EDR limits).</p> <p>Alternatively, the forum should have a discretion to allow redress in exceptional circumstances, such as where the person is experiencing financial hardship.</p>
Outside EDR time limits	<p>The past disputes forum should provide redress in this circumstance. We note that many of the legacy uncompensated losses arise out of the Global Financial Crisis in 2007-08. We refer to our comments on time limits below.</p> <p>Alternatively, the forum should have a discretion to allow redress in exceptional circumstances, such as where the person is experiencing financial hardship.</p>

Circumstance	Comments
The firm was not in EDR when they ought to be	<p>The past disputes forum should provide redress in this circumstance. Where the firm was not an EDR member but ought to have been (for example, where the firm was unlicensed, was excluded from EDR or let its membership lapse), the consumer's only recourse was legal action in a court or tribunal. To put consumers in the position that they would have been but for the firm's misconduct, these consumers and small businesses should have access to a past disputes forum if they have uncompensated losses.</p> <p>Alternatively, the forum should have a discretion to allow redress in exceptional circumstances, such as where the person is experiencing financial hardship.</p>
Other reasons	<p>The past disputes forum should provide redress in this circumstance. However, if it is not possible to fully compensate all claimants, it may be appropriate that claimants in this category receive lower priority.</p> <p>Alternatively, the forum should have a discretion to allow redress in exceptional circumstances, such as where the person is experiencing financial hardship.</p>

Question 45: What time limits should apply?

For many years, consumer advocates have strongly supported a retrospective compensation scheme of last resort. As new consumer protections such as the FOFA reforms have only recently been implemented, to be effective and go some way towards restoring the lost consumer confidence in the financial system, the scheme needs to address problems created in the last ten or more years that still have not been addressed by major financial institutions.

We support the following time limits:

- an application window of at least two years to lodge past disputes. To ensure accessibility, there would need to be extensive community education about the process for redress, including appropriate advertising, communication with key agencies assisting consumers in financial distress and outreach to particularly vulnerable communities, such as remote Aboriginal communities.
- in terms of the age of the dispute, we propose the following:
 - matters within time for EDR are ineligible and must be lodged in EDR in the usual way.
 - matters outside the time limit for EDR can be lodged, but only where the cause of action arose within at least 10 years.

Many of the losses caused by financial misconduct went uncompensated when firms collapsed due to the Global Financial Crisis in 2007-08. If the aim of redress for past disputes forum is to provide justice to victims of financial misconduct, and to restore the lost trust and confidence in the financial system, then the past disputes forum must reach back that far.

This timeframe is also consistent with the payment of legacy unpaid EDR determinations dating back to 2008. This consistency is important for people who did not or could not pursue action at the time because they were advised by lawyers or EDR scheme itself that any claim would be futile. These people should not be in a worse position than those who pursued an (ultimately unpaid) EDR determination against the same firm.

Question 45: Should any mechanism for dealing with past disputes be integrated into the new Australian Financial Complaints Authority (once established) or should it be independent of that body?

The past disputes forum should be an independent body or, alternatively, a separate part of the new EDR scheme until all claims are finalised.

Question 47: Who should be responsible for funding redress for past disputes? Is there a role for an ex gratia payment scheme (that is, payment by the Government)?

Generally, redress for past disputes should be funded by industry. However, it may be appropriate for the Government to contribute to funding redress for past disputes, particularly in light of the regulatory framework that enabled the collapse in forestry managed investment schemes. The harm caused by the collapse of Timbercorp and others is well-documented.¹⁵ Tax rules created by the Government facilitated agribusiness managed investment schemes. As the Senate Economics Committee noted in its report, the tax advantage for these schemes 'was a factor and certainly a major plank in the marketing strategy for these products.'¹⁶ Similarly, the Committee found that regulators and government must share responsibility for the harm caused by these failed schemes, given their lack of decisive action in monitoring the marketing and performance of the schemes.¹⁷

Redress for past disputes will also provide a wider benefit to the community in reduced calls on social security, health and other welfare services as a result of uncompensated losses.

One option is to use some of the proceeds from the Major Bank Levy. This levy applied from 1 July 2017 and is estimated by Treasury to raise \$6.2 billion over the next four years.¹⁸

We also refer to our comments in response to Question 24.

Question 48: Should there be any monetary limits? If so, should the monetary limits that apply be the EDR scheme monetary limits?

As a general principle, the past disputes forum should compensate people for the loss suffered. Alternatively, if a monetary limit is to apply, it should be not less than the relevant EDR limit that applied at the time that the cause of action arose.

Question 49: Should consumers and small businesses whose dispute falls within the new (higher) monetary limits of the proposed Australian Financial Complaints Authority but was outside the previous limits be able to apply to have their dispute considered?

Please refer to the above table.

Question 50: If it is not possible to fully compensate all claimants, should a 'rationing' mechanism be used to determine the amounts of compensation which are awarded? Should such mechanism be based on hardship or on some other measure?

Yes, if it is not possible to fully compensate all claimants, a rationing mechanism based on financial hardship should be used to determine the amount of compensation awarded.

¹⁵The Senate, Economics References Committee, *Agribusiness Managed Investment Schemes: Bitter Harvest*, available at: http://www.afc.gov.au/Parliamentary_Business/Committees/Senate/Economics/MIS/Report/b03.

¹⁶ Ibid xxii.

¹⁷ Ibid xxiv.

¹⁸ The Hon Scott Morrison MP, above n 12.

We would be pleased to discuss the issues addressed in this submission in further detail. Please contact Policy Officer Cat Newton at Consumer Action Law Centre on 03 9670 5088 or at cat@consumeraction.org.au if you have any questions about this submission.


Yours sincerely



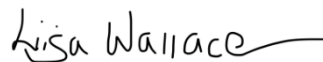
Gerard Brody
Chief Executive Officer
Consumer Action Law Centre



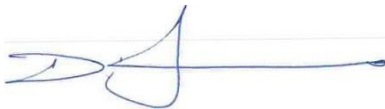
Karen Cox
Coordinator
Financial Rights Legal Centre



Gemma Mitchell
Acting Centre Manager and Principal Solicitor
Consumer Credit Legal Service (WA) Inc



Liisa Wallace
Financial Counsellor and Policy Officer
**Care Inc Financial Counselling Service and
the Consumer Law Centre of the ACT**



David Ferraro
Managing Solicitor
Consumer Credit Law Centre SA

APPENDIX A: ABOUT THE CONTRIBUTORS

Consumer Action Law Centre

Consumer Action Law Centre is an independent, not-for-profit consumer organisation based in Melbourne. We work to advance fairness in consumer markets, particularly for disadvantaged and vulnerable consumers, through financial counselling, legal advice and representation, and policy work and campaigns. Delivering assistance services to Victorian consumers, we have a national reach through our deep expertise in consumer law and policy and direct knowledge of the consumer experience of modern markets.

Financial Rights Legal Centre

Financial Rights is a community legal centre that specialises in helping consumers understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the NSW answer point for the National Debt Helpline, which helps consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies. Financial Rights took over 25,000 calls for advice or assistance during the 2015/2016 financial year.

Care Inc Financial Counselling Service and the Consumer Law Centre of the ACT

Care Inc. Financial Counselling Service has been the main provider of financial counselling and related services for low to moderate income and vulnerable consumers in the ACT since 1983. Care's core service activities include the provision of information, counselling and advocacy for consumers experiencing problems with credit and debt. Care also has a Community Development and Education program, provides gambling financial counselling, outreach services in the region and at the Alexander Maconochie Centre, and operates the ACT's first No Interest Loans Scheme, established in 1997, and makes policy comment on issues of importance to its client group.

Consumer Credit Legal Service (WA) Inc

Consumer Credit Legal Service (WA) Inc is a not-for-profit charitable organisation which provides legal advice and representation to consumers in WA in the areas of credit, banking and finance, and consumer law. CCLSWA also takes an active role in community legal education, law reform and policy issues affecting consumers. In the 2015 / 2016 financial year, CCLSWA provided comprehensive legal advice to 1350 clients on 1424 matters.

Consumer Credit Law Centre South Australia

The Consumer Credit Law Centre South Australia was established in 2014 to provide free legal advice, legal representation and financial counselling to consumers in South Australia in the areas of credit, banking and finance. The Centre also provides legal education and advocacy in the areas of credit, banking and financial services. The CCLCSA is managed by Uniting Communities who also provide an extensive range of financial counselling and community legal services as well as a large number of services to low income and disadvantaged people including mental health, drug and alcohol and disability services.