

Establishing a Compensation Scheme of Last Resort

Legal Aid NSW submission to Treasury

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Legal Aid 
NEW SOUTH WALES

About Legal Aid NSW

The Legal Aid Commission of New South Wales (**Legal Aid NSW**) is an independent statutory body established under the *Legal Aid Commission Act 1979* (NSW). We provide legal services across New South Wales through a state-wide network of 24 offices and 221 regular outreach locations, with a particular focus on the needs of people who are socially and economically disadvantaged.

We assist with legal problems through a comprehensive suite of services across criminal, family and civil law. Our services range from legal information, education, advice, minor assistance, dispute resolution and duty services, through to an extensive litigation practice. We work in partnership with private lawyers who receive funding from Legal Aid NSW to represent legally aided clients.

We also work in close partnership with LawAccess NSW, community legal

centres, the Aboriginal Legal Service (NSW/ACT) Limited and pro bono legal services. Our community partnerships include 29 Women's Domestic Violence Court Advocacy Services.

The Legal Aid NSW Civil Law Division focuses on legal problems that impact most on disadvantaged communities, such as credit, debt, housing, employment, social security and access to essential social services.

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Introduction

Legal Aid NSW welcomes the opportunity to respond to Treasury's Discussion Paper on *Implementing Royal Commission Recommendation 7.1 – Establishing a Compensation Scheme of Last Resort* (December 2019). We welcome the Government's commitment to establish a compensation scheme of last resort, to ensure that consumers and small businesses receive compensation, where a financial service provider is found to have engaged in misconduct and the provider is unable to pay.

Our feedback is informed by the legal services we provide to consumers in NSW, including Aboriginal and Torres Strait Islander consumers living in remote and regional communities. It is a continuation of Legal Aid NSW's advocacy during the Financial Services Royal Commission,¹ and the Ramsey Review.²

A Compensation Scheme of Last Resort (**CSLR**) has the potential to be an important means of:

- providing cost-effective, accessible redress for vulnerable and disadvantaged consumers
- promoting the fair and equitable treatment of a broad range consumers
- building confidence in the financial system.

Many of our clients are already in financial hardship when they seek out credit and financial services,³ and so the impact of recalcitrant or asset-poor financial firms failing to pay compensation awarded by the Australian Financial Complaints Authority (**AFCA**), a Court or a Tribunal, is exacerbated.

Legal Aid NSW supports the establishment of a CSLR that:

- is sufficiently broad in coverage to ensure that consumers, regardless of the nature of the industry or product that has caused loss, obtain redress

¹ Legal Aid NSW, *Financial Services Royal Commission Interim Report - Submissions in Response* (2018).

² Legal Aid NSW, 'Submission to the Review of the Financial System External Dispute Resolution Framework' (2016) 1 <<https://treasury.gov.au/consultation/dispute-resolution-and-complaints-framework-issues-paper>>.

³ Senate Economics References Committee, *Credit and Financial Services Targeted at Australians at Risk of Financial Hardship* (2019) <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Creditfinancialservices/Report>

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- encompasses determinations made against voluntary members of AFCA and those required to join AFCA by the Australian Securities and Investment Commission (**ASIC**) pursuant to regulatory action
 - allows for the payments to be made up to AFCA's compensation limits
 - is flexible and dynamic to allow for the emergence of new financial products and services and regulatory action
 - is appropriately funded by industry in a way that ensures that consumers are fully compensated in a timely manner
 - prioritises payments for disadvantaged and vulnerable consumers, particularly those experiencing financial hardship
 - manages unexpected costs without causing detriment to scheme applicants, and
 - is administered to promote compliance and minimise the occurrence of unpaid determinations.

Legal Aid NSW's responses to the questions raised in the Discussion Paper focus on areas informed by our direct casework experience.

Part 1: Coverage, beyond personal advice

Q1 What is the appropriate coverage for the CSLR, beyond the provision of personal advice?

Broad coverage approach

Legal Aid NSW considers that the CSLR should cover all activities, including credit products and financial services, undertaken by entities required to hold AFCA membership, as well as activities by entities that hold voluntary AFCA memberships.

In our view a 'broad coverage' approach would protect vulnerable consumers, provide increased consumer confidence in the credit and financial systems, and prevent stratification of outcomes at AFCA.

Further benefits to a broad coverage approach are that it:

- avoids market distortion by reducing the likelihood that entities will hive off those activities not covered by the CSLR into subsidiaries which do not require AFCA membership
- promotes clarity for consumers - particularly consumers from culturally and linguistically diverse backgrounds, consumers with vulnerabilities and or limited financial literacy

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- reduces consumer confusion - entities should not be able to benefit from the reputational and marketing advantages of being voluntary AFCA members in circumstances where consumers would associate such membership with the CSLR, but receive no protection under it
 - promotes equity - consumers, irrespective of the requirement for an Australian Financial Services Licence (**AFSL**) or an Australian Credit Licence (**ACL**), are entitled to expect compensation in the event of loss, if the entity is a member of AFCA
 - ameliorates the impact of existing regulation - some entities appear to structure their operations to avoid mandatory licensing,⁴ while also targeting people on low incomes without access to other products.⁵

In our casework experience, the occurrence of unpaid determinations is not limited to personal advice,⁶ and includes advice from entities with mandatory and voluntary membership of AFCA.

Limiting the coverage of the CSLR to personal advice may further entrench disadvantage and financial exclusion experienced by our clients, who often do not seek out personal advice due to the perceived cost and absence of relevance.⁷ Instead, our clients often rely on pay-day loans, small amount credit contracts, consumer leases and buy-now pay later schemes to manage financial difficulty.⁸

Case study: Inclusion of activities beyond personal advice

Legal Aid NSW assisted a group of Aboriginal clients from a remote community. This community was targeted by a consumer lease provider leasing household goods. Many of the clients were signed up to contracts during unsolicited home visits.

Legal Aid NSW assisted the clients to complain to the External Dispute Resolution (**EDR**) scheme (a predecessor to AFCA), arguing that the provider had engaged in unconscionable conduct and committed multiple breaches of consumer protection laws. As the provider refused to take part in the EDR scheme, it was expelled from the scheme.

⁴ Senate Economics References Committee, *Credit and Financial Services Targeted at Australians at Risk of Financial Hardship* (2019) <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Creditfinancialservices/Report>.

⁵ Ibid.

⁶ Australian Financial Complaints Authority, 'Submission to Treasury Discussion Paper - Establishing a Compensation Scheme of Last Resort' (2020).

⁷ Australian Securities and Investment Commission, *Report 627: Financial Advice: What Consumers Really Think* <<https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-627-financial-advice-what-consumers-really-think/>>.

⁸ Consumer Action Law Centre, *The Debt Trap: How Payday Lending Is Costing Australians* (2019) <<https://consumeraction.org.au/20191112-the-debt-trap-report/>>.

The majority of our clients who suffered loss were left uncompensated after being unable to access redress through the EDR scheme, and due to the prohibitive cost of taking the matter to Court.

If Treasury adopts a broad coverage approach, and similar complaints were to proceed through AFCA, its constitution binds expelled members to its rules in relation to commenced complaints and determinations made before expulsion.⁹ This would allow consumers to access the CSLR if the determinations against recalcitrant or insolvent entities are unpaid.

For some consumers, accessing a low cost and accessible scheme will be the only forum available to recover from loss. For example, enforcing judgement debts or commencing proceedings to wind up entities who don't pay is an unrealistic option for many of our clients, particularly as legal aid is generally not available for these kinds of matters.

We also consider that prudentially regulated firms should be covered by the CSLR.

Defining 'voluntary'

The scheme should explicitly include voluntary members and those that are required to be AFCA members due to ASIC's intervention. For example, pursuant to an enforceable undertaking.¹⁰

Until financial products such as funeral insurance, buy now pay later, and short-term credit providers are appropriately regulated and required to have AFCA membership, the CLSR should extend to AFCA's voluntary members. This is particularly important given that ASIC is currently unable to make a product intervention order requiring an entity to join an EDR scheme, such as AFCA, if they are not required to hold an AFS licence.¹¹

The Discussion Paper assumes that 'voluntary members' of AFCA are entities that are not required by legislation to be members of AFCA due to their status as AFSL or ACL holders, but who choose to do so. However, Legal Aid NSW draws Treasury's attention to a current AFCA member that falls outside of this definition, as illustrated in the following case study.

Case study: Funeral funds

⁹ Australian Financial Complaints Limited, *Constitution* (2018) <<https://www.afca.org.au/about-afca/corporate-information/constitution/>>.

¹⁰ Australian Securities and Investments Commission, '15-090MR ASIC Accepts New Enforceable Undertaking from Wealthsure Pty Ltd and Wealthsure Financial Services Pty Ltd' <<https://asic.gov.au/about-asic/news-centre/find-a-media-release/2015-releases/15-090mr-asic-accepts-new-enforceable-undertaking-from-wealthsure-pty-ltd-and-wealthsure-financial-services-pty-ltd/>>.

¹¹ *Corporations Act 2001* (Cth)

The Aboriginal Community Benefit Fund Pty Ltd and Aboriginal Community Benefit Fund No 2 Pty Ltd (ACBF) were found, in a 2004 court case brought by ASIC,¹² not to be covered by the ‘funeral expenses policy’ exemption in the *Corporations Act 2001* (Cth) and were therefore required to hold an AFSL to remain operating.

Both companies then applied for an exemption from that requirement. ASIC refused to grant the exemption as it would allow the sale of insurance policies without an AFSL. ASIC took a no-action position against ACBF on the condition that its trustees:

- became and remained a member of an external dispute resolution scheme;
- did not take on any new members;
- did not take any action that would increase members’ contribution fees; and
- did not provide financial product advice.¹³

Both entities became members of the Financial Ombudsman Service (FOS) and are current members of AFCA.

However, Legal Aid NSW remains concerned that Aboriginal people risk exclusion from a cost-effective and accessible means of redress, given:

- the significant number of unresolved ACBF complaints before AFCA
- the existence of potentially thousands of unrealised low value complaints¹⁴
- the volume of consumers reliant on the solvency of ACBF to pay funeral benefits¹⁵

If such entities are considered ‘voluntary’ members of AFCA, they would be excluded from the CSLR under the proposal in the Discussion Paper. We provide further detail of the impact of such an exclusion in response to Q2 below.

Q2 Would there be any unintended consequences from initially excluding court and tribunal decisions or from excluding voluntary members of AFCA from the CSLR?

Exclusion of voluntary members

¹² *Australian Securities & Investments Commission v Aboriginal Community Benefit Fund Pty Ltd* [2004] FCA 178

¹³ Australian Securities and Investment Commission, *Report 39: Overview of decisions on relief applications from financial service providers (August to December 2004)* https://download.asic.gov.au/media/1341368/Overview_relief_report_Aug-Dec04.pdf.

¹⁴ Royal Commission into Misconduct into the Banking, Superannuation and Financial Services Industry, *Witness Statement Bryn Jones*, Exhibit 4.146, ACBF.0008.0001.020

¹⁵ Consumer Action Law Centre, *Royal Commission into Misconduct into the Banking, Superannuation and Financial Services Industry: Submission on Round 4 Hearings* (2018) <<https://policy.consumeraction.org.au/wp-content/uploads/sites/13/2018/07/180716-ConsumerAction-Submissions-Policy-Round4.pdf>>

We note AFCA¹⁶ and Treasury's concerns, as set out in the discussion paper, that the inclusion of voluntary AFCA members into the CSLR may result in members choosing to exit AFCA or not join at all, resulting in fewer consumers having access to a credible and free EDR service. However, Legal Aid NSW considers that it is unclear if this would present a barrier for entities to join AFCA.

Further, there are number of factors which militate against the risk of a reduction in AFCA membership, including:

- careful crafting of CSLR membership arrangements and its levy/fee structure for voluntary members
- the reputational and marketing advantages of AFCA membership
- the small number of existing voluntary AFCA members¹⁷
- AFCA's Constitution, which requires 12 months written notice before cessation of voluntary membership takes effect, and imposes a requirement to deal with existing complaints and determinations¹⁸
- AFCA's Rules, which allow it to proceed directly to determination if it thinks the complaint is unlikely to be resolved by other means.¹⁹

However, Legal Aid NSW considers that the risk of an overall reduction of voluntary AFCA members is outweighed by the serious, detrimental unintended consequences that would arise from excluding 'voluntary' members of AFCA from the CSLR. We consider that obtaining an AFCA determination that cannot be realistically enforced is not a sufficient alternative, particularly for vulnerable consumers, and does not offer any option for redress.²⁰

As discussed above, Legal Aid NSW considers that ACBF's exclusion from the CSLR has the potential to leave a large cohort of Aboriginal people on low incomes without a cost effective or accessible means of redress, in the event that the entity becomes insolvent or is otherwise unable to meet its obligations. We submit that voluntary AFCA members should therefore be included within the scope of coverage of the CSLR.

Inclusion of court and tribunal decisions

We consider that small claims jurisdictions of courts and tribunals should be included in CSLR's initial remit on the basis that:

¹⁶ Australian Financial Complaints Authority (n 7).

¹⁷ Ibid.

¹⁸ Australian Financial Complaints Limited (n 17).

¹⁹ Australian Financial Complaints Authority, 'Complaint Scheme Rules' (2019) <<https://www.afca.org.au/about-afca/rules-and-guidelines/>>.

²⁰ Senate Economics References Committee (n 5).

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- coverage is limited to those court judgments or tribunal awards where the circumstances giving rise to the claim would have been eligible for consideration by AFCA
 - small claims are limited to \$40,000 under the section 199 of the *National Consumer Credit Protection Act 2009* (Cth)
 - small claims jurisdictions are often low volume – for example, there were eight Federal Circuit Court judgements within the consumer law jurisdiction in 2018-2019.²¹

Excluding such court and tribunal decisions from the CSLR would unfairly impact consumers who choose, or out of necessity are forced into, pursuing a non-AFCA remedy, as illustrated by the case study below.

Case study: Consumer lease provider

Legal Aid NSW acted for an Aboriginal woman, a single mother with two children from a remote community, in a dispute with a consumer lease provider. She purchased a couch and a television.

The provider engaged in practices that Legal Aid NSW considered were unconscionable and in breach of their responsible lending obligations. We assisted the client to lodge a dispute with an EDR scheme. The provider refused to engage in the EDR process and was expelled from the scheme.

Legal Aid NSW assisted the client to obtain a default judgement in the District Court for the entirety of her claim, for the amount of approximately \$9000 plus interest. However, our client has been unable to enforce the judgment as the provider has become insolvent. She remains uncompensated and this loss has compounded her circumstances of financial hardship.

If there is a decision to delay the inclusion of court and tribunal decisions in the CSLR, we submit that one year is a sufficient amount of time to analyse court and tribunal data, quantify the potential exposure and draft relevant procedures to address any concerns.

Part 2: Funding arrangements

Q3 To what extent should the funding model be based on risk?

²¹ Federal Circuit Court of Australia, *Annual Report*
<<http://www.federalcircuitcourt.gov.au/wps/wcm/connect/fccweb/reports-and-publications/annual-reports/2018-19/2018-19-annual-report>>.

Legal Aid NSW strongly supports the CSLR being adequately funded by industry, to ensure that all consumers have immediate access to compensation as soon as practicable following confirmation of their eligibility. We agree that the funding model should be risk-based.

Q5 Should the funding model assess risk at the individual financial firm level or at the financial service class level?

We support risk-based funding at an industry, rather than a company level. Industry-based fees will ensure that firms are incentivised to improve conduct industry-wide.

Q11 Is it better to avoid levy volatility or funds being tied up in a capital base that may not be often used?

The CSLR should be adequately funded in such a way that ensures consumers get access to compensation as soon as practicable following confirmation of their eligibility.

We support Treasury's proposal to build up the capital base in the CSLR's first few years of operation, whilst ensuring that levies are paid on an industry and participant basis.

Legal Aid NSW considers that the benefit to consumers of having a well-funded CSLR, in terms of available capital, outweighs the detriment that may be caused to financial firms in contributing capital that may not be often used.

Part 3: Compensation to be paid

Q18 How should compensation limits be used by the CSLR to balance the interests of consumers and those funding the scheme?

Legal Aid NSW supports the aligning of compensation limits under the CSLR with AFCA's compensation limits from time to time. This will ensure consistency of approach, greater certainty for both consumers and industry, and fairer outcomes for consumers.

Q19 If the CSLR compensation limits are to be lower than AFCA's claim limits, what limit would be appropriate?

Legal Aid NSW does not support CSLR compensation limits being set below AFCA limits.

In our view, this would be contrary to the intention of the scheme regarding comparability of outcomes. It may also cause confusion for consumers and industry and result in unfair

outcomes for consumers subject to non-compliance with industry standards or misconduct.

Q20 How should the CSLR manage claims associated with large unexpected failures?

The CSLR should be funded in such a way that there is sufficient capital funding to ensure that consumers who are entitled to compensation as a result of large unexpected failures are promptly paid out.

We consider that Treasury should work closely with ASIC and industry to determine whether this is best achieved by raising capital over time, the imposition of special levies, or a combination of both.

Q21 Should the CSLR be able to spread compensation payments over time and, if so, what would an appropriate maximum time period be?

Legal Aid NSW is not generally supportive of compensation payments being spread over time. However, we acknowledge that this may be a reasonable alternative mechanism to deal with large unexpected failures.

Our clients are generally disadvantaged before they seek out credit and financial services – often seeking out credit and financial services to purchase essential household goods, second hand cars, pay for food and utilities and repay debts because of statutory or low incomes. In addition, at the point at which compensation under the CSLR becomes payable, they have generally been through a lengthy and stressful process of internal dispute resolution and then external dispute resolution or getting orders in a Court or Tribunal. We consider that they should not be further disadvantaged by the delay in the provision of full compensation.

If compensation payments are to be spread over time, the permissible time limit should be as short as possible. To ensure that further hardship or disadvantage is avoided, we consider that priority should be given to immediately paying those consumers in hardship. For example, for those in financial hardship, people suffering from health impacts of financial problems, those at risk of eviction or home repossession or those unable to access housing.

Q23 How should compensation for legal and professional costs be limited?

To ensure consistency of approach, compensation for legal and professional costs should be limited to the amount set under AFCA's rules (see Rule D.5.2 of AFCA's rules that limits to \$5,000 the contribution of a financial firm to legal and other professional costs).

Part 4: Managing scheme evolution

Q24 What aspects of the design and operation of the CSLR should be determined by the CSLR and what aspects should be prescribed in legislation?

Legal Aid NSW supports a dynamic, flexible CSLR that is equipped to respond quickly to the changing nature of the financial landscape, whilst having ASIC oversight.

The discussion paper notes that one approach in designing the CSLR would be to *‘follow the framework for AFCA. That is, while legislation would prescribe certain aspects of the CSLR’s operations, a high degree of flexibility would be left to the scheme to determine other aspects of operations.’*

The matters that we consider should be legislated aspects of the CSLR include:

- the alignment of compensation to AFCA limits
- the methodology for calculating levies to ensure that the CSLR has enough funds to meet its obligations, and to ensure that industry pressure doesn’t result in the setting of insufficient levies
- ASIC oversight of the CSLR
- ensuring that its governance model includes consumer representation, and
- requirement by AFCA to advise consumers of their rights under the CSLR.

While we appreciate the need for the governance of CSLR to remain independent of AFCA, having the CSLR administratively incorporated into AFCA would result in clarity for consumers and oversight by AFCA of relevant determinations.

The CSLR and AFCA should ensure that its public facing material (factsheets, approaches and guidance) includes detailed information about the CSLR.

Legal Aid NSW submits that the establishment of the CSLR should also be accompanied by a targeted communication strategy to ensure that consumers are informed about:

- the function of the scheme
- eligibility requirements
- limitation periods
- how to access the scheme.

Vulnerable and marginalised consumers, including people with low literacy, older people and people from culturally and linguistically diverse backgrounds and associated service providers, such as financial counsellors, should be specifically targeted by a communication strategy to promote equitable access to the scheme.

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