MEDIA RELEASE

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COMPENSATION SCHEME FAILS TO PREVENT SOURCE OF UNPAID DETERMINATIONS

The Financial Services Council (FSC) has urged the Government to amend the proposed Compensation Scheme of Last Resort (CSLR) to prevent the “moral hazard” of shifting costs onto companies and consumers who have done nothing wrong.

The FSC also calls on ASIC to strengthen enforcement of existing laws to prevent the source of unpaid determinations resulting from advice failures.

The proposed design of the CSLR does little to reduce the risk of unpaid Australian Financial Complaints Authority (AFCA) determinations and simply shifts the cost, via levies, to financial services companies that have done nothing wrong.

EY economic modelling commissioned by the FSC demonstrates the future cost of advice failures for the CSLR is likely to be $59.2 million, significantly higher than the $8 million forecast by the Government, once ‘black swan’ events, such as a financial crisis, are taken into account.

The FSC recommends:

- ASIC introduce minimum capital requirements for Advice Licensees;
- ASIC has proactive oversight of Professional Indemnity Insurance (PI) held by Advice Licensees;
- Provisions in the CSLR are introduced to prevent phoenixing;
- Retaining the $150,000 cap on claims proposed by the Government; and
- House the CSLR in Treasury to remove conflicts of interest and reduce operational costs.

The FSC’s recommendations would lower costs and protect all advice businesses that act with integrity from those that are unable to meet compensation demands and instead push the cost of failure onto the broader industry

FSC CEO Sally Loane said: “For the CSLR to genuinely be a scheme of last resort for consumers ASIC must strengthen its oversight of existing requirements for advice licensees to have appropriate capital, professional indemnity insurance and compensation arrangements in place.”

“Weak enforcement has been a significant contributor to the current scale of unpaid determinations and the future cost of the scheme, and a more proactive approach to enforcing the law is essential,” Ms Loane said.

“Why put a safety net under a leaky bucket? Mandating that sound financial services businesses to fund consumer compensation for those businesses which have failed is moral hazard writ large.”

“The FSC recommends ASIC undertake risk-based reviews of a representative sample of advice licensees to encourage good practice and reduce the risk of consumer unpaid determinations arising from those businesses that are undercapitalised and have inadequate insurance.

“The CSLR should also be amended to prevent phoenixing, where an operator abandons a company to avoid compensation and shifts the cost onto the CSLR, only to start a new company in the same sector. In the UK phoenixing has contributed to the ballooning 700-million-pound cost of their compensation scheme.”

EY economic modelling demonstrates that if the FSC’s recommendations are implemented by the Government, future costs arising from the CSLR can be reduced from $59.2 million to $7.8 million through the following measures:

- Introducing capital requirements and stronger ASIC oversight of PI insurance, in addition to requiring the scheme operator to comprehensively pursue third party recovery, would reduce the cost of the scheme by $46.4m; and
- Introducing measures to prevent phoenixing would reduce the scheme by $5m.

Simplifying the governance of the scheme would be expected to have a modest impact on reducing the operational costs of the scheme over time but were not included in the EY modelling.

The above measures show that sensible scheme design measures, as well as concurrent reform to strengthen advice licensees, can significantly lower future CSLR costs whilst also providing a significant safety net for consumers.

For a copy of the key findings of the EY Report: https://fsc.org.au/resources/2267-ey-economic-analysis-cslr-summary/file

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