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CONSULTATION PAPER 111

Compensation and financial resources arrangements for credit licensees

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B1Q1 Do you agree with proposal B1? Please give reasons for your views.

Self assessment is always a good thing but you must remember current practices have been set for licence holders in Western Australia at $1,000,000 up to $3,000,000 (variances within) depending on what services you are offering. For example; retail versus commercial, number of employees/contractors, but clear guidelines were set, even though the amounts required versus the risk factor could best be described as excessive. Another issue I see here is that in Western Australia there are currently many licence holders and each is required to carry their own PI insurance cover, whilst under this new credit regulation the actual amount of licensees will reduce considerably as the licence holders come to realise their roles and responsibilities. Hence they will be looking to remain in business but move towards becoming an authorised representative or alternatively maintain their independence by becoming a Corporate Authorised representative under a licence holder. One could not imagine a licence holder being too overly pleased to carry the PI cover for all its authorised representatives that operate under their control as that may be cost prohibitive in some cases.

Issues may also occur with insurers being able to distinguish between employees and contractors operating under a licensee's licence and also to have a clear understanding of the risk coverage required may be an issue.

B1Q2 Do you think that proposal B1 gives adequate assurance that we will achieve our objectives identified at paragraph 22? Please give reasons for your views.

Given there are many unexplained issues as above, the way forward needs further discussions with thoughtful input. You must also understand that guidance will be required by many who may also seek to undervalue their risk to reduce the costs associated with obtaining Professional Indemnity insurance. Whilst the Finance/Mortgage Broking industry has been functioning in WA since 1988, there are many new Finance Brokers operating in the industry and many more who will for the first time be exposed to a regulated environment. Remember some states have had no minimum requirements in the past. Also it has not been compulsory for all finance brokers to be a member of an association nor to meet minimum current and ongoing educational requirements. ASIC's new requirements will ensure this now happens, which in turn will lift the professionalism and results within the industry.

B2Q1 Do you think that proposal B2 gives adequate assurance that credit licensees will have sufficient minimum liquidity? Please give reasons for your views.

All licence holders have a requirement under the corporations act to ensure they have adequate resources to conduct their business within the normal day to day operations. The imposition of the three months in advance rule will be new to many given that they will have knowledge of their expenses but the income over the next three months may be harder to determine. The latest credit crunch is a case in point and one must also understand that many current licence and future new credit licence holders rely on their future cash flows to meet their ongoing business trading viability. Having adequate back-up resources via over drafts etc is certainly one way for a licensee to be in a position to be able to sign off on the three month in advance viability.
Adequate PI Cover must be a consideration if the business/licence holder cannot prove there are other financial arrangements available to meet a claim if called upon to cover the unexpected. There would be very few businesses that could cover any such claims by clients from their cash flow.

B2Q2 Do you think that ASIC should set minimum financial requirements that apply to all credit licensees such as a base level solvency and/or a net tangible asset requirement? For example, will competitive pressure to hold less liquidity mean that credit licensees will not maintain sufficient levels of capital and liquid assets? Would imposing a base level requirement amount to an unreasonable burden?

Yes I feel this is unreasonable, as all licence holders would have their required obligations (duties and responsibilities of its Directors) under the Corporations Act and imposing such an obligation is not warranted. Whilst current FSR licence obligations certainly do have this requirement and as you have stated Credit is considered less risk, imposing a minimum level of PI cover depending on the business model would serve more benefit and security to all.

B2Q3 Do you think that ASIC should provide additional guidance to credit licensees about what might be considered 'adequate' financial resources?

Once again we are talking about business owners who are in fact governed already by the Corporations Act but as mentioned above, guidance on PI level cover would certainly provide the right direction for all licence holders.

B3Q1 Do you agree with our proposal regarding the ongoing assessment process? If not, why not? For example, does this proposal give adequate assurance that a licensee will comply with our financial requirements?

Under the FSR licence obligations the accounts of the licence holder have to be audited annually and signed off to verify ongoing viability. Given the risk factor with non credit providers as already discussed I feel this step may be an expensive overkill and let us not forget company directors are already held accountable under the Corporations Act.

B3Q2 Do you think that we should require credit licensees to provide an annual audit report about compliance with our financial requirements? What would be the additional cost of imposing an audit requirement and would this amount to an unreasonable burden?

Verification of correct PI cover and review of current cover amount would be more beneficial to all.

Having the financial report completed on an annual basis also brings into play other issues in that to try and get a reasonable priced audit report that covers financial matters is a difficult and expensive process. Most auditors undertaking this role charge high fees and many are reluctant to undertake the role due to the fear factor that has attached itself to this process.
Requiring all licence holders to sign off that they have adequate funding available would not be burdensome as directors already complete this process when signing off annual accounts.

C1Q1 Do you agree with our proposals on what is an adequate amount of cover?

Yes I agree with the fact that a minimum be set for non lenders but feel given we have already established the credit losses for non lenders via customer claims have not been totally over excessive. Hence I feel a starting minimum cover should be set at $1,000,000 and be capped at $20,000,000 in line with current FSR requirements. Complexity of the respective licensee's service offerings would need to be considered overall. It is necessary to have some guidelines to enable licensees to meet the required amounts and without guidelines it will cause unnecessary stress and issues.

Certainly lenders will be in a much stronger position to assess their own risk factors and also they may wish to self insure which they do on many other risk factors associated with their business models. Therefore to seek PI coverage from them may in some cases not be reasonable as they would have adequate resources to cover via self insurance etc. This would depend on the lender being controlled under the banking licence or a non bank funder as each has different risk issues associated with their respective business models.

C1Q2 Should ASIC distinguish between lenders and non-lenders as outlined in the proposal? Please give reasons for your views.

Yes for the reasons stated above and to reinforce this again, lenders would normally be in a much stronger position to self insure and would also constantly review their risk factors on an ongoing basis. Non lenders on the other hand would certainly need to be adequately covered with PI.

C1Q3 Do you believe that $2 million is an appropriate minimum level of PI insurance cover for credit licensees (as currently applies to AFS licensees)? Or do you think that different risk considerations apply and a lower limit of $1 million is appropriate (as currently applies to finance brokers licensed in Western Australia)?

It has already been established through Consultation Papers 110 and 111 that the finance industry does not pose the same amount of risk as the Financial Planning and advising industry and therefore minimum cover should commence at $1,000,000 for any one claim and $2 million in the aggregate. One issue to consider here as well is; say a non lender writes large deals in excess of their PI cover how would that then be addressed, would higher coverage need to be sought on one off deals? This would add further cost burdens to the overall approval process or the overall risk given that the amount of exposure may not be that high due to security held etc.

C2Q1 which definition of 'lender'/'non-lender' do you prefer and why?

I consider (a) a simple assessment of the situation as you will find some licence holders also provide credit via white label or other types of funding and at the same time employing an authorised representative to sell such products. Non lenders are considered just the resellers of such products.

C2Q2 Do you think the description of the 'primary business' test is sufficiently clear for you to apply it to your activities? If not, what additional detail do you suggest?

Would need to include any licensee that provides credit no matter if its primary business or not.

C3Q1 Do you agree with our proposal on what is an adequate *scope* of cover? Please give reasons.

Agree with the summarisation of the PI cover here given the potential lower level of risk associated with holding a credit licence. There must be some guidelines and measurement for licence holders to be guided by.

C3Q2 Do you agree with our proposal that an adequate policy must continue to provide access for potential claims for a reasonable period after the policy expires or the credit licensee ceases business? Please give reasons

This is a must and competition within the insurance industry if this is a requirement, then competition will ensure this requirement is included in all PI policies and made available to all finance licence holders and their authorised advisers.

C4Q1 Should anyone other than an APRA-regulated insurer or limited direct offshore foreign insurers be able to provide PI insurance cover for the purposes of the compensation requirements for credit licensees? Please give reasons.

Whilst one would associate with many insurers that fall under the control of APRA, we must also understand that there are mutual's operating in the Australian market very successfully and they are under the control and supervision of ASIC. These mutuals have operated for many years in the Australian market and service very large client bases and to exclude them from the ability to provide the PI cover could then best be described as restrictive trade. ASIC maintains strong controls over these mutual's' and hence they are also strongly regulated and should not be excluded from providing the required cover to meet ASIC's requirements.

C5Q1 Are the steps in Table 1 and questions in Table 2 helpful for licensees to consider in assessing what is adequate cover? Are there any other processes or procedures that you follow when obtaining and maintaining PI insurance that ASIC should discuss in its policy?

Processes that have been listed will certainly give licence holders a valid checklist to determine that their new policy meets all the regulator’s requirements but by being able to determine the amount of cover may cause some early confusion. Insurers already cover Dealer Licence holders and one would think it would be a great PR exercise for them to show how they currently assess required coverage. Insurers in turn would need to ensure the policies/wording that ASIC is requiring to be met would also be included in the policy document and offering from the insurer. As the industry grows and develops competition, experience will also assist the industry in finding the middle ground. Associations could also assist in giving no liability presentations on this matter to assist their members in getting and understanding on how to place a value on the PI cover.

C5Q2 Is the guidance in this section of the paper likely to directly result in any increase in your compliance costs? Please give details, including figures and reasons.

Insurers need to also be partners and assist their clients by ensuring the correct policy document is offered to meet all the ASIC requirements. Each Licence holder would then be required to ensure the policy contains all the required clauses in the policy statement.
Verification of the policy document wording at start up and at each renewal would not be an over burden or add too much cost to the business. It is always a risky practice to read and fully understand what you are buying and that it does meet your needs.

C6Q1 Are there any practical problems with requesting this information?

Requesting of such information is a necessary and required process which ensures that all parties are protected before issuing the licence. Licence holders need to understand their business meets all requirements and that they are being met on an ongoing basis.

D1Q1 Do you agree with our approach to assessing alternative arrangements? Please give reasons.

Given ASIC's experience already under RG126, it is only fair to also allow some Credit Licence holders to hold alternative approved arrangements without the need to hold PI cover issued via an insurer. This may also allow some licence holders to maintain a competitive advantage rather than facing the added burden of meeting large PI insurance premiums.

D1Q2 Are there other alternative arrangements you might consider using in place of PI insurance cover? Please provide details

No. I feel you have it covered

D2Q1 Do you agree with our proposal on approved guarantees? Please give reasons.

Yes given the cover will be effectively the same as issuing the PI policy, the Licence holder will in fact is able to meet the claim requirements if called upon.

D2Q2 We understand that APRA may treat such guarantees as a form of capital support. Taking this into consideration, to what extent do you think that this exemption is likely to be used?

As long as the time limit and amount meet the requirements of the Licence holder if called upon and provide no less protection than adequate PI insurance cover, I have no issues with APRA treating such guarantees as a form of capital support.

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