

Submission to the Senate Economics Legislation Committee

Inquiry into the Financial Sector Reform (Hayne Royal Commission Response No. 3) Bill 2021 and related Bills

Disclosure and Disclaimer

Until 31 October 2021 I was the Chief Executive Officer of the National Insurance Brokers Association of Australia. In that capacity I made submissions to and participated in discussions with the Ramsay Review and the Federal Government consultations regarding the proposed Compensation Scheme of Last Resort.

This submission is prepared and presented on my own behalf, and does not and is not intended to reflect or represent the views of the National Insurance Brokers Association or its members. The views expressed in this submission are my personal views on this important topic.

The submission is intended to assist Senators understand a number of important issues relating to the Compensation Scheme of Last Resort (CSLR).

Outline of Submission

I note the Inquiry relates to provisions of the Bills. Given the CSLR was recommended by the Hayne Royal Commission, and seeks to remedy instances of substantial injustice, I expect the Bills will be passed by the Parliament in due course.

However, in doing so, the Parliament needs to be aware that this scheme will be funded by responsible, law abiding financial services organisations, including many thousands of medium and small businesses that hold and operate under Australian Financial Services Licences. The CSLR establishes a process whereby the responsible are required to fund the losses incurred by the irresponsible, those who avoid and evade important regulatory obligations.

As such, responsible financial services companies (large and small) will have to carry the burden of yet another industry levy. Ultimately it will be the clients of the responsible businesses that finance this scheme.

In order to avoid the moral hazard associated with the transfer of financial responsibility inherent in this scheme, the regulatory obligations associated with the operation of financial services businesses must operate, and must be monitored and enforced, efficiently and effectively at all times.

Last Resort

As noted in the Explanatory Memorandum¹, the CSLR is intended to provide compensation to eligible consumers where they have an AFCA determination in their favour and where the relevant financial firm has not paid the consumer in accordance with the determination.

The scheme operator will investigate applications for compensation in order to determine eligibility, the existence of an AFCA determination in favour of the applicant, and the fact that the

¹ Chapter 2, paragraph 2.9, page 60.

determination is and is likely to remain unpaid. As such, the scheme is intended to operate only when all other mechanisms for meeting the determination in favour of the applicant have failed.

AFS Licensee Obligations

Holders of an Australian Financial Services licence (AFSL) have number of important obligations under the Corporations Act 2001². The regulatory requirements include obligations in relation to –

- The competence, knowledge and skills of responsible managers;
- Ensuring your financial advisers and authorised representatives comply with the financial services laws;
- Compliance, managing conflicts of interests and risk management; and
- **The adequacy of your financial, technological and human resources.**

ASIC Regulatory Guide 166 sets out in detail the regulatory obligations relating to the financial position of the financial services business.

A key financial obligation of the Corporations Act is the requirement to have available adequate financial resources to provide the financial services covered by the AFS licence and to carry out supervisory arrangements³. The financial resources held by the business must be enough to cover any risks the business faces that may affect the cash position and that it is reasonable for the business owner to plan and manage⁴.

All AFS licence holders must meet the following base level financial requirements⁵:

- The solvency and positive net assets requirement
- The cash needs requirement
- The audit obligations.

It is clear that a financial services business must remain financially viable in order to meet its statutory and regulatory obligations, including the obligations to meet any determination against it by AFCA.

ASIC has clearly set out the obligations and expectations of AFS licence holders in Regulatory Guide 166. Responsible business owners recognise the regulatory requirements, and ensure they are observed and met at all times.

Monitoring and Enforcement

The primary process for monitoring compliance with the financial requirements on AFS licence holders is the audit report that must be provided by each AFS licence holder⁶.

In addition to the role of the auditor in assessing and reporting on the extent to which the business complies with its regulatory financial obligations, one would assume that ASIC has a process to identify businesses of actual or potential concern, and has the capacity to take appropriate steps

² See: [AFS licensee obligations | ASIC - Australian Securities and Investments Commission](#)

³ ASIC Regulatory Guide 166, paragraph RG166.1.

⁴ ASIC Regulatory Guide 166, paragraph RG166.29.

⁵ ASIC Regulatory Guide 166, paragraph RG166.30.

⁶ ASIC Regulatory Guide 166, paragraph RG166.63.

where and when necessary to ensure the AFS licence holder continues to meet its regulatory obligations. This is consistent with the policy intent of the recently enacted ASIC Product Intervention Powers, which give the regulator the power to act BEFORE consumers sustain losses from dangerous or inappropriate financial products.

Effective monitoring and enforcement of the financial obligations in the Corporations Act 2001 will ensure that CSLR genuinely remains a “last resort” scheme, hopefully to be called upon only in a small number of instances in the future.

Where CSLR is called upon, it would suggest there has certainly been a failure by those responsible for managing the business, but it would also suggest there has been a failure in the monitoring and enforcement processes – the financial services regulatory structures - which oblige business owners to maintain sufficient financial resources at all times.

My submission is that the passage of this legislation should not reduce in any way the importance of strong and effective audit and regulatory oversight of financial services businesses. Only strong and effective enforcement will ensure the number of last resort compensation awards is kept to a minimum, and the cost of CSLR will not become an adverse burden on responsible financial services operators.

Insurance Cut Through Rights

The Explanatory Memorandum⁷ indicates the amount of compensation to be offered to the consumer will take account of amounts already received by the consumer from a range of sources. This is intended to prevent double compensation for the loss.

In some instances, it is possible for a person with a claim for damages against an insured entity (in the current circumstances it is assumed the insured entity – the AFS licence holder – would have taken out professional indemnity insurance) to pursue the claim directly against the insured’s insurer.

There are a number of statutory provisions which give an innocent third party “cut through” rights to claim directly against the insurer. One such example is section 601AG of the Corporations Act 2001, which enables a third party with a claim against a deregistered company to sue the company’s liability insurer directly.

A detailed article on statutory cut through rights was published in 2018 by Western Australian barrister Greg Pynt. The article⁸ is available on the AUSTLII database.

My submission is that cut through rights should be explored and utilized, where available, prior to any final payment under the CSLR scheme.

Thank you for the opportunity to make this submission.

Dallas Booth

⁷ Explanatory Memorandum, Chapter 2, paragraph 2.46 and following.

⁸ Pynt, Greg – “When can a third party claim the benefit of another person’s liability insurance contract?” [2018] PrecedentAULA 71.