

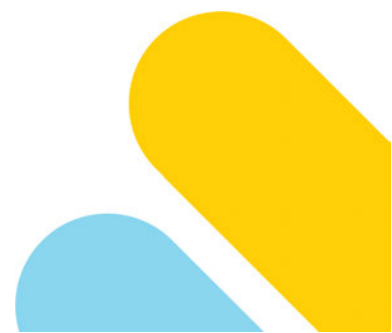
# **Inquiry into Australian Securities and Investments Commission investigation and enforcement**

Submission to the Senate Economics Reference Committee

March 2023

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## Overview

The Australian Financial Complaints Authority (**AFCA**) is the independent external dispute resolution (**EDR**) scheme for the financial sector. For over 25 years, AFCA and its predecessor schemes<sup>1</sup> have provided fair, independent, efficient and effective external dispute resolution services for Australian consumers and small businesses.

The Ramsey Review set out the blueprint for the formation of AFCA in 2018, as the independent dispute resolution scheme for the Australian financial services industry.

In its role as the financial industry regulator, the Australian Securities and Investments Commission (**ASIC**) is responsible for overseeing and regulating the effective operation of the dispute resolution system for financial services, which includes regulatory oversight of AFCA.<sup>1</sup>

While ASIC and AFCA have distinct roles and respective responsibilities, AFCA works closely and effectively with ASIC to inform and assist its regulatory work and is an important part of enabling ASIC to undertake proportionate investigation and enforcement action.

The functions of AFCA in its dispute resolution work and ASIC as the financial services regulator are both essential components in ensuring that financial markets can operate efficiently, effectively and fairly.

There have been multiple government instigated reviews, inquiries, and a Royal Commission (the Reviews) that have considered and dealt with the components that support effective and efficient financial market outcomes.

It is clear from these Reviews that efficient market outcomes in financial services cannot be achieved without a fair, independent, accessible, efficient and effective dispute resolution system for consumers and market participants.

AFCA not only focuses on resolving disputes, it also works to improve industry practices and minimise the causes of disputes arising in the first place. As a cheaper, quicker, more informal and accessible alternative to the Courts, AFCA seeks to meet diverse community needs and be trusted by all.

Since 1 November 2018, AFCA has handled over 313,000 disputes and delivered over \$978 million in compensation to consumers.<sup>2</sup>

Significant compensation and outcomes for consumers has also been delivered through AFCA's systemic issue investigation work, in which AFCA reports to and works with ASIC, amongst other regulators. Since 1 November 2018, as a result of

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<sup>1</sup> The Corporations Act 2001 and ASIC Regulatory Guide 267: *Oversight of the Australian Financial Complaints Authority*. cover ASIC's regulatory oversight of AFCA and requirements of the AFCA scheme

<sup>2</sup> Further AFCA statistics are provided on page 5 of this submission.

our systemic issues investigations AFCA has facilitated a return of more than \$250 million to consumers.

During the 2021-22 Financial Year, the average time for AFCA to close a dispute was 72 days.<sup>3</sup>

If AFCA and dispute resolution more generally was not available to consumers, many of these complaints would end up in court, costing more, taking more time, clogging up the courts and impacting confidence and efficient market operations. Many other consumers would simply be unable to pursue their rights and find redress for harm. The existence of AFCA and our work plays a key role in restoring trust and confidence in the financial services sector.<sup>4</sup>

AFCA welcomes the opportunity to provide a submission<sup>5</sup> in response to the Senate Economics References Committee's Inquiry into Australian Securities and Investments Commission (ASIC) investigation and enforcement (the Inquiry). As the Inquiry is considering several topics external to our function, we limit our comments to a section of topic (a), and provide a response to the following:

The potential for dispute resolution to distort efficient market outcomes.

## Efficient Market Outcomes

As noted above, there have been multiple Reviews that have considered the components that support effective and efficient financial market outcomes, including:

- Commonwealth of Australia Financial Systems Inquiry (2014)
- Commonwealth of Australia Review of the financial system external dispute resolution and complaints framework (2017) ('The Ramsey Review')
- Commonwealth of Australia Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (2019), and
- The Independent Review of AFCA conducted by Federal Treasury into AFCA in 2021.

Without a comprehensive observation of market efficiency and effectiveness as a starting point, there is the potential for the barometer to be set in a way where

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<sup>3</sup> AFCA 2021-22 Annual Review (Pg i)

<sup>4</sup> See Appendix for further information about AFCA's functions.

<sup>5</sup> This submission has been prepared by the staff of AFCA and does not necessarily represent the views of individual directors of AFCA.

outcomes adversely ripple through society, disproportionately impacting the most vulnerable consumers along the way.

The Reviews have highlighted that efficiency is not the sole measure of the financial system, but rather it is a combination of elements. The Financial Systems Inquiry Final Report November 2014 said:

‘the focus of financial system policy should be primarily on the degree of efficiency, resilience and fairness the system achieves in facilitating economic activity, rather than on its size or direct contribution (such as through wages and profits) to the economy.’<sup>6</sup>

The Final Report of this Inquiry also noted that a ‘market economy operates more effectively where participants enter into transactions with confidence they will be treated fairly.’<sup>7</sup>

In line with this observation, important components include fair treatment of participants, social awareness and financial inclusion, public confidence, and trust. Efficient market outcomes cannot be achieved without these other key components.

AFCA considers that efficient and effective dispute resolution arrangements in financial services, and its work and engagement with ASIC, underpin these components. Efficient market outcomes in financial services cannot be achieved without a fair, independent, accessible, efficient and effective dispute resolution system for consumers and market participants.

This is also reflected internationally, by the existence of industry and statutory dispute Ombudsman schemes in many other jurisdictions. In Australia we also have Ombudsman schemes in a range of other markets including telecommunications, energy and public transport.

## The Reviews

The Reviews referenced above consistently affirmed that fair and effective dispute resolution builds consumer and small business confidence and trust in the financial system, balancing rights and responsibilities and ensuring fairness in the system.

The key fundamentals to an efficient and effective financial system include:

- an effective regulatory framework
- access to dispute resolution
- fair treatment

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<sup>6</sup> Financial System Inquiry Final Report November 2014 (Pg 3)

<sup>7</sup> Commonwealth of Australia 2014, Financial System Inquiry Final Report Pg xv

- public trust and confidence.

Further information on these Reviews is set out at Appendix 1.

## ASIC's Oversight of AFCA

### Oversight

In its role as the financial industry regulator, ASIC is responsible for overseeing and regulating the effective operation of the dispute resolution system for financial services. This includes regulatory oversight and guidance covering both the requirements for financial firms' Internal Dispute Resolution (IDR) obligations and systems, and oversight of AFCA (EDR). ASIC regulatory guides 271<sup>8</sup> and 267 set out the standards and requirements for IDR and EDR. There has been significant reform of both IDR and EDR systems in the last five years, to ensure they are fit for purpose.

ASIC also has a range of powers in relation to its oversight of AFCA under the *Corporations Act 2001* (the Act).

### How AFCA works with ASIC

To meet its responsibilities, AFCA regularly engages with ASIC and reports detailed information relating to the complaints we deal with. Information and insights that AFCA provides to ASIC includes:

- an extensive range of complaint statistics and data
- information about emerging trends arising from complaints,
- industry sector specific issues, and
- possible systemic issues regarding particular financial firms.

In addition to resolving individual financial disputes, AFCA has responsibilities in accordance with the Corporations Act 2001 and RG 267<sup>9</sup> to identify, resolve and report on systemic issues and to notify ASIC, and other regulators, of possible serious contraventions of the law.

While ASIC has an oversight role over the AFCA scheme, AFCA remains independent and responsible for its own internal processes and the management of complaints. ASIC has no role in individual complaints handling and does not intervene in the independent decision-making processes of AFCA.

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<sup>8</sup> ASIC Regulatory Guide 271 Internal Dispute Resolution

<sup>9</sup> Refer to Part C, Reporting Requirements, of ASIC Regulatory Guide 267.

## Statistical reporting

In addition to other data and insights that AFCA regularly reports to ASIC to inform its work, AFCA also provides reports on a quarterly basis and provides detailed data and statistics to ASIC. These reports include:

- the number of complaints received
- products and issues related to the complaints
- AFCA's current caseload, including the age and status of open complaints
- the time taken to resolve complaints
- the number of complaints closed, and complaint outcomes.

## Systemic Issues Reporting

AFCA provides important timely and evidence-based intelligence to ASIC and other regulatory agencies on systemic issues and possible serious contraventions of the law.<sup>10</sup> This intelligence is used as appropriate for regulatory and other actions by regulators in order to address issues that may otherwise distort the market due to a reduction of consumer trust and confidence, fair treatment and conduct, market participation, and in other ways.

ASIC also receives a large volume of information from many other sources relating to financial firm conduct, including through breach reporting and directly from consumers and other organisations. As such, AFCA is part of the regulator's broader intelligence gathering activities.

## Information about AFCA's Systemic Issues outcomes and ASIC referrals

AFCA includes information about its systemic issues outcomes and regulator referrals in its Annual Review. AFCA also now publishes regular reports which provide further insights about its systemic issues outcomes and regulator referrals (AFCA 'Systemic Issues insights report' attached).

Since 1 November 2018, as a result of our systemic issues investigations AFCA has facilitated a return of more than \$250 million to consumers.

In the 2021-22 financial year alone, the following outcomes from our systemic issue work were achieved:

- 153 detailed systemic issues investigations conducted
- 67 systemic issues reported to regulators
- 23 possible serious contraventions of the law and other breaches identified
- 167,033 consumers remediated as a result of identified systemic issues, and
- \$18,275,607 in refunds were made to consumers.

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<sup>10</sup> S1052E Corporations Act

## ASIC action from AFCA referrals

AFCA's referrals of definite systemic issues, possible serious contraventions of the law and other information sharing (in accordance with AFCA's obligations) has led to significant regulatory action by ASIC over time.

These regulatory actions and outcomes include:

- suspension and cancellation of financial firm licenses
- legal and other enforcement action against financial firms and their directors, resulting in fines, banning of directors and other sanctions including enforceable undertakings
- consumer remediation programs being established and implemented by financial firms which have delivered significant compensation and redress to many consumers.

These outcomes reflect the effective working relationship and reporting of information between AFCA and ASIC, which achieve outcomes that benefit consumers, rebuild and ensure trust and confidence in financial services and enable more fair and efficient operations in financial services.

Several recent examples of outcomes where AFCA has reported conduct to ASIC include the following:

The Federal Court found Membo Finance Pty Ltd (Membo) and its sole credit representative breached the National Consumer Credit Protection Act (the Credit Act) and ordered the companies to pay over \$6m in penalties. The Court found both Membo and its representative failed to act efficiently, honestly and fairly when dealing with debtors in financial hardship and commenced court proceedings to enforce credit contracts in a state other than where the borrower or guarantor lived.

General Commercial Group Pty Ltd (formerly known as Urban Commercial Group) and Eden Capital (Australia) Pty Ltd (formerly known as Southside Lending) were each penalised \$50,000 by the Federal Court for failing to cooperate with AFCA. For the next 12 months, both companies were restrained from engaging in credit activity and the respective directors were restrained from being involved in any business carrying on credit activity.



## Other Efficiency benefits from Dispute Resolution

Dispute resolution in financial services is funded by industry and based on a user pays model. Access to free EDR services provided by AFCA frees up both the courts and regulatory agencies by having disputes fairly, efficiently and quickly dealt with by AFCA. It also assists and enables efficient and improved financial services by quickly identifying and reporting issues that need to be addressed by the industry.

Multiple government-initiated reviews have shown that alternative dispute resolution provides greater consumer confidence in financial services, which assists in a more efficient and fairer market. As observed in the 2014 Financial System Inquiry, rebuilding consumer confidence and trust in the financial system in the long term helps to limit the need for more interventionist regulation.

## Conclusion

AFCA believes that consumer access to EDR builds and ensures trust and confidence in the financial services sector and ensures fair and efficient market outcomes.

There is no evidence of dispute resolution distorting efficient market outcomes. A number of Government initiated reviews and inquiries have concluded that access to dispute resolution is core to ensuring consumers are treated fairly and can have confidence and trust in the financial system.

Access to efficient dispute resolution and rebuilding trust and confidence in the financial services sector, especially when things go wrong, immeasurably supports the efficiency, resilience and fairness of markets and market outcomes.

AFCA has a collaborative, efficient and effective relationship with ASIC in its role as the financial services regulator. AFCA looks forward to continuing to work effectively with ASIC for the betterment of Australian consumers, small businesses and the financial services industry.

## Appendix

### Appendix 1 – The Reviews

#### Financial Systems Inquiry (2014)

The Financial System Inquiry (The Inquiry) was tasked with examining how the financial system could be positioned to best meet Australia's evolving needs and support Australia's economic growth. The Inquiry handed down its final report in November 2014 (the Final Report).

The Final Report highlighted that confidence and trust are essential ingredients in building an efficient, resilient and fair financial system that facilitates both economic growth and meets the financial needs of Australians.

The Final Report confirmed the importance of financial firms treating customers fairly and that fair treatment occurs where participants act with integrity, honesty, transparency, and non-discrimination. The Final report noted that a 'market economy operates more effectively where participants enter into transactions with confidence they will be treated fairly.'<sup>11</sup>

Under the heading 'Fair Treatment' the Final Report said the following:

'Financial firms need to place a high degree of importance on treating customers fairly. This includes providing consumers with clear information about risks; competent, good-quality financial advice that takes account of their circumstances; and access to timely and low-cost alternative dispute resolution and an effective judicial system.'<sup>12</sup>

The Inquiry recognised the importance of treating customers fairly and how having access to timely alternate dispute resolution links to fair treatment and trust. This importance was solidified by the below remarks.

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.<sup>13</sup>

To ensure consumers are treated fairly and can have confidence and trust in the financial system, they should have access to effective redress.<sup>14</sup>

<sup>11</sup> Commonwealth of Australia 2014, Financial System Inquiry Final Report Pg xv

<sup>12</sup> Commonwealth of Australia 2014, Financial System Inquiry Final Report, Pg 6

<sup>13</sup> Commonwealth of Australia 2014, Financial System Inquiry Final Report, Pg 12

<sup>14</sup> Commonwealth of Australia 2014, Financial System Inquiry Final Report, Pg 197.

These key remarks were subsequently requoted together in the 2017 Review of the financial system external dispute resolution and complaints framework Final Report.<sup>15</sup>

The Inquiry also stated that:

‘rebuilding consumer confidence and trust in the financial system in the long term would help to limit the need for more interventionist regulation in the future.’<sup>16</sup>

### **Review of the financial system external dispute resolution and complaints framework (2017)**

The comprehensive review of the financial system external dispute resolution and complaints framework in 2017 (the EDR Review) was an opportunity to ensure Australia’s EDR framework delivered effective outcomes in a rapidly changing and dynamic financial system. The EDR Review was led by Professor Ian Ramsay.

The Ramsay Review Final Report was issued in April 2017 (Ramsay Report) and highlighted the interconnectedness of effective markets and:

1. treating consumers fairly and
2. providing confidence and trust, by way of an effective regulatory framework and access to effective dispute resolution.

‘The financial system plays a vital role in raising the living standards of all Australians, with its ultimate purpose being to facilitate sustainable economic growth by meeting the financial needs of its users. For the system to operate effectively, it should be subject to market forces and be overseen by a strong and effective regulatory framework.’<sup>17</sup>

When things go wrong, it can have distressing consequences for individuals and families. There have been a number of financial collapses in the past 10 years that have affected over 80,000 consumers, with losses totalling more than \$5 billion, or \$4 billion after compensation and liquidator recoveries. Common factors have been consumers receiving poor advice, having difficulty understanding complex documents and products and, in some cases, being taken advantage of for their lack of financial literacy. In these and other circumstances, it is important that people have access to effective redress mechanisms.<sup>18</sup>

<sup>15</sup> Commonwealth of Australia 2017, Review of the financial system external dispute resolution and complaints framework Pg 20

<sup>16</sup> Commonwealth of Australia 2014, Financial System Inquiry Final Report, Pg 28

<sup>17</sup> Commonwealth of Australia 2017, Review of the financial system external dispute resolution and complaints framework Pg 19

<sup>18</sup> Commonwealth of Australia 2017, Review of the financial system external dispute resolution and complaints framework Pg 8

## A new single EDR body to handle all financial disputes 2018

The Final Report made 11 recommendations that represented an integrated package of reforms that would see the EDR framework well-placed to address current problems and ensure its design would withstand the challenges of a rapidly changing financial system.

The Final Report's central recommendation was for the establishment of a new single EDR body for all financial disputes (including superannuation disputes) to replace three predecessor schemes. It was concluded that an industry ombudsman scheme was the appropriate model for all areas of the financial system.

In 2018, the then Minister of Revenue and Finance authorised AFCA to be the external dispute resolution service for the financial industry. The Treasury Laws Amendment was tabled as '*Putting consumers first*'.

## Royal Commission (2017-2019)

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry was established on 14 December 2017 (Royal Commission). The central task of the Royal Commission was to inquire into, and report on, whether any conduct of financial services entities might have amounted to misconduct and whether any conduct, practices, behaviour or business activities by those entities fell below community standards and expectations.

The Final Report in February 2019 (Final Report) referred to identified conduct by 'many entities that took place over many years causing substantial loss to many customers but yielding substantial profit to the entities concerned.'<sup>19</sup>

The Final Report said that very often, the conduct had broken the law. And if it has not broken the law, the conduct fell short of the kind of behaviour the community not only expects of financial services entities but is also entitled to expect of them.

Misconduct was defined in the Letters Patent of the Financial Services Royal Commission dated 14 December 2017<sup>20</sup> in several ways including 'a breach of trust, breach of duty, or unconscionable conduct.' Commissioner Hayne said that:

'Misconduct can have significant consequences for financial soundness and stability. It undermines trust in the financial system.'<sup>21</sup>

The Royal Commission was also asked to consider the effectiveness of mechanisms for redress of consumers of financial services who suffer detriment as a result of misconduct by financial services entities.

<sup>19</sup> Royal Commission Final Report (Pg 1 of Vol. 1)

<sup>20</sup> [Letters Patent | Royal Commissions](#)

<sup>21</sup> Royal Commission Final Report (Pg 345 of Vol.1)

At the time of the Final Report, AFCA had been operational as the EDR scheme for the financial industry sector for less than six months. Commissioner Hayne noted the creation of AFCA as a result of the government instigated review of the EDR framework. Commissioner Hayne therefore made no recommendation for changes to AFCA's operations and affirmed that 'AFCA should be permitted to set about its work.'<sup>22</sup>

## Appendix 2 – AFCA's process

### AFCA's Complaints process

In order to provide financial advice a person is required to hold an Australian financial services licence (AFSL) or be a representative of a licensee. All AFSL holders must be a member of AFCA, by way of their license conditions.

As an independent not for profit EDR scheme, and as mentioned above, AFCA has several functions that include investigating and resolving consumer and small business complaints. Individual complaints lodged by consumers and small business are considered as part of our complaint resolution process. In these complaints, we consider the specific circumstances that each complaint presents, in accordance with our Rules and Operational Guidelines (OG).

### AFCA's Systemic Issues obligations

In accordance with section 1052E of the *Corporations Act 2001* (the Act), and ASIC Regulatory Guide 267: Oversight of the Australian Financial Complaints Authority (RG 267), AFCA has an obligation to identify and report contraventions, breaches and systemic issues.

Most of the systemic issues investigations conducted by AFCA are initiated after a consumer or small business complaint we are considering indicates the financial firm's conduct, processes or systems etc. have resulted in or caused a systemic issue. A systemic issue is defined in our Rules as an issue that is likely to have an effect on consumers or Small Business beyond the parties to a complaint.

In these instances, AFCA refers the issue to the financial firm for a response. If a definite systemic issue is ultimately identified by AFCA, we work with the financial firm to resolve the issue, including any remedial activity that should be undertaken. AFCA also refers any identified serious contravention of the law to the relevant regulator, in accordance with our obligations.

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<sup>22</sup> Royal Commission Final Report (Pg 482 of Vol. 1)

## Appendix 3 – Treasury Led Independent Review of AFCA

### Treasury Led Independent Review of AFCA

In 2021, AFCA was pleased to take part in the first independent review of AFCA's functions and performance. The Review was conducted by Federal Treasury with the final report publicly released in November 2021.

Key findings of the Review included that 'AFCA is performing well in a difficult operating environment and a changing regulatory landscape' and 'AFCA's decision-making is fair, independent and efficient'.

The Review also affirmed AFCA's:

'critical role in providing consumers and small business with access to a binding, out-of-court dispute resolution service', and the benefit to financial firms and consumers from this service 'as an alternative to a court or tribunal process'.

The IR Report included 14 Recommendations that look to further strengthen and support the work AFCA does. AFCA accepted the recommendations made and has a program of work underway to implement the recommendations.