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Senator Anthony Chisholm
Chair
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Senator Chisholm,

Financial Accountability Regime Bill 2021 [Provisions] and Financial Services Compensation Scheme of Last Resort Levy Bill 2021 [Provisions] and related bills

CPA Australia represents the diverse interests of more than 168,000 members, working in over 100 countries and regions supported by 19 offices around the world. We make this submission on behalf of our members and in the broader public interest.

CPA Australia believes it is essential that there is an appropriate external dispute resolution (EDR) framework for the financial services sector that ensures industry participants are accountable for the financial products and advice they provide. The framework should appropriately protect consumers and where necessary, allow them access to adequate compensation and redress.

It is for these reasons that CPA Australia supports the Government's intent to establish a Compensation Scheme of Last Resort (CSLR), which will help fulfil this objective while also supporting confidence in the financial sector's dispute resolution framework.

While the Government has introduced the Financial Sector Reform (Hayne Royal Commission Response No. 3) Bill 2021 to establish a CSLR, we are concerned that the scheme proposed in the Bill has significant short comings, including its narrow scope, appears to provide inadequate coverage to consumers and does not look to address the underlying causes of unpaid determinations.

CPA Australia also believes that all financial product providers and advisers, not just those in the retail financial advice sector, have a shared responsibility to lift the confidence and trust in the sector.

We are concerned that while the Federal Government has made a commitment to reducing red tape to cut the cost of doing business, the proposed scheme will arguably add significant cost and complexity, which seems to be at odds with this commitment.

The financial planning sector has undergone significant structural changes since the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*. With the exit of many large institutions, including the big four banks, many financial advisers are now sole traders or small businesses who simply cannot afford the continuing rising costs associated with increased complex regulation. The proposed scheme therefore risks making financial advice less affordable and accessible



in an environment where the impacts of COVID and Australia's ageing population mean that the need for advice continues to grow.

Our detailed responses are contained in the Attachment.

If you have any queries about this submission, please contact Keddie Waller, Head of Public Practice & SME on [REDACTED] or [REDACTED]

Yours sincerely

[REDACTED]

Dr Gary Pflugrath
Executive General Manager, Policy and Advocacy
CPA Australia

1. Scope of the Compensation Scheme of Last Resort

The proposed CSLR will consider claims for unpaid Australian Financial Complaints Authority (AFCA) determinations (that is, where a complaint was made to AFCA from 1 November 2018) and the determination is in relation to a financial product or service within the scheme's scope.

The Bill proposes that the CSLR will encompass five financial products and services:

- personal advice on relevant financial products to retail clients
- credit intermediation
- securities dealing
- credit provision; and
- insurance product distribution.

It is proposed that the CSLR levy framework will align with the ASIC Industry Funding Model (IFM), which currently applies to 48 sub-sectors across the financial services industry¹.

Of note, the Government announced² in August that Treasury will review the ASIC IFM to ensure it remains fit for purpose in the longer term given the structural changes taking place in the advice industry. The Government also announced temporary levy relief for financial advisers during this review, to support Australians having access to affordable professional advice. Given the review potentially may result in structural changes to the current ASIC IFM, this raises concerns with respect to aligning the CSLR levy framework to this model.

Additionally, unless the scope of the CSLR as proposed in the package of Bills before Parliament is amended to include all financial products, not all consumers who engage with an ASIC regulated financial product, with or without seeking professional advice, will have access to adequate compensation and redress. For example, the narrow scope of the proposed CSLR means that managed investment schemes (MIS) and other complex financial products will be excluded.

This exclusion will leave many consumers who invest directly into financial products including MIS, without first seeking professional advice, unable to seek appropriate compensation or redress in the event of a future collapse. This will have a significant impact on the wellbeing and financial security of those individuals and will place further pressure on the social security system as victims will be forced to rely on the Aged Pension.

The proposed scope is in part based on historic unpaid determinations data when financial product issuers were not required to be a member of an EDR scheme and complaints about financial products and providers fell outside of the jurisdiction of AFCA's predecessor schemes. However, where losses are incurred due to misconduct, misrepresentation or fraud of a product issuer or manufacturer, consumers should have a right to be protected. The proposed exclusion of this group is of concern given the significant losses that have been suffered by direct investors in the past.

CPA Australia recommends that the scope of the CSLR be amended to ensure consumers are adequately protected by including all Australian Financial Services (AFS) licensees who are legally required to be a member of AFCA as part of their respective AFS licence conditions.

This amendment would capture:

- AFS licensees who provide financial services to a retail client must be a member of AFCA (*Corporations Act 2001* s912A (1)(g) and s912A(2)(c)), which would include the responsible entity of a registered MIS (further discussed below), and
- Australian Credit licensees (*National Consumer Credit Protection Act 2009* s47(1)(i)).

To effect this change, the following changes would need to be made in the *Financial Sector Reform (Hayne Royal Commission Response No. 3) Bill 2021*:

- the removal of s1065 (1)(a)(ii)

¹ ASIC SUPERVISORY COST RECOVERY LEVY REGULATIONS 2017 (F2017L00805) - SCHEDULE 1

http://classic.austlii.edu.au/au/legis/cth/num_reg/asclr2017201700805566/sch1.html

² <https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/temporary-and-targeted-relief-asic-levies-financial>

- the removal of s1065(2)
- the replacement of all references to '*sub-sector*' with '*AFCA member*' in s1069M, which sets out the scope via notifiable instrument of will pay the CLSR levy, and
- the replacement of '*sub-sector*' with '*AFCA member*' and related terms throughout the Bill.

Noting that the *Financial Sector Reform (Hayne Royal Commission Response No. 3) Bill 2021* already refers to '*AFCA member*' throughout the Bill, these amendments would not only achieve the broader scope but also provide greater consistency within the Bill.

In both the *Financial Services Compensation Scheme of Last Resort Levy Bill 2021* and the *Financial Services Compensation Scheme of Last Resort Levy (Collection) Bill 2021* relevant references to the ASIC IFM such as '*sub-sector*' and '*levy period*' would also need to be replaced with '*AFCA member*' to align with the suggested amendments (above) to the *Financial Sector Reform (Hayne Royal Commission Response No. 3) Bill 2021*.

The levy payable to fund the CSLR could then form part of the annual AFCA membership invoice, which would also streamline the administration and associated operation costs of the scheme. Relevant amendments would need to be made to reflect this provision.

2. The role of Professional Indemnity Insurance

If financial services are being provided to retail clients, there must be arrangements in place to compensate aggrieved clients for breaches of Chapter 7 of the Corporations Act 2001 (Corporations Act). The primary way for AFS licensees to comply with this obligation is to require them to have professional indemnity (PI) insurance cover.

A contributing factor to the need for the CSLR is the failure of Professional Indemnity Insurance (PII) to respond appropriately to disputes, often leading to awarded decisions by AFCA remaining unpaid. Accessibility and affordability of PII for the retail personal financial advice sector have been challenges for many years, with the impact of the Financial Services Royal Commission resulting in some PII providers exiting the market.

The shrinking nature of available cover and associated risk premiums have resulted in many AFS licensees increasing their excess payable or accepting exclusions in cover to secure PII on an ongoing basis. It is also not uncommon for the approval process for PII to take three to six months. To ensure adequate consumer protection and the viability of a true CSLR, AFS licensees must be able to access affordable cover that is adequate for the nature of the AFS licensee's business and can adequately meet the potential liability for compensation claims.

CPA Australia recommends that Treasury undertake a government funded thematic review of PII for the retail personal advice sector, focusing on keys risks including:

- **accessibility**
- **adequacy**
- **exclusions, and**
- **impact on capital adequacy of the AFS licensee.**

As noted above, to ensure the viability of a true CSLR all AFS licensees must continue to hold appropriate PII cover. However, it is our understanding that ASIC only assesses if PII cover is appropriate for an AFS licensee at time of application or as part of a surveillance activity. In contrast, registered tax agents and BAS agents are required to provide details of their PII policy at time of application and must demonstrate at renewal of their registrations that they continue to hold appropriate PII that meets the requirements of the Tax Practitioners Board.

We recommend that ASIC adopt a similar model for AFS licensees. This model would have many benefits, including:

- ensuring that the AFS licensees continue to hold appropriate PII cover
- sending a signal to all participants that the regulator will be proactively regulating this obligation, motivating some non-complaint, or at risk, AFS licensees to retain appropriate cover, and
- providing insight to the regulator on trends and issues that may be occurring in the PII market.

CPA Australia recommends that ASIC requires all AFS licensees to submit their PII cover details as part of their existing annual compliance obligations. ASIC should audit a random sample across market participants to ensure there is adequate consumer protection for the users of financial products and advice.

3. Managed Investment Scheme Registration and Oversight

To register an MIS, the proposed responsible entity must:

- be a registered Australian public company
- hold an Australian financial services (AFS) licence authorising the responsible entity to:
 - operate the scheme (either an ‘in-kind’ scheme authorisation or ‘named-scheme’ authorisation)
 - provide any other relevant financial services in relation to the scheme and its underlying assets.

The responsible entity must also submit an application to ASIC that identifies the kind of scheme that is being registered, along with the scheme’s compliance plan that should consider issues such as compliance controls that will respond to the identified compliance obligations, risks and objectives.

Registered MIS are also required to meet financial obligations, as the holder of an AFS licence, which include that:

- the entity must be solvent at all times
- sufficient resources are available to meet anticipated cash flow expenses, and
- information about compliance with these financial obligations must be included in the annual audit report.

Given this, we believe it is reasonable for an individual considering investing directly into an ASIC registered MIS, that holds an ASIC issued AFS licensee, to be able to have a level of comfort that the company has had an appropriate level of assessment and oversight from the regulator, such that it is appropriate for the MIS to be commercially operating.

However, in its submission to the Parliamentary Joint Committee Inquiry into the collapse of Trio Capital Limited in 2011, ASIC stated:

Consistent with the economic philosophy underlying the FSR regime, ASIC does not take action on the basis of commercially flawed business models. A significant feature of a number of collapses leading to investor losses is flawed business models—that is, models that could only prosper if asset prices continually rose and debt markets remained open and liquid. Responsibility for flawed business models lies with management and the board.³

While this statement is some years old and we recognise ASIC can now apply product intervention powers, we question the appropriateness of the current regulation and oversight of registered MIS products if a commercially flawed business can be ‘approved’ and offered to the community. Of further concern is that often these products are complex and high risk, yet they are marketed directly to consumers through seminars and targeted advice.

We also question if this approach aligns with the Government’s statement of expectations for ASIC that it promotes the sound functioning of capital markets and the corporate sector for the benefit of businesses and households.

CPA Australia is concerned that there is a significant consumer protection gap in current regulatory settings in regard to these financial products. This must be addressed to protect those who choose to invest in such products without seeking professional advice – either by choice or because they may not realise that they are directly investing in a financial product.

CPA Australia recommends a review to assess the adequacy and effectiveness of the regulation and oversight of MIS to ensure that the community is appropriately protected and to assist in preventing future consumer losses.

3 PJC Inquiry Into the collapse of Trio Capital Limited, [Submission by the Australian Securities and Investments Commission](#). p.15