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Dear Sirs

Review of the financial system external dispute resolution and complaints framework: Submission of Patersons Securities Limited (Patersons)

1. Introduction

1.1 Patersons wishes to thank you for the invitation to lodge a written submission with respect to the issues raised in the interim report issued by the panel in the course of its review of the financial system external dispute resolution and complaints framework (the **Interim Report**).

1.2 Founded in Western Australia in 1903, Patersons is one of Australia's largest full-service stockbroking and financial services firms. Patersons is currently a member of the Financial Ombudsman Service (**FOS**) and has been since its inception.

1.3 Patersons has a network of offices across Australia. The services offered by Patersons may be grouped into four key classes:

(a) wealth management services including stockbroking; financial planning; portfolio management; superannuation; margin lending; derivatives trading and insurance;

(b) corporate finance services including initial public offerings; convertible note issues; placements; roadshows and market-related advice; rights issues; mergers and acquisitions; share purchase plans; corporate advice and capital reconstructions;

(c) institutional dealing focused on fulfilling the specialised requirements of international and domestic institutional clients investing in Australia;

(d) highly-regarded equities research about listed Australian entities; and

1.4 This submission has been prepared to enable Patersons to share its views with respect to certain of the draft findings and recommendations made by the panel in the Interim Report.

2. Summary

2.1 This submission is limited to the following findings and recommendations:

Recommendation No.	Detail of recommendation
Draft recommendation 1: A new industry ombudsman scheme for financial, credit and investment disputes.	There should be a single industry ombudsman scheme for financial, credit and investment disputes (other than superannuation disputes) to replace FOS and Credit and Investments Ombudsman (**CIO**).
Draft recommendation 2: Consumer monetary limits and compensation caps.	The new industry ombudsman scheme for financial, credit and investment disputes should provide consumers with monetary limits and compensation caps that are higher than the current arrangements, and that are subject to regular indexation.
Draft recommendation 6: Ensuring schemes are accountable to their users.	Both new schemes should be required to meet the standards developed and set by ASIC…In addition, ASIC's regulatory guidance should require the new scheme for financial, credit and investment disputes to regularly review and update its monetary limits and compensation caps so that they remain relevant and fit-for-purpose over time.
Panel observation	The Panel is of the view that there is considerable merit in introducing an industry-funded compensation scheme of last resort.

2.2 Patersons' submission in respect of the abovementioned recommendations and observation may be distilled into four key propositions:

(a) the creation of a single industry ombudsman scheme for financial, credit and investment disputes (other than superannuation disputes) may be appropriate in the event that saved costs and resources are directed to ensuring the delivery of an improved service to financial firms and consumers in respect of *all* classes of disputes;

(b) whilst significantly higher monetary limits and compensation caps may be appropriate for particular classes of disputes, that is not the case for disputes that fall within what FOS describes as the "investments and advice" product line;

(c) particularly in circumstances in which it proposed that compensation caps be increased to an amount that is a significant multiple of the minimum jurisdictional limit of the District or County Courts of the States or, perhaps, in excess of the upper jurisdictional limit of those Courts, it is appropriate that any scheme is accountable to its users, has significant oversight from ASIC and that there is a real right of review available to the parties in appropriate cases;

(d) in circumstances in which financial firms already fund the various EDR schemes through the payment of membership and other fees charged during the course of a dispute[1], it is not reasonable to expect financial firms to fund an additional scheme which is intended to respond in circumstances in which another firm has failed to maintain appropriate levels of capital or insurance coverage having regard to the nature of the business.

3. Draft recommendation 1: A new industry ombudsman scheme for financial, credit and investment disputes

3.1 As noted in the Interim Report, there has already been considerable consolidation of the various industry ombudsman schemes that existed at the beginning of the millennium.[2]

[1] See the table subjoined to paragraph 4.59 of the Interim Report.
[2] See, for example, paragraph 4.4 of the Interim Report.

3.2 This consolidation has led to a scenario where there is no longer a dedicated service for what FOS classifies as the "investments and advice" product line. Previously, complaints falling within this product line were determined by the Financial Industry Complaints Service (**FICS**).

3.3 In the ordinary course, this fact might not be particularly significant. However, disputes falling with the "investments and advice" product line make up no more than 5% of the disputes handled by FOS.[3] That being so, there is a real risk that insufficient resources may be directed to ensuring that any relevant EDR scheme has the appropriate resources and/or expertise to resolve such disputes in a manner consistent with the objectives of such schemes.

3.4 Patersons does not suggest that this is occurring at present. Nevertheless, the risk exists and has the potential to increase in the event that there is to be further consolidation of EDR schemes. That is particularly so in circumstances in which:

(a) disputes falling within the "investments and advice" product line will often be more complex given that many of these disputes relate to a number of transactions and dealings over a period of time (possibly many years); and

(b) a merger of FOS and CIO, or the creation of a new scheme to replace FOS and CIO, is likely to see an even lower percentage of disputes falling with the "investments and advice" product line having regard to the nature of the disputes generally considered by CIO.

3.5 Particularly in circumstances in which financial firms are responsible for funding FOS, Patersons wishes to ensure that this funding is used in the most efficient manner, whichever scheme or schemes may be in place. Accordingly, if there is to be some consolidation of the EDR schemes to achieve an outcome where the available funding is better utilised, Patersons would support that outcome, provided that any savings made as a result of the achieving of efficiencies was directed to achieving an improvement of the service levels provided in respect of *all* classes of disputes.

4. Draft recommendation 2: Consumer monetary limits and compensation caps

4.1 The Panel proposes to recommend that the new industry ombudsman scheme for financial, credit and investment disputes should provide consumers with higher monetary limits and compensation caps than those currently employed by FOS.

4.2 It is also proposed that these higher monetary limits and compensation caps be subject to regular indexation.

4.3 This draft recommendation is underpinned by a draft finding that "*[t]he current monetary limits for consumers are inadequate*".

4.4 Currently, the FOS monetary limit and compensation cap which apply to investment disputes is $500,000 and $309,000, respectively. The compensation cap is now subject to indexation[4] and has been reviewed and raised on several occasions, including most recently in 2012 (increase in compensation cap for "investments and advice" disputes from $150,000 to $280,000) and 2015 (increase in compensation cap for "investments and advice" disputes from $280,000 to $309,000).

4.5 Patersons understands that submissions have been made which, if accepted, would increase the monetary limits and compensation caps to $1 million or more and make those limits the subject of indexation. In fact, the Joint Consumer submission (as it is referred to in the Interim Report) proposes that the cap be increased to $2 million.[5]

[3] FOS Annual Review 2015-16, page 59.
[4] FOS Terms of Reference, paragraph 9.8
[5] See, for example, paragraphs 5.46 to 5.49 of the Interim Report and the submissions referred to therein.

4.6 Generally speaking, the jurisdictional limits of Courts are not the subject of indexation. Rather, those limits are reviewed at appropriate times and decisions are made as to whether the relevant limits need to be increased.

4.7 Despite this fact, Patersons is not opposed to the indexation of existing monetary limits and compensation caps at an appropriate rate (eg, at the rate of "underlying inflation").

4.8 However, for the reasons set out below, Patersons does not support an increase to the monetary limits and compensation caps, at least with respect to disputes that fall with the "investments and advice" product line.

4.9 The main reason cited in the Interim Report for the proposed increase is that the current monetary limits and compensation caps are "*no longer in line with the values of some financial products (such as mortgage balances) that may give rise to disputes, resulting in a gap in EDR coverage.*"[6] Indeed, when advocating for monetary limits and compensation caps of $2 million, the Joint Consumer submission cites the following in support of their submission:

(a) "*many mortgages on the family home will now fall outside* [the current] *limits*";

(b) "*the vast majority of personal guarantee disputes for home loans will now be outside the limits as the cost of housing continues to increase*"; and

(c) "[a] *common jurisdictional problem involves insurance disputes relating to claims on Home Building or Home Building and Contents insurance policies*" citing the fact that "*building and repair costs have increased significantly.*"[7]

4.10 Likewise, those from the financial services sector who are amenable to an increase in the monetary limits and compensation caps include the Australian Bankers' Association Inc (**ABA**), who stated in their submission that they "*support an increase in the monetary limits of the EDR scheme to ensure the appropriate disputes are heard and compensation is meaningful.*" The ABA's submission suggests an increase to $1 million.[8]

4.11 It is unsurprising that the call by the Joint Consumer Group for an increase would be based on matters such as the size of mortgages and the amounts at stake in insurance disputes. Nor is it surprising that the ABA is prepared to acknowledge such matters may give rise to a need for an increase or that the Panel sees such submissions as having merit. Indeed, credit and insurance disputes made up 69% of the disputes received by FOS in the 2015-16 financial year (45% and 29%, respectively).[9] In contrast,"investments and advice" disputes account for no more than 5% of the disputes received by FOS.[10]

4.12 However, such reasoning highlights the dangers of a one-stop shop for disputes which applies the same monetary limits and compensation caps across all classes of dispute.

4.13 Patersons accepts that it *may* be reasonable for the monetary limit or compensation cap for a dispute about a mortgage or insurance policy to increase as the average price of the underlying asset (ie, the house) increases. Any such increases would need to be measured and have regard to the state of housing prices across the nation as a whole.

4.14 But, even if one were to adopt the reasoning of the Joint Consumer submission, it seems difficult to justify an increase in the monetary limits and compensation caps to an amount which is just under:

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[6] Interim Report, page 148.
[7] Joint Consumer Group, EDR Review Issues Paper submissions dated 10 October 2016, page 41.
[8] Australian Bankers' Association Inc, EDR Review Issues Paper submissions dated 10 October 2016, pages 5, 14.
[9] FOS Annual Review 2015-16, page 59.
[10] Ibid, page 59.

(a) 150% greater than the mean price of residential dwellings in NSW (which, at $822,100, is the highest in the country); and

(b) 600% greater than the mean price of residential dwellings in Tasmania (which, at $335,300, is the lowest in the country).[11]

4.15 Patersons makes no submission with respect to whether the price of housing in the country justifies an increase in the monetary limits and compensation caps of the quantum proposed for disputes relating to mortgages, guarantees that might be given in respect of residential housing and home insurance.

4.16 However, whatever may be the case in respect of those disputes, it cannot be said that the value of housing in the country justifies an increase in the monetary limits and compensation caps for "investments and advice" disputes.

4.17 As was submitted by CIO, there is a point at which the amount in dispute means that a Court is the most appropriate forum for the resolution of the dispute.[12] Patersons submits that this point is an amount no greater than the current compensation cap applied by FOS.

4.18 "Investments and advice" disputes, particularly those with respect to stockbroking services, primarily relate to complaints about the provision of advice with respect to a portfolio of shares.

4.19 These disputes are fundamentally different from disputes with respect to other types of financial services, such as mortgage and insurance disputes. In the case of the latter, the factual issues are far more likely to be limited and involve a more limited and discrete course of dealing.

4.20 In contrast, "investment and advice" disputes often turn on value judgements made by case managers with respect to financial product advice provided over a long period of time and can be factually intensive.

4.21 The existing EDR schemes do not have the resources to test the veracity of the evidence that might be provided by the parties with respect to such disputes. This is not a criticism. Rather, it is an inevitable corollary of the fact that disputes relating to "investments and advice":

(a) are generally not limited to a discrete time period;

(b) may involve a changing in the circumstances of the consumer;

(c) regularly relate to a number of different investments; and

(d) often involve unsubstantiated allegations with respect to people's recollection of events that might have occurred many years ago and which may be susceptible to hindsight bias.

4.22 Moreover, some of the legal issues that can arise in the context of "investments and advice" disputes can be incredibly complex.

4.23 One example of the complex legal issues that can arise in the context of "investments and advice" disputes is any entitlement that a consumer may have to compensation for a 'lost opportunity' and, if so, the amount of that loss. There are numerous decisions issued by FOS where it has been determined that a consumer is entitled to an award of compensation for a 'lost opportunity' and that such losses are not subject to the cap on awarding "consequential losses".

[11] ABS Residential Property Price Indexes: Eight Capital Cities, Sep 2016, released on 13 December 2016 - http://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/6416.0Main%20Features2Sep%202016?opendocument&tabname=Summary&prodno=6416.0&issue=Sep%202016&num=&view=

[12] See paragraph 5.48 of the Interim Report and the submission of the CIO cited therein.

4.24 The issue of whether a consumer is entitled to an award of compensation for a 'lost opportunity' requires a critical analysis of whether:

(a) the loss suffered is actually a consequential loss (and, therefore, subject to the applicable cap);

(b) it can be established that the consumer would have made some alternative investment; and

(c) if so, how the loss arising from this 'lost opportunity' is to be calculated.

4.25 Particularly when one has regard to the fact that a failure to properly characterise a particular loss as "consequential loss" can lead to a substantially increased award of compensation, justice demands that compensation not be ordered without recourse to the legal principles that underpin the rationale for such awards.

4.26 In any event, there does not appear to have been any empirical evidence advanced as to why the monetary limits and compensation caps in respect of investment and advice disputes:

(a) are presently inadequate; and

(b) should be increased, perhaps substantially.

4.27 Against that background, an increase in the relevant monetary limits and compensation caps is not appropriate, at least in the context of "investments and advice" disputes.

5. Draft recommendation 6: ensuring schemes are accountable to their users

5.1 The need to ensure that EDR schemes are accountable to their users will be heightened in the event that one or more of the draft recommendations are implemented.

5.2 As presently structured, the ability of financial firms to seek a review of the final decision of an EDR scheme is severely limited by the binding nature of decisions on financial firms and the reluctance of the Courts (based on legal principle) to re-open and review decisions that may be made by an EDR scheme.

5.3 This reluctance is demonstrated by the fact that no party (either complainant or financial firm) has to date been successful in overturning a FOS determination in Court.[13] This is despite there being a number of cases where the Court found that FOS's decision was, at least in part, attenuated with error.[14]

5.4 It is to be recalled that, whilst financial firms are bound by the decisions of FOS, consumers are not. That is, if a consumer is unsatisfied with the outcome of the determination of their complaint by FOS, the consumer remains free to pursue that complaint through the Courts.

5.5 In some respects, this creates an uneven playing field - whilst the consumer is free to seek a review of FOS's decision, the financial firm is not.

5.6 This imbalance will only increase in the event that there is only one EDR scheme. In such a scenario, financial firms will not be able to 'vote with their feet' by ceasing membership with one EDR scheme and joining another.

5.7 Similarly, there will be a far greater risk of injustice occurring in the event that compensation caps are increased and the current state of affairs pertains such that financial firms may not be able to obtain a judicial review of a decision which is incorrect.

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[13] See paragraph 4.29 of the Interim Report.

[14] See, for example, *Mickovski v Financial Ombudsman Service Ltd* (2012) 36 VR 456 at [15].

5.8 In Patersons' submission, accountability cannot be assured unless there is an avenue for independent review of individual disputes.[15] This is something which the draft recommendation proposes not occur.

5.9 Patersons does not propose that any independent review be accompanied by an ability to overturn a decision. However, it is appropriate that there be an avenue where financial firms can raise issues associated with the approach adopted by FOS by reference to particular decisions and to have those complaints adjudicated upon by an appropriately qualified individual (such as a retired judicial officer). If the complaint is upheld, it may have the effect of avoiding similar mistakes being made in the future (assuming that the relevant scheme is obliged to implement any changes to approach recommended by the independent assessor).

5.10 In Patersons' view, the ability to seek such a review will increase the confidence in EDR schemes and potentially reduce the imbalance in the rights of the parties to a dispute.

5.11 As to the final paragraph of draft recommendation 6, Patersons submits that any update to monetary limits and compensation caps should not be made without industry consultation and approval from ASIC. Patersons also repeats to the matters raised in section 4 above.

5.12 Patersons otherwise supports draft recommendation 6.

6. Panel observation: introduction of an industry-funded compensation scheme of last resort

6.1 The Interim Report notes that the Panel sees considerable merit in introducing an industry-funded compensation scheme of last resort.

6.2 The form such an industry-funded compensation scheme would take is presently unclear. However, Patersons is of the view that such a scheme should not be introduced. It would, in effect, require diligent financial firms who ensure that they have sufficient capital and insurance to meet their obligations to underwrite the obligations of financial services firms who do not.

6.3 As the Interim Report makes clear, financial firms are already responsible for funding FOS, such that the service is free for consumers.[16]

6.4 Whilst Patersons does not have any objection to that state of affairs, it is unreasonable to expect that financial services firms who have taken prudent steps to ensure that they can meet their commitments should be obliged to fund a compensation scheme to meet the obligations of those who are not so prudent.

6.5 A failure of a financial services licensee to have adequate capital and insurance arrangements to meet its obligations and to compensate clients who have suffered loss as a result of a breach by the licensee of its obligations would likely constitute a breach of the obligations imposed by section 912B of the *Corporations Act* 2001 (Cth) and the relevant parts of the *Corporations Regulations* 2001 (Cth).[17]

6.6 Relevantly, section 912B(2) requires that the relevant arrangements satisfy any relevant regulations or be approved by ASIC.

[15] Patersons does not consider that the test case procedure (FOS Terms of Reference, paragraph 10.1) or the informal or formal review procedures set out in the FOS Operational Guidelines, section 19A) represent genuine avenues for independent review given FOS's involvement in each procedure and the difficulties associated with a financial firm accessing the formal review process.
[16] See the table at the top of page 11, and the table in paragraph 4.59, of the Interim Report.
[17] See also ASIC Regulatory Guide 126 (particularly Section C) and reg 7.6.02AAA of the *Corporations Regulations* 2001 (Cth).

6.7 Given these provisions, it is Patersons' submission that any concerns as to the ability of financial firms to compensate clients for losses suffered should be addressed by action being taken to redress any extant breaches of the obligations imposed by section 912B of the *Corporations Act* 2001 (Cth). In the event that the concerns pertain despite such action, a legislative response can be considered. These courses of action should be pursued before consideration is given as to whether compliant organisations are required to contribute to a fund to address the consequences of the non-compliance of other.

7. Conclusion

7.1 As noted at the outset, Patersons is grateful for the opportunity to provide comments on the draft findings and recommendations that have been suggested in the Interim Report.

7.2 Members of the Patersons' team would be happy to meet with members of the panel to discuss this submission or any other matters that the panel may wish to raise.

Yours sincerely
PATERSONS SECURITIES LIMITED

MICHAEL MANFORD
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