



8 November 2021

Senator Anthony Chisholm
Chair
Senate References Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Email: economics.sen@aph.gov.au

Dear Senator Chisholm,

SMSF ASSOCIATION SUBMISSION – STERLING INCOME TRUST INQUIRY

The SMSF Association welcomes the opportunity to provide this submission to the Senate Economics References Committee’s Inquiry into Sterling Income Trust. This submission does not seek to provide specific comment on the circumstances that led to the collapse of the Sterling Income Trust or associated entities. The focus of our submission will be in relation to the following terms of reference:

- Item B - The need for legislative and regulatory reform to prevent such losses in the future
- Item C - Access to justice and redress for victims of the Sterling Income Trust Collapse
- Item F - Any related matters

The Sterling case highlights that current consumer protections are insufficient. Currently there is no last resort compensation scheme applicable to some product manufacturers and providers. Of particular concern are managed investment schemes (“MIS”) and complex products.

The Association has repeatedly called for a last resort compensation scheme to be established to protect investors where there is serious misconduct, malfeasance, or fraud. This is essential for individual investors who invest personally or via their self managed superannuation fund.

Sadly, since the collapse of Trio Capital in 2011, and the various reviews and inquiries conducted, little has changed to improve consumer protections with regards to product providers. The breach reporting regime that applies to financial advisers does not extend to product providers. Product providers are exempt.

In addition, the proposed Compensation Scheme of Last Resort, which is currently tabled in the House of Representatives *Financial Sector Reform (Hayne Royal Commission Response No. 3) Bill 2021* provides for compensation in relation to personal financial advice and limited financial products only.

The exemption of financial product providers from the breach reporting regime creates a gap in the ability for consumers to be fairly and appropriately compensated for inappropriate behaviours and failures of product providers.



Breach reporting requires that a breach or likely breach is reported to ASIC. This will identify issues at a much earlier point in time and will mitigate consumer harm. The risk that breaches, likely breaches, and misconduct continue undetected is significantly reduced. Further, the costs of investigation and compensation are a liability of the entity that is at fault, rather than a cost levied across sector participants.

The early detection, investigation, and remediation of matters of concern delivers a stronger system and better outcomes for consumers. The outcome being likely intervention before consumer harm becomes significant or widespread.

The breach reporting regime needs to be expanded to include product providers. This will increase the level of accountability and obligations of product providers, and ultimately an earlier opportunity for regulator intervention.

The drafting of the proposed compensation scheme of last resort legislation restricts application of the scheme to financial advice, securities, and credit intermediaries only. Financial products, such as managed investment schemes and other complex products are excluded from the proposed scheme.

Under the proposed scheme, consumers are in effect, actively encouraged or incentivised to seek to find fault with the advice they received. Where the product provider has collapsed or been forcibly wound up, the only avenue for advised consumers will be to seek redress from the adviser. Any compensation awarded by AFCA would then be supported by the proposed compensation scheme.

We agree that where inappropriate advice is given, the appropriate action should be taken, including the compensation of consumers. AFCA determinations do show that, where applicable, fault is shared between advice and product. However, in the event of the insolvency of the product provider, consumers will generally only be protected via the compensation scheme for damages awarded in relation to the advice given.

This creates an unfair burden of responsibility with the perception of fault levied on the advice sector. More importantly, any consumers who are unadvised, having invested directly with a managed investment scheme that has collapsed or failed, will likely have no ability to seek compensation from any other avenues. Limited opportunities may be available through the commencement of costly court action where the scheme operator remains solvent. If available, this avenue is often out of reach of the average person, particularly where they have already suffered significant financial losses such as the investors in the Sterling Investment Trust. Access to the proposed compensation scheme is then denied.

The proposed compensation scheme, in its current form, will not provide a safety net to investors in the Sterling Income Trust.

We support the compensation scheme of last resort and the safety net it provides consumers for unpaid AFCA determinations. However, an urgent review is needed to include product manufacturers and providers. The scheme needs to be fair and equitable, with those responsible to compensate consumers who are impacted.

There is a need for greater regulatory oversight with regards to complex, novelty styled products. The Sterling case highlights the impacts to ordinary Australians, in this case retirees, who have suffered



life changing losses. These include significant financial losses but also a loss of security and dignity in retirement.

There is an urgent need for compensation to restore some level of normalcy and stability for the victims of the Sterling Investment Trust.

The Sterling case highlights the gross deficiencies in the existing legislative framework and the compensation scheme as it is currently proposed.

If you have any questions about our submission, please do not hesitate to contact us, and we thank you again for the opportunity to provide this submission.

Yours sincerely,

Peter Burgess
Deputy CEO/Director of Policy and Education
SMSF Association

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak body representing SMSF sector which is comprised of over 1.1 million SMSF members who have more than \$700 billion of funds under management and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for advisors and education standards for trustees. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial planners and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them access to independent education materials to assist them in the running of their SMSF.