From the Desk of Director Andy Semple

Association of Securities & Derivatives Advisers of Australia

25th September 2017

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Phone: +61 2 6277 3540
Fax: +61 2 6277 5719

Submission sent via the website and cc'd to economics.sen@aph.gov.au

Treasury Laws Amendment (Putting Consumers First—Establishment of the Australian Financial Complaints Authority) Bill 2017

SUBMISSION BY THE ASSOCIATION OF SECURITIES AND DERIVATIVES ADVISERS OF AUSTRALIA - ASDAA

The Association of Securities and Derivatives Advisers of Australia (ASDAA) appreciates the opportunity to provide feedback on the Bill and accompanying regulations.

ASDAA represents the interests of its members, who are from the Securities and Derivatives advisory profession.
Its members are comprised of individuals who are either directors, or employees, of small to medium sized firms which hold an Australian Financial Services Licence (AFSL), but are not a Participant Member of the Australian Stock Exchange.

ASDAA has a strong desire to see that investor's receive sound investment advice and the appropriate investor protection. ASDAA members rely on the ongoing trust of their clients, and on the integrity of the Australian financial markets, for their livelihood. Without both, our clients wouldn't participate in the markets and trade in securities, exchange traded options, and other listed financial products.

ASDAA
ASDAA is the trading name of the Association of Securities & Derivatives Advisers of Australia Ltd
A.C.N. 609 160 321
309 2-4 Creek Street COOLANGATTA QLD 4225 - PO BOX 1323 COOLANGATTA QLD 4225
Telephone 07 5657 3620 Fax 07 5657 7017 Web: www.asdaa.com.au

ASDAA is not supportive of the creation of the Australian Financial Complaints Authority or AFCA.

Industry already has its own nick name for AFCA – *Frank*.
Frank is short for Frankenstein because that is precisely what AFCA is – a juggernaut Frankenstein-like aggressive consumer advocate granted with massive judicial like powers without sufficient oversight.

As we stated in previous submissions, ASDAA is very disappointed the Ramsay Review has given ZERO consideration in both of their interim and final reports on how to help reduce EDR red tape and lower the EDR cost to the FSP's (Financial Service Providers).
Everything presently on the table represents increased red tape and will put significant upside pressure on higher EDR membership and dispute fees to FSP's.

Furthermore, it is just mind boggling that the Ramsay Review failed to conduct any sort of cost benefit analysis in replacing CIO, FOS and the SCT with AFCA.

The numerous shortcomings of the current EDR bodies, FOS and CIO, have been completely ignored by the Ramsay Review (and the Government) and sadly are now firmly part of the DNA of AFCA.

AFCA is a rebadging exercise that achieves nothing – just like moving the deck chairs on the Titanic.
AFCA is nothing more than a political announcement and the appearance of action because of Government inaction to hold a Royal Commission into the Banking sector. It's no surprise the big banks have endorsed the Government's new EDR creation.
If anyone in Government thinks AFCA will weed out the disgraceful and entrenched poor corporate bank culture or even come close to addressing the long list of financial scandals is deluded. Only a Royal Commission can do this. AFCA has zero investigative powers and is completely powerless and toothless to prevent the re-occurrence of financial scandals.

All our previous correspondence to Treasury with regard to the current and new EDR framework are enclosed as appendices to this submission.

> **Review into the External Dispute Resolution & Complaints Framework** – Published 4 Oct 2016.
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> **Interim Report Review into the External Dispute Resolution & Complaints Framework** – Published 19 Jan 2017.
>
> **The External Dispute Resolution & Complaints Framework** – Published 14 Jun 2017

ASDAA strongly encourages all Senate committee members to read the aforementioned submissions as our submissions clearly identify significant flaws with the EDR process.

Aspects of the bill that concern the members of ASDAA

1.36 AFCA's determinations of superannuation complaints will be subject to appeal to the Federal Court on a question of law.

ASDAA recommend that provisions which apply to superannuation complaints within the Bill are extended to apply to **all disputes**. Proposed section 1057(3) requiring that all decisions must not be contrary to the law and proposed sections 1056 and 1061(1) providing for appeal to the Federal Court on questions of law should be extended to **all disputes**.

There is no reason why these very important "rule-of-law" provisions should be limited to Superannuation only complaints.

1.48 The scheme's operations must be financed through contributions made by members of the scheme, with the funding arrangements to be determined by the board of the operator of the scheme;

ASDAA recommend that the initial compulsory membership fees payable by small FSP's be fixed for a period of three years and the membership fee be no higher than what present EDR bodies FOS and CIO presently charge.

1.50 Appropriate expertise must be available to deal with complaints;

ASDAA recommend that the AFCA should ensure that the Case Managers who are assigned to assess a Securities/Stockbroking dispute hold a relevant University degree and have also had at least three years relevant work experience in the Securities/Stockbroking industry.
Compulsory FSP members need to have the faith that the AFCA individuals assigned to case manage a Securities/Stockbroking dispute also have relevant practical experience in the area they will be assessing.

If the single EDR body needs to hire such expertise then they should be made to hire in the expertise.
It is ASDAA's opinion that inexperienced and unqualified Case Managers form opinions on what experienced and qualified Securities and Derivatives professionals should have done with the added benefit of hindsight. We lack any confidence that AFCA will be any different to the beasts they are replacing (FOS & CIO).
Just because the AFCA Case Manager has a Law degree doesn't equip them to make judgements on what a qualified Securities and Derivatives professional standard of advice and care should be.

Just imagine the outcry if this happened in other professions say Medicine or Accounting or in the Federal Bureaucracy?

Law degrees do not include training in Medicine, Accounting or Securities and Derivatives Advisory.

1.57 Time limits for bringing complaints under the scheme;

Anyone who invests their money into listed equities, whether they received personal advice or general advice, needs to understand and accept that the value of their equity portfolio can not only go up in value but that it can decline in value. This point is highlighted in writing, and verbally, to the clients of FSP'S before commencing any market trading activity.

Market risk obviously does exist, but the current EDR complaint structure does not seem to be able or willing to differentiate between "market risk" and "inappropriate advice" when accepting complaints to pursue.

FOS, for example, encourages a consumer (a disgruntled investment client) to make a complaint of economic loss on the basis of "inappropriate advice" within **6 years** of when the consumer **first became "reasonably" aware** of such "economic loss."

This extended time period is grossly unfair to the adviser and their FSP, as it enables clients to "test" their adviser's recommendation over a significant length of time (6 years), and if the investment falls in value it can be pursued as "inappropriate advice" by a client years after the advice has been received and acted upon.

It is ASDAA's position that the committee consider reducing the statute of limitations to make such a complaint of "inappropriate advice" from the ***Investments and Advice*** **product line** expire **6 months** after the date of purchase of a listed equities and derivatives transaction.

It is vital this amendment is incorporated into AFCA's ToR (Clause 15.2 of FOS' ToR is the point example).

It is extremely prejudicial that a consumer can have virtually an uncapped statute of limitations to make a complaint on the grounds of "inappropriate advice."

It should also be acknowledged that there is no legislative "Cooling Off" period for anyone who buys and sells listed securities and derivatives.
ASDAA knows of no other profession that faces such a generous statute of limitations. It is unique to all FSP's.

Preservation of capital in the stock market is not guaranteed and this is generally well understood and acknowledged by the vast majority of investors. By allowing consumers to lodge a complaint about economic loss on the pretence of receiving "incorrect or inappropriate advice" as determined by an AFCA Case Manager is implying that such a guarantee does in fact exist.

2.8 The enhanced IDR framework will also require IDR Firms to report their IDR activities in accordance with ASIC requirements. ASIC will be provided with the power to determine the content and form of IDR reporting by IDR Firms.

2.12 ASIC will also be provided with additional powers to determine the content and form of IDR reporting by IDR Firms and to publish this data at both the aggregate and firm level.

It is ASDAA's position that the last thing any FSP needs is more bureaucratic red tape and this recommendation delivers more red tape in spades.

FSP's are made up from "one man band" firms through to massive global investment/insurance conglomerates so there is no "one size fits all" IDR scheme to follow, as no one business is alike. There are small firms who deal in highly complex financial areas like Derivatives, while some large firms deal in relatively easy to understand financial areas like basic deposit products.

All AFS Licensees, regardless of their size, have the following condition noted on their license:

> **Compliance Measures to Ensure Compliance with Law and Licence**
> *The licensee must establish and maintain compliance measures that ensure, as far as is reasonably practicable, that the licensee complies with the provisions of the financial services laws.*

And all licensees are required to maintain a ***breach and complaints registers***, which must be reviewed by the FSP's external Compliance Auditor.

Licensees are already obligated to inform ASIC should a significant and material breach occur i.e. Fraud.

Under RG165, all licensees must have in place a process to try and resolve disputes internally. ASIC sensibly have left it up to the particular licensee to self-determine what their IDR process is. **The last thing any FSP wants is for an ASIC bureaucrat to determine what the content and format of IDR reporting should be**.

Moreover, AFCA will have the power to report to ASIC any form of "systemic" risk they may determine as a FSP goes through their respective EDR process. So any further bureaucratic impost is certainly not welcome.

Furthermore, if it's the Ramsay Reviews concern that because there is a lack of publically available IDR information that it could possibly lead to FSP's being able to hide from scrutiny any internal shortcomings let ASDAA explain to the Committee the three contemporaneous external audit processes each and every licensee, regardless of their business size, face annually.

Each FSP that holds an AFS License **must;**

1. Be financially audited by an ASIC noted Financial Auditor.
2. Have and external compliance review that is audited by a suitably qualified External Compliance Auditor.
3. Obtain a PI insurance policy with a min cover of $2.5 million which will only be considered by a reputable PI insurer once they have obtained a current copy of both the Financial and Compliance Audit.

All of these costs are 100% borne by the FSP. ASDAA would like to note that the costs of these audits are substantial in nature to the FSP, and especially to the small business FSP's, who has no capacity to pass the cost onto their clients in the current marketplace.

For example, an FSP with revenue in the vicinity of one million dollars per annum would be paying a financial audit fee of approximately $15,000, a compliance audit fee of approximately $15,000 and PI plus Director's insurance premiums of approximately $35,000 per annum (These PI fees are significantly higher for FSP's who had even minor EDR settlement payouts by their insurer). They would also face a substantial Accountants cost because they must provide special purpose accounts for the FSP's Auditor.

ASDAA can't see why a licensee's privacy should be waived so that ASIC can save in a database some more insignificant statistical information. ASIC already have the power to walk into any licensees place of business and demand the FSP turn over any requested information should the need arise.

What matters here are hard results. If a licensee and a complainant can come to an agreeable settlement via IDR then that's the best outcome, and is it then really anyone else's business to know what happened? If IDR fails, then that's what EDR schemes are set up for – to hopefully make an independent unbiased complaint determination.

As for IDR statistical info, if a consumer has complained to AFCA and they are now assessing it, then statistically the IDR process was 100% unsuccessful.

As for ASIC publically publishing FSP details (2.22), this should only ever occur under the most dire of circumstances. Should an FSP IDR fail in the opinion of a subjective assessment from an ASIC or AFCA bureaucrat and they are publically shamed that would represent a most grievous denial of the FSP and advisers natural justice.

It's also commonly accepted knowledge by industry that because there is a free EDR scheme to consumers; it basically makes the IDR process redundant.

3.11 This Bill is compatible with human rights as it does not raise any human rights issues.

AFCA denies an adviser and the FSP to their **constitutional right to a fair trial and fair hearing**. See attached link for further details:

https://www.ag.gov.au/RightsAndProtections/HumanRights/Human-rights-scrutiny/PublicSectorGuidanceSheets/Pages/Fairtrialandfairhearingrights.aspx

Australia is a party to seven core international human rights treaties. Fair trial and fair hearing rights are contained in article 14 of the **International Covenant on Civil and Political Rights (ICCPR)**.

By adopting and continuing the previous FOS/CIO structures into AFCA the Government is effectively circumventing its obligation to ensure that everyone has a right to fair trial and fair hearing as this applies to cases before courts and tribunals.

Unlike AFCA, Federal Court judges are bound by the law, the rules of evidence, contract law, and their prior decisions. Federal Court judges just can't do whatever they like, and their decisions are subject to appeal.

With respected to FOS' ToR 8.1, it is incredible that FOS is **not bound by any legal rules of evidence**. ASDAA asks the committee to ensure that AFCA will be bound by the rules of evidence and their prior decisions.

An adviser or their FSP affected by an adverse AFCA decision in effect has **no right of reply**, and this is not fair. An AFCA decision can ruin a FSP and adviser's reputation, the FSP may lose their ability to get PI insurance, lose their AFS licence, and/or be forced into administration or liquidation of the business.

All of that may happen because the FSP has no right of appeal or a review of an adverse AFCA Determination.

Even criminals get the right to appeal their sentences.

Current EDR bodies - FOS and CIO - are not judicial bodies and neither is AFCA. AFCA is a public company limited by guarantee which will derive their jurisdictional powers from ASIC (**Regulatory Guide 139**), and forms a contract with its compulsory FSP members via their respective Terms of Reference (ToR).

ASIC in effect controls AFCA's ToR, and AFCA will not independent of ASIC.

As administrative bodies, CIO and FOS are not subject to the Freedom of Information (FOI) regime. There is no way for anyone to shine a light on its internal processes. (Being a private organisation, there has always been some question as to whether or not decisions by FOS and CIO should be subject to judicial review).

A good place for the committee to start would be to ensure AFCA is subjected to an FOI regime.

ASIC should also ensure the AFCA doesn't expose its financial members (FSP's) to unreasonable terms. Our members have also shared their opinions with respect to FOS's **13.3 ToR clause** regarding Defamation protection.

The clause strictly prohibits a FSP from instigating defamation action of any kind against a consumer in respect of allegations made by the consumer about an adviser or their FSP to the EDR. Again, this is why our members feel the FOS dice is so firmly loaded against them because the same prohibitions are **not** restricted to the consumer who instigated such action against the FOS member. The prohibitions even include any employee, agent or contractor of the FSP member.

ASDAA believes this could have a significantly detrimental impact on an adviser or an FSP's reputation, which is founded on trust and credibility.

Whilst ASDAA agrees that certain information provided by a consumer to AFCA as part of their dispute be subjected to qualified privilege so that the consumer can confidentially put their matter before AFCA, we strongly object to the fact that the complainant is freely able to make defamatory statements to the general public, the media, and especially on social media platforms against an adviser and their FSP.

Disputes should at all times be handled in a civil matter and its ASDAA's position that should it be found during the dispute process that an adviser, or their FSP, are defamed either in or outside the AFCA process then they should be allowed to

take external legal matters to defend their professional reputations. Better still, AFCA should inform the complainant that unless they immediately cease and desist their defamatory remarks then their case against the FSP will be closed without prejudice.

One of ASDAA's members was recently in receipt of dreadful defaming allegations made against him by a former disgruntled client. The complainant in written correspondence to FOS that was cc'd to the adviser used words like "*crooked, corrupt, low life, dishonest, liar, incompetent, thief, inept, criminal*" in describing the adviser.

Fortunately for the adviser in question, whom FOS found in his favour, the defaming allegations about his character were noted only in the correspondence to FOS and to the adviser.

Fortuitously for the adviser, nothing was repeated (to his knowledge) to the public or on social media.

ASDAA asks the committee, "***Surely it isn't AFCA's role to embolden complainants to freely shred to pieces an adviser or their FSP's reputation during and even after the dispute process***?"

Furthermore, it should be incumbent on AFCA to ensure the consumer who lodges a complaint keeps all information pertaining to a dispute confidential. If the FSP is obligated to keep confidentially then so should the complainant.

It is ASDAA's preference that CIO and FOS are left alone to operate as completing EDR bodies.

ASDAA is not aware of any monopoly created that has demonstrated that it is cheaper, more efficient, less complex, more accountable and transparent in the absence of competition. Service does not improve if there is only one player in the market.

We appreciate that there are currently only three EDR bodies that are presently active, SCT, FOS and CIO, but at least they can each benchmark themselves against each other. This benchmarking actually produces better outcomes for consumers and FSP's because it forces the EDR's to adopt best practice and improve their service offerings. As the Ramsay Review Interim Report notes on Page 11, FOS gets 75% of its revenue via dispute fees, whilst its competitor CIO gets 70% of its revenue via membership fees. This is a very stark difference in funding, which only competition can bring about. Remove competition and just watch the single EDR percentage of revenue ultimately become 100% from dispute fees.

It's accepted economic theory that when firms have a monopoly power they charge prices that are higher than can be justified based upon the costs of production, and prices are higher than they would be if the market was more competitive.

For example – look at ASIC's companies registry business.

The cost to ASIC of operating the registry is less than $6 million a year, yet this bears no resemblance to how much it charges businesses and the public for using it – about $720 million annually, a return to ASIC of more than 10,000%[1]

The bottom line is that when companies have a monopoly, prices are too high and production is too low. There's an inefficient allocation of resources which will lead to lower levels of service.

So why would the Ramsay Review conclude a monopoly EDR body would act any differently to a body or corporation that monopolises the companies registry, telecommunications, or the banking spaces for example?

The fact that FOS, a current EDR body, recommended in their initial submission (Page 23) the merger of CIO **into** FOS - smacks of opportunism and rampant self-interest. If the outcome sought is to further entrench institutional bias then let FOS takeover CIO and be reborn as AFCA.

If one follows the logic put forward by the Ramsay Review to merge FOS, CIO and SCT then the same argument could be made that the big four banks should do the same and merge forming one big "mega" bank, but we all know that wouldn't be allowed to happen because a big "mega" bank monopoly would be a bad outcome for everyone.
AFCA is also a bad outcome for everyone.

Since monopolies are the only provider, they can set any price they choose. That's known as price-fixing. They can do this regardless of demand because they know the FSP has no choice but to pay whatever membership and dispute fees they deem fit.

The problems with monopolies also go beyond the economic effects. AFCA will also have considerable political influence, and the ability to "capture" the political and regulatory process over time. This allows AFCA to tilt the legal and regulatory processes against any potential threat to its market power, and to bring about changes that further enhance the revenue it earns.

Furthermore, a forced merger of CIO into FOS would mean FSP's who are dissatisfied with service levels or costs would have nowhere else to go. That's unhealthy and a poor outcome.

If there must be one EDR body - AFCA – then it should be statutory tribunal established under legislation as it is in the UK (**UK FOS**). For Government and ASIC to bestow such market and jurisdictional power to an unlisted public company limited by guarantee trading as a monopoly EDR scheme is just mind boggling.

[1] ASIC 'screwing' small companies with registry fees. The Australian December 23 2016

ASDAA appreciates the opportunity to provide this Submission to Senate Standing Committees on Economics.

ASDAA would be happy to discuss any issues arising from our submission, or to provide any further material that may assist the Standing Committee.

ASDAA implores the Senate Standing Committees on Economics to take heed of our concerns.

Should the Senate Standing Committees on Economics require any further information, or decide to hold public hearings, please contact myself on (07) 5657 3620 or email andy@asdaa.com.au

Yours Sincerely,

Andy Semple
B.Com., B.App.Sc., MEASDAA
Director

APPENDIXES