



**ASIC**

Australian Securities & Investments Commission

## REGULATORY GUIDE 210

# Compensation and insurance arrangements for credit licensees

March 2010

### **About this guide**

This guide is for credit licensees and insurers.

It sets out how we will administer the compensation requirements under s47 of the *National Consumer Credit Protection Act 2009* (National Credit Act).

### About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

**Consultation papers:** seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

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- explaining when and how ASIC will exercise specific powers under legislation
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets:** provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports:** describe ASIC compliance or relief activity or the results of a research project.

### Document history

This regulatory guide was issued on 29 March 2010 and is based on the credit legislation and regulations as at 29 March 2010.

### Disclaimer

This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the credit legislation and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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## A Overview

### Key points

If you are a credit licensee (and not also regulated by APRA) you must have adequate arrangements in place for compensating consumers: see RG 210.1–RG 210.6.

The primary way to comply with this obligation is to have professional indemnity insurance (PI insurance). We may also approve alternative arrangements.

We will administer the compensation requirements with the objective of reducing the risk that credit licensees cannot meet claims for compensation, due to insufficient financial resources: see RG 210.7–RG 210.14.

Whether a PI insurance policy for credit licensees is adequate depends on the amount and scope of cover and the relevant terms and conditions of that policy.

## Legislative background

- RG 210.1 Under s48(1) of the *National Consumer Credit Protection Act 2009* (National Credit Act), a credit licensee must have in place adequate arrangements for compensating consumers for loss or damage suffered because of breaches of the National Credit Act by the licensee or its representatives.
- RG 210.2 These arrangements must either satisfy the requirements prescribed in the National Consumer Credit Protection Regulations 2010 (National Credit Regulations) or be otherwise approved by us in writing as alternative arrangements. Regulation 12 requires a credit licensee to hold PI insurance cover that is adequate having regard to:
- (a) the licensee's membership of an external dispute resolution (EDR) scheme or schemes (including those schemes of which its credit representatives are members), taking account of the maximum liability that has, realistically, some potential to arise in connection with any particular claim against the licensee and all claims in respect of which the licensee could be found to be liable; and
  - (b) relevant considerations relating to the credit activities of the credit licensee, including:
    - (i) the volume of business;
    - (ii) the number and kind of clients;

- (iii) the kind or kinds of business; and
- (iv) the number of representatives.

RG 210.3 All credit licensees must comply with the requirement to hold PI insurance unless exempt under the National Credit Regulations: see reg 12.

RG 210.4 Regulation 12 exempts from the requirement to hold PI insurance:

- (a) a credit provider whose sole business is lending (i.e. it only engages in credit activities as defined in items 1, 3, 4 and 5 of the table in s6(1) of the National Credit Act, and only provides credit services in relation to its own credit contracts or consumer leases);
- (b) an authorised deposit-taking institution (ADI), general insurance company or life insurance company regulated by the Australian Prudential Regulation Authority (APRA); and
- (c) a company for which a related, APRA-regulated entity has provided a guarantee approved by ASIC.

Credit licensees that fall within one or more of these exemptions are still subject to the general obligation to have in place adequate arrangements for compensating consumers under s48(1); however, these licensees may determine how best to satisfy this requirement themselves, and may do so in some other way than through holding PI insurance if they choose. Such licensees are not required to seek our approval of their compensation arrangements.

Note: The Explanatory Statement to the National Credit Regulations states that only a person who does not hold adequate PI insurance and who does not meet the definition of an exempt licensee will need to seek approval of alternative compensation arrangements: see p. 7.

RG 210.5 This means that the credit licensees that have to comply with the requirement to hold PI insurance are:

- (a) lenders that undertake some non-lending credit activities (other than simply providing credit services in relation to their own credit contracts and consumer leases); and
- (b) credit licensees that undertake non-lending credit activities (such as finance brokers, mortgage brokers, credit advisers and loan advisers). We refer to these credit licensees as ‘non-lenders’.

RG 210.6 When considering alternative arrangements, in addition to the adequacy measures in reg 12, we must have regard to the credit activities carried on under the credit licence and whether the arrangements will be sufficient to cover consumers after the licensee ceases to engage in credit activities, and for how long: see s48(3)(b). This is discussed further in Section C.

Note: In this guide, the requirements set out in s48 of the National Credit Act and reg 12 of the National Credit Regulations are referred to as the ‘compensation requirements’.

## Our general approach

### Our objective

- RG 210.7 Our objective in administering the compensation requirements is to reduce the risk that losses sustained by consumers cannot be compensated by a credit licensee, because of a lack of available financial resources.
- RG 210.8 The proposed compensation requirements are not, however, meant to be a mechanism for providing compensation directly to consumers and may not cover all possible consumer losses.

### Our approach

- RG 210.9 We think that three main factors are particularly relevant to determining whether a PI insurance policy is adequate for the purposes of the compensation requirements:
- (a) the amount of the cover;
  - (b) the scope of the cover; and
  - (c) whether any of the terms and conditions of the policy would undermine its overall effect (e.g. by excluding cover for key aspects of the credit licensee's business).

Our requirements in relation to each of these elements are discussed further in Section B. In addition, Table 2 (in Section B) sets out questions we think will assist licensees in determining whether a PI insurance policy is adequate.

- RG 210.10 The standards we have set in relation to what constitutes adequate PI insurance cover will also set the benchmark for our approval of any alternative compensation arrangements proposed by credit licensees.

### What this means for credit licensees

- RG 210.11 Credit licensees will need to determine whether they are legally required to hold PI insurance, or whether they can rely on an exemption from this requirement: see RG 210.3–RG 210.4.
- RG 210.12 If a licensee is subject to the requirement to hold PI insurance, then it must hold a policy that:
- (a) provides at least \$2 million in cover per claim and in the aggregate; and
  - (b) meets the other requirements we have set in relation to the scope of the cover (see Section B).

- RG 210.13 If a licensee wishes to use a compensation mechanism other than PI insurance to meet its obligations under the National Credit Act, it must apply to us for approval to use that arrangement.

### **What this means for consumers**

- RG 210.14 Our approach in administering the compensation requirements is designed to reduce the risk that credit licensees will have insufficient financial resources to compensate losses sustained by consumers.

## **Meeting the compensation requirements**

- RG 210.15 Credit licensees must meet the compensation requirements in order to undertake credit activities. For further information on how we will assess compensation requirements during the credit licence application process, see Regulatory Guide 204 *Applying for and varying a credit licence* (RG 204).

## B PI insurance

### Key points

We will administer the compensation requirements to reduce the risk that losses sustained by consumers cannot be compensated by credit licensees: see RG 210.16.

Whether a PI insurance policy for a credit licensee (other than one that is also APRA-regulated) is adequate depends on three factors:

- the amount of the cover (see RG 210.19–RG 210.24);
- the scope of the cover (see RG 210.25–RG 210.30); and
- whether the terms and conditions of the cover undermine the overall effect (e.g. by excluding cover for key aspects of the credit licensee’s business) (see RG 210.31–RG 210.35).

Based on these factors, licensees should assess what is adequate PI insurance cover to meet their obligations under s48(2) and obtain such cover: see RG 210.37–RG 210.44.

Credit licensees not otherwise exempt from the requirement to hold PI insurance will be subject to a specific licence condition that they obtain adequate PI insurance.

### Policy objective

- RG 210.16 Our objective in administering the compensation requirements is to reduce the risk that losses sustained by consumers cannot be compensated by a credit licensee, because of a lack of available financial resources. However, our requirements are not meant to be a mechanism for providing compensation directly to consumers, and may not cover all possible consumer losses.

### What is ‘adequate’?

- RG 210.17 The National Credit Regulations provide that, unless otherwise exempt, a credit licensee must hold PI insurance cover that is adequate, having regard to:
- (a) the credit licensee’s membership of an approved EDR scheme or schemes, taking into account the maximum liability that has, realistically, some potential to arise in connection with:
    - (i) any particular claim against the licensee; and



- (ii) all claims in respect of which the licensee could be found to have liability; and
- (b) relevant considerations relating to the regulated credit business carried on by the credit licensee, including:
  - (i) the volume of the licensee's business;
  - (ii) the number and kind of clients;
  - (iii) the kind or kinds of credit activities; and
  - (iv) the number of representatives of the licensee.

This is not an exhaustive list of the factors that credit licensees need to take into account in assessing what PI insurance cover is adequate in their circumstances.

Note: See reg 12.

- RG 210.18 We think the following factors are particularly relevant in determining whether a PI insurance policy for a credit licensee is adequate:
- (a) the amount of the cover;
  - (b) the scope of the cover; and
  - (c) whether the terms and conditions of the cover undermine the overall effect (e.g. by excluding cover for key aspects of the credit licensee's business).

### **Amount of cover**

- RG 210.19 If a PI insurance policy is going to be an effective mechanism for compensating consumer losses, the amount of cover provided must be sufficient. In this context, this means both:
- (a) the per-claim limit of indemnity—that is, the maximum insurance cover for each individual claim; and
  - (b) the aggregate limit of indemnity—that is, the maximum insurance cover for all claims.
- RG 210.20 What is an adequate amount of cover will differ between credit licensees. More specifically, the following considerations are relevant:
- (a) the extent of the credit activities undertaken by a credit licensee, including the scale of activities undertaken by credit representatives;
  - (b) the nature of its business; and
  - (c) the likelihood of claims against that credit licensee.

Note: See reg 12.

- RG 210.21 Credit licensees should assess all areas of their business to determine their potential exposure to consumer claims. For example, licensees that engage in both lending and non-lending activities may determine that a higher level of

cover is required for the non-lending portion of their business; however, it is still prudent for these licensees to examine their business as a whole when assessing their PI insurance needs.

- RG 210.22 We have set minimum requirements for the amount of PI insurance cover that credit licensees should hold. That is, credit licensees that are required to hold PI insurance should assess the amount of PI insurance that they require on a sliding scale, as follows:
- (a) the policy should cover at least \$2 million per claim and in the aggregate; and
  - (b) cover should be approximately equivalent to actual or expected revenue from credit activities relating to consumers (up to a capped maximum of \$20 million).

Note 1: Revenue has the same meaning in this context as in AASB 118 *Revenue*.

Note 2: For the purposes of this minimum requirement, a credit licensee's revenue should be calculated including the revenue that any credit representatives receive from engaging in credit activities.

Note 3: Revenue may be calculated based on the financial year ended prior to taking out the insurance policy and reassessed on each policy renewal. For new licensees, or if a licensee believes revenue is likely to change substantially, the licensee should make an estimate of expected revenue.

- RG 210.23 We understand that many PI insurance policies cover claims against non-lenders by both consumers and lenders. As claims by lenders may cause the cover to reach its annual limit very quickly, we believe they should be excluded from the prescribed minimum amount of cover. If non-lenders consider it is needed, they should assess this risk separately, and ensure that their PI insurance policy includes sufficient cover for both consumer and non-consumer claims.

- RG 210.24 Some credit licensees will require more cover than others for their PI insurance policies to be adequate. Credit licensees must retain records of how they determined what amounts were adequate for them.

### **Scope of cover**

- RG 210.25 Section 48(1) requires that the compensation arrangements cover loss or damage suffered because of a contravention of the National Credit Act by the credit licensee or its representatives.
- RG 210.26 Credit licensees are subject to broad obligations under the National Credit Act, including a duty to do all things necessary to ensure that the credit activities authorised by their licences are engaged in efficiently, honestly and fairly: see s47. Credit licensees are also subject to a range of specific obligations. Losses caused by negligent, fraudulent or dishonest conduct that amounts to a breach of the National Credit Act should be covered.

RG 210.27 Our minimum expectations as to the key features of an adequate PI insurance policy are that the policy must:

- (a) cover loss or damage suffered by consumers because of breaches of obligations under the National Credit Act or licence obligations;

Note: The policy need not explicitly refer to ‘breaches of obligations under the National Credit Act or licence obligations’ or ‘compensation awards made by EDR scheme(s)’. The policy must, however, have the effect of providing cover for breaches of these obligations and for meeting those awards.

- (b) cover breaches by both the credit licensee and its representatives; and

Note 1: Credit licensees need to take into account all of their representatives (not just credit representatives) when considering the type and extent of cover that will be adequate. This is because a consumer will generally have the same remedies against a credit licensee as against its representatives.

Note 2: The credit licensee’s policy does not need to indemnify the licensee for acts of its representatives if such acts are adequately covered by the representatives’ own PI insurance cover and the licensee has a contractual right to be indemnified by its representatives.

- (c) be available to cover compensation awards made by the EDR scheme(s) to which the credit licensee and its representatives belong.

RG 210.28 In our view, an adequate PI insurance policy would also continue to provide access for potential claims that come to light for a reasonable period (i.e. at least 12 months) after either the policy expires or the credit licensee ceases business (run-off cover). However, we are aware that it may be difficult for some licensees to obtain such cover, depending on the nature of their business or of the insurance market at the time of seeking the cover.

RG 210.29 Therefore, we require credit licensees to make reasonable efforts to obtain a minimum of 12 months automatic run-off cover; however, we will not require a credit licensee to hold run-off cover where it is not reasonably available to them. By ‘automatic’ run-off cover we mean cover that is provided for in the PI insurance policy itself, and that applies where the licensee retires or sells the business.

RG 210.30 In assessing whether a licensee has made reasonable efforts, we will have regard to:

- (a) whether more than one insurer has indicated that it is not prepared to offer automatic run-off cover to the licensee in question; or
- (b) if automatic run-off cover has been offered to the licensee, whether the cost of obtaining such cover would be disproportionately expensive in relation to the licensee’s expected business revenue.

Note: Australian Financial Services (AFS) licensees are not required to hold run-off cover as part of their PI insurance policies: see Regulatory Guide 126 *Compensation and insurance arrangements for AFS licensees* (RG 126). We are aware that it may be difficult for a person holding both AFS and credit licences to obtain run-off cover, and will take this into account when assessing whether a licensee has made reasonable attempts to obtain run-off cover.

Credit licensees should document the process of seeking run-off cover, for example, by retaining correspondence with insurers, and produce this documentation on request.

### **Terms and conditions that undermine the effect of the policy**

- RG 210.31 Even if a PI insurance policy generally meets our requirements in relation to the amount of cover and scope, if any individual terms and conditions would undermine the overall effect of the policy it will not be adequate. Particular examples of such terms and conditions include those providing for exclusions, excesses and deductibles.

#### **Exclusions**

- RG 210.32 Exclusions in a PI insurance policy that impact on the credit licensee's ability to compensate consumer losses will ordinarily make that policy inadequate, especially exclusions that relate directly to the minimum scope of cover outlined above. In general, a policy containing exclusions relating to breaches of the National Credit Act and the associated regulations would not be adequate.

- RG 210.33 More specifically, we consider exclusions dealing with the following to be significant:

- (a) EDR scheme awards and awards made by the Federal Court under the proposed small claims (i.e. up to \$40,000) jurisdiction;

Note: A policy will not be inadequate merely because it contains a lower sub-limit on the amount that can be claimed as a result of an EDR scheme award.

- (b) loss caused by the conduct of representatives;  
 (c) fraud and dishonesty by agents and representatives; and  
 (d) claims for misrepresentations about services.

#### **Excesses and deductibles**

- RG 210.34 Excesses and deductibles are common features of PI insurance policies currently in the market. However, a high excess or deductible might have the effect of the credit licensee having to draw heavily on its financial resources before being able to draw on the policy to meet a consumer's claim for compensation.

- RG 210.35 Credit licensees must assess what financial resources are required (to cover the excess and gaps in cover due to various exclusions) and ensure that they have the necessary financial resources available to them. Licensees should be able to demonstrate to us that they have such financial resources available, and should retain records of those assessments. These records should indicate how the financial resources were calculated (e.g. using capital, cash flow, overdraft or support from a parent company).

Note: See Regulatory Guide 207 *Credit licensing: Financial requirements* (RG 207) for guidance on measuring financial resources.

## Which entities can provide the cover?

RG 210.36 Our experience in administering other compensation arrangements is that it is crucial that licensees only hold PI insurance cover from financially sound and well-regulated insurers. As such, we believe that only an insurer that is regulated by APRA under the *Insurance Act 1973*, or is exempted from regulation under that Act, is able to provide adequate cover. This does not prevent licensees from seeking our approval of alternative arrangements with bodies other than these. Such arrangements are discussed further in Section C.

## Process for assessing adequacy and obtaining cover

RG 210.37 Whether a PI insurance policy is adequate for a particular credit licensee depends on all of the relevant facts and circumstances, including the nature, scale and complexity of the credit licensee's business and its other financial resources. It is therefore left to each credit licensee to determine what is adequate to meet its obligations under s48(2). Some credit licensees might find it helpful to engage external consultants, actuaries, brokers or advisers to undertake risk assessments of their businesses and provide advice on the amount and type of cover that they should obtain.

RG 210.38 Our role is not to assess the adequacy of every PI insurance policy covering credit licensees. Therefore, we will not formally 'approve' a credit licensee's PI insurance arrangements, whether or not the credit licensee already has PI insurance cover in place upon the commencement of the National Credit Act.

### Initial assessment

RG 210.39 As noted in RG 210.17, credit licensees should consider the list of factors in reg 12 regarding what constitutes adequate PI insurance cover. However, this should not be regarded as an exhaustive list of the relevant factors to consider. For example, the terms of the insurance policy itself will also be relevant to whether the policy is adequate.

RG 210.40 We suggest that licensees use the assessment process outlined in Table 1 to determine the PI insurance that will be adequate for them.

**Table 1: Initial assessment process**

Step 1	Assess the business, including claims history, level of business, and risk management procedures (including proposed changes to the business).
Step 2	Assess potential liability. We suggest that a credit licensee can determine 'the maximum liability that has, realistically, some potential to arise', as required by reg 12, by making a reasonable estimate of the following factors: <ul style="list-style-type: none"> <li>• the maximum exposure to a single consumer (worst-case scenario);</li> <li>• the number of claims that could arise from a single event (potential for multiple claims); and</li> <li>• the number of claims that might be expected during the policy period.</li> </ul>
Step 3	Ask insurers or insurance brokers for a list of key policy features, exclusions and available extensions (based on full disclosure of the information the licensee has assembled under Steps 1 and 2).
Step 4	Consider whether the amount and scope of cover is adequate in light of the factors identified in Section B.
Step 5	Review the policy by asking a series of questions (outlined in Table 2) as to the adequacy of the cover.

RG 210.41 We suggest that licensees review the policy features by asking the key questions in Table 2. This will help determine whether a particular policy is adequate. This is not intended as an exhaustive list of potentially relevant questions.

**Table 2: Key questions for credit licensees**

Policy features	Questions to ask
<b>Scope of cover and extensions</b>	Does the policy cover: <ul style="list-style-type: none"> <li>• losses from breaches of the National Credit Act by the credit licensee and its representatives;</li> <li>• negligence and other common law claims generally;</li> <li>• fraud and dishonest conduct by agents and representatives;</li> <li>• EDR scheme awards relating both to the credit licensee and all of its representatives; and</li> <li>• agreements reached through the EDR scheme conciliation process?</li> </ul>
<b>Amount of cover</b>	Does the policy have an adequate level of indemnity to cover a reasonable estimate of consumer losses?  Is the level of indemnity adequate to cover claims brought both inside and outside EDR schemes?  Does the level of indemnity cover claims for losses relating to activities for which a credit licence is not required? This is important as these claims can reduce the amount of cover available for claims that are made by consumers, meaning the licensee might need to increase the level of cover to take account of this factor.  Are defence costs covered separately from the amount of indemnity cover?  Does the policy provide for automatic reinstatement? This means that if the limit of the policy is exhausted before the end of the policy period, the credit licensee can pay a new premium so that the limit of indemnity is reinstated for the balance of the period, to cover any new

<b>Policy features</b>	<b>Questions to ask</b>
	<p>claims that might arise before the policy is renewed.</p> <p>Does the business carry a higher risk of claims or is it exposed to a higher volume of claims and therefore require a larger amount of PI insurance cover?</p> <p>Have weaknesses been identified in your compliance systems, such as a high number of claims or high-risk products/practices, which might mean a higher level of cover is required?</p>
<b>Excesses and deductibles</b>	If the policy includes an excess, is the excess at a level that the business can confidently sustain as an uninsured loss, taking into account the credit licensee's financial resources?
<b>Exclusions</b>	What are the exclusions from cover? Are the exclusions significant? Does the credit licensee have sufficient financial resources to cover these exclusions?
<b>Approved product list</b>	Is cover limited to services provided in relation to an agreed list of products?
<b>Who is covered</b>	<p>Does the policy cover the credit licensee and all of its representatives? This coverage can be under the primary policy or under a separate policy under which the credit licensee has a right of indemnity.</p> <p>Are there many representatives and are they geographically dispersed? If so, the limit of indemnity might need to be appropriately higher to manage this risk.</p>
<b>Retroactive cover</b>	If the credit licensee had a previous PI insurance policy prior to being licensed, does the new policy provide retroactive cover from the date of expiration of the previous policy?
<b>Run-off cover</b>	<p>Does the policy provide automatic run-off cover or an extended reporting period? If so, for how long?</p> <p>Note: By automatic run-off cover we mean cover that has effect where a credit licensee retires or otherwise sells/ceases its business.</p>

## Ongoing assessment

- RG 210.42 We expect that credit licensees will review their PI insurance or other compensation arrangements at least annually to ensure they continue to be adequate (e.g. when existing policies are due for renewal). Licensees should also review the adequacy of compensation arrangements in light of any major changes to their businesses (e.g. starting to provide new services or products, or engaging more representatives).

## Compliance systems

- RG 210.43 We expect credit licensees will ensure that senior people are accountable for ensuring that their PI insurance policies are renewed when required, that premiums are paid on time and that their insurance or other compensation arrangements continue to be adequate. Licensees will need to make provision in internal dispute resolution systems for ensuring that claims are promptly notified to insurers.

**Licence conditions**

RG 210.44 Credit licensees that are not otherwise exempted from the requirement to hold PI insurance under the National Credit Regulations will be subject to a specific licence condition that they obtain PI insurance that is adequate in terms of its amount, scope, and other terms and conditions.



## C Alternative arrangements and exemptions

### Key points

A credit licensee wishing to apply for our approval of alternative compensation arrangements under s48(2) needs to lodge an application for approval: see RG 210.45–RG 210.50.

Applications for approval of alternative arrangements will be assessed on a case-by-case basis: see RG 210.51–RG 210.55.

A subsidiary of an APRA-regulated entity that is a credit licensee may be exempt from the requirement to hold PI insurance, where it has an approved guarantee from that entity: see RG 210.57–RG 210.59.

### How to apply for approval

- RG 210.45 Credit licence applicants will be asked in the online licence application whether they are going to seek our approval for compensation arrangements other than PI insurance. Licensees should apply for approval of alternative arrangements as part of the licence application process.
- RG 210.46 Some examples of hypothetical alternative arrangements are provided at Table 3. These are examples only and we will assess applications for alternative arrangements on a case-by-case basis. By including these examples in the table, we make no statement as to whether arrangements of this kind would always constitute adequate compensation arrangements or would be approved in any particular circumstance or for any given credit licensee.
- RG 210.47 We expect that an application for our approval of alternative compensation arrangements will address the following issues:
- (a) whether more than one credit licensee will be covered by the arrangements and, if so, who they are. This will apply where the arrangements cover a group of related credit licensees or an industry sector or other sub-group of licensees;
  - (b) how the arrangements provide protection comparable to PI insurance (see Section B);
  - (c) any benefits, risks or costs to consumers arising from the credit licensees using these arrangements rather than PI insurance; and
  - (d) any circumstances particular to the credit licensee(s) or the industry sector that make these arrangements more appropriate than PI insurance.

- RG 210.48 We will assess each application on its merits. We will give priority to group applications, for example, where they apply to an industry sector or sub-sector.
- RG 210.49 Where a credit licensee with high levels of financial resources wishes to self-insure (i.e. cover the cost of claims using its own available financial resources) rather than hold PI insurance, we will assess these arrangements using the same process as for other arrangements.

**Table 3: Examples of hypothetical alternative arrangements (subject to case-by-case approval)**

<b>Industry member fund</b>	<p>We may approve alternative arrangements proposed by an industry body. For example, an industry body's members might wish to set up a compensation fund supported by compulsory levies of members.</p> <p>This could be in addition to PI insurance (i.e. to compensate consumers where a member's insurance is inadequate or it ceases trading or becomes insolvent) or instead of PI insurance. Approval of a fund would depend on the amount of compensation that would be available for consumers and the circumstances in which the fund would compensate consumers.</p> <p>We encourage industry bodies to consider whether alternative arrangements are appropriate for their members and we are keen to discuss any such arrangements with them.</p>
<b>Self-insurance</b>	<p>Some very highly capitalised credit licensees might take a self-insurance approach (i.e. to completely replace PI insurance). This might be appropriate for credit licensees that are so substantial that failure to pay claims is very unlikely. This is akin to the exemption for some APRA-regulated entities.</p> <p>We believe that only credit licensees that are very highly capitalised will find this an adequate alternative to PI insurance cover.</p>
<b>Discretionary mutual fund</b>	<p>Discretionary mutual funds (DMFs) are entities that offer 'discretionary cover'—that is, an insurance-like product that may involve an obligation on the DMF to consider meeting a claim made on it, but gives the DMF a discretion as to whether it will pay the claim. A DMF may be a trust, mutual, company limited by guarantee or other structure.</p>

- RG 210.50 Our policy on relief applications is set out in Regulatory Guide 51 *Applications for relief* (RG 51). In addition to this policy, we will also consider the intention behind the introduction of s48, which is that all credit licensees have arrangements to minimise the risk that consumer losses cannot be compensated. On this basis, it is unlikely that we would grant relief from the requirements in s48 and reg 12.

## How we will assess applications

- RG 210.51 Under reg 12, when deciding whether to approve alternative compensation arrangements, we are required to have regard to:
- (a) the nature of the credit activities undertaken; and

- (b) whether the arrangements provide cover after the credit licensee ceases the business and, if so, for how long.

RG 210.52 The regulation also explicitly requires us to take into account the factors we use to assess adequacy of PI insurance, before approving alternative arrangements. This means that alternative arrangements must also be adequate having regard to:

- (a) the credit licensee's membership of an EDR scheme or schemes (including the schemes of which the licensee's credit representatives are members), taking into account the maximum liability that has, realistically, some potential to arise;
- (b) the volume of business;
- (c) the number and kind of clients;
- (d) the kind or kinds of business; and
- (e) the number of representatives.

RG 210.53 When an individual credit licensee asks us to approve alternative arrangements, it should follow the steps outlined in Table 1 (in Section B) and share the outcome of this assessment with us. This will help us evaluate whether the alternative arrangements are adequate. If the credit licensee is unable to demonstrate confidently that its proposed alternative arrangements can cover the estimated exposure (as confirmed by an external expert, such as an auditor or actuary), we are unlikely to approve the arrangements.

RG 210.54 When a credit licensee seeks approval of alternative arrangements, we will consider whether the proposals will achieve the legislative objective of ensuring compensation for consumer losses.

RG 210.55 We will assess applications for alternative arrangements by comparing them to PI insurance arrangements, to ensure that credit licensees and consumers have comparable protection where alternative arrangements are used in lieu of PI insurance.

## Licensees exempt under the National Credit Regulations

- RG 210.56 The National Credit Regulations provide that certain credit licensees are exempt from the requirement to hold PI insurance. This applies to:
- (a) a credit provider whose sole business is lending and that only provides credit services in relation to its own credit contracts or consumer leases;
  - (b) an ADI, general insurance company or life insurance company regulated by APRA that also undertakes credit activities; and
  - (c) a subsidiary of an APRA-regulated institution that has a guarantee, approved by us, from that institution.

**Guarantee provided by APRA-regulated institution**

- RG 210.57 A credit licensee that is related to any APRA-regulated institution (i.e. an ADI, general insurance company or life insurance company) is also exempt where it has a guarantee provided by the APRA-regulated institution and approved by us.
- RG 210.58 We will approve guarantees only where they provide at least the same protection as adequate PI insurance cover: see reg 12.
- RG 210.59 In considering whether to approve a guarantee of this nature, we will consider the same factors outlined in Section B in relation to the adequacy of PI insurance. APRA-regulated entities are permitted to give guarantees that are limited in time and amount, and we have no in-principle objection to such limits in guarantees put to us for approval (assuming, of course, that the limits are appropriate in the circumstances).

## Key terms

Term	Meaning in this document
ADI	An authorised deposit-taking institution as defined under the <i>Banking Act 1959</i>
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries out a financial services business to provide financial services Note: This is a definition contained in s761A of the Corporations Act.
AFS licensee	A person who holds an Australian financial services licence under s913B of the Corporations Act Note: This is a definition contained in s761A of the Corporations Act.
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
automatic reinstatement	If the limit of the policy is exhausted before the end of the policy period, upon payment of a new premium the limit of indemnity is reinstated for the balance of the period, to cover any new claims that may arise. The number of automatic reinstatements refers to the number of times the limit of indemnity may be reinstated
compensation requirements	The requirements of s48 of the National Credit Act and reg 12 of the National Credit Regulations
consumer lease	A consumer lease to which the National Credit Code applies Note: See s169–171 of the National Credit Code
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
credit legislation	Has the meaning given in s5 of the National Credit Act
credit licence	An Australian credit licence under s35 of the National Credit Act that authorises a licensee to engage in particular credit activities
credit licensee	A person who holds an Australian credit licence under s35 of the National Credit Act
credit provider	Has the meaning given in s5 of the National Credit Act
credit representative	Authorised representative of a credit licensee under the National Credit Act
EDR scheme	An external dispute resolution scheme approved by ASIC under RG 139
lender	A credit provider

<b>Term</b>	<b>Meaning in this document</b>
National Credit Act	<i>National Consumer Credit Protection Act 2009</i>
National Credit Code	National Credit Code at Schedule 1 of the National Credit Act
National Credit Regulations	National Consumer Credit Protection Regulations 2010
non-lender	All credit licensees that are not lenders. This category includes persons who provide credit assistance under s8 of the National Credit Act and persons who act as intermediaries under s9 of the National Credit Act
PI insurance	Professional indemnity insurance
reg 8 (for example)	A regulation of the National Credit Regulations (in this example numbered 8)
RG 148 (for example)	An ASIC regulatory guide (in this example numbered 148)
run-off cover	Cover for claims made after the insurance policy has ended that have arisen from the acts or omissions of the insured during the period of insurance cover
s35 (for example)	A section of the National Credit Act (in this example numbered 35), unless otherwise specified

## Related information

### Headnotes

Australian credit licence, compensation arrangements, credit activities, consumers, professional indemnity insurance, adequate professional indemnity insurance, risk management, external dispute resolution scheme, representatives, authorised insurer, direct offshore foreign insurer, alternative compensation arrangements

### Regulatory guides

RG 51 *Applications for relief*

RG 139 *Approval and oversight of external dispute resolution schemes*

RG 204 *Applying for and varying a credit licence*

RG 207 *Credit licensing: Financial requirements*

### Legislation

*Banking Act 1959*

*Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Act 2007*

*Insurance Act 1973*

National Credit Act, Ch 2 Pt 2-2 Div 5, s6, 8, 9, 10, 35, 47, 48; National Credit Code, s204; National Credit Regulations, reg 12

### Consultation papers and reports

CP 111 *Compensation and financial resources arrangements for credit licensees*

CP 125 *Compensation requirements for credit licensees: Further consultation*

REP 193 *Response to submissions on CP 125 Compensation requirements for credit licensees: Further consultation*