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8 November 2021

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

By email: [economics.sen@aph.gov.au](mailto:economics.sen@aph.gov.au)

Dear Senator Chisholm,

### **Inquiry into Sterling Income Trust**

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 supports the Federal Parliament's decision to call on the Senate Economics References Committee to undertake an Inquiry into the collapse of Sterling Income Trust. We are not in a position to comment specifically on the Australian Securities and Investments Commission's (ASIC) oversight of the Sterling Income Trust. However, we believe this collapse warrants further consideration and assessment to determine the case for legislative and regulatory reform to prevent future consumer losses, in particular from failed registered Managed Investment Schemes (MIS). We also believe that regulatory reform is essential to ensure that, in the future, all victims of financial product failure and/or poor financial product advice can access appropriate and efficient means to seek justice and redress.

### **Compensation Scheme of Last Resort**

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.

It is our understanding that, as it stands, many victims of the Sterling Income Trust collapse have been unable to access compensation or redress through the Australian Financial Complaints Authority (AFCA) as their complaints falls outside of the EDR scheme's jurisdiction. However, we understand that AFCA has paused complaints in relation to Sterling Income Trust until the scope of Government's proposed CSLR is known.

While the Government has tabled in Parliament 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 and may not assist victims of Sterling Income Trust. The CSLR, as proposed, is too narrow in scope, appears to provide inadequate coverage to consumers and does not seem to address the underlying causes of unpaid determinations.

The narrow scope of the proposed CSLR means that MIS and other complex products are excluded. This is, in part, because the Bill is based on historic unpaid determinations data, when 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.

This exclusion will leave many consumers who invest directly into schemes such as Sterling First ultimately 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.

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

**CPA Australia recommends that the scope of the CSLR Bill be amended to include all financial products to ensure all consumers who engage with a financial product, with or without seeking professional advice, have access to adequate compensation and redress.**

### **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 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 Australian Financial Services (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 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 require 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.**

## 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 take 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.<sup>1</sup>*

While this statement is some years old, 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 promote 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 they are directly investing in a financial product.

CPA Australia believes that a review must be undertaken 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.

Yours sincerely

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

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<sup>1</sup> PJC Inquiry Into the collapse of Trio Capital Limited, [Submission by the Australian Securities and Investments Commission](#). p.15