Inquiry into Wealth Management Companies

AFCA submission to the Senate Economics References Committee

November 2024

afca
Australian Financial Complaints Authority

Introduction

AFCA is the independent external dispute resolution (EDR) scheme authorised under the *Corporations Act 2001 Cth* (Corporations Act) to deal with complaints about financial products and services from consumers and small businesses.

AFCA's purpose is to provide fair, independent, efficient and effective solutions for consumers and small business to have their financial complaints resolved.

AFCA welcomes the opportunity to provide a submission in response to the Senate Economics References Committee's Inquiry into Wealth Management Companies (the Inquiry).

Terms of reference

The Inquiry is looking at the reasons for the collapse of wealth management companies, and the implications for the establishment of the Compensation Scheme of Last Resort (CSLR) and challenges to its ongoing sustainability, with particular reference to Dixon Advisory & Superannuation Services Pty Ltd (DASS) as an example.

Executive summary

AFCA and its predecessor schemes have a long history of dealing with complaints across the financial services sector, including complaints about personal financial advice.

In the previous financial year AFCA received 3,559[1][2] Investments and Advice (I&A) complaints against a total of 104,861[3] total complaints received at AFCA. Only 1,316 I&A complaints related to advice (and 60% of these were DASS complaints).

However, although complaint numbers overall have been relatively low against financial advisors, AFCA has continued to receive a number of disputes against different financial advice firms about investor losses resulting from conflicted financial advice and product mis-selling. This suggests there is ongoing risk, related to some financial advice business models and conduct, that may continue without some level of change or intervention.

[1] AFCA 2023-24 Annual Review (pg. 86)
[2] Complaints can belong to more than 1 product type
[3] AFCA 2023-24 Annual Review (pg. 4)

In these cases, the advice firm, or a related party, developed, issued, distributed and, on occasions, managed the financial products that the advice firm promoted to its client base. Systemic failures by the advice firm to provide advice in a client's best interests and to prioritise its interests above its clients, resulted in investor losses.

Often in these situations, professional indemnity policies (PII) have failed to respond. Further, the "corporate veil" has prevented responsible actors from being held accountable for the misconduct.

To support the Inquiry's consideration of the issues, AFCA's submission provides the following:

1 An overview of the number of complaints received by AFCA against DASS, along with the outcomes of closed matters.

2 An outline of the issues found when investigating DASS complaints with a focus on the AFCA 'lead' decision.

3 Examples of other matters (other than DASS) where similar issues presented, causing harm to consumers.

4 An outline of how AFCA attributes fault and calculates loss in financial advice matters.

5 An overview of AFCA's membership, including cessation of membership.

6 Other matters which may be of interest to the committee.

1 Overview of DASS Complaints, along with the outcome of closed matters

DASS became a member of AFCA on 1 November 2018, when AFCA commenced operations as the single EDR scheme for the financial services sector. Prior to that date, DASS was a member the Credit Industry Ombudsman (CIO).

AFCA received an unprecedented number of complaints against DASS. Whilst AFCA has seen large batches of complaints in the past, AFCA has not seen a batch of this size against a financial advice firm. While the theme of each complaint is similar (i.e. conflicted advice), each complaint will turn on information specific to each consumer, including their stated tolerance to risk, objectives, financial situation and needs at the time of the provision of each event of advice.

The numbers of DASS complaints received and other key metrics are stated below:

Key statistics (as at 1 Nov 2024)	DASS
Total complaints received (since AFCA commencement)	2,746*
Complaints finalised	148
Complaints currently open without decision	2,598
Complaints determined by AFCA	110
% determined in favour of complainants	98.2%
Total compensation awarded in AFCA determinations	$35,639,656
Average compensation awarded per determination	$329,996
Total compensation claimed for undetermined (open) complaints	$ 440,079,444^
Average compensation claimed for undetermined complaints	$169,391^

**AFCA reported 2,773 complaints as at 30 June, however actual volume has fallen as duplicate complaints are identified and merged. Total complaints will reduce if further duplicates are identified.*

^ Compensation claimed by complainants is untested by AFCA before investigation, so is only a guide to potential compensation levels. 1 in 5 open DASS complaints do not have a claim amount recorded by the complainant

AFCA has invested significantly in increasing our complaint investigation function to progress and conclude this batch of complaints. This has included investing in tools to provide efficiency and consistency to support our investigation of these complaints, increasing the size of our workforce, as well as appointing a Senior CSLR Ombudsman to accelerate DASS case investigations.

2 Issues found when investigating DASS complaints with a focus on an AFCA 'lead' decision

2.1 The lead decision

AFCA issued the lead decision on DASS complaints on 6 February 2024.[4] The AFCA Panel found that DASS did not provide appropriate advice nor act in the complainant's best interests and awarded $254,000 in compensation to the complainant.

In this matter the complainant was a corporate trustee of a self-managed superannuation fund (SMSF) and was a client of the financial firm from July 2012 to

[4] Determination

September 2019. The complainant says that the financial firm's advice was not appropriate for the SMSF during this period because:

- the recommended asset allocation was too aggressive for its members and it was unnecessary to take on the recommended degree of risk to achieve their goals and objectives, and
- the financial firm was conflicted in making its recommendations. The financial firm says its recommendations were appropriate for the complainant. It says it managed any potential conflicts of interest in accordance with its obligations.

The key issues AFCA considered were:

- Did the financial firm provide appropriate advice and act in the complainant's best interests?
- Did the financial firm prioritise the complainant's interests ahead of its own?
- Did the breaches cause the SMSF to incur loss?

AFCA found that DASS:

- recommended investments that were too aggressive for the complainant's risk profile
- failed to provide advice within the risk parameters it had set out
- failed to diversify the investments
- following the provision of advice, investor portfolios were often overweight in growth assets (which were mainly property) beyond industry norms and not aligned to client needs and objectives. Complaints appear to have exposure to a US-based property fund – the US Masters Residential Property Fund (URF), a DASS-related product.
- recommended a high proportion of related entity investments without justification
- failed to act in their clients' best interests in the provision of financial advice
- made inadequate disclosure to clients about the risks of the investments

The Panel determined that "But for" the failure, the consumer should have been invested in a less risky, diversified portfolio and used the Vanguard passive index fund to assess loss.

2.2 Subsequent complaints

Subsequent AFCA determinations issued identify a number of similar themes, including that the complainants were older and either close to or post-retirement, with many clients having high levels of exposure to high-risk growth assets.

In all determined complaints to date, AFCA has found that DASS engaged in inappropriate personal financial product advice. AFCA's response to questions on

notice to this Committee in June 2024 confirmed that it is uncommon to see the level of related party investment as seen in the DASS complaints.[5]

In summary, AFCA's assessment to date of the advice provided by DASS has been that it was too often compromised by conflicts of interest embedded in the business model. This resulted in cookie-cutter advice recommending investments into related party products that was not compliant with DASS's licence obligations. These include the obligation to give advice in the best interests of the client and to prioritise the client's interests over the interests of the firm.

3 Other matters (other than DASS) where similar issues presented causing harm to consumers

Although DASS has so far led to the largest volume of complaints that AFCA has received for this sector, it is not the only advice firm where AFCA had found that the licensee conduct was inappropriate. Example of other matters, where the business model has similar issues of conflicted advice follow together with other business models that are now part of CSLR[6]:

Advice firm	Conduct Issues
United Global Capital Pty Ltd (in Liquidation) (UGC)	Issue relates to the conduct of the firm when recommending retail clients to set up self-managed superannuation funds to invest in related-entity funds. This includes recommending its clients invest in the related property investment company Global Capital Property Fund (GCPF). On 5 July 2024, UGC was placed into voluntary administration, and on 9 August 2024, UGC entered liquidation. The Australian Securities Investments Commission (ASIC) has obtained interim Federal Court asset-freezing orders against UGC and GCPF. ASIC has also made certain interim stop orders and registered its cancellation of UGC's Australian Financial Services Licence. In cancelling UGC's licence, ASIC requires it to remain a member of the AFCA scheme until at least **31 May 2025.** Provided AFCA has jurisdiction to consider a complaint, AFCA can accept complaints about UGC while the firm remains a current member.

[5] AFCA Reference QON 12 - Senate Ref: Portfolio Question Number 12
[6] Other conduct related collapses include Storm Financial in which the Financial Services Royal Commission Final Report (Vol 1 pg. 128) tabled losses of about $830 Million.

Advice firm	Conduct Issues
	AFCA currently has about **129 cases** received against United Global Capital. The first determination will be issued before the end of November 2024.
A.C.N 140 520 225 (formerly known as MyPlanner Planner Australia Pty Ltd (In Liquidation)) & MyPlanner Professional Pty Ltd (In Liquidation)	The conduct issues involved financial advisers recommending self-managed superannuation funds to buy residential investment properties through conflicted referral arrangements with financial brokers, property developers and real estate agents. AFCA and the predecessor scheme received **83 complaints** against these firms.
Anne Street Partners Financial Services Pty Ltd (In Liquidation)	AFCA has also received numerous complaints where financial advisers recommended retail clients establish self-managed superannuation funds so they can invest in residential properties sourced from related-entity property brokers (for example Anne Street Partners Financial Services Pty Ltd (In Liquidation)). AFCA and the predecessor scheme received **43 complaints** against Anne Street Partners.
Storm Financial	Storm Financial was an Australian financial services company that collapsed in early 2009, leaving thousands of investors, many of whom were retirees, in severe financial distress The Financial Services Royal Commission Final Report[7] says: *Many investors lost their investment, their homes and their life savings and still had significant debts outstanding. ASIC estimated the total loss suffered by investors who borrowed to invest through Storm was about $830 million.* The Financial Systems Inquiry Final Report[8] says: *Financial collapses that involved poor distribution practices, such as Storm Financial and Opes Prime. More than 3,000 consumers lost more than $1.4 billion, of which around half was recovered.*

[7] The Financial Services Royal Commission Final Report (Vol 1 Pg. 128)
[8] Financial Systems Inquiry Final Report Pg. 208

Advice firm	Conduct Issues
DOD Bookeeping Pty Ltd (In liquidation) (DOB)	On 17 May 2021, ASIC commenced proceedings against DOD for allegations of breaching the prohibition against conflicted remuneration and failing to provide appropriate financial advice and discharge its bests interests' duty in relation to financial advice to selected clients. **AFCA Determination** On 29 March 2024, AFCA made a determination against DOD. The complaint related to 2015 advice by the firm to the complainants to set up a SMSF and then purchase two residential properties, one inside and one outside of superannuation, using mostly borrowed funds. The properties purchased were recommended by the firm or by a related property investment arm of the firm, operating under the same corporate group. The complainants say the advice they received was not appropriate and has caused them to suffer losses both personally and from the SMSF. The AFCA Determination found that the firm failed to provide appropriate advice and did not act in the complainant's best interests in relation to the personal investment property. **CSLR** DOD failed to pay the determination and subsequently, on 23 October 2024, the CSLR paid $64,860.05 to the complainant for the AFCA determination and notified ASIC.[9] As a result of these events, on 7 November 2024, ASIC cancelled DOD's AFS licence. AFCA received **12 complaints** against the firm.
Ultiqa Lifestyle Promotions (Ultiqa)	On 3 November 2021, ASIC commenced proceedings against Ultiqa. On 17 May 2022 in the Federal Court. The Court found that between October 2017 and March 2019, financial advisers acting as authorised representatives of Ultiqa advised consumers to invest in the Ultiqa Lifestyle Scheme, a timeshare scheme, despite such advice not being in the consumers' best interests and not being appropriate to their circumstances.

[9] ASIC 24-256 MR

Advice firm	Conduct Issues
	AFCA Determination On 28 June 2024 AFCA made a determination against Ultiqa. The complaint was about the purchase of membership points in a time-sharing managed investment scheme (membership) following a sales presentation. The complainants say that the firm misrepresented the membership at the time of sale. The AFCA Determination found that the firm did not provide appropriate advice in the complainants' best interests. The complainants were awarded a sum equal to their loss, with interest. **CSLR** Ultiqa failed to pay the above determination. Subsequently, on 2 October 2024, the CSLR paid $19,429.60 to a person for AFCA's determination and notified ASIC.[10] As a result, ASIC cancelled Ultiqa's AFS and credit licences on 16 October 2024. AFCA received **7 complaints** against the firm.

Common themes

Common themes in all these collapses that resulted in significant investor losses were:

- Mis-selling
- Misleading and deceptive conduct
- Conflicted remuneration
- Vertical integration
- Poor quality (often cookie-cutter) advice
- Systemic failures to act in the best interests of clients
- Poor and inadequate diversification of risk and investment advice that amplified losses by the adoption of wholly inappropriate gearing strategies.

To be clear, even though these matters all related to a failed product, the failings were in the advice process.

[10] ASIC 24-233 MR

4 How AFCA attributes fault and calculates loss in financial advice matters

4.1 How AFCA determines liability

AFCA has a published Approach document[11] that clarifies how we approach liability and loss when a financial advice firm has been found to have breached its obligations to the complainant, in circumstances where the Responsible Entity (RE) of one or more Managed Investment Schemes (MISs) that the complainant invested in have subsequently become insolvent. Before publishing this Approach document, AFCA undertook consultation with the industry.

In summary, for complaints AFCA receives about advice to invest in a failed product, AFCA will consider whether the advice met the standards prescribed in the law, that is, whether that advice was in the best interests of the client. AFCA will then consider, as a separate issue, whether the failure caused loss to the client and whether it is fair in all the circumstances having regard to the law, the actions of the product provider and adviser to attribute all or part of the loss to the advice firm.

Where AFCA has evidence that another financial firm contributed to the loss and that financial firm is a member of AFCA, we may join that firm to the complaint. In these circumstances, we may reduce the liability of one firm where we consider the other firm shares some liability for the conduct that caused the loss. AFCA will also consider the actions of the consumer and whether they contributed to the loss.

Financial advice firms can limit their liability in any complaint about financial advice by ensuring the advice they give complies with their obligation to provide advice that is in the best interests of their clients, is appropriate to their client's needs and objectives and prioritises their client's interest ahead of their own.

In determining loss, AFCA does not award capital loss but rather applies the "but for" test i.e. "But for" the failure of advice, what would the consumer have invested in. This approach has been endorsed by the Courts in the case of *Patterson Securities Ltd v FOS* [2015] WASC 321.

For example, if a consumer was incorrectly placed in a high growth asset allocation, and they were found to be incorrectly classified, AFCA will determine loss based on the returns they would have received had they been invested correctly. AFCA's approach to loss is found here:

AFCA Approach - Calculating loss in financial advice[12]

[11] AFCA Approach - Determining compensation in complaints against Financial Advice Firms where the Responsible Entity of a Managed Investment Scheme has become insolvent
[12] See section 2.2 Deciding on what is appropriate compensation (pg. 4-5)

4.2 Complaints against the product provider

Under the AFCA Rules, AFCA excludes complaints raising issues that relate to the management of a fund as a whole, or complaints solely about poorly or under-performing investments.[13]

Many product failures have been caused by management of the fund as a whole, and therefore would be excluded from AFCA's jurisdiction on this basis. Even if the matter was within AFCA's jurisdiction, if the Managed Investment Scheme has gone into administration, AFCA would not ordinarily consider such matters as they are outside the scope of the CSLR.

5 AFCA membership, including cessation of membership

5.1 General

Membership of AFCA is a licence condition for financial firms who hold an Australian Financial Services Licence (AFSL) or Australian Credit Licence (ACL).

Membership of the AFCA scheme is also a threshold requirement for AFCA to be able to accept and resolve complaints against firms as lodged by consumers or small businesses.

Once a firm ceases to hold AFCA membership, no new complaints can be lodged against that firm. AFCA manages scheme membership in accordance with the relevant provisions of the Constitution and applicable processes to ensure that there is a consistent approach to consumer access to the AFCA scheme, regardless of whether a member is being expelled or withdrawing from membership voluntarily.

AFCA's Constitution (the Constitution) sets out the relevant requirements for cessation of scheme membership including for a firm who wishes to voluntarily withdraw from the scheme or for the AFCA Board to expel firms from the scheme.

Circumstances in which the AFCA Board may expel firms from the scheme include:

- failing to comply with the AFCA Constitution or AFCA Rules or with any binding decision (however described) made pursuant to the AFCA Rules
- failing to pay AFCA fees
- where a firm ceases to be duly authorised, licensed or to carry on business in the Industry, or
- becomes insolvent, including liquidation and administration.[14]

In broad terms, AFCA's approach to cessation of membership is to allow 12 months from either the circumstance giving rise to the expulsion event, or from when a firm

[13] (Rules C.1.5 (a) and (b)).
[14] See s3.4 of AFCA's Constitution (pg. 11-13)

gives notice of voluntary cessation, before the AFCA membership is brought to an end. The requirement to maintain an AFCA membership for a period of 12 months after a particular event provides for a fair and consistent approach to the expulsion of members and limits consumer detriment that may be caused by the sudden expulsion/withdrawal of a membership with AFCA.

6 Other matters which may be of interest to the Committee

6.1 General

Under the *Treasury Laws Amendment (Financial Services Compensation Scheme of Last Resort) Bill 2023* [and associated bills], there is a requirement that AFCA must take '*Appropriate steps*'[15] to seek payment of an unpaid AFCA determination. After meeting the appropriate steps requirements, and if the compensation awarded in the AFCA determination remains outstanding, a consumer may pursue payment with the CSLR.

6.2 Professional indemnity insurance (PII)

6.2.1 PII requirements for AFS licensees

Section 912B of the Corporations Act requires AFS licensees to have arrangements for compensating retail clients for losses they suffer as a result of a breach by the licensee or its representatives of obligations in Chapter 7 of the Act.

These arrangements must be either:

- PI insurance cover that is 'adequate' considering the nature of the licensee's business and its potential liability for compensation claims or
- approved by ASIC as 'alternative' arrangements.

In ASIC's Regulatory Guide 126, Section C sets out guidance on what ASIC regards as the minimum requirements for 'adequate' PI insurance. Other parts of RG 126 explain matters such as approval of alternative arrangements and exemptions from compensation requirements.

6.2.2 Limitations of PII

PI insurance covers business risks and is not designed to be a consumer compensation mechanism. It is noted that:

- the total funds available under the insurance contract may not cover the full award of compensation;
- the insurance contract may not cover the conduct which is the subject of the award of compensation;

[15] Appropriate Steps to be taken by AFCA are tabled in s1064 (2)(a) – (2)(d) of the CSLR Bill

- the amount of compensation awarded may be below the excess under the insurance policy
- complainants cannot make a claim directly on a financial firm's PII policy, receive no information about why a firm's claim might be refused and have no standing to challenge any claim refusal, and
- claims about a financial service might be made several years after the service is provided and a firm's policy may have expired by then in circumstances where 'run-off' cover was unavailable or prohibitively expensive.

6.2.3 AFCA jurisdiction

AFCA currently does not have jurisdiction in respect of professional indemnity insurers. Once AFCA issues a determination, the financial firm then has 30 days to pay the findings of the determination, from which point AFCA has limited visibility of what the financial firm does.

In many cases we would suggest that the compensation is paid out of the financial firms operating account, however some cases they may make a claim to their insurer, depending on the level of cover that they have and what the cover is for.

Anecdotally we understand that every insurance policy could be different (in terms of level of cover, excess etc) and suspect that in some cases there are members of ours who are paying that claim through their insurer.

If a consumer comes back to us to advise the financial firm has not complied with the determination, AFCA will proceed to report that to ASIC.

6.2.4 PII Transparency

PII is the first line of defence to pay compensation awarded in an AFCA determination where a firm has engaged in misconduct. An effective PII framework is also essential to ensuring the CSLR is truly a scheme of last resort.

Under current settings, AFCA may receive complaints about financial advice given by a particular firm, but AFCA lacks any information about whether:

- an advice licensee has a compliant PII policy in place[16]
- a policy may have specific exclusions relevant to AFCA's assessment of a complaint (such as an exclusion for advice about related party products)
- a claim or claims have previously been notified or paid by the insurer
- a coverage limit has been reached or exceeded.

ASIC, in its 2017 submission to the *Supplementary issues paper: Review of the financial system external dispute resolution framework*,[17] invited consideration of the merit of requirements that licensees that rely on PII to meet their licensing

[16] See ASIC RG 126
[17] ASIC - Submission to the EDR Review Supplementary Issues Paper

obligations should provide ASIC with data about their PII on an annual, ongoing basis.

ASIC suggested that that such data could be used to monitor the scope of PII coverage, particularly in the context of the introduction of a CSLR and support ASIC to perform its role as a risk-based regulator. For example, decisions about surveillance targets may be informed by the PII coverage of industries and entities. Relevant data points may include, for example, the insurer's name, the level of cover, the amount of the excess and whether any PII claims have been paid in the previous year.

In considering whether licensees should provide data about PII to ASIC on an annual basis, ASIC noted that—other than in the context of a specific surveillance action—it only collects information about a licensee's PII at the time of licence application.

AFCA supports greater transparency of PII cover and annual data reporting to ASIC alongside appropriate information sharing arrangements between ASIC and AFCA. This would support the performance of AFCA's complaints handling role and effective and timely reporting to regulators.

6.3 Corporate Veil

We note stakeholder concerns about AFCA's ability to pursue parties beyond the firm in administration or liquidation for redress.

For example, under the appropriate steps requirements, AFCA may take any other steps it considers appropriate and cost effective. These may include looking to the administrator or liquidator of the advice licensee who may have open claims under a PII policy in place which may cover some part of the compensation owed. However, AFCA cannot pursue parties, including other corporate entities, who may have purchased the company.

It is a policy matter for Government to consider if there are additional steps or reforms that may be necessary to ensure parties who may have some responsibility for large scale failures contribute to the cost of compensation. Further, we suggest PI arrangements be considered in further detail.