Stockbrokers and Financial Advisers Association

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Email: remediation@asic.gov.au

Amanda Fairbairn, Policy Lawyer
The Behavioural Unit
Australian Securities and Investments Commission
Level 5, 100 Market Street
Sydney NSW 2000

Dear Ms Fairbairn

CONSULTATION PAPER 335: CONSUMER REMEDIATION

The Stockbrokers and Financial Advisers Association (SAFAA) is the professional body for the stockbroking and investment advice industry. Our members are Market Participants and Advisory firms which provide securities and investment advice, execution services and equity capital-raising for Australian investors, both retail and wholesale, and for businesses. Practitioner Members are suitably qualified professionals who are employed in the securities and derivatives industry.

SAFAA welcomes the opportunity to provide feedback on ASIC *Consultation Paper 335: Client review and remediation conducted by advice licensees* that proposes changes to Regulatory Guide 256.

Executive summary

We note that since publication of RG 256 ASIC has monitored or overseen remediations across the financial system including in relation to insurance, superannuation and banking products. The case studies included in the Consultation Paper relate to scenarios involving insurance companies and large banks.

SAFAA is concerned that ASIC proposes a 'one size fits all' approach to remediation that is suited to large financial institutions that typically have been the focus of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, but is not appropriate for organisations in the stockbroking and investment advice industry. SAFAA disagrees with the following proposals set out in the Consultation Paper:

- the proposed two-tiered approach to initiating a remediation
- the proposal to alter the relevant remediation period
- the use of an assumption-based approach for financial services licensees
- the proposition that the government or charities should benefit from remediation money that cannot be paid to consumers
- ASIC's statement that asking consumers to enter into a settlement deed as part of a remediation will not always be efficient, honest and fair
- that it is problematic to require a consumer to sign and return a deed of settlement and release, possibly requiring a witness.

In its current form Regulatory Guide 256 is functional and appropriate. We consider that changing it in the ways that have been suggested will create uncertainty and added costs for licensees and will add to their regulatory burden with no real benefit for investment clients. Any extra costs imposed on the industry will ultimately force up the cost of providing investment advice and services to clients.

As SAFAA has previously stated in its submissions to ASIC on Internal Dispute Resolution (see our most recent submission here) the stockbroking and listed securities advice sector has an exemplary record as regards the handling of customer complaints. As reported in the most recent AFCA Complaint statistics, out of a total of 80,833 complaints received during the period 1 October 2019 to 30 September 2020, only 4,595 complaints related to investments and advice. Of this number, only 488 complaints (or 0.6%) were made against stockbrokers. To place this complaints figure into context, during the 2020 calendar year, there were 439, 360, 450 equity trades on the ASX. Of the 4,595 complaints related to investments and advice, 4,432 have been closed, with the majority of the complaints either falling outside of the rules or resolved by the financial firm.

The rate of investor complaints in the listed securities sector is very low and, to the extent that complaints do arise, they are being effectively dealt with through the licensees' IDR process. SAFAA is concerned that stockbroking and investment advice businesses are being asked to implement a remediation process that is geared to addressing the actions of large financial institutions — actions in which members of our industry played no part.

Our members are currently preparing for or implementing many major regulatory changes that are impacting on the legal and compliance costs of stockbrokers and investment advisers providing advice to retail clients. These changes include:

- forward fee disclosure
- breach reporting
- the Design and Distribution Obligations
- reference checking
- IDR reforms.

SAFAA recommends that ASIC takes into account both the escalating regulatory burden and costs impacting our members — which in turn adds to the cost of accessing financial advice — and the very low number of customer complaints made against our members each year when considering whether changes to regulatory guidance are appropriate for the stockbroking and investment advice industry.

To assist ASIC understand the issues of key concern to our members we provide the following detailed comments.

Detailed comments

B1Q1 Do you agree with our proposed two-tiered approach to initiating remediation? If not why not?

B1 Q2 Are there any practical problems associated with this approach? Please give details.

We note that the updated guide proposes providing guidance on a two-tiered approach to initiating a remediation:

(a) Tier 1 – a remediation must be initiated when a licensee has engaged in a misconduct, error or compliance failure that has caused one or more consumers to have suffered potential or actual loss, detriment or disadvantage as a result. (We note that this in essence applies to a breach of law or contract); and

(b) Tier 2 – a licensee should consider whether a remediation is warranted when a failure causing loss has breached certain standards, expectations and/or values.

SAFAA disagrees with the proposed two-tiered approach.

The guidance that Regulatory Guide 256 currently provides is scalable. It recognises that review and remediation is not a one-size-fits-all approach. In contrast, the proposed updated Regulatory Guide 256 appears to apply a one-size-fits-all model. This is highlighted by the fact that while the proposed update significantly expands the extent of licensees to which RG256 directly applies, it fails to adequately distinguish between the very different legal obligations applicable between advice licensees on the one hand and credit licensees and RSE licensees etc, on the other.

The changes to RG 246:

- propose that any (undefined) 'failure' which results in loss requires remediation — even where it does not involve any breach of any law or any contractual term. It therefore extends significantly beyond any reportable misconduct
- are much broader that the misconduct that is sought to be addressed by the *Financial Sector Reform (Hayne Royal Commission Response) Bill 2020* (FSRC Bill)
- propose remediation for breaches that extend well outside any recognised and available insurance cover
- remove the reference in RG 256 to 'systemic' issues, such that 'remediation' would be required even where only one consumer has suffered loss.

Although Tier 2 is not framed in mandatory terms the proposed update considers that remediation is applicable to 'failures' that do not involve a breach of the law or a contractual provision, but other (undefined) expectations, values or even non-binding 'standards' that do not have the force of law or are subject to an objective or legal standard.

The Tier 2 approach fails to provide for certainty or objectivity. This is required for both licensees and consumers. The standards a licensee is required to adhere to and which a consumer or the broader community may expect from a licensee should not subjective and undefinable or differ greatly from the legal obligations that are cast upon the licensee. To introduce subjectivity will create practical problems for licensees as it will not be possible for them to prepare for or prevent failures that are contrary to undefined, shifting or broad external 'expectations'.

Additionally, licensees may end up adopting inconsistent approaches in determining what constitutes a failure under Tier 2, resulting in inaccurate data arising from the subjective nature of the Tier 2 obligations. The proposed approach will cause inherent difficulty for the financial services industry.

The extent of the application of the proposed amended guidance to persons' conduct

The update seeks to expand the scope of 'failures' for which a licensee is said to be responsible to failures of:

- a current or former representative
- a current or former third-party service or product provider
- a consultant engaged by the licensee
- a subsidiary.

If ASIC intends that licensees are required to bear responsibility to consumers for all 'failures' of these persons as opposed to only some 'failures', then the extension of a licensee's responsibility to all failures would represent a

substantial expansion of existing legal responsibility. This extension is not warranted and the language should be clarified to confirm that is not the intent.

Insurance issues

The proposed changes will have a detrimental impact on the ability of licensees to obtain professional indemnity insurance.

Section 912B of the Corporations Act requires a financial services licensee to have in place adequate arrangements for compensating retail clients for loss or damage suffered because of breaches of the Corporations Act by the licensee or its representatives. Insurance cover can be taken out for that as well as for breaches of other applicable laws. However, professional indemnity insurers are unwilling to provide insurance against failures that cannot be defined with any degree of certainty — particularly for matters that do not involve a breach of any legal standard that amounts to misconduct.

In our submission to ASIC dated 18 January 2021 on promoting access to affordable advice for consumers (see here), SAFAA highlighted how the increase in regulatory burden is impacting the cost and availability of professional indemnity insurance. Stockbrokers and investment advice businesses with high excesses and exclusions are essentially self-insuring for client claims. Our members report that they are investigating ways to improve their ability to obtain more affordable cover and that removing retail business may be an option they are required to take. This is expected to substantially reduce the availability of advice to retail clients.

Systemic issues

We also note that the two-tiered approach removes the reference to 'systemic issues' so that licensees must initiate remediations where only 'one or more' consumer has suffered loss rather than 'a number of consumers'. This will be an extremely onerous undertaking on the part of smaller licensees who are required to identify, investigate and initiate remediation programs in respect of all individual 'failures' (including subjective matters that involve no breach of any applicable legal standards) that take place, regardless of their impact on the client.

At a fundamental level, we observe also that all 'failure' investigations initiated by a licensee do not fall within the accepted definition of 'claim' as provided in claims made insurance policies (which require an issue to be raised by the client themselves). This is a significant issue as it means that licensees cannot then expect to receive insurance support in respect of remediations in general. The consequence will be that the industry (apart from perhaps the large financial institutions that have resources that extend well beyond most industry participants) cannot protect themselves with insurance and victims of misconduct may then be unable to recover their losses (if any).

SAFAA considers that an approach to remediation that inherently removes or is fundamentally inconsistent with the availability of the very insurance cover that participants are required to hold to meet consumer losses benefits no one.

Review period to start from when a failure first caused loss to a consumer

C1Q1 Do you agree with this proposal? If not, why not?

C1Q2 Are there any practical problems associated with this proposal? Please give details.

C1Q3 Are there any other matters that we should consider to help us provide appropriately scalable guidance?

Updated Regulatory Guide 256 proposes to provide guidance that, as a starting point, the relevant period for a remediation should begin on the date a licensee reasonably suspects the failure first caused loss to the client. In doing so, ASIC appears to expect licensees to investigate and remediate loss no matter how long ago it occurred. This is inconsistent with consumers' rights as affected by limitation periods.

SAFAA strongly disagrees with the proposal to alter the relevant remediation period.

This guidance effectively removes the current seven-year limitation period which applies to the investigation of misconduct and goes far beyond the six-year limitation period that applies to court and AFCA proceedings. This has no regard to the fact that consumer rights are and remain affected by limitation periods. SAFAA is concerned that the guidance seeks to remove licensee rights administratively without a proper legal basis to do so.

We note that in contrast, the FSRC 2020 Bill proposes that remediation occur only where the consumer has a 'legally enforceable right to recover the loss'. (FSRC Bill (chapter 12).

Paragraph 12.32 of the Explanatory Memorandum identifies the concept of an enforceable right as ‘a potential claim that if pursued by the affected client, may be enforced as a judgment by the court against the licensee’. The Explanatory Memorandum goes on to note (at 12.33) that ‘A client would not have a legally enforceable right where, for example, the underlying cause of action has been extinguished or barred as not enforceable by expiry of the relevant limitation period’.

Even the AFCA Rules apply statutory limitation periods.

RG 256 should only require remediation to occur with respect to legally enforceable rights. If it were otherwise it seeks to administratively impose a policy that is neither recognised by nor consistent with the law. Further, it also again impacts the availability of insurance to meet 'loss'. No insurance cover can be obtained for circumstances where a consumer has no legally enforceable right.

Limitation period issues aside, this again emphasise the extreme gulf created by the second tier of the proposed update, which purports to apply remediation to circumstances where there are no enforceable rights at all. As a matter of consistent legal principle, if a person does not have a right to seek recovery of loss or damage, they ought to not have a right to claim remediation. There must be consistency between the two.

Accordingly, SAFAA does not agree with the removal of a limitation period on the investigation of misconduct. Aside from creating a lack of insurance cover requiring our members to self-insure for these claims, it will also raise issues relating to document retention, privacy and certainty.

Smaller licensees are likely to face logistical barriers with document retention and all licensees will be required to potentially breach privacy regulations so that they can hold documents for a period longer than seven years.

Furthermore, holding client information for a longer period of time creates greater risk of privacy breaches resulting from cyberattack. It is not in clients’ best interests that their documents be retained for long periods in the unlikely event that a compliance issue is found.

Professional indemnity insurers will be unwilling to consider insurance coverage for claims that have no limitation period for liability, as it creates uncertainty in respect of the quantum of damage that may be awarded to the client. It will also create practical difficulties in determining which professional indemnity insurer will be liable for the loss, considering that licensees change professional indemnity insurers from time to time and liability for a compliance issue may arise more than seven years after the loss was suffered.

Using beneficial assumptions

D1Q1 Do you agree with our proposal for assumptions to be beneficial and that they should satisfy certain considerations? If not, why not?

Updated Regulatory Guide 256 proposes to provide guidance that licensees should only use assumptions in a remediation if they are beneficial to the client. Beneficial assumptions are to be relied upon in the absence of records or to improve the efficiency with which the remediation is conducted.

SAFAA disagrees with the use of this assumption-based approach for financial services licensees for the following reasons:

- any guidance is unlikely to 'cover the field' with respect to the particular circumstances when assumptions may be appropriate. The result will be that licensees will still be required to make subjective judgment calls about when and how to use assumptions
- it will create issues of additional uncertainty in terms of the quantum of damage which may arise from a particular remediation
- loss of records can occur through no fault of a licensee (eg, flooding has caused loss of records in the past)
- the assumption-based approach is unbalanced — consumers often fail to keep relevant records material to a claim
- beneficial assumptions that are intended to give rise to overcompensation are inconsistent with the proposition that compensation should be fair and just, reflecting the legal liability that exists to meet a claim
- professional indemnity insurers will not be able to price the risk of applying a beneficial assumption, and may withhold insurance altogether as a consequence.

We observe also that an averaging approach will not always be appropriate in all situations as some clients will not recoup their entire loss in the event that the losses suffered are significantly skewed across a group of affected clients.

SAFAA considers that if statutes of limitation are complied with, licensees are more likely to hold relevant client records, therefore eliminating the need for beneficial assumptions to be applied.

Clarifying our guidance for remediation money that cannot be returned

G1 Q1 Do you agree with our proposal? If not, why not?

G1 Q2 Is it appropriate for ASIC to provide guidance that any money that cannot be directly returned to consumers be lodged in an unclaimed money regime? If not, why not?

Updated Regulatory Guide 256 proposes to clarify current guidance for when remediation money cannot be returned to consumers. That is, if a licensee cannot, despite best endeavours, find consumers to pay them compensation, the licensee must not profit from the failure and the residual funds should be sent to a relevant state or federal unclaimed money regime in the first instance, and as an alternative, should be paid to a charity or not-for-profit organisation.

SAFAA disagrees with the proposition that the government or charities should benefit from remediation money that cannot be paid to consumers.

The proposal to make payments to an unclaimed money regime or charity organisation creates fundamental challenges in respect of receiving insurance payments (assuming any cover for remediation), as professional indemnity insurers will not reimburse payments not made directly to clients, on the basis that this does not constitute the resolution of a 'claim' under the policy definition.

The proposal fails to take into account situations where a client representative can be contacted in respect of a remediation payment, but payments cannot be made for other reasons. For example, payment may not able to be made to the actual client because it is a deregistered company (i.e. the relevant 'client' no longer exists), and the relevant former director no longer has authority to speak on its behalf. While it is theoretically possible for a company in some circumstances to be re-registered, the costs of doing so may be prohibitive and outweigh any perceived benefit.

Again, SAFAA makes the point that this proposed guidance is geared to large financial institutions, but does not take account of the stockbroking and investment advice industry. We note that the stockbroking and investment advice industry was not called before the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry and should not be subject to remediation processes aimed at those that did appear before the Royal Commission.

Settlement deeds and fair consumer outcomes

H1Q1 In what circumstances, if any, are settlement deeds essential to protect your legitimate interests?

Updated Regulatory Guide 256 proposes to clarify guidance about if and when using settlement deeds and relying on implied consent may or may not be appropriate as part of a remediation. The guidance suggests that settlement deeds are not always appropriate and should be avoided in certain situations.

SAFAA agrees with the current wording of RG 256 that settlement deeds or contracts are an important part of a remediation for advice licensees.

SAFAA disagrees with ASIC's statement that asking consumers to enter into a settlement deed as part of a remediation will not always be efficient, honest and fair.

The proposed removal of the ability to obtain a signed deed of settlement fails to give adequate regard to the interests of a financial services licensee and its insurer, who require:

- certainty with respect to the resolution of a dispute

- protection against future claims being brought on the basis of the same set of facts.

In our members' experience:

- deeds of settlement are commonplace in the financial serves industry, especially when an insurer contributes to a settlement sum. We acknowledge things may be different with large financial institutions that might self-insure, but stress again that these institutions are not representative of the industry
- if a settlement covers a claim or potential claim there is no need to reserve a right to proceed to AFCA or through IDR as the claim will be extinguished via the settlement. Consumers are routinely encouraged to obtain independent legal and financial advice before accepting a settlement proposal
- it is uncommon for a consumer to receives a settlement sum payment without first having had prior awareness of or involvement in the claim or remediation process and/or an ability to obtain independent legal and financial advice before accepting a settlement proposal.

SAFAA **disagrees** that requiring a consumer to sign and return a deed of settlement and release, possibly requiring a witness, is problematic. Having a legal document witnessed is a common activity across multiple areas of commerce. Further, there is no industry 'principle' that says it is too much to ask a person to sign a formal document to acknowledge the settlement of any enforceable claim. Rather the contrary is true. Industry expectation and practice is that a formal document will be signed.

SAFAA considers that it is not honest, efficient and fair to remove formal settlement terms and rely instead on an 'implied consent'. To do so will expose settlements to an unnecessary level of uncertainty, compared to terms that are reduced to writing and signed by persons who are identified as having authority to accept the settlement. It will also create the risk that clients might attempt to bring the same claims multiple times and receive multiple settlement amounts for the same conduct.

Settlement deeds are essential to licensees as they provide crucial certainty to the client, the licensee and their insurer. SAFAA is of the view that the 'implied settlement' suggestion lacks sufficient certainty and is not in the public interest. Consumer rights can be adequately protected without the 'implied settlement' concept. To ensure that clients are not entering into settlement deeds without understanding their force and effect and the possible loss of future legal rights, we suggest that the settlement deeds be restricted to the particular conduct being remediated, as is the case under the current Regulatory Guide 256 and the AFCA Rules.

SAFAA suggests that as part of the settlement and remediation process, the clients' legal rights may be protected by:

- ensuring they are informed of their internal and external dispute resolution rights
- providing a minimum enforced cooling off period to consider the deed before signature and/or a monetary allowance to allow the client to seek independent legal advice in respect of the settlement offer.

Conclusion

SAFAA is concerned that ASIC's proposed changes to RG 256 apply a 'one size fits all' approach to remediation that is more appropriate for large financial institutions for whom large-scale remediations are commonplace.

The rate of investor complaints in the listed securities sector is low and they are effectively dealt with through licensees IDR process.

The proposed remediation guidance is not appropriate for stockbrokers and investment advisers. Our members encourage ASIC to take these points into account when considering whether changes to the existing guidance are necessary.

We note that this is the first round of a two-part consultation process. SAFAA looks forward to engaging with ASIC on the next draft of the guidance.

Yours sincerely

Chief Executive Officer