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Financial System Division
Treasury
Langton Crescent
Parkes ACT 2600

By email: CSLR@treasury.gov.au

Dear Sir/Madam,

We welcome the opportunity to provide feedback in relation to Treasury's draft bills, explanatory materials and proposals paper regarding the Compensation Scheme of Last Resort.

Maurice Blackburn Pty Ltd is a plaintiff law firm with 33 permanent offices and 30 visiting offices throughout all mainland States and Territories. The firm specialises in personal injuries, medical negligence, employment and industrial law, dust diseases, superannuation (particularly total and permanent disability claims), negligent financial and other advice, and consumer and commercial class actions. The firm also has a substantial social justice practice.

Our Superannuation and Insurance and Financial Advice Disputes practice has represented and assisted thousands of claimants for over 20 years. We have the largest practice of its kind in Australia and currently have approximately 125 staff nationally working in the team. At any one time we provide legal assistance to approximately 3,500 to 4,000 clients.

A major part of this work involves providing comprehensive advice and representation in cases involving often egregious and negligent behaviours on the part of financial service providers. We witness first-hand the ramifications and impacts of poor corporate behaviours by Financial Service Providers (FSP), which can create significant financial hardship in our clients' lives.

Maurice Blackburn congratulates Treasury on the development of the draft Bills, explanatory materials and proposals paper. We believe that the model presented is, across the board, sound and robust, and a good reflection of the feedback received following the release of the discussion paper early last year.

There are a number of areas where we believe the draft could be enhanced, and importantly, made more focused on the victims of poor corporate behaviours. We offer suggestions below for modest adjustments that would ensure fairness for consumers who, through

circumstances not of their making, may end up reliant on a Compensation Scheme of Last Resort (CSLR).

For ease of readership, we have used the headings and section numberings from the proposals paper to delineate our suggestions.

2. Scope

Financial Products or Services In-scope

We note from the proposals paper that the scope of the CSLR has moved beyond merely coverage for personal advice failures, and that:

> *…it is proposed that the CSLR will encompasses five financial products and services, as follows:*
> - *personal advice on relevant financial products to retail clients;*
> - *credit intermediation;*
> - *securities dealing;*
> - *credit provision; and*
> - *insurance product distribution*[1]

We are pleased to see that 'credit intermediation' has been included. We believe that having lending disputes that fall under the *National Consumer Credit Protection Act 2009* as part of the scheme will be of great benefit to a large number of consumers who might otherwise miss out.

We submit that the CSLR could be further enhanced by including cover for general as well as personal advice.

The draft documents describe a scheme which excludes advice variations that may fall outside the strict definition of personal advice (e.g. general advice, execution only or limited/scaled advice).

Given this, we advocate for the CSLR to apply a liberal, consumer centric test of whether personal advice has been offered. We note that the documents provided do not currently articulate the test for how '*personal advice on relevant financial products to retail clients'* is determined.

Maurice Blackburn submits that the CSLR rules should specify that the test for determining whether a personal advice retainer exists is whether the consumer reasonably believed that the adviser took their personal information into account in providing his/her advice - rather than testing the adviser's formal position around the scope of the retainer.

This is because, in assisting consumers who have suffered losses due to poor advice, we often see FSPs argue, wrongly, that they were not providing personal advice as defined under the *Corporations Act 2001*. To support their position, they have relied upon the dearth of proper personal advice documentation such as risk profiling documents like fact find questionnaires, or a compliant Statement of Advice.

The use of the abovementioned test was bought into focus in the case of Evans and Brannelly.[2] The consumer's reasonable belief, rather than the adviser's intent that the advice

[1] Proposals Paper: p.7
[2] Evans & Ors v Brannelly & Ors [2008] QDC 269

was provided, was the key determinant for deciding whether advice was provided. In that case. It was found that:

> *Where advisers provide general advice to retail clients, they have an obligation to warn the client that their advice does not take account of the client's relevant personal circumstances (their objectives, financial situation, or needs) and that the client should not act on the advice before considering their own personal circumstances (s 949A(2) CA). A failure to do so, in the absence of a legitimate offence, may attract a penalty of $10,000 and/or 2 years in prison.*

It is important that the adviser, who is responsible for clearly setting the parameters of the retainer does so, and ensures the nature of the advice is properly documented. The failure of FSPs to appropriately document the context in which the advice was offered should not be held against the consumer, including a consumer seeking recourse under the CSLR.

A related problem occurs where financial advisers classify clients as wholesale investors in order to circumvent personal advice legal requirements. We encourage Treasury to ensure that, under the CSLR, such consumers remain eligible where the classification was based on their net wealth/income rather than their properly assessed level of financial sophistication.

In that regard, our experience confirms that a consumer's wealth/income is not necessarily a good indicator of financial literacy. For example, a recipient of a large personal injuries settlement who is classified as a wholesale client by their adviser due to their net assets, should not be excluded from the CSLR where the advice was unlawful and they would otherwise be eligible.

Many of the findings of the Royal Commission spoke of the need to adopt a more consumer-centred approach to the provision of financial services, and that the best interests of consumers is prioritised over other consideration. The adoption of a test, based on the understanding of the consumer, is more in keeping with these findings.

Court and Tribunal Decisions

The proposals paper tells us that:[3]

> *Court and tribunal decisions will also be out of scope of the CSLR at the commencement of the scheme.*

Maurice Blackburn notes AFCA rule C.1.2 (d) which states that AFCA must exclude:

> *A complaint that has already been dealt with by a court, dispute resolution tribunal established by legislation or a Predecessor Scheme, unless the Complainant has requested a stay on the execution of a default judgment on the basis of financial difficulty, difficulty assistance request, and the request has not previously been dealt with.*

Hence, if the CSLR is limited only to consumers with AFCA determinations, a consumer who elected to pursue court proceedings rather than go through AFCA, as is their right, would be irredeemably prejudiced from accessing the CSLR.

This is an inherently unfair outcome, particularly for those who made the choice to bring court/tribunal proceedings prior the finalisation of the CSLR framework.

[3] Proposals Paper: p.8

To remedy this, and provide a fair compromise, Maurice Blackburn submits that the CSLR should respond to court and tribunal decisions, up to the standard jurisdictional cap set for the CSLR applying to AFCA matters, where the consumer would have been eligible for AFCA coverage at the time the court or tribunal proceedings were commenced.

No prejudice can be alleged by the FSP's funding the CSLR as one can be confident that a court and tribunal decision would be no less robust and just than that of an AFCA determination.

We note that:

> *… there is currently no data on the number and amounts of court and tribunal determinations that remain unpaid*[4]

Maurice Blackburn submits that it is manifestly unfair to carve out any meritorious claims on the basis of a lack of data.

By limiting the CSLR to only respond to unpaid AFCA determinations, consumers will be understandably less inclined to pursue litigation whilst their AFCA matter is processed for fear that their access to the CSLR will be denied or prejudiced.

Some consumers, through their decision to utilise AFCA/CSLR processes may run out of time to pursue their matter through the courts (e.g. most time limitation statutes require a court action to be commenced within 6 years of the conduct complained of).

While the Proposals Paper contemplates subsequent court action, noting *'a claimant retains their right to pursue compensation through other avenues for any compensation owed that is not met by the CSLR'*[5], that will not be a possible option for a consumer who has run out of time to sue whilst they were exercising their AFCA/CSLR rights in good faith. In that respect, most consumers in AFCA are legally unrepresented and are therefore frequently oblivious to court time limits until it's too late.

Maurice Blackburn therefore submits that time limits should be paused while the consumer is engaged in the AFCA process.

3. Paying Claims

Eligibility for CSLR Payment

We note from the Proposals Paper that:

> *Legislation and regulations will outline the eligibility criteria to claim compensation from the CSLR.*[6]

We agree that this is an appropriate approach, using regulations to allow for flexibility in eligibility as causes fluctuate.

In our submission in repose to the discussion paper last year, we drew Treasury's attention to a particular cohort of consumers who stand to miss out on access to the CSLR, due to

[4] Proposals Paper: p.8
[5] Proposals Paper: p.28
[6] Proposals Paper: p.9

circumstances not of their own making. By reiterating our advocacy on behalf of these consumers below, we hope that the regulations might be developed with sufficient flexibility that their case may fit eligibility criteria.

While we acknowledge the need for the CSLR to be prospective, there are legitimate concerns by some cohorts of consumers that warrant consideration. In addition to the CSLR, and in response to Royal Commission recommendations, the following initiatives have been implemented to make good the losses of consumers caused by unlawful FSP conduct:

- Legacy complaints: On 20 February 2019, the Government extended AFCA's remit to consider financial complaints against current AFCA members, dating back to 1 January 2008. AFCA will receive legacy complaints from 1 July 2019 until 30 June 2020.

- The Paying Legacy Unpaid External Dispute Resolution Determination program: On 4 April 2019, regulations were made to enable the payment of unpaid determinations made under FOS and the CIO.

As at 2016, 35 financial firms had been unwilling or unable to comply with 143 FOS determinations made in favour of approximately 203 consumers. The value of these outstanding determinations is over $17 million.

By comparison, as at 2016, four financial firms had been unwilling or unable to comply with five CIO determinations. The value of these outstanding determinations was approximately $414,443.

The vast difference in unpaid determinations between FOS and CIO is due only in part to their relative size. Based on our experience, the more significant factor is that unlike FOS, the CIO's practice was to decline to process matters to determination where the financial service provider had or was expected to be unlikely to be able to compensate claimants.[7]

It follows that there is a cohort of consumers who had meritorious claims against CIO members which were never determined for this reason. Those consumers are ineligible for the unpaid determinations scheme through no fault of their own. They are also ineligible for AFCA's legacy complaints scheme as the AFS licensee is not an AFCA member.

Maurice Blackburn submits that it would be manifestly unjust if these consumers were also denied access to the CSLR.

Such an outcome would be inconsistent with the Government's response to Commissioner Hayne's Recommendation that:

> *The Government is committed to ensuring consumers and small businesses affected by misconduct have access to redress.*[8]

It would also contradict AFCA's statement in respect to the CSLR that:

> *A compensation scheme of last resort is a really important back-stop that ensures that people who have been the victims of misconduct, and lost out through no fault of their own can finally be properly compensated.*[9]

[7] This is consistent with the findings of the final report of the Independent Review into CIO Phil Khoury and Debra Russell (2012)
[8] https://www.moneymanagement.com.au/news/policy-regulation/govt-will-pay-unpaid-fos-determinations
[9] https://www.afca.org.au/news/media-releases/afcas-statement-on-the-royal-commissions-final-report

Please consider the following case study:

> *Our clients, whose identities will remain private, are part of the cohort of consumers affected by this remediation reform lacuna. Their complaint concerned unlawful financial advice to borrow heavily to invest aggressively. The advice was given by an authorised representative of Wealthsure Pty Ltd (a company that went into liquidation after a spate of negligence claims following investment losses in the GFC).*[10]
>
> *Despite us providing expert and lay evidence in support of a clear case for damages exceeding $400,000, in September 2015 the CIO Case Manager informed us that the CIO was unable to take any further action in the complaint due to the likely insolvency of Wealthsure. The matter was not progressed and no determination was made so as to trigger eligibility for the legacy complaints scheme.*

You will appreciate that this is a most disappointing and frustrating outcome for our clients.

For them, and others like them, they have been failed, firstly by their adviser, secondly by the CIO and now potentially by the architects of the remediation initiatives which are supposed to ensure that 'consumers and small businesses affected by misconduct have access to redress'.

We therefore call for the CSLR to deem eligible, through regulations, those CIO complainants who had their complaints closed rather than determined, on the basis of the insolvency of the FSP, where it can be demonstrated to the CSLR (through AFCA) that their claim is meritorious.

Compensation Cap

The Proposals Paper tells us that:[11]

> *The scheme's legislation sets out the maximum compensation that can be paid through the CSLR. The $150,000 compensation cap balances the provision of compensation to claimants and scheme sustainability for those financial firms that are not responsible for the misconduct giving rise to the compensation being claimed but are nonetheless being required to pay for it. The maximum compensation for each AFCA determination is proposed to be $150,000.*

Maurice Blackburn submits that the stated cap risks grossly undercompensating many victims of poor corporate behaviour.

We believe that any cap should be expressed in terms directly related to the compensation cap available to consumers through AFCA.

The Senate Legal and Constitutional Affairs References Committee, in their report into their inquiry into the resolution of disputes with financial service providers within the justice system, made the following recommendation:[12]

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[10] https://insolvencynotices.asic.gov.au/browsesearch-notices/notice-details/Wealthsure-Pty-Ltd-097405108/29715203-2859-45f1-9f05-2f6090417b7b

[11] Proposals Paper: p.11

[12] Recommendation 7: https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Legal_and_Constitutional_Affairs/banksandlegalsystem/Report/b01

The committee recommends that the Australian Government:

- *increase the current compensation cap available to consumers through the Australian Financial Complaints Authority (AFCA) to $2 million, including for credit, insurance and financial advice disputes; and*
- *remove the sub-limit on compensation available to consumers through AFCA for indirect financial loss and for non-financial loss.*

Maurice Blackburn agrees that the recommended compensation cap for AFCA decisions of $2 million per consumer is appropriate. The CSLR cap should be expressed as a sliding scale, embedded in the regulations, using the AFCA cap as its comparison point.

Utilising a flat rate cap means that the most profoundly impacted victims of poor advice will be impacted most by the cap – especially if that cap is set as low as $150,000 (13% of what they may have received if circumstances did not force them to rely on the CSLR).

4. Funding the Scheme

We note from the Proposals Paper that:

> *This levy framework is based on the Government commitment that the CSLR would be funded by industry*[13]

While not seeking to make comment on the proposed levying methodology, Maurice Blackburn submits that the addition of some level of government contribution (such that the scheme is not 100% industry funded) would help alleviate the stinginess of the cap described in Part 3.

Maurice Blackburn believes that the most effective way of managing the sustainability of the CSLR is to reduce the burden of claims it faces, without compromising the value of the scheme to the consumers it is designed to serve.

Maurice Blackburn suggests that one way this could be done would be by extending the membership of AFCA to Professional Indemnity (PI) insurers of FSPs.

This course of action was specifically recommended by Senate Legal and Constitutional Affairs References Committee, in their report into their inquiry into the resolution of disputes with financial service providers within the justice system.[14]

As noted by the Committee, that approach would be consistent with the practical doctrine of 'direct recourse' reflected in the comments of the Australian Law Reform Commission (ALRC) Report No.20 that:[15]

> *The fact that an insurer under a third party liability policy usually takes over the conduct of a claim by a third party against the insured might suggest that a third party should be entitled to bring a claim directly against an insurer in all cases.*

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[13] Proposals paper: p.13
[14] Recommendation 8: https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Legal_and_Constitutional_Affairs/banksandlegalsystem/Report/b01
[15] http://www.austlii.edu.au/au/other/lawreform/ALRC/1982/20.pdf?stem=0&synonyms=0&query=law%20reform%%2020insurance%20contracts : (p.210 of the report and p.250 of the PDF).

Indeed, there has been no serious argument made that third parties should not have a right of direct recourse so long as the insurer's rights to defend the action, as if it had been brought against the insured in the normal manner, are preserved. That is, giving the insurer the same rights and liabilities as if the action were against the insured[16] and providing that the insurer's liability is no greater than its liability to the insured.[17]

Maurice Blackburn believes that such reforms would also lead to better AFCA determinations as the complaint made against an FSP that is insolvent or unable to defend an EDR matter could be responded to by the PI insurer (which is what occurs in practice where the FSP is solvent anyway).

5. Governance

Maurice Blackburn notes from the Proposals Paper that:

> *CSLR Co will be overseen by a Board with an independent Chair (initially appointed by the Minister) and four other members. The other Board member must include one of AFCA's industry directors, one of AFCA's consumer directors, a person who holds actuarial qualifications or expertise, and a person with expertise in claims handling. The appointment of AFCA directors will ensure consistency, communication, and shared knowledge between AFCA and CSLR Co.*[18]

While agreeing that the establishment of a stand-alone scheme operator is an appropriate model, and that closely aligning the governance of the CSLR and AFCA is also appropriate, we are concerned that the consumer/victim voice is under-prioritised in the governance structures.

The inclusion of '*one of AFCA's consumer directors'* is a positive step, however that director will still be grossly outnumbered by representatives whose experience and expertise is not in consumer protection or representation. The membership remains skewed in favour of the industry. For a scheme whose sole purpose is compensating victims for wrongs committed against them, it is vital that the consumers' voice is at least equal, if not the most prominent, in the governance structure.

Please do not hesitate to contact me and my colleagues on 07 3014 5051 or at JMennen@mauriceblackburn.com.au if we can further assist with Treasury's important work.

Yours faithfully,

Josh Mennen
Principal Lawyer
Maurice Blackburn

[16] Andjelkovic v AFG Insurances Ltd (1980) 47 FLR 348 at 355-6.
[17] Section 51(1) Insurance Contracts Act 1984; Gorczynski v Wandft Osmo Pty Ltd [2010] NSWCA 163 at [82], [83].
[18] Proposals Paper: p.25