



Insurance Council
of Australia

Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Submitted via Online Portal

7 October 2022

To whom it may concern

Inquiry into the Financial Accountability Regime Bill 2022 [Provisions]; Financial Sector Reform Bill 2022 [Provisions]; Financial Services Compensation Scheme of Last Resort Levy Bill 2022 [Provisions] and the Financial Services Compensation Scheme of Last Resort Levy (Collection) Bill 2022 [Provisions]

The Insurance Council of Australia (ICA) is the representative body of the general insurance industry in Australia and represents approximately 89 per cent of private sector general insurers. A foundational component of the Australian economy, the general insurance industry employs approximately 60,000 people and on average pays out \$148.7 million in claims each working day (\$38.8 billion per year).

The ICA thanks the Senate Economics Legislation Committee for the opportunity to make a submission to its inquiry on the above Bills. Our comments below refer to the Compensation Scheme of Last Resort (CSLR), on which we have previously made submissions to several inquiries.¹ Our submission takes into account recent engagement with The Treasury on the impact of the collapse of Dixon Advisory and Superannuation Services Ltd (Dixon Advisory). These developments have materially and substantially changed the circumstances and impact of the upfront levy component of the Scheme.

We wish to highlight two matters arising as a result of the Dixon Advisory collapse and the consequential impact on the Scheme. First, the upfront levy on large financial services companies would place a significant impost on some of Australia's largest insurers while excluding the sub-sector (advice) that principally contributed to unpaid determinations flowing from the collapse of Dixon Advisory. This significant and material change in the situation since the initial introduction of the legislation in late 2021 and the engagement that took place with government at that time should be taken into account.

Second, we reiterate our view that the CSLR should operate as a scheme of *last* resort, not as a port of first call. The example of the Dixon Advisory collapse reinforces our concerns regarding the moral hazard risks of cross-subsidisation. Complementary measures – including enforcement of requirements that financial advice companies hold appropriate professional indemnity (PI) insurance – are needed to minimise calls on the scheme and ensure that the CSLR operates as intended.

¹ ICA, *Submission to the Compensation Scheme of Last Resort Discussion Paper* ([link](#)); ICA, *Submission to the Compensation Scheme of Last Resort Proposals Paper* ([link](#))



Material Change in Circumstances

When the enabling legislation for the CSLR was initially introduced on 28 October 2021 it included provision for large financial services companies to pay a one-off upfront levy to fund the payment of complaints to the Australian Financial Complaints Authority (AFCA) that had been lodged by a specific date (the date of the Bill's introduction) but not been paid.

While the Scheme proper, once operating, funds unpaid AFCA determinations (complaints to AFCA that have been through AFCA's processes to determination, with verified loss) the approach to the up-front levy is different, only requiring that complaints have been lodged with AFCA by a certain date. While the Bill requires the Scheme Operator to form a view on the amount that should be raised through the up-front levy, the funds to be raised from select companies via the up-front levy may exceed the amount payable under subsequent AFCA determinations regarding the complaints lodged prior to the cut-off date. Further, the Bill expressly states that any excess amount raised via this levy will not be returned to those companies. The ICA does not believe that this approach is consistent with good public policy.

For the avoidance of doubt, the ICA reiterates that prudentially regulated insurers are not the subject of any unpaid AFCA determinations. While insurers have previously expressed concerns regarding this aspect of the Scheme's design,² at the time of the Scheme's design and legislative introduction the overall amount of the entire pool to be funded by this upfront levy (estimated at around \$20 million) was not seen as excessive and was in line with earlier Commonwealth Government contributions to fund legacy unpaid determinations.

Parliament did not deal with the legislation prior to the May 2022 election, and it was re-introduced in September 2022. In the intervening period, the collapse of Dixon Advisory has added significantly to the accumulation of unpaid complaints. The ICA understands that relevant financial services companies have been advised by The Treasury that the quantum of total accumulated complaints may reach the \$250 million cap for the upfront levy, of which three general insurers would be required to fund approximately \$50 million. Participants in the sub-sector in which the collapse occurred would not be required to fund any of the upfront levy.

While Dixon Advisory has been the subject of a Federal Court penalty,³ AFCA has yet to finalise any determinations. Indeed, AFCA halted its consideration of complaints regarding Dixon Advisory earlier in 2022.⁴ There are also ongoing class action proceedings, which may result in compensation for the same losses that are the subject of the complaints to AFCA (and therefore could be within scope for payments via the CSLR). Further, while Dixon Advisory's voluntary administration is ongoing, the extent of recoverable assets to fund compensation claims is unknown as is any recourse to PI insurance.

In any event, the increase of the upfront levy quantum from ~\$20 million to \$250 million is a significant and material change and should prompt reconsideration. Understanding and planning for financial liabilities is critical for insurers, particularly given that the industry continues to support customers impacted by recent natural disasters and is already in the process of preparing for extreme weather events over the coming months.

² ICA, *Submission to the Compensation Scheme of Last Resort Proposals Paper* ([link](#)) p3

³ ASIC *Media Release – Dixon Advisory Penalised \$7.2million for Breaches of Best Interest Obligations* ([link](#))

⁴ AFCA *Dixon Advisory and Superannuation Services in Administration* ([link](#))



Given the substantial and material change in circumstances over the last year, the ICA therefore recommends that the legislation be amended to change the unpaid accumulated levy date to the date on which the legislation was introduced in the previous Parliament (ie. 28 October 2021).

Importantly, this change would *not* mean that Dixon Advisory complainants would go uncompensated. Instead, this approach would allow completion of processes relating to Dixon Advisory's voluntary administration (including any payments to creditors), the ongoing class action proceedings, and provide for the usual AFCA processes to be completed (including verifying the amount of uncompensated loss). To the extent that there remains any uncompensated loss after these processes, the CSLR may then respond as a true scheme of last resort, including through raising funds across entire industry sectors (including the sector that has given rise to the unpaid complaints).

Addressing Cross-Subsidisation: A Genuine Scheme of Last Resort

An effective CSLR should operate as a scheme of last resort, not as a first port of call.

In earlier submissions, we have noted the potential cross-subsidisation raises for moral hazard risks, as it essentially requires companies that meet expected ethical and prudential standards to underwrite those who do not and then avoid paying compensation to consumers. The Dixon Advisory matters neatly illustrate these concerns. By moving the bulk of the potential liability onto insurers and banks, no incentive is provided for the advice sub-sector to improve its practices and regulatory compliance, nor is there any incentive for the regulator to oversee those sectors more effectively.

The CSLR's built-in mechanism for cross-subsidisation (the Ministerial special levy) has been described as necessary to ensure appropriate compensation for "black swan" events. However, it is inappropriate to describe these events as "black swans". Far from being rare and unpredictable events, collapses of non-prudentially regulated financial services firms occur on an unfortunately regular basis.⁵

When similar incidents occurred in banking and insurance (for example, the HIH collapse of 2001), Government tightened supervisory and prudential standards. This was an appropriate response that heightened standards, prevented further collapses and protected consumers in subsequent years.

The regulatory framework should be designed to minimise calls on the CSLR. From a customer perspective, it is far preferable for regulatory supervision to prevent such collapses rather than seek to remedy them after they occur. Even if consumers are eventually remedied, post-facto remediation creates years of stress, anxiety and uncertainty. Key elements of a successful CSLR scheme should therefore include action to ensure that financial services entities hold appropriate levels of capital and PI insurance. We note the Government has indicated it is actively considering the regulation of the managed investment scheme sector,⁶ and we suggested that consideration be given in respect of other non-prudentially regulated sectors.

The former Government undertook to consult on the effectiveness of PI insurance in responding to compensation claims,⁷ although this did not progress. The ICA notes that ASIC already requires financial services firms to hold "adequate" levels of PI insurance coverage.⁸ While not setting out an

⁵ For example, Opes Prime and Storm Financial

⁶ Assistant Treasurer and Minister for Financial Services Steven Jones MP, *Second Reading Speech, Bills - BILLS - Financial Accountability Regime Bill 2022, Financial Sector Reform Bill 2022, Financial Services Compensation Scheme of Last Resort Levy Bill 2022, Financial Services Compensation Scheme of Last Resort Levy (Collection) Bill 2022 - Second Reading*, 28 September 2022

⁷ Treasury Media Release *Government Meets Legislative Commitments* ([link](#))

⁸ ASIC *Regulatory Guide 126 – Compensation and Insurance Arrangements for AFS Licensees* ([link](#))



exhaustive list of factors that firms need to consider when assessing adequacy, RG 126 makes clear that key matters are “liability for claims brought through [AFCA]”⁹ at a level that would cover “a reasonable estimate of retail clients’ potential losses”.¹⁰ The ICA and insurers remain willing to work with Government to ensure appropriate enforcement of RG 126.

Next Steps

We again thank the Committee for the opportunity to make this submission. Should you wish to discuss this response further, contact Ms Aparna Reddy, General Manager, Policy and Regulatory Affairs, at [REDACTED] or [REDACTED].

Regards



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Chief Operating Officer

⁹ Ibid, RG 126.41
¹⁰ Ibid, RG 126.43