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Enhancing the effectiveness of financial service professional indemnity insurance

The Super Members Council (SMC) thanks Treasury for the opportunity to make a submission to this consultation. In a fair and sustainable system, mechanisms like the Compensation Scheme of Last Resort (CSLR) must operate strictly as a true last resort – protecting consumers from catastrophic failures while ensuring costs are borne by those responsible for harm. Frequent reliance on the scheme, including through special levies, undermines its purpose and erodes levy payer confidence. As a well targeted last-resort mechanism, it would also be more efficient and sustainable in protecting members from most egregious harm, while ensuring that the costs of the scheme that are ultimately borne by consumers, do not escalate.

Strengthening professional indemnity insurance (PII) requirements can play a role in improving consumer outcomes, particularly for adviser-level misconduct where PII is capable of responding. Mandating relevant financial firms, especially in higher-risk segments of personal advice, to maintain adequate, reliable PII helps ensure that a portion of straightforward misconduct claims are addressed before they escalate to the CSLR. While this will not materially reduce claims arising from large-scale licensee failures or insolvency, where PII typically does not respond, targeted improvements to PII settings can still reduce some routine claims pressure, reinforce basic accountability, and modestly limit the number of smaller disputes reaching the scheme. These measures should therefore be viewed as complementary to, rather than substitutes for, the broader regulatory and supervisory reforms needed to preserve the CSLR as a genuine last-resort mechanism and to shield compliant levy payers from the costs of systemic failures.

For APRA-regulated trustees, the Operational Risk Financial Reserve (ORFR) provides robust protection against losses from misconduct or failure providing capital that can be used to insulate losses for members. Extending similar principles to PII for relevant licensees, such as through tighter minimum coverage limits, reduced excesses, and clearer fraud exclusions would ensure perpetrators bear primary responsibility while preserving CSLR reserves for exceptional cases. Well-designed PII is one part of an improved system of accountability and consumer protections. It shapes incentives to manage risk, determines who ultimately bears the cost of failure and affects whether the group can withstand major advice-related losses without defaulting to members or the CSLR.

While enhanced PII requirements represent a vital lever to protect consumers and stabilise the CSLR, they are not a substitute for upstream prevention. Gaps in the existing regulatory architecture, including inconsistent enforcement of licensee obligations under ASIC's RG 234, limited proactive risk monitoring, and inadequate oversight of high-pressure or conflicted sales practices, continue to permit consumer harm. Without reforms to existing anti-hawking provisions, conflicted remuneration prohibitions, licensing frameworks for platforms providers and early-intervention mechanisms, these weaknesses will continue to drive PII claims and premiums upward. In the absence of a more consistent and preventive approach, PII may become prohibitively expensive for compliant firms, reducing the availability and accessibility of quality financial advice for consumers.

SMC notes that any increase in regulatory requirements or obligations relating to PII is likely to lead to premium repricing and potentially higher costs across the market. Such changes could shift the distribution of the cost burden among different segments of the financial services industry. It is essential that any significant adjustments to PII settings be informed by robust consultation and supported by modelling to understand how changes in premiums and availability may affect all insured entities across the financial services sector.

Further, and in line with PII being the first line of defence, SMC also reiterates its previous calls to Government to explicitly rule out any extension of CSLR levies to APRA-regulated super trustees. These funds already meet dedicated compensation and remediation costs through fund reserves including their required ORFR and have no history of CSLR claims.

SMC recommends that Treasury:

1) Mandate PII for relevant licensees including appropriate risk-tiering for minimum coverage, calibrated to absorb typical claims before CSLR intervention.
2) Impose liability caps calibrated to verified claims experience to help avoid over-insurance that burdens smaller licensees.
3) Draw on appropriate technical expertise from the insurance sector to advise on targeted adjustments to coverage limits, exclusions, pricing structures and disclosure that improve consumer outcomes while preserving the availability and affordability of cover.
4) Work with ASIC to increase prevention and oversight through mechanisms such as:

– consumer disclosures on unpaid determinations.

– standardised PII data collection and targeted ASIC supervision to detect under-insurance before harm crystallises.

5) Legislate options to permit CSLR to claim directly where appropriate, or to “stand in the shoes” of an insolvent licensee/administrator to pursue the insurer reducing socialisation of losses through CSLR levies.

– To supplement this, mandate that claims must be lodged via a licensee’s PII provider before claim can progress to the CLSR.

– Compensation should also be sought from the failed firm’s related entities, including directors, executives, and affiliates responsible for misconduct, if monies cannot be recouped from the failed entity. This measure should be available before any recourse to the CSLR levy-funded pool.

6) Exploring targeted government funding for legacy misconduct cases (e.g., pre-CSLR) to avoid ongoing levy burdens on current compliant firms.

About the Super Members Council

We are a strong voice advocating for the interests of 12 million Australians who have over $1.6 trillion in retirement savings managed by profit-to-member super funds. Our purpose is to protect and advance the interests of super fund members throughout their lives, advocating on their behalf to ensure super policy is stable, effective, and equitable. We produce rigorous research and analysis and work with Parliamentarians and policy makers across the full breadth of Parliament.

Strengthen PII as a first defence

SMC represents 12 million Australians whose retirement savings are affected by CSLR levy design and any spill-over of costs from higher-risk sectors. While not an association in insurance, SMC as a member council in super can offer a system-wide perspective on how CSLR settings interact with APRA's prudential framework for super trustees (including the ORFR requirements) and identify where levy structures and cross-sector cross-subsidies risk undermining members retirements.

The CSLR should operate as a tightly targeted, last-resort that supports confidence in the financial system without eroding the retirement of members. To that end, PII serves as the first line of defence for consumers, absorbing claims from licensee misconduct before they reach the CSLR. While those interacting directly in the PII market are best placed to propose the detailed design changes to insurance settings, SMC recommends reforms to minimum PII requirements to ensure the primary role of PII is effective, reducing scheme pressure and protecting levy payers from socialised costs.

SMC recommends that Treasury:

- Mandate PII for relevant licensees including appropriate risk-tiered minimum coverage to absorb typical claims before CSLR intervention. This would align with the findings made by the Post-Implementation Review on the CSLR.[1] This would position PII as a first line of defence, reducing CSLR claims pressure and promoting scheme sustainability without the need to socialise costs across low-risk sectors like APRA-regulated super funds.
- Impose liability caps calibrated to verified claims experience to help avoid over-insurance that burdens smaller licensees.

Promoting prevention and oversight

ASIC oversight to prevent harm

Recent collapses in wealth and advice have revealed entrenched governance, product and conduct failures that PII settings alone cannot fix. Targeted annual audits of higher-risk AFSLs, such as those operating complex managed investment scheme (MIS) structures, or aggressive super switching models, would surface systemic weaknesses earlier and reduce the cost pressures on both the PII and CSLR.

SMC recommends Treasury coordinate with ASIC to strengthen enforcement through annual compliance audits for high-risk licensees and public breach reporting. This may include proactive licensee monitoring via risk-based supervision before systemic issues result in a spike of disputes escalating to AFCA or CSLR. Public reporting of serious or repeated breaches would also add reputational and market discipline by making chronic non-compliance visible to consumers, trustees and counterparties, helping them avoid firms that repeatedly fail to meet obligations or pay AFCA determinations.

ASIC oversight of adequate PII

SMC also recommends that ASIC implement standardised PII data collection and targeted ASIC supervision to detect under-insurance before harm crystallises. This could include:

- Mandating periodic confirmations from licensees that PII is current and adequate, shifting from reactive to proactive oversight.
- Reviewing PII policies directly for consumer protection alignment and integrate checks into breach reporting or risk-based targeting based on complaints and notifications.
- Enhanced data sharing with AFCA and CSLR to flag non-use of PII early.

Enhance CSLR recovery mechanisms

Under the current framework, the CSLR's reliance on ordinary subrogation rights and general insolvency processes creates practical problems as identified in Treasury's consultation paper. These structural weakness in the recovery pathway undermine the sustainability of the CSLR.

Financial Services Council modelling suggests that if the CSLR could recover even 50% of outlays

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[1] Post-Implementation Review: Compensation Scheme of Last Resort Submission by the Compensation Scheme of Last Resort March 2025, page 12

through direct insurer pursuit, scheme costs could fall dramatically – from tens of millions to as low as $12.8 million in some scenarios.[2] Legislating nationally consistent, enhanced subrogation rights would:

- Maximise recoveries by empowering the CSLR operator to lodge proofs of debt directly in licensee wind-ups and pursue PII insurers without relying on patchwork state laws.
- Restore "last resort" integrity by shifting costs back to those with primary responsibility (insurers underwriting the risk), rather than socialising losses via industry levies.

SMC recommends that Government introduces a nationally uniform subrogation framework that expressly empowers the CSLR operator to claim directly against a licensee's PII insurer once compensation has been paid to the consumer.

Further, SMC recommends that compensation should also be sought from the failed firm's related entities, including directors, executives, and affiliates responsible for misconduct, if monies cannot be recouped from the failed entity. This measure should be available before any recourse to the CSLR levy-funded pool.

SMC also recommends Treasury explore targeted government funding for legacy misconduct cases (e.g., pre-CSLR) to avoid ongoing levy burdens on current compliant firms.

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[2] Financial Services Council, Compensation Scheme of Last Resort (FSC submission), August 2021