FSC FINANCIAL SERVICES COUNCIL

7 March 2025

Director
Programs and Redress Unit
Treasury
Langton Cres
Parkes ACT 2600

By email: CSLRreview@treasury.gov.au

Dear Director

Post-Implementation Review of the Compensation Scheme of Last Resort

The Financial Services Council (**FSC**) welcomes the opportunity to make a submission to Treasury's Post-Implementation Review into the Compensation Scheme of Last Resort (**CSLR**).

The FSC is a peak body which sets mandatory standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services. Our full members represent Australia's retail and wholesale funds management businesses, superannuation funds, financial advice licensees and investment platforms.

The financial services industry is responsible for investing more than $3 trillion on behalf of over 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is one of the largest pools of managed funds in the world.

As a peak body for both fund managers and financial advice businesses, the FSC is in a unique position to bring together the views of the industry on the current and future scope and operation of the CSLR.

In this submission, the FSC sets out the view that the CSLR is not sustainable in its present form, and is no longer acting as a scheme that is truly last resort. While the FSC supports the scheme's policy intent, unfortunately its present structural flaws are causing the CSLR's costs to blow out rapidly. The scheme's actuaries expect it to reach "*liquidity constraints*" by mid-August 2025 unless special levies are imposed on industry, and administrative costs are growing exponentially.

This is a threat to those who rely on the scheme as well as to the shrinking number of industry participants who are required to shoulder an increasing proportion of its rapidly growing outgoings. By FY26, total levies under the scheme are forecast to exceed the original estimate by 860%. By FY27 this will rise to 1,381%. Meanwhile, the number of financial advisers (who contribute the most to support the CSLR) has fallen from 28,000 in 2018 to around 15,600.

The FSC considers the CSLR's outgoings have become unmanageable– leading to unduly high levies – principally due to:

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- the retrospective inclusion of legacy cases, especially Dixon Advisory Superannuation Services Ltd;
- the application of an inappropriate methodology for calculating compensable loss;
- the scheme's high administrative costs (including costs attributed to it by other bodies); and
- a decision by Government not to fund the scheme's first full year of operation (combined with a slower than anticipated processing of cases which would otherwise have been eligible for government funding during the scheme's first full year of operation).

The FSC recommends that the CSLR should be redesigned to promote its long-term sustainability and to ensure it is a truly a scheme of last resort, including key measures such as to:

- amend the compensation methodology;
- reign in unduly high administration costs; and
- introduce a one-off injection of government funding to deliver on the initial government commitment to do so.

As will become apparent from this submission, the CSLR is closely interrelated with Australian Financial Complaints Authority. Therefore, the FSC believes there is merit in reviewing the ongoing costs of AFCA to achieve efficiencies which, we anticipate, would significantly benefit the stakeholders of both the CSLR and AFCA.

The FSC would be happy to assist Treasury further. Please do not hesitate to contact Jack Morgan (Policy Director, Investments and Funds Management) or Julia Hukka (Policy Manager, Financial Advice and Platforms) at jmorgan@fsc.org.au or jhukka@fsc.org.au.

Sincerely,

Chaneg Torres
Executive Director, Policy

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1. List of recommendations

The FSC proposes the following recommendations related to the CSLR and related matters. These are explored in greater detail in the body of the submission.

Recommendations regarding AFCA (section 4.1)

Recommendation #1: The FSC strongly supports excluding hypothetical capital gains from being compensable under the CSLR.

Recommendation #2: The FSC recommends that compensation under the CSLR should be calculated by AFCA strictly by reference to a consumer's actual capital losses adjusted for CPI.

Recommendation #3: The FSC recommends that AFCA urgently and significantly reduces its administrative costs which are reimbursed by the CSLR.

Recommendation #4: The FSC recommends that investigations be undertaken to improve the efficiency of AFCA's decision-making processes.

Recommendation #5: The FSC recommends that AFCA increase its transparency, especially on the level, quantum and calculation of unpaid fees attributed to the CSLR.

Recommendation #6: The FSC urges that AFCA expenses (including staff costs) should only be attributable to the CSLR through fees where the expenses are incurred directly in relation to a case where compensation is paid through the CSLR.

Recommendation #7: The FSC recommends that the "unpaid fee" charges imposed by AFCA on the CSLR be capped at a prescribed level per AFCA determination. The precise level of this cap should be determined following consultation with industry.

Recommendation #8: The FSC suggests AFCA adopt – or be required to adopt – the Australian Government's Cost Recovery Guidelines.

Recommendation #9: The FSC recommends providing the CSLR operator with greater independence from AFCA.

Recommendation #10: The FSC recommends that AFCA fees attributed to the CSLR should be exempted from GST.

Recommendation #11: The FSC recommends that AFCA be required to report annually to ASIC on the "reasonable steps" it undertakes in each case to ensure compliance with its determinations prior to making referrals to the CSLR.

Recommendation #12: The FSC supports improving decision-making by AFCA to ensure CSLR payments occur in a consistent, transparent and accountable manner, and making assessments more rigorous through the involvement of a contradictor to scrutinise compensation claims.

Recommendation #13: The FSC strongly supports restricting access to the CSLR to retail investors.

Recommendation #14: The FSC endorses the exclusion of wholesale or sophisticated investors' complaints from AFCA's jurisdiction, except in instances where retail investors have been incorrectly classified as such.

Recommendation #15: The FSC recommends that AFCA be more vigilant in expelling members who are likely to be a source of future claims.

Recommendation #16: The FSC recommends that there be a comprehensive review of AFCA to consider the impact, sustainability, and outcomes it delivers for consumers and industry. It is recommended the review consider the following:

1. measures to increase AFCA's efficiency;
2. administrative costs imposed on the CSLR by AFCA;
3. an analysis of what is contributing to unpaid AFCA determinations, including an analysis of underlying factors and risks giving rise to consumer claims and the inability for Financial Services Providers (FSPs) to meet their financial obligations as and when required;
4. whether regulatory strengthening is needed to reduce the risk of unpaid determinations in a given sector and make recommendations for proposed reform to address weaknesses and gaps (whether required in ASIC guidance or legislative change);
5. ways to ensure that AFCA operates productively and does not act to the detriment of the CSLR;
6. how AFCA can strengthen the industry and reduce the need for consumers to rely on the CSLR;
7. AFCA's funding model, including its interrelationship with the CSLR and its impact on competition and industry viability.

Recommendations regarding CSLR administration (section 4.2)

Recommendation #17: The FSC suggests Treasury consider reducing the $150,000 cap on CSLR claims.

Recommendation #18: The FSC supports a comprehensive risk-based funding approach at an individual firm level being implemented by the Government as soon as reasonably practical. The CSLR should collect sufficiently detailed information about the profile of each firm and the reason for the unpaid determination to enable it to develop a more comprehensive risk-based funding approach in future.

Recommendation #19: The FSC supports introducing a per annum cap on the per capita amount that can be levied on financial advisers for the CSLR. This cap would provide

certainty and financial stability for advisers, ensuring they can continue to operate sustainably.

Recommendation #20: The FSC recommends that the government amend the *Financial Services Compensation Scheme of Last Resort Levy Act 2023* to reduce the $20 million annual subsector levy cap to $10 million.

Recommendation #21: The FSC supports amending the CSLR framework to ensure that funds raised through levies are not directed towards paying for the CSLR operator's administrative expenses.

Recommendation #22: The FSC supports reducing CSLR operator costs by:

1. reducing the duplication of functions between AFCA and the CSLR operator; and
2. requiring the CSLR operator to focus on its core responsibilities to administer the CSLR without undertaking research, advocacy and policymaking activities.

Recommendation #23: The FSC suggests that section 1065 should be amended to clarify that the CSLR only has jurisdiction to issue compensation in personal financial advice cases where the subject of a complaint was specifically authorised under their AFS licence to provide personal financial advice.

Recommendation #24: The FSC recommends the annual report published by the CSLR operator should include:

- information by entity name, parent entity, and also by subsector when outlining the number and value of payments of compensation made during the levy period;
- information about the size of the entity (e.g. sole operator) and the reason for the unpaid determination (e.g. insufficient capital to fund the excess under the PI policy), as opposed to information about the types of products and/or services covered by the relevant AFCA determinations;
- information on any monies the CSLR operator has recovered under the subrogation rights and any expenses associated with the recovery;
- in relation to any compensation claim paid by the CSLR operator, whether the operator exercised its right of subrogation and pursued compensation under a relevant professional indemnity policy and, if not, a clear explanation as to why it did not take these actions.
- a balance sheet for each sub-sector to show whether there are any reserves attributable for each sector at the end of each levy period.

Recommendations regarding the role of the Government and the possible exercise of ministerial powers (section 4.3)

Recommendation #25: The FSC supports a one-off injection of government funding to fund claims arising from the Dixon Advisory collapse.

Recommendation #26: The FSC recommends that, in addition to a one-off injection of government funding, the Minister stagger the CSLR levies or charge the levies by

instalments to assist advice licensees in bearing the costs when there are large-scale incidents that are to be covered by the CSLR levies such as the Dixon and UGC claims.

Recommendation #27: The FSC recommends that, in the event that CSLR levies cannot be staggered for financial advice licensees, the Minister stagger the payment of individual compensation awards across multiple years to smooth the impact of one-off large-scale insolvencies.

Recommendations regarding the CSLR's subrogation powers (section 4.4)

Recommendation #28: The FSC recommends the scheme operator should enforce subrogation rights to backdated claims. This includes the CSLR operator, or ASIC, using reasonable endeavours to pursue recovery under the financial services provider's professional indemnity insurance policy for the benefit of investors.

Recommendation #29: The FSC supports enhancements to the CSLR operator's subrogation rights and powers.

Recommendation #30: The FSC recommends the Government should consider strengthening the CSLR's subrogation rights, by imposing an obligation to use reasonable endeavours (ie not solely providing the CSLR operator a right) to pursue recovery. Consideration should also be given to imposing a legal requirement for financial services providers to provide a copy of their professional indemnity insurance policy to the scheme operator where the financial services providers have unpaid AFCA claims.

Recommendation #31: The FSC recommends Treasury investigate the possibility of increasing the priority given to the CSLR operator's creditor claims in liquidation or other means of streamlining subrogation rights to ensure the CSLR operator's claims are not prejudiced by statutory processes.

Recommendations relating to preventative measures to reduce the impact of insolvencies on the CSLR (section 4.5)

Recommendation #32: The FSC recommends ASIC should be encouraged to exercise its power under section 915H of the Corporations Act to require an AFS licensee to hold PI insurance for the same length of time as ASIC requires the licensee to maintain AFCA membership after its licence is cancelled, and at a minimum no less than 12 months after the cancellation of their AFS licence.

Recommendation #33: The FSC recommends ASIC should be encouraged to exercise existing powers under s920A(1)(j) and (ja) of the Corporations Act to ban a person linked to an AFSLs refusal or failure to pay AFCA determinations.

Recommendation #34: The FSC recommends Treasury explore the viability of professional indemnity and capital adequacy requirements for advice licensees to reduce the burden on the CSLR.

Other recommendations (section 4.6)

Recommendation #35: The FSC recommends clarifying the application of special levies in circumstances where financial service providers have divested themselves of leviable entities.

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2. Background

2.1. The creation of the Compensation Scheme of Last Resort

The CSLR operator is a not-for-profit corporation founded to compensate retail consumers for financial misconduct after they have exhausted all other compensation avenues. The CSLR was created in response to a recommendation from the government-commissioned Ramsay Review (2017) and findings from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry that many consumers, despite being owed compensation, were left without recourse when certain financial services companies became insolvent or unable to pay.

There were multiple attempts to establish the CSLR. The first CSLR bills were initially introduced to Parliament by the former Government in October 2021 then lapsed at dissolution in 2022. The second CSLR bills were introduced by the current Government in September 2022 but were discharged from the notice paper to be replaced by the third and final bills.[1] The third CSLR bills were introduced to Parliament in March 2023 and passed on 22 June 2023. The CSLR was designed to be jointly funded in its first year by the Government and through a levy on the 10 largest banking and general/life insurance groups and subsequently funded on an ongoing basis through a new annual levy on four sub-sectors:[2]

1. financial advisers;
2. credit providers;
3. credit intermediaries; and
4. securities dealers.

[1] Parliament of Australia, Treasury Laws Amendment (Financial Services Compensation Scheme of Last Resort) Bill 2023 [and associated Bills], 2023.
[2] Parliament of Australia, Explanatory Memorandum, Treasury Laws Amendment (Financial Services Compensation Scheme Of Last Resort) Bill 2023; Financial Services Compensation Scheme Of Last Resort Levy Bill 2023; and Financial Services Compensation Scheme Of Last Resort Levy (Collection) Bill 2023, 8 March 2023, p.15.

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2.2. Operation of the Compensation Scheme of Last Resort

The CSLR's day-to-day functions are principally enabled by:

1. Parts 7.10A and 7.10B of the *Corporations Act 2001* (Cth) (**Corporations Act**);
2. The *Financial Services Compensation Scheme of Last Resort Levy Act 2023* (Cth);
3. The *Financial Services Compensation Scheme of Last Resort Levy (Collection) Act 2023* (Cth); and
4. Related subordinate legislation, rules and policy documents developed by the Australian Financial Complaints Authority (**AFCA**).

In practice, the annual CSLR levy is calculated and imposed as follows:

1. The CSLR engages an independent actuarial consultancy as Principal Actuary.
2. The Principal Actuary recommends an estimate of costs by conducting detailed modelling and analysis and following legislative and regulatory compliance.
3. A second independent Reviewing Actuary reviews the estimate determined by the Principal Actuary as a quality assurance mechanism.
4. The Principal Actuary produces an independent report for each estimate, which the CSLR publishes.
5. The levy instrument and explanatory memorandum are registered on the Federal Register of Legislation managed by the Office of Parliamentary Counsel.
6. The instrument is tabled in each House of Parliament.
7. ASIC determines the levy portion for each financial firm. The levy is based on subsector caps and the firm's size.[3]
8. ASIC issues individual invoices to each firm.

The levy on each of the four sub-sectors is individually capped at $20 million per financial year and total overall levies cannot exceed a combined $250 million. The Minister for Financial Services (**Minister**) can vary the annual levies (up to the $20 million subsector cap) or impose an additional special levy up to the total combined cap of $250 million.[4] Special levies may be imposed on a range of subsectors, including those not subject to annual levies.

The CSLR can award a maximum of $150,000 for claims from retail consumers related to personal financial advice, credit provision, credit intermediation, or securities dealing.[5]

Before a claim can be lodged, a consumer must have an unpaid determination from AFCA.[6]

As set out in the Explanatory Memorandum, Division 2 of Part 7.10B of the *Corporations Act* provides that:

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[3] Compensation Scheme of Last Resort, How we're funded, 2025.
[4] Parliament of Australia, Treasury Laws Amendment (Financial Services Compensation Scheme of Last Resort) Bill 2023 [and associated Bills], 2023.
[5] Parliament of Australia, Treasury Laws Amendment (Financial Services Compensation Scheme of Last Resort) Bill 2023 [and associated Bills], 2023.
[6] Parliament of Australia, Treasury Laws Amendment (Financial Services Compensation Scheme of Last Resort) Bill 2023 [and associated Bills], 2023.

"The CSLR operator cannot consider the merits or facts of a dispute between a consumer and an AFCA member underpinning a relevant AFCA determination. Rather, the CSLR operator must make a compensation payment to a consumer if:

- *a relevant AFCA determination has been made in favour of the consumer;*
- *the consumer is eligible for compensation;*
- *the consumer makes an application for compensation under the CSLR; and*
- *the consumer accepts the CSLR operator's offer of compensation."*[7]

[7] Parliament of Australia, Explanatory Memorandum, Treasury Laws Amendment (Financial Services Compensation Scheme Of Last Resort) Bill 2023; Financial Services Compensation Scheme Of Last Resort Levy Bill 2023; and Financial Services Compensation Scheme Of Last Resort Levy (Collection) Bill 2023, 8 March 2023, p.15.

2.3. The high costs of the CSLR

The CSLR was created to implement recommendation 7.1 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. The rationale behind this recommendation was to foster accountability in the sector and to provide only a genuine last resort pathway to compensation. It is important for any reforms to the CSLR to be aligned with these objectives.

While the CSLR levies are directly paid by scheme members (such as financial advice licensees), ultimately they are paid for using funds raised from consumers. Given the consumer cost implications arising from a CSLR, it is important to ensure that CSLR payments are proportionate to losses and that the scheme is sustainable not only in ordinary or average claim years but also in the years where there are large, unexpected losses. The FSC also considers that the CSLR should remain true to purpose: that is, a truly last resort scheme.

The CSLR places financial strain on financial advisers. Adviser numbers have fallen from 28,000 in 2018 to around 15,600 more recently.[8] This harms consumers by reducing their access to affordable financial advice. While CSLR levies are imposed on licensees, the levies are based on a licensee's number of advisers, disincentivising growth. As adviser numbers shrink, the CSLR's rising costs are spread among fewer and fewer professionals, adding to financial strain within the industry. This runs counter to the government's efforts to expand access to advice through implementing the recommendations of the Quality of Advice Review. The CSLR is undermining recent and planned reforms aim to reduce administrative burdens on financial advisers and expand the profession to make financial advice more accessible and affordable. Instead of supporting this growth, the costs of the CSLR and uncertainties around a special levy discourage new entrants to the industry.

Compensation is not payable under the CSLR until there is an unpaid determination by AFCA. Since it has taken a number of years for AFCA to process a backlog of CSLR-eligible compensation claims, the full limitations of the CSLR have only recently become apparent. These problems are set out in detail in section 4.

Overall outgoings

CSLR levy estimates are forecast to grow exponentially: from $24.1 million in FY25[9] to $78 million in FY26[10] to an estimated $120 million in FY27.[11] By FY26, $70 million – or 90% – of the total figure will be driven by complaints in the financial advice subsector,[12] and the FSC expects that without remedial action the scheme – and its significant burden on financial advisers – will continue to grow.

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[8] Adviser Ratings, 2024 Australian Financial Advice Landscape, 2024, p.26
[9] Finity, Actuarial Estimate for 1st and 2nd Levy Period, March 2024, p.5.
[10] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.4.
[11] David Berry, Conexus Summit: Professional Planner 2025 Advice Policy Summit (11 February 2025).
[12] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.4.

These sums and trends are very large in the context of a scheme whose annual subsector caps were set at $20 million in the expectation that this would be sufficient to cover most years' outgoings. Indeed, Treasury estimated a typical year of CSLR expenditure would involve only $8.1 million being paid in compensation across all subsectors.[13] In the latest Federal Budget, Treasury concluded that possible liabilities under the scheme were "*unquantifiable.*"[14]

In the absence of a special levy, the CSLR's actuaries expect it to reach "*liquidity constraints*" by mid-August 2025.[15]

With special levies, by FY26 Treasury's original annual forecast of levies is expected to be overshot by 860%,[16] and by FY27 it is on track to be exceeded by 1,381%.[17] Reliance on special levies to fund CSLR spending year-on-year would be at odds with the CSLR's design intent, which was for them to only be used in response to "*black swan*" events.[18]

Clearly growth in overall outgoings has reached unsustainable proportions, contributing to the reduction in the availability of financial advice for consumers. There is an urgent imperative to make the CSLR more sustainable.

Dixon and UGC

Importantly, 92% of all CSLR claims for FY26 relate to one of two corporate collapses: Dixon Advisory Superannuation Services Ltd (**Dixon**) or United Global Capital Pty Ltd (**UGC**) (or 95.3% of financial advice claims).[19] Overall, an estimated:

- 1,030 Dixon complaints (lodged after the pre-CSLR period) will be successful, equivalent to approx. $125 million;[20] and
- 334 UGC complaints will be successful, equivalent to $49 million.[21]

Sections 3.1 to 3.3 below set out more information about the Dixon and UGC cohorts, as well as possible future large sources of CSLR claims.

Compensation methodology

At present, AFCA determines compensation using *"but for"* compensation principles, looking at the opportunity cost of the investment relative to a retrospectively selected benchmark. Under this methodology, AFCA assesses what a client's portfolio might have looked like if unsuitable advice or other misconduct had not occurred. The "*but for*" approach results in

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[13] Treasury, Compensation Scheme of Last Resort - Proposal Paper (treasury.gov.au), p.19.
[14] Treasury, FY25 Budget Paper No 1 (Budget Strategy and Outlook), p.331.
[15] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.60.
[16] The original estimate for total annual levies was $8.1 million (The Treasury, Compensation Scheme of Last Resort - Proposal Paper (treasury.gov.au) , p.19) and by FY26 it has increased to $78 million (Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.60.).
[17] David Berry, Conexus Summit: Professional Planner 2025 Advice Policy Summit, 11 February 2025.
[18] Parliament of Australia, Explanatory Memorandum, Treasury Laws Amendment (Financial Services Compensation Scheme Of Last Resort) Bill 2023; Financial Services Compensation Scheme Of Last Resort Levy Bill 2023; and Financial Services Compensation Scheme Of Last Resort Levy (Collection) Bill 2023, 8 March 2023, p.55.
[19] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.4-5.
[20] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.40.
[21] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.43.

CSLR compensation occurring for hypothetical gains rather than directly addressing actual capital losses. The CEO of the CSLR operator has publicly stated that as of November 2024, 80% of the compensation that occurred under the CSLR was for unrealised capital gains, and 20% was for capital losses.[22]

This approach has driven a significant increase in the overall cost of the CSLR and risks compromising its financial sustainability. Furthermore, this outcome moves the CSLR away from being a genuinely 'last resort' scheme, and closer to underwriting potential investment losses, which was not the original intent of the scheme.

More information about AFCA's methodology for determining compensation is addressed at recommendations 1 and 2 below.

Administrative costs

In addition to paying for compensation claims, the CSLR is also under pressure from significant administrative costs. The CSLR is required to bear administrative costs from:

- The CSLR operator ($6.3 million in FY26);[23]
- AFCA for its unpaid fees[24] ($9.4 million in FY26);[25] and
- ASIC for the collection of levies ($1.3 million in FY26).[26]

$17 million in administration fees alone is a significant burden for the CSLR – equivalent to nearly 22% of the anticipated outgoings for FY26.[27] This excludes the impact of a further $1.7 million required to be paid to the CSLR operator in the form of capital contributions.[28]

Crucially, outgoings from the CSLR to AFCA are expected to grow exponentially. In the 12 months from FY26 to FY27, AFCA's unpaid fees attributed to the CSLR are projected to grow more than 70% from $9.4 million to over $16 million.[29] This is from an original starting base of $2.5 million in FY25,[30] equating to a 540% increase in cumulative fees over two years.

Also concerningly, the CSLR operator's administrative costs of $6.3 million for FY26[31] are exceeding Treasury's original estimate by 71%.[32]

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[22] Independent Financial Adviser, CSLR uncovered: Adviser impacts and the path forward, Webcast, 32:30min; Note: Since this announcement, UGC claims are understood to be largely actual losses, which will likely reduce the proportion of compensation paid for hypothetical capital gains.
[23] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.4.
[24] Required under the *Corporations Act* at ss 1069B and 1069C.
[25] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.4.
[26] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.4.
[27] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.4.
[28] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.4.
[29] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.52.
[30] Finity, Actuarial Estimate for 1st and 2nd Levy Period, March 2024, p.5.
[31] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.4.
[32] Treasury, Compensation Scheme of Last Resort - Proposal Paper (treasury.gov.au), pp.17,19.

The costs of the CSLR operator, AFCA and ASIC are individually excessive but collectively are adding unjustifiable strain to an already overburdened scheme and industry. Overall, administrative costs are not stabilising: they are deteriorating rapidly.

There needs to be a greater focus on keeping administrative costs as low as is reasonably practical as it is unacceptable for administrative costs to represent such a high proportion of the CSLR's expenditure. The CSLR was not designed to withstand its present volume of claims, or the costs being incurred in administering them. Industry – especially the financial advice industry – is insufficiently resourced to pay the exponential growth in CSLR levies which will prove necessary to support the scheme.

2.4. The proposed expansion of the CSLR

The CSLR was initially proposed by the government-commissioned Ramsay Review (2017) to provide redress in situations where consumers suffer financial loss due to unpaid compensation arising from financial advice failures. The Ramsay Review recommended that the CSLR should be targeted and limited to areas of the financial sector with the greatest evidence of need, and that its primary scope should be financial advice failures.[33] The rationale behind this limitation was to ensure the CSLR remains efficient, manageable, and true to its core purpose of addressing specific systemic gaps, without overextending its coverage.

Design Intent of the CSLR

The Ramsay Review emphasised that the CSLR should not be a broad safety net for all financial sector failures but should instead be scalable to cover other financial services only if evidence arises showing substantial problems with unpaid compensation in other areas.[34] By focusing on financial advice failures, the CSLR addresses a well-documented area where consumers have been left vulnerable due to the collapse of advice firms and unpaid determinations from AFCA.

The CSLR's design also hinges on the principle that strong regulatory settings must exist to ensure financial firms are accountable and capable of compensating consumers in the first place. Expanding the scheme too widely could detract from the regulatory focus needed to ensure firms are held responsible for their own failures.

Risks of Expanding the CSLR

The proposition to expand the CSLR poses a number of systemic risks, including:

- **Dilution of Focus:** Expanding the CSLR risks diluting its original purpose and effectiveness. The scheme was designed to fill a gap where there was clear evidence of firms being unable to meet compensation obligations, primarily in the financial advice sector.
- **Increased Financial Burden:** Broadening the scope of the CSLR would significantly increase the financial burden on the entire financial services industry,
- **Moral Hazard:** Expanding the CSLR could inadvertently encourage a greater moral hazard, where clients, licensees or others captured by the scheme become less cautious, knowing that any financial shortfall will be covered by the CSLR, or regulators become less motivated to undertake enforcement activities against bad actors to recover lost funds. This would undermine the regulatory objectives of ensuring firms are held accountable for the financial risks they assume. A broader

[33] Commonwealth of Australia, Supplementary Final Report: Review of the financial system external dispute resolution and complaints framework, 2017, p.58.
[34] Commonwealth of Australia, Supplementary Final Report: Review of the financial system external dispute resolution and complaints framework, 2017, p.60.

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CSLR might also weaken market discipline by reducing incentives for consumers to exercise caution when making financial decisions.

Risks associated with the incorporation of AFCA complaints concerning MISs into the CSLR

Some industry participants have raised questions about whether the collapse of Dixon (explained in section 3.1) was primarily an issue with financial advisers breaching the best interests duty or a product issue with the URF, and used this to advocate incorporating managed investment schemes (**MISs**) into the CSLR. The incorporation of AFCA complaints concerning MISs would significantly expand the inherent moral hazard involved in the CSLR and fail to address the core structural issues with the CSLR which have made it unsustainable.

The FSC proposes that there are more appropriate mechanisms that could reduce the cost burden, which are explored in section 4. If complaints against MISs were to be brought within the scope of the CSLR, it is not immediately clear why it should not also be expanded to capture other subsectors such as banking, superannuation or insurance. Given this is not desirable, the government's focus should be on the cost sustainability of the scheme.

It is important to note that the Federal Court has accepted Dixon engaged in breaches of the best interests duty (section 961B of the *Corporations Act*) and appropriate advice duty (section 961G of the *Corporations Act*),[35] but has made no adverse findings against Dixon associated with the design of the URF as an MIS. The Court simply accepted that the URF products were "*highly risky*", which was why the Court considered the Dixon advisers' financial advice to so clearly breach sections 961B and 961G.[36]

Furthermore, for a loss to be compensable under the CSLR, among other steps, AFCA must uphold a complaint. The AFCA approach document entitled "*Approach to determining compensation in complaints against Financial Advice Firms where the Responsible Entity of a Managed Investment Scheme has become insolvent*" clearly states that where an MIS has failed, a financial advice complaint will not be upheld as a matter of course. It is first necessary for the financial advice firm to have:

> "*breached their legal obligations. … [F]or the avoidance of doubt, if a MIS fails and the financial advice firm has not breached any obligations, they will not be responsible for the complainant's losses, including those arising from the MIS failure.*"[37]

In other words, there is a need for causation between misconduct by a financial adviser and the loss incurred by the AFCA complainant.

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[35] Federal Court of Australia, Australian Securities and Investments Commission v Dixon Advisory & Superannuation Services Ltd [2022] FCA 1105, 19 September 2022.
[36] Federal Court of Australia, Australian Securities and Investments Commission v Dixon Advisory & Superannuation Services Ltd [2022] FCA 1105, 19 September 2022.
[37] AFCA, Approach Document: The AFCA Approach to determining compensation in complaints against Financial Advice Firms where the Responsible Entity of a Managed Investment Scheme has become insolvent, January 2024, pp.6-7.

There are a number of reasons why it would be inappropriate to incorporate MISs into the CSLR. These include:

- **Government underwriting investment risk:** Investment inherently involves risk, and losses in these schemes are typically linked to market performance or the underlying asset values. Unlike financial advice failures, losses in MISs may not stem from misconduct or negligence. Including them in a CSLR might create an inappropriate expectation for compensation where the loss is market-driven rather than a failure of regulatory obligations or advice standards. If the objective of the CSLR is to protect consumers from all downside risk and financial loss, additional subsectors such as banking, superannuation and life and general insurance companies could arguably be captured, which would be problematic for the general financial services industry. AFCA compensation is currently determined on the basis of "*but for*" principles; ie if a bad investment was made on advice that contravened financial advice regulations, the compensation is made on the basis of the earnings which would have been made from investing in an average market product. Therefore, the determinations are linked to the inappropriateness of the advice (that is, the product recommendation) rather than the product failure.
- **Costs passed on to consumers:** Higher regulatory costs are frequently transferred to consumers through increased fees. If the CSLR levy is applied to MISs in addition to financial advisers, there is a risk of double-charging consumers. This would happen if a client invests in an MIS and simultaneously receives advice from a financial adviser, as both the MIS and the advice service could pass on their respective CSLR-related costs to the consumer.
- **Design and Distribution (DDO) obligations:** DDO obligations commenced in October 2021. Under Part 7.8A of the *Corporations Act*, issuers and distributors of financial products must comply with design and distribution obligations which aim to ensure that products are being designed and distributed to their target market, reducing the risk of consumer detriment as high-risk MISs should not typically be offered to retail investors.
- **Product intervention powers:** Under Part 7.9A of the *Corporations Act* and Part 6-7A of the *National Consumer Credit Protection Act 2009*, ASIC has a product intervention power which enables them to intervene and when necessary, ban financial products and credit products when there is a risk of significant consumer detriment (see ASIC Regulatory Guide RG 272).[38] Therefore ASIC's intervention can limit MIS failures before they occur, reducing their risk of failure and the need for CSLR coverage. Furthermore, there is a moral hazard risk that including MISs within the scope of the CSLR might discourage ASIC from the proactive use of its product intervention powers to protect consumers.

The inclusion of MISs in the scheme was considered early on in its creation but ultimately rejected in favour of a review of the MIS regulatory framework which commenced in 2023.[39]

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[38] Australian Securities and Investment Commission, Regulatory Guide 272: Product Intervention Power, June 2020.
[39] Treasury, Review of the regulatory framework for managed investment schemes, 2023.

In a government document outlining Q&As around the CSLR, they acknowledged evidence of unpaid AFCA determinations relating to managed investment schemes, but considered that they were *"unsuitable for inclusion at this time"* and that *"the scope of the CSLR reflects financial products that have undergone significant regulatory reform which have reduced the risk of misconduct and failure. Managed investment schemes can involve high risk investments."*[40]

The FSC also notes that Treasury is undertaking a separate review of the MIS regulatory framework.

[40] Treasury, Q&A: Compensation Scheme of Last Resort, p.4.

3. Large sources of CSLR claims

According to the latest actuarial report, 92% of the expected claims paid for FY26 of the initial estimate are from two failed firms – Dixon Advisory Superannuation Services Limited (**Dixon**) and United Global Capital (**UGC**).[41] The circumstances behind their collapses, and how they affected the financial sustainability of the CSLR are explored below.

3.1. The collapse of Dixon

Impact on the CSLR

The collapse of Dixon had a significant impact on the CSLR. Estimates suggest that the collapse will contribute approximately $124.8m to the total CSLR's compensation costs, which will translate into a higher levy for financial advisers.[42]

The actuarial report states that Dixon complains represent over 50% of the currently open, in-scope, post CSLR complaints and are therefore likely to be a significant contributor to the FY26 levy.[43] The CSLR operator also estimates that 95% of Dixon complainants will be awarded a non-zero determination in their favour.[44]

The collapse of Dixon

Dixon entered voluntary administration in January 2022 after directors determined that the liabilities from class actions, settlements and regulatory penalties would cause Dixon to become insolvent.[45] The company was accused of offering poor advice, particularly around investing in related-entity products. These investment recommendations caused many clients to suffer financial losses and led to over 2,798 complaints against Dixon being made to the AFCA as at 30 June 2024.[46]

Retrospective legislation

The CSLR was not legislated until 22 June 2023 and it did not become operational until 2 April 2024. Nonetheless, the CSLR has been designed in such a way that has made financial advice licensees liable to compensate former Dixon clients, whose losses were mostly incurred well before 2022. The significant decline in financial advisers over the last 6 years from 28,000 advisers in 2018 to around 15,600 in 2024 has also exacerbated the issue as the financial burden is spread across fewer advisers.[47]

This development has raised legitimate concerns: Dixon clients are receiving compensation from an industry-funded scheme which did not exist at the time the conduct in question

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[41] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.3.
[42] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.38.
[43] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.3.
[44] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.36.
[45] Jonathan Shapiro and Carrie LaFrenz, Dixon Advisory files for voluntary administration as claims mount, *Australian Financial Review*, 19 January 2022.
[46] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.17.
[47] Adviser Ratings, Australian Financial Advice Landscape, 2024, p.26

occurred and was perpetrated by an entity which never paid CSLR levies. Instead, the scheme penalises current advice licensees for the historical misconduct of others.

Consequently, the financial advice industry is now left facing significantly higher ongoing levies contributing to the already growing costs of providing financial advice.[48] These higher costs are ultimately shouldered by consumers: either in the form of paying higher fees or being squeezed out of the market entirely.

Regulatory failures

Steep CSLR levies on financial advisers are not only a result of poor timing, but also a failure of regulatory deterrence and by ASIC for failing to intervene earlier. Dixon's conflicted advice structure was difficult to reconcile with the best interests duty which was mandatory from 1 July 2013.

While regulators have limited budgets and must make difficult choices with the resources available to them, it is important to note that earlier regulatory action could have mitigated the Dixon collapse. Moreover, since financial advice licensees paid (and continue to pay) levies to support ASIC's regulation of their industry, there is not a clear rationale for requiring licensees to pay higher CSLR levies to address claims arising from these systemic failures.

[48] John Collett, Consumers locked out of financial advice as fees keep rising, *Sydney Morning Herald*, 24 June 2024; *The Australian*, Compensation scheme of last resort has only just started and advisers are bracing for $135m bill, 19 July 2024.

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3.2. United Global Capital

Impact on the CSLR

The collapse of UGC and its related entity, Global Capital Property Fund (**GCPF**), is expected to be the largest contributor to compensation payments under the CSLR during the third levy period, accounting for an estimated 70% of total claims.[49] There was no allowance for a failure like UGC in the levy estimates for the 1st and 2nd levy period. This means the CSLR is unlikely to be able to pay these claims until FY26.[50]

According to actuarial reports, 98% of complaints against UGC are expected to result in a non-zero determination in favour of the complainants.[51] As of January 2025, 141 complaints against UGC have already been lodged with AFCA. Since UGC is required to remain an AFCA member until 31 May 2025, the number of complaints is projected to rise to approximately 346, with approximately 307 claims expected to be paid in FY26.[52,53]

Given the significant investment losses, the average compensation amount is estimated at $145,000 per claim.[54] While UGC has assets available for liquidation, actuarial analysis suggests that cost recovery will be minimal, meaning that the CSLR will bear the majority of the financial burden.[55]

The collapse of UGC and GCPF

UGC was founded in Melbourne in 2017 as a financial service firm (including providing financial advice).[56] According to ASIC, its related entity, GCPF, a property investment company in which a UGC director had a financial interest, became an authorised representative of UGC on 25 March 2020.[57]

UGC was accused of providing poor financial advice, particularly by recommending investments in its related product, GCPF, despite an alleged conflict of interest. ASIC alleged that UGC engaged in several breaches, including:

- UGC used a client onboarding process that encouraged people into investing their retirement savings in UGC-related products by having calls made to prospective clients using details, including those obtained from a third-party website operator, offering them a free superannuation "*health check*".

[49] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.23.
[50] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.4.
[51] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.39.
[52] Independent Financial Adviser, Why is UGC the main contributor to FY25–26 CSLR levy?, 12 February 2025.
[53] Independent Financial Adviser, Why is UGC the main contributor to FY25–26 CSLR levy?, 12 February 2025.
[54] Independent Financial Adviser, Why is UGC the main contributor to FY25–26 CSLR levy?, 12 February 2025.
[55] Independent Financial Adviser, Why is UGC the main contributor to FY25–26 CSLR levy?, 12 February 2025.
[56] ASIC, United Global Capital Pty Ltd (in liquidation), October 2024.
[57] ASIC, ASIC bans United Global Capital (in Administration) director for 10 years and cancels licence, 31 July 2024.

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- Through its authorised representatives, UGC recommended that clients invest in high-risk, speculative assets, including GCPF, a fund in which a director had a financial interest.
- ASIC determined that UGC failed to meet its general obligations as an AFS licensee, including:
    - Failing to provide financial services efficiently, honestly, and fairly.
    - Failing to ensure its representatives complied with financial services laws.
    - Failing to implement adequate arrangements to manage conflicts of interest.[58]

In June 2024, ASIC obtained interim Federal Court orders freezing the assets of UGC and GCPF. As a result of their investigation, ASIC cancelled the AFSL of UGC and a director from providing financial services for 10 years.[59].

Following these events, UGC entered voluntary administration on 5 July 2024 and was then placed into liquidation following a resolution by its creditor.[60] The clients of UGC are not creditors in the liquidation, and therefore are unlikely to recover their investment losses from this avenue.[61]

[58] Laura Dew, UGC complaints quadruple in 4 months, December 2024.
[59] ASIC, ASIC bans United Global Capital (in Administration) director for 10 years and cancels licence, 31 July 2024.
[60] Jonathan Shapiro and Carrie LaFrenz, Dixon Advisory files for voluntary administration as claims mount, *Australian Financial Review*, 19 January 2022.
[61] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.20.

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3.3. Other potential large sources of CSLR claims

The collapses of MISs like the Sterling Income Trust (**SIT**) and the Shield Master Fund (**SMF**) could have a significant impact on the CSLR, depending on whether financial advice firms are found to have breached their duties by advising clients to invest in these products. The misconduct of the responsible entities; Theta Asset Management Ltd for the Sterling Group and Keystone Asset Management Ltd for the SMF, resulted in considerable financial losses for investors.[62]

ASIC Commissioner Alan Kirkland confirmed that "*potential investors were called by telemarketers who referred them to financial advisers*" and that these financial advisers "*encouraged them to…put some or all of their superannuation into the Shield Master Fund.*"[63] If AFCA issues determinations against these advice firms, and they are unable to compensate due to insolvency, then it is likely that some of the victims of the collapse of SMF will be captured by the CSLR.

Similarly, there is potential for claims to be lodged against Libertas Financial Planning, which is now in liquidation.[64] Libertas was associated with Sterling Corporate Services (**SCS**), the investment manager for the SIT, which operated as a corporate authorised representative of Libertas from 2017-2019.[65] As of February 2025, it remains unclear whether any complaints have been lodged against Libertas for providing inappropriate advice in relation to the Sterling MIS. However, if such complaints are upheld, those investors could also potentially be eligible for CSLR compensation.

The actuarial report estimates that there will ordinarily be an estimated 98 advice-related complaints per year, leading to an annual compensation cost of around $6m.[66] Crucially, however, this estimate excludes future large-scale collapses like Dixon, UGC, SIT and SMF or the impact of an economic downturn, as well as the annual administrative costs of AFCA, the CSLR and ASIC.[67] The report itself acknowledges that "*there are many sources of uncertainty in the estimates of the levies.*"[68]

The reliability of levy estimates

There are several challenges in making an accurate estimate of future levies, including the lack of comparable systems to the CSLR, and that it only recently started operating.[69] As a result, there is limited data available to draw reliable conclusions. The actuarial assumptions, therefore, rely more on reasoned estimates than on solid historical data.[70] Even with better historical data, the actual costs of the CSLR remain uncertain because they depend on unpredictable future events, such as the failure of financial firms, which do not occur in a regular pattern. This results in a level of randomness in the outcomes that makes precise

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[62] ASIC, Shield Master Fund, December 2024, ; ASIC, Sterling Group investigation, 2023.
[63] Laura Dew, ASIC's Kirkland warns on Shield advice misconduct, November 2024,
[64] AFCA, Sterling Group investors - February 2021, 2025.
[65] AFCA, Sterling Group investors - February 2021, 2025.
[66] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.49.
[67] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.61.
[68] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.57.
[69] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.58.
[70] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.6.

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forecasting difficult.[71] This uncertainty surrounding CSLR levies (as well as prospective special levies) creates financial and operational challenges for financial services businesses, making it difficult to plan for future costs. Without a clear expectation of levy amounts, firms may struggle to budget appropriately, potentially leading to underestimation of liabilities or the need for unexpected adjustments. This unpredictability can also deter investment and expansion, as businesses are hesitant to commit resources when future obligations remain unclear.

[71] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.6.

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4. Recommendations

4.1. Recommendations regarding AFCA

The CSLR and AFCA are closely interrelated. AFCA finalises claims and, where they are unpaid and otherwise eligible, the CSLR makes payment and levies industry.

Recommendation #1: The FSC strongly supports excluding hypothetical capital gains from being compensable under the CSLR.

Recommendation #2: The FSC recommends that compensation under the CSLR should be calculated by AFCA strictly by reference to a consumer's actual capital losses adjusted for CPI.

Currently AFCA determines compensation using "*but for*" compensation principles, essentially looking at the opportunity cost of the investment relative to a retrospectively selected benchmark. Under this methodology, AFCA assesses what a client's portfolio might have looked like if unsuitable advice or other misconduct had not occurred. AFCA describes this as follows:

> "*We work out the amount of a consumer's loss by comparing the consumer's actual financial position as a result of the inappropriate financial advice (or the misleading conduct) with the financial position they would have been in if they had received appropriate financial advice (or had not been misled by the adviser).*"[72]

By way of example, in AFCA's lead determination for Dixon, the complainant earned actual profits of $225.023.84 but with the benefit of hindsight might have earned as much as $479,336.56 had they invested in a balanced Vanguard fund, leading to an award of $254,312.72 plus interest.[73] Based on Dixon's limited remaining assets, a claim of this nature would likely then proceed to the CSLR and be subject to its $150,000 cap on claims.

The "*but for*" approach results in CSLR compensation occurring for hypothetical gains rather than directly addressing direct capital losses. The CEO of the CSLR operator has publicly stated that as of November 2024, 80% of the compensation which has occurred under the CSLR was for unrealised capital gains and 20% was for actual capital losses.[74]

This is an extraordinarily large proportion of the payments occurring under the CSLR and was never contemplated by the Government when it legislated the scheme, Treasury when it designed and oversaw consultation on the scheme, or industry when it provided support for the scheme.

[72] AFCA, Approach Document: The AFCA Approach to calculating loss in financial advice complaints, December 2023, p.2.
[73] AFCA Lead Dixon Determination (Dixon Advisory & Superannuation Services Pty Ltd (Subject to Deed of Company Arrangement), case 716627, 6 February 2024), p.13.
[74] Independent Financial Adviser, CSLR uncovered: Adviser impacts and the path forward, Webcast, 32:30min.; Note: Since this announcement, UGC claims are understood to be largely actual losses, which will likely reduce the proportion of compensation paid for hypothetical capital gains.

If "*but for*" compensation is to occur in CSLR cases, it is essential for it to be justified by a transparent, robust and fair policy rationale. The FSC submits that no such rationale has been articulated.

AFCA explained to the Senate Economic References Committee:

> "*In determining loss, AFCA does not award capital loss but rather applies the "but for" test i.e. "But for" the failure of advice, what would the consumer have invested in. This approach has been endorsed by the Courts in the case of Patterson Securities Ltd v FOS [2015] WASC 321.*"[75]

Importantly, the Patterson case essentially applied a "*but for*" methodology to calculate loss,[76] however it did so in circumstances where the defendants were not insolvent and CSLR compensation was not available. In fact, both AFCA and the CSLR were years away from being established. It is therefore not analogous to apply the methodology used in the WA case to cases compensable by the CSLR.[77]

Courts apply a broad spectrum of methodologies to determine compensation. A more analogous case involved the Dixon administrators reaching a settlement in the Watson class action,[78] where in recognition of practical and resource constraints **the Federal Court endorsed the use of an "*Actual Loss Approach*"[79] over a "*Loss of Opportunity Approach*".**[80]

In the view of an independent expert, endorsed by Justice Thawley, the "*Loss of Opportunity Approach*":

> "*… would require investigation into the former clients' investment history and investment goals, the advice they received and the alternative possible investments (along with the probability that they would have invested in them). It would be an expensive, protracted, and impractical process, assuming it were possible …*"[81]

By way of qualification, Justice Thawley was presiding over the settlement of a class action in circumstances where the defendant (Dixon) was in administration. The matter at hand was not a legal challenge to a compensation decision by AFCA or the CSLR. Nonetheless, the following lessons can be extrapolated:

1. "*But for*" (or "*Loss of Opportunity*") compensation is not the de facto compensation methodology applied universally by the courts;

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[75] AFCA, Submission to the Senate Economics References Committee Inquiry into Wealth Management Companies, November 2024, p.11.
[76] *Patterson Securities Ltd v FOS* [2015] WASC 321 at paras [6] and [149].
[77] AFCA, Submission to the Senate Economics References Committee Inquiry into Wealth Management Companies, November 2024, p.11.
[78] *Watson & Co Superannuation Pty Ltd v Dixon Advisory and Superannuation Services Ltd (Settlement Approval)* [2024] FCA 386.
[79] Defined at paragraph 124 as "*the loss of the capital sum actually invested by the former clients*".
[80] Defined at paragraph 124 as "*the loss of profit that could have been earned on that invested capital*".
[81] *Watson & Co Superannuation Pty Ltd v Dixon Advisory and Superannuation Services Ltd (Settlement Approval)* [2024] FCA 386 at [126] and endorsed at [153].

2. Courts and other decision-makers should make proactive decisions on what compensation methodology to rely on, having regard to criteria including the availability of funds to finance compensation; and
3. The time, cost and inconvenience of attempting to achieve a perfectly calculated allocation of scarce compensation resources on a '*but for*' basis is not always warranted.

Since the CSLR's actuaries have indicated that, in the absence of a special levy, it is expected to reach "*liquidity constraints*" by mid-August 2025,[82] the CSLR is clearly not in a financial position to continue to fund the "*but for*" methodology. Shifting to compensating consumers for their actual capital losses and adjusting this for CPI (noting the statutory cap on CSLR claims would still apply) is a reasonable alternative, bearing in mind that all compensation is paid by firms which did not contribute to the losses in question.

The FSC submits that for the CSLR to go beyond compensating consumers for their actual losses and instead compensate them for hypothetical missed gains undermines the key design principle of the CSLR: that it is truly a scheme of last resort. Whether the "*but for*" compensation methodology is appropriate in other AFCA cases, such as those which are not eligible for the CSLR, is debatable, but it is inappropriate for industry to be levied to fund such a cripplingly expensive compensation mechanism. The FSC therefore urges the government to urgently revise the eligibility of AFCA determinations made on a '*but for*' basis to receive compensation from the CSLR.

The FSC recommends that in making its determinations, AFCA both:

- continue to seek compensation from the liable party according to the "*but for*" methodology; and
- calculate the actual financial loss (the difference between the amount invested and the capital value post-advice or misconduct, rather than theoretical portfolio gains), which is the sum that should be paid by the CSLR if the liable party fails to comply with its obligations.

Such an arrangement makes the CSLR a truly last resort scheme. It would also provide a more consistent, transparent approach to awarding compensation under the CSLR, reduce costs, and ultimately ensure that compensation is directed toward clients who have suffered verifiable financial harm.

The FSC notes that the broader appropriateness of the "*but for*" test in other AFCA cases could be considered in the course of the review contemplated in recommendation 16.

Recommendation #3: The FSC recommends that AFCA urgently and significantly reduces its administrative costs which are reimbursed by the CSLR.

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[82] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.60.

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Recommendation #4: The FSC recommends that investigations be undertaken to improve the efficiency of AFCA's decision-making processes.

Recommendation #5: The FSC recommends that AFCA increase its transparency, especially on the level, quantum and calculation of unpaid fees attributed to the CSLR.

Recommendation #6: The FSC considers that AFCA expenses (including staff costs) should only be attributable to the CSLR through fees where the expenses are incurred directly in relation to a case where compensation is paid through the CSLR.

Recommendation #7: The FSC recommends that the "unpaid fee" charges imposed by AFCA on the CSLR be capped at a prescribed level per AFCA determination. The precise level of this cap should be determined following consultation with industry.

As noted in section 2.3 above, the CSLR is required to pay AFCA's unpaid fees under sections 1069B and 1069C of the *Corporations Act*. In the 12 months from FY26 to FY27, AFCA's unpaid fees attributed to the CSLR are expected to grow over 70% from $9.4 million to over $16 million.[83] This is from an original starting base of $2.5 million in FY25,[84] meaning fees will increase by 540% over two years.

This appears to be a continuation of a pre-existing trend of fee growth impacting AFCA's broader membership. In AFCA's latest reporting, between FY23 and FY24, receipts from members and others increased by 30% (by $45 million to a total of $197 million), while the volume of complaints only increased by 8% (these are overall figures, not CSLR-specific).[85]

AFCA charges a membership levy, user charge and complaint fee.[86] The overwhelming majority of funds payable to AFCA by the CSLR are for the user charge and complaint fees, which are essentially user pays levies for use of AFCA's external dispute resolution service. It is unsurprising that as the CSLR matures and backlogs of CSLR-eligible cases are processed, this will result in more determinations and therefore more unpaid fees being attributed to the CSLR. Nonetheless, there are several issues with AFCA's approach.

The quantum of fees for completed determinations

In December 2023, the CSLR's actuaries assumed that AFCA's unpaid fees for each case would be $10,000 to $12,000 per finalised complaint (incl GST).[87] This was based on an "*indication from AFCA management*".[88] However, by FY25 actuarial estimates increased the figure to $20,718,[89] and by FY26 the per finalised complaint cost is expected to reach

[83] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.52.
[84] Finity, Actuarial Estimate for 1st and 2nd Levy Period, March 2024, p.5.
[85] AFCA, Annual Review 2023-24, 2024, at pp. 145 and 154.
[86] Treasury, Review of the Australian Financial Complaints Authority, August 2021, p.33.
[87] CSLR, Actuarial Estimate Pre-CSLR Complaints Initial Estimate, December 2023, p.28.
[88] CSLR, Actuarial Estimate Pre-CSLR Complaints Initial Estimate, December 2023, p.28.
[89] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.51.

$26,334 (including a $5,000 allowance for "*uncertainty in future complaint fee and user charge arrangements for unpaid AFCA fees*").[90]

The reason for the inaccuracy of AFCA's original estimate or for the continued fee growth is unclear, including to what extent the growth reflects AFCA's actual cost of delivering external dispute resolution services. According to the CSLR's actuaries:

> "*AFCA has indicated that **the broad intention** is that AFCA would be **reimbursed for approximately the cost** it incurs (mostly staff costs) in respect of CSLR matters.*" (emphasis added)[91]

In comparison, in 2023-24 it cost Division 2 of the Federal Circuit and Family Court of Australia approximately $1,037 for each separate determination it reported, based on the $104.7 million[92] it spent to make approximately 100,966 decisions.[93] AFCA, which is under a statutory obligation to deliver an efficient, accountable and effective external dispute resolution service,[94] appears to be more expensive than the courts.

One possible explanation is that AFCA determinations involve matters of greater complexity. However, AFCA's cost of delivering its services appears to be approximately the same amount that it costs the Federal Court of Australia to resolve proceedings in its caseload, which mainly consists of factually and legally complex matters. In the Federal Court's 2023-24 annual report, the Court indicated that it had finalised 4,266 cases at the cost of $93.4 million, which equates to a cost of $21,900 per decision.[95] It is not clear why Federal Court decisions would be produced at roughly the same cost as AFCA determinations, since AFCA was never intended to resolve complaints of the same complexity. According to AFCA:

> *"AFCA is not a court. It is not bound by rules of evidence and it does not determine the legal rights of the parties. **AFCA is designed to be an informal and low-cost complaint resolution scheme**."* (emphasis added)[96]

An alternative explanation for the fee differential is that AFCA's decision-makers might apply different skill sets. This appears to be at least partially rebutted by AFCA's disclosure that "*[o]ver 96 per cent of AFCA ombudsmen hold a law degree and are admitted as a lawyer*".[97]

The above statistics on court costs exclude the parties' own legal costs (as do AFCA's), may include some decisions by registrars, are not adjusted to reflect the fact that some matters

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[90] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.60.
[91] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.51.
[92] Federal Circuit and Family Court, Annual Report for 2023-24, p.236.
[93] 13,541 finalisations of applications for family law final orders, 18,702 finalisations of applications for family law interim orders, 44,851 divorce application finalisations, 16,289 family law consent order application finalisations, 807 other family law application finalisations, 3,048 general federal law finalisations, 3,728 migration application finalisations (Federal Circuit and Family Court, Annual Report for 2023-24 at pp. 24, 126, 128, 130, 131, 136 and 156).
[94] *Corporations Act* at s 1051A.
[95] Federal Court, Annual Report for 2023-24, 30 September 2024, pp.7,18.
[96] AFCA, AFCA Independent Review: AFCA Submission, March 2021, pp.7-8.
[97] Treasury, Review of the Australian Financial Complaints Authority, August 2021, p.36.

would have been finalised due to cases being discontinued or settled (although in many instances, related orders would still have required judicial input, and even discontinued AFCA complaints are projected to cost the CSLR $5,023 per matter),[98] and may include instances where multiple determinations are being made in the course of the same case (eg interim and then final orders).

Nonetheless, these cost comparisons raise questions about the efficiency of AFCA decision-making, which due to the CSLR's obligation to cover AFCA's unpaid fees – and AFCA's commitment to set them approximately at cost – is a directly relevant question to the sustainability of the CSLR.

Inefficiencies contributing to fee growth

AFCA's high fees appear to be partly a result of unnecessary inefficiencies.

By way of example, prior to awarding compensation AFCA must holistically assess each case and write a detailed determination. Consequently, there will be enormous duplication as it processes the 2,746 unique complaints[99] from the Dixon cohort. Based on the estimated per finalised complaint cost of $26,334 (incl GST), AFCA would charge the CSLR (and ultimately industry) approximately $72 million to finalise cases where the key details are overwhelmingly already known, the decision-making process involves a significant delay and there is expected to be little dispute as to culpability (95% of open Dixon complaints are expected to result in a determination in the complainant's favour).[100]

As Justice Thawley stated in relation to the Dixon cohort in the context of the Watson class action, applying a "*Loss of Opportunity Approach*" individually to members of the cohort to assess their claims:

> *"… would require investigation into the former clients' investment history and investment goals, the advice they received and the alternative possible investments (along with the probability that they would have invested in them). It would be an expensive, protracted, and impractical process, assuming it were possible …"*[101]

This is the exercise which AFCA undertakes as a matter of course in such situations.

While the FSC certainly does not advocate the payment of claims without appropriate scrutiny, in this example where unlike future scenarios it is not possible for further Dixon claims to be lodged, applying generous assumptions[102] it would be more efficient to simply pay out ineligible claims (adding approximately $20.6 million to the compensation bill) rather than to pay the administrative costs associated with individually testing each claim (approx.

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[98] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.52.
[99] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.20.
[100] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.38.
[101] *Watson & Co Superannuation Pty Ltd v Dixon Advisory and Superannuation Services Ltd (Settlement Approval)* [2024] FCA 386 at [126] and endorsed at [153].
[102] That the 137 (5% of total complaints) complaints AFCA would filter out as ineligible for compensation would each reach the $150,000 cap on compensation.

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$72 million). The FSC would not like to see this happen: it would like to see AFCA undertaking more efficient case management processes where they are required.

The key takeaway here is that substantially similar claims can and should be managed more efficiently.

Timeliness of decision-making is also an efficiency issue. In 2021, Treasury's post-implementation review of AFCA identified that "*AFCA will need to continue to develop and improve its processes as it consolidates its place in the financial system.*"[103] It also "*identified some shortcomings in the timeliness of AFCA's resolution of complaints*".[104]

Timeliness was also identified as an issue in AFCA's Independent Decision Review Report 2023-24, where barristers the Hon Julie Dodds-Streeton KC and Ahmed Terzic identified instances in which cases were "*unreasonably prolonged*" for reasons that were "*not always possible for us to determine*".[105] In other instances, parties were afforded "*too much latitude*" and firmer deadlines and protocols should have been set.[106]

Similarly, AFCA's Independent Assessor found in July to December 2024 that "*many complaints about unreasonable delays in progressing and finalising financial firm complaints were substantiated during this period*".[107] More broadly, out of 713 general service-related issues raised in complaints (excluding membership and determination service issues), 360 (51%) were substantiated.[108]

Also relevantly, Treasury's 2021 post-implementation review of AFCA identified:

> "*extensive feedback particularly from financial firms that AFCA sometimes does not make a decision early enough, particularly on jurisdictional issues, which from their perspective unnecessarily adds to the time and cost involved to close the case*"[109]

The FSC strongly supports measures to enhance the efficiency and timeliness of AFCA processes.

Outsourcing by AFCA

The FSC notes that AFCA has disclosed an intention to outsource decision-making to a "*third-party provider to process a backlog of potential CSLR complaints against a single former member*".[110]

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[103] Treasury, Review of the Australian Financial Complaints Authority, August 2021, p.10.
[104] Treasury, Review of the Australian Financial Complaints Authority, August 2021, p.10.
[105] The Hon Julie Dodds-Streeton KC and Ahmed Terzic, AFCA Independent Decision Review Report 2023-24, 8 February 2024, p.10.
[106] The Hon Julie Dodds-Streeton KC and Ahmed Terzic, AFCA Independent Decision Review Report 2023-24, 8 February 2024, p.13.
[107] AFCA Independent Assessor, Public Report, 2024.
[108] AFCA Independent Assessor, Public Report, 2024.
[109] Treasury, Review of the Australian Financial Complaints Authority, August 2021, p.64.
[110] AFCA, General Purpose Financial Report 2024, p.165.

While the FSC is cautiously optimistic that this may introduce some efficiencies, we note with concern the authorisation requirements for an external dispute resolution scheme in section 1050 of the *Corporations Act* may be an impediment to this.

The FSC also notes that the rationale for establishing AFCA was to have a third-party corporation resolving disputes. The involvement of a fourth-party corporation may be a source of unnecessary bureaucracy.

Conflict of interest and the need for improved transparency

In Treasury's 2021 post-implementation review of AFCA, industry feedback was received that:

> "*AFCA's staff are fundamentally conflicted in having an incentive to push cases through to later stages of AFCA's processes as it will result in a higher revenue stream for the organisation."*[111]

Similarly, in CSLR-eligible cases, AFCA is presented with often sympathetic complainants and AFCA's decision-makers have the ability to award them sums of money raised from industry. Since AFCA only appears to receive unpaid fees through the CSLR if the case is eligible for CSLR-compensation (which, among other things, requires a determination in favour of the complainant), finding in favour of complainants also benefits AFCA financially: $26,334 per case by FY26.[112] AFCA may therefore have no financial incentive to reconsider measures like its use of the "*but for*" test, even though without a one-off special levy the CSLR is expected to reach "*liquidity constraints*" by mid-August 2025 (with the increasingly likely prospect of annual special levies being required to fund subsequent years of CSLR expenditure).[113]

It is important for AFCA to ensure that it maintains its independence and avoid a perception of having a conflict of interest. In *D H Flinders Pty Ltd v Australian Financial Complaints Authority Limited* [2020] NSWSC 1690 (which did not relate to the fee levels set by AFCA), Justice Stevenson warned that AFCA risked breaching its procedural fairness and impartiality obligations by providing inappropriate advice to the complainants: it "*was acting in an advisory relationship with the complainants*".

Similarly, in Treasury's 2021 post-implementation review of AFCA:

> *"A wide range of financial firms that responded to the Review expressed concerns about AFCA's approach to fairness in its decision making. These concerns centred on AFCA using its fairness jurisdiction to hold financial firms to a higher standard than required by the law or agreed contract terms."*[114]

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[111] Treasury, Review of the Australian Financial Complaints Authority, August 2021, p.81.
[112] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.60.
[113] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.60.
[114] Treasury, Review of the Australian Financial Complaints Authority, August 2021, p.63.

To address concerns both about the general quality of AFCA's decision-making and more specifically, potential conflicts arising from its fee structure, AFCA should become more transparent.

While some information is presently available through the CSLR operator's actuarial reports, the actuaries acknowledge the documents are prepared for the narrow purpose of determining upcoming levies.[115]

In 2021, Treasury's post-implementation review of AFCA (endorsed by the then Government)[116] recommended:

> *"AFCA should improve the transparency of its fees for financial firms and how the fees are being used to support AFCA's activities."*[117]

While it is unclear to the FSC whether this recommendation has been partially adopted, the FSC strongly supports the adoption of greater fee transparency by AFCA, especially in relation to how it sets fees which the CSLR is required to pay.

The FSC also sees merit in increasing the public reporting of other AFCA statistics related to the CSLR, for example decision-making timeframes, outcomes, sources of claims, etc.

Proposed limitations on the payment of AFCA expenses by the CSLR

While AFCA's fees are directly paid by the CSLR, which is in turn funded by scheme members (such as financial advice licensees), ultimately the funds are raised from consumers. Given the consumer cost implications, it is important to ensure that payments to the AFCA are proportionate to the services it is delivering and that fees deliver value for money.

The FSC considers that AFCA expenses (including staff costs) should only be attributable to the CSLR where the expenses are incurred directly in relation to a case where compensation is paid through the CSLR.

As noted by the CSLR's actuaries:

> "*AFCA has a specific role which is largely unrelated to CSLR. The structure, approach and data held by AFCA are not designed with CSLR needs in mind, although further progress in this direction has been made in recent months and can be anticipated for the future.*"[118]

A consequence of this is that in CSLR matters, AFCA's use of resources does not appear to be subject to any meaningful constraints.

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[115] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.62.
[116] Treasury, Government response to the Treasury Review of the Australian Financial Complaints Authority, November 2021, pp.4-5.
[117] Treasury, Review of the Australian Financial Complaints Authority, August 2021, p.14.
[118] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.58.

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The FSC strongly recommends imposing a per determination cap on the amount of unpaid fees that AFCA should be able to recover from the CSLR. Based on Division 2 of the Federal Circuit and Family Court of Australia's ability to make decisions at approximately $1,037 per determination and the Federal Court's ability to make decisions at approximately $21,900 per determination (both as at 2023-24), the FSC recommends that AFCA's fee recovery from the CSLR be subject to a mandatory cap significantly below $26,334, having regard to the typical costs of other decision-making bodies. Such cap might be enshrined in legislation or possibly imposed by ASIC under its powers to give directions to AFCA.[119]

The FSC notes that whether such a cap should be adopted more broadly to all AFCA cases is worth investigating in the course of the review suggested at recommendation 16.

Recommendation #8: The FSC suggests AFCA adopt – or be required to adopt – the Australian Government's Cost Recovery Guidelines.

In its 2021 post-implementation review of AFCA, Treasury observed:

> *"AFCA should communicate more with members about its fees and charges. While AFCA, as a non-government entity, is not subject to **the Australian Government Cost Recovery Guidelines**, these guidelines (specifically documentation requirements associated with the cost recovery implementation statement) **could provide a useful guide for AFCA as to the type of reporting and transparency that financial firms seek. Strong oversight and transparency of AFCA's funding is appropriate given the compulsory nature of membership for financial firms** (emphasis added)."*[120]

The FSC endorses Treasury's recommendation.

Recommendation #9: The FSC recommends providing the CSLR operator with greater independence from AFCA.

In the negotiation of AFCA's pricing of unpaid fees attributed to the CSLR, it is important to note the relationship between the CSLR operator and AFCA. The CSLR operator is a company limited by guarantee. The CSLR operator's only member (ie shareholder) is AFCA. Furthermore, a member of AFCA's board is also a board member of the CSLR operator. For this reason, AFCA is described as a "*related party*" in the CSLR operator's financial reports.[121]

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[119] *Corporations Act* at ss 1052A, 1052BA and 1052C.
[120] Treasury, Review of the Australian Financial Complaints Authority, August 2021, p.85.
[121] CSLR operator, Financial Report for the period ended 30 June 2024, September 2024, p.19.

The FSC recommends providing the CSLR operator with greater independence from AFCA. The FSC anticipates that this would provide the CSLR operator with greater bargaining power in negotiating fees and advocating for the best interests of complainants and industry.

This recommendation is informed by AFCA's view in cases such as the Dixon lead determination that particular caution is required where one organisation is paying fees to a related party.

Recommendation #10: The FSC recommends that AFCA fees attributed to the CSLR should be exempted from GST.

The FSC notes that since AFCA's external dispute resolution service is operated independently of government, its fees incorporate GST. Given:

1. the quantum of AFCA fees being paid by the CSLR (expected to be $26,334 in FY26 as set out above);
2. the fact that AFCA is performing these services effectively as a government agent; and
3. that AFS licensees are required by law to be members of AFCA and submit themselves to its services (including the user-pays fee system for which the CSLR is the payer of last resort),

The FSC recommends the exclusion of GST from AFCA's fees.

Recommendation #11: The FSC recommends that AFCA be required to report annually to ASIC on the "reasonable steps" it undertakes in each case to ensure compliance with its determinations prior to making referrals to the CSLR.

Subsection 1051(4)(d) of the *Corporations Act* requires "*reasonable steps are taken to ensure compliance by members of the scheme with [AFCA's] determinations*". AFCA "*must ensure*" this is complied with.[122]

Given current pressures on the CSLR's fund model and the potential for misalignment between AFCA and the CSLR which has been acknowledged by the CSLR's actuaries, the FSC supports the introduction of a requirement for AFCA to report on the steps which it undertakes to ensure its determinations are complied with.

[122] *Corporations Act* at s 1052.

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Recommendation #12: The FSC supports improving decision-making by AFCA to ensure CSLR payments occur in a consistent, transparent and accountable manner, and making assessments more rigorous through the involvement of a contradictor to scrutinise compensation claims.

The FSC notes industry concerns that AFCA's approach to awarding compensation has in some instances become misaligned with the legislation which it is tasked with administering. It also underscores the importance of ensuring AFCA administers its caseload consistently, accurately and transparently.

By way of example, it is important to ensure that the $150,000 cap on compensation is applied consistently. Similarly, the requirements for a formal complaint under section 1065 of the *Corporations Act* need to be carefully observed. Regrettably, Treasury's 2021 post-implementation review of AFCA identified instances of inconsistent decision-making by AFCA.[123]

In cases where the recipient of an AFCA complaint has collapsed and it is no longer represented before AFCA, the Government should introduce an independent contradictor into AFCA's dispute resolution process to increase accountability, accuracy and consistency in its decision-making. A contradictor is particularly necessary in cases which form the basis of lead determinations, as AFCA's disposition of such cases can have significant implications for the CSLR's caseload. The use of a contradictor would also increase trust in AFCA's assessments from both consumers and industry.

The FSC notes that the CSLR is required to pay unpaid AFCA fees for cases eligible for CSLR compensation, even in cases where complaints are discontinued. Since the purpose of introducing a contradictor would be to reduce administrative expenses associated with the CSLR, the FSC would not support steps to charge the CSLR for the costs associated with a contradictor – particularly in instances where a complaint is ultimately unsuccessful.

The FSC also notes the need for AFCA to consult on the preparation of the Approach Documents which it prepares to guide its decision-makers and manage parties' expectations. Indeed, Treasury's 2021 post-implementation review of AFCA recommended: "*AFCA should ensure consultation is undertaken on each Approach Document prior to final publication.*"[124]

Unfortunately, however, in some instances the consultation undertaken by AFCA appears to be inexplicably brief. For example, in its FY25 consultation on 10 separate proposed documents,[125] consultation was only open for 14 days. The brevity of the consultation window meant that only 6 responses were received.[126]

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[123] Treasury, Review of the Australian Financial Complaints Authority, August 2021, p.53.
[124] Treasury, Review of the Australian Financial Complaints Authority, August 2021, p.15.
[125] AFCA, Annual Approach documents schedule, accessed 18 February 2025.
[126] AFCA, Consultation Feedback Report: Annual Approach documents schedule for the financial year 2024-25, July 2024, p.3.

The FSC suggests that meaningful consultation requires a longer consultation window, particularly where multiple consultations are undertaken simultaneously.

Recommendation #13: The FSC strongly supports restricting access to the CSLR to retail investors.

Recommendation #14: The FSC endorses the exclusion of wholesale or sophisticated investors' complaints from AFCA's jurisdiction, except in instances where retail investors have been incorrectly classified as such.

Section 1065 of the *Corporations Act* indicates that access to the CSLR for financial advice is restricted to "*personal advice provided to a person as a retail client …*". Unfortunately, the wording "*as a retail client*" has left room for the interpretation that a wholesale investor who invests in retail products "*as a*" retail client does may be eligible to access the CSLR.

This interpretation is inconsistent with the intention of the legislation. The Revised Explanatory Memorandum states that it is meant to cover "*providing financial product advice that is personal advice to a retail client*".[127]

The FSC strongly supports restoring the scheme to its original intention by restricting access to the CSLR to retail investors. The FSC also queries whether wholesale or sophisticated investors should be able to seek remedies from AFCA in the first place, especially where the matter can be pursued in the courts.

Importantly, in 2021 Treasury recommended:

> *"AFCA should exclude complaints from sophisticated or professional investors, unless there is evidence that they have been incorrectly or inappropriately classified."*[128]

Treasury also stated that this exclusion should occur "*as a matter of course*".[129]

This recommendation does not appear to have been implemented.

Recommendation #15: The FSC recommends that AFCA be more vigilant in expelling members who are likely to be a source of future claims.

[127] Revised Explanatory Memorandum to the Treasury Laws Amendment (Financial Services Compensation Scheme of Last Resort) Bill 2023 at paragraph 1.43.
[128] Treasury, Review of the Australian Financial Complaints Authority, August 2021, p.14.
[129] Treasury, Review of the Australian Financial Complaints Authority, August 2021, p.17.

The FSC notes that a claim cannot be made to AFCA unless the subject of the complaint is a current member of AFCA.[130] Section 912A of the *Corporations Act* sets AFCA membership as a mandatory requirement for firms which provide financial services to retail clients. AFCA's constitution gives it discretion to cancel an AFCA member's membership if it ceases carrying on business, becomes insolvent, loses its AFS licence, fails to comply with AFCA's constitution or rules (eg by complying with an AFCA determination) or fails to pay its AFCA fees.[131]

This can create a dilemma for AFCA: a high volume of unpaid determinations may weigh in favour of prompt membership cancellation to trigger an AFS licence cancellation process, yet AFCA may also wish to extend a firm's membership for as long as possible to provide investors with the opportunity to lodge complaints and preserve their eligibility for CSLR compensation. Frequently this prevents AFCA from taking preventative action and aggravates pressure on the CSLR.

The FSC considers that a reasonable balance needs to be struck in conducting this exercise but is concerned that AFCA is erring on the side of leaving membership open for too long. The FSC is also concerned that AFCA has agreed to waive membership fees outstanding from insolvent firms,[132] which exacerbates the strain placed on the CSLR.

By way of illustration, in the Dixon case the firm entered voluntary administration in January 2022 and yet Dixon was permitted to remain an AFCA member until 30 June 2024. This created an opportunity for costs which ought to have been attempted to have been recovered through other avenues to instead be pursued through AFCA and, ultimately, the CSLR.

The FSC is also concerned to see that it appears AFCA will be permitting UGC to remain a member until at least 31 May 2025,[133] despite UGC entering voluntary administration in July 2024.[134]

The FSC also suggests that better ways should be found to impose a deadline on consumer complaints.

Recommendation #16: The FSC recommends that there be a comprehensive review of AFCA to consider its impact, sustainability and efficiency, as well as the outcomes it delivers for consumers and industry.

It is recommended the review consider the following:

1. measures to increase AFCA's efficiency;

[130] ASIC, submission to the Senate Economics References Committee Inquiry into Wealth Management Companies, November 2024, p.12.
[131] ASIC, RG 267 (Oversight of the AFCA) at RG 267.160 to RG 267.162; ASIC, submission to the Senate Economics References Committee Inquiry into Wealth Management Companies, November 2024, p.12.
[132] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.33.
[133] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.38.
[134] ASIC, United Global Capital Pty Ltd (in liquidation), October 2024.

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2. administrative costs imposed on the CSLR by AFCA;
3. an analysis of what is contributing to unpaid AFCA determinations, including an analysis of underlying factors and risks giving rise to consumer claims and the inability for Financial Services Providers (FSPs) to meet their financial obligations as and when required;
4. whether regulatory strengthening is needed to reduce the risk of unpaid determinations in a given sector and make recommendations for proposed reform to address weaknesses and gaps (whether required in ASIC guidance or legislative change);
5. ways to ensure that AFCA operates productively and does not act to the detriment of the CSLR;
6. how AFCA can strengthen the industry and reduce the need for consumers to rely on the CSLR;
7. the compensation methodology used by AFCA to calculate loss; and
8. AFCA's funding model, including its interrelationship with the CSLR and its impact on competition and industry viability.

The CSLR and AFCA are closely interrelated. AFCA finalises claims and, where they are unpaid and otherwise eligible, the CSLR makes payment and levies industry.

The FSC notes that any review of the CSLR necessarily opens up questions about AFCA, some of which are beyond the scope of this review. An efficient, effective and accountable AFCA is not just an aspirational target: it is part of AFCA's statutory mandate.[135]

As noted by the CSLR's actuaries:

> "*AFCA has a specific role which is largely unrelated to CSLR. The structure, approach and data held by AFCA are not designed with CSLR needs in mind, although further progress in this direction has been made in recent months and can be anticipated for the future.*"[136]

It is important to ensure that the CSLR and AFCA are operating together as efficiently as possible. To achieve this, the FSC recommends that AFCA be subject to its own dedicated review to ensure that it is operating efficiently, effectively and accountably, in alignment with the best interests of the CSLR, consumers and industry. The need for a dedicated review of AFCA should be apparent from recommendations 1 to 15 above.

[135] *Corporations Act* at s 1051A.
[136] Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.58.

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4.2. Recommendations regarding CSLR administration

Recommendation #17: The FSC suggests Treasury consider reducing the $150,000 cap on CSLR claims.

While it is not the FSC's preferred course of action, if the present structural issues with AFCA's decision-making and fees are not resolved, the FSC recommends that Treasury consider reducing the $150,000 cap on claims.

This is a product of the fact that (assuming special levies occur) by FY26 Treasury's original annual forecast of levies is expected to be exceeded by 860%,[137] and by FY27 it is on track to be exceeded by 1,381%.[138] This represents an unacceptable impost on industry. If AFCA is unable or unwilling to reduce the volume and quantum of claims, then unfortunately the existing cap on CSLR payouts must be reduced.

Recommendation #18: The FSC supports a comprehensive risk-based funding approach at an individual firm level being implemented by the Government as soon as reasonably practical. The CSLR should collect sufficiently detailed information about the profile of each firm and the reason for the unpaid determination to enable it to develop a more comprehensive risk-based funding approach in future.

The FSC considers that a robust and well-considered risk-based funding model, including detailed risk assessment at the individual firm level, should be the preferred approach for funding the CSLR. The FSC notes, however, that establishing a risk-based model at the individual firm level may have its challenges due to a shortage of suitable data. That said, the FSC submits that moving to a risk-based model at the firm level should be seriously considered and planned for by collecting and analysing suitable, available data.

If there is not a longer-term move to risk-based funding at the firm level, then the CSLR costs will continue to be disproportionately imposed on low-risk FSPs while higher-risk FSPs will avoid paying the costs they impose on the scheme. If low-risk FSPs are required to continually fund the failings of higher-risk FSPs, low risk FSPs will likely need to unduly increase their service costs to their customers. This in turn could result in consumers moving towards higher-risk FSPs, which will further increase the costs of the CSLR and exacerbate the moral hazard problems inherent in the CSLR.

For the CSLR to move towards a risk-based funding model, sufficient relevant data on the types of FSPs and the reasons for unpaid determinations should be collected, and the Government and CSLR using the data should develop a risk profile of FSPs to establish a

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[137] $8.1 million (The Treasury, Compensation Scheme of Last Resort - Proposal Paper (treasury.gov.au) at p.19) to $78 million (CSLR, Actuarial Estimate for 3rd Levy Period (January 2025) at p.4).
[138] David Berry, Conexus Summit: Professional Planner 2025 Advice Policy Summit, 11 February 2025.

more comprehensive risk-based funding model. Specific risk considerations could include the proportion of SMSF clients in an FSP's portfolio, the proportion of in-house product recommendations they make and the presence of robust compliance and risk management frameworks.

The CSLR should collect and analyse data to determine the best and most efficient way to move towards a funding model based on risks at the individual firm level.

Initially, risk should be assessed based on data available from historical unpaid determinations for the financial services class level.

In assessing sector-based risk, the implicit presumption has been, for example, that all financial advice licensees have similar risk of calling on the CSLR, similarly for financial advice and other sectors covered by the CSLR. However, it is arguable that some licensees are more likely to generate claims than others and certain types of advice are more likely to generate claims. Therefore, there should be consideration of the value of assessing sector-based risk at a more finely grained level.

Recommendation #19: The FSC supports introducing a per annum cap on the per capita amount that can be levied on financial advisers for the CSLR. This cap would provide certainty and financial stability for advisers, ensuring they can continue to operate sustainably.

The FSC notes recent precipitous falls in financial adviser numbers and growing financial imposts from Government on licensees, advisers and their clients. On balance, the FSC considers a per capita limit on annual CSLR levies is appropriate until a risk-based funding model at the individual FSP level can be adopted. The FSC would be eager to work with Treasury on how a per capita limit may operate. This is an equitable and proportionate approach for the cap that would not unfairly advantage small or large businesses. Since the CSLR is imposed on the basis of the number of individual financial advisers employed by a licensee, the FSC sees such as cap as a simple way to ensure financial advice remains affordable.

There are clear advantages in imposing such a cap as they will limit the scheme's costs and encourage the CSLR operator to function efficiently. These ensure the scheme is sustainable, the industry remains competitive, and business has some degree of certainty. Limiting scheme costs would also help reduce the risk of high CSLR levies causing business failures, which would further exacerbate reliance on the CSLR (because a firm that fails due to the CSLR costs could in turn cause additional consumers seeking compensation via CSLR claims) and potentially cause a contagion effect.

Recommendation #20: Government should amend the *Financial Services Compensation Scheme of Last Resort Levy Act 2023 to* reduce the $20 million annual subsector levy cap to $10 million.

In the alternative to recommendation 19, reducing the annual subsector levy cap from $20 million to $10 million would improve the financial sustainability of the CSLR by ensuring that those who do not cause the losses paid by the CSLR are not unfairly burdened with its excessive costs. Under the current structure, financial advisers who had no involvement in the misconduct that led to compensation claims are required to fund a disproportionate share of the scheme. This creates an unjust situation where well-run businesses and individuals who have complied with all regulatory requirements are forced to pay for the failures of other firms. Lowering the subsector cap would provide much-needed relief to financial advisers, allowing them to remain viable while still contributing to consumer protection in a more equitable manner.

Reducing the cap on annual levies is also appropriate having regard to the significant decline in financial advisers from 28,000 advisers in 2018 to around 15,600 in 2024.[139] Since CSLR expenditure has grown significantly while the number of advisers it is spread between has fallen, levies have grown exponentially. Reducing the cap on annual levies by 50% would reflect the nearly 50% decrease in the number of advisers.

Indeed the original design of the scheme capped the subsector levy at $10 million per year rather than $20 million.[140] However, this was later changed during the legislative process, possibly in response to concerns around funding Dixon claims.[141]

The $20 million subsector cap is currently codified in s17(2) of the *Financial Services Compensation Scheme of Last Resort Levy Act 2023* which stipulates that:

> *"the total amount of levy that may be imposed for the second levy period, or a later levy period, across all members of a particular sub - sector must not exceed the cap (the sub - sector levy cap) that is the highest of the following:*
>
> *(a) $20 million;*
>
> *(b) the amount prescribed (or the amount worked out in accordance with a method prescribed) for the levy period and the sub - sector by the regulations for the purposes of this paragraph"*

Section 17(1) of the Act also mandates that *"the total amount of levy that may be imposed for any levy period across all persons across all sub-sectors must not exceed $250 million."*

[139] Adviser Ratings, Australian Financial Advice Landscape, 2024, p.26
[140] Division 3, s(17)(2) Financial Services Compensation Scheme of Last Resort Levy Bill 2021.
[141] FAAA, Compensation Scheme of Last Resort, 2025.

In FY25, the CSLR levy imposed on the financial advice sector was $18.5 million.[142] With approximately 15,651 advisers operating in Australia during that period, this equates to an average levy of roughly $1,186 per adviser.[143] If a $10 million subsector cap had been in place, this figure would have been reduced to around $639 per adviser – a far more sustainable figure in the context of the other levies payable by financial advisers (such as the ASIC levy which was $2,691 per adviser in the same year).[144]

Recommendation #21: The FSC supports amending the CSLR framework to ensure that funds raised through levies are not directed towards paying for the CSLR operator's administrative expenses.

The annual administrative costs for the CSLR have consistently exceeded Treasury estimates. In FY26, CSLR operator's administrative costs (excluding AFCA and ASIC costs attributed to the CSLR) are projected to reach $6.3 million, surpassing Treasury estimates by 71%.[145]

The FSC considers the primary focus of the scheme should be on compensating consumers and any leftover funds should be returned to scheme participants in the form of reduced levies in subsequent levy periods.

The FSC considers that the planned allocation of $6.3 million of total levies to scheme administration is unduly high, having regard to the nature of the CSLR's remit. The CSLR operator is not engaged in making findings of fact like AFCA or substantive administrative decisions. Their primary task is to engage independent actuarial consultancies to determine the levies so its administrative operations and staffing requirements should be quite limited.

Section 1069Q of the *Corporations Act* states:

> *(1) The money of the CSLR operator is to be applied only:*
>
> > *(a) to pay compensation under section 1063; and*
> > *(b) to pay AFCA's unpaid fees under section 1069B; and*
> > *(c) to pay AFCA's accumulated unpaid fees under section 1069C; and*
> > *(d) to pay the CSLR operator's administrative costs; and*
> > *(e) to reimburse to ASIC the costs that ASIC has notified to the CSLR operator under subsection 9(4) of the Financial Services Compensation Scheme of Last Resort Levy (Collection) Act 2023; and*

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[142] Finity, Actuarial Estimate for 1st and 2nd Levy Period, March 2024, p.3.
[143] Jasmine Siljic, Qualified advisers are the 'only potential relief' to CSLR levy, Independent Financial Adviser, April 2024.
[144] Industry Updates, ASIC final FY24 levy sees slight reduction, *Professional Planner*, November 2024.
[145] The Treasury, Compensation Scheme of Last Resort - Proposal Paper (treasury.gov.au), pp.17,19; Finity, Actuarial Estimate for 3rd Levy Period, January 2025, p.2.

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> *(f) to establish and restore the capital reserve (within the meaning of the Financial Services Compensation Scheme of Last Resort Levy (Collection) Act 2023).*

The essential role of the CSLR is to administer payments in accordance with decisions made by other government entities. This function should not require extensive back-office capabilities and administrative costs should be relatively low.

On this basis and as an accountability mechanism, the FSC supports imposition of a limitation on the funds raised by annual and special levies to prevent them from being spent on the CSLR operator's administrative costs. This would necessitate Government funding for the modest annual expenditure that ought to be required to operate the CSLR, while earmarking funds collected from industry to be expended on victim compensation.

Recommendation #22: The FSC supports reducing CSLR operator costs by:
1. reducing the duplication of functions between AFCA and the CSLR operator; and
2. requiring the CSLR operator to focus on its core responsibilities to administer the CSLR without undertaking research, advocacy and policymaking activities.

As noted, the FSC considers that the CSLR operator's core responsibility is to distribute compensation to consumers as determined by AFCA. Nonetheless, the CSLR operator may presently undertake a number of advocacy and marketing activities which appear to stray beyond these core responsibilities.

Given the present strain on the CSLR operator's budget stemming from the Dixon and UGC cohort and the high likelihood of a special levy being imposed, the FSC does not consider it appropriate for the CSLR operator to undertake activities beyond those which are strictly required for it to perform its statutory functions.

If the CSLR operator continues to duplicate functions of AFCA, the FSC notes that under section 1060 of the *Corporations Act* it is possible for the entities to be merged, which might represent an alternative means of reducing the scheme's administration costs.

Recommendation #23: The FSC suggests that section 1065 should be amended to clarify that the CSLR only has jurisdiction to issue compensation in personal financial advice cases where the subject of a complaint was specifically authorised under their AFS licence to provide personal financial advice.

The FSC notes that the current drafting of section 1065 of the *Corporations Act* is agnostic as to the source of personal financial advice which may trigger CSLR compensation. This has the potential to create a broader pool of potential claim sources than was initially

contemplated by industry, while (except in the case of special levies) the source of funds to compensate advice complainants would remain confined to the financial advice industry.

By way of example, if an AFCA-member provides personal financial advice despite their AFS licence not authorising them to do so (eg if a credit intermediary was to do so), claims may potentially be made to AFCA and, in the event of non-payment (and subject to AFCA's determination in the case), paid through the CSLR.

Requiring the CSLR to compensate investors in these situations is not consistent with the original intention underlying the scheme.

The FSC recommends reforming this section to remove ambiguity in this area.

Recommendation #24: The FSC recommends the annual report published by the CSLR operator should include:

- information by entity name, parent entity and also by subsector when outlining the number and value of payments of compensation made during the levy period;
- information about the size of the entity (e.g. sole operator) and the reason for the unpaid determination (e.g. insufficient capital to fund the excess under the PI policy), as opposed to information about the types of products and/or services covered by the relevant AFCA determinations;
- information on any monies the CSLR operator has recovered under the subrogation rights and any expenses associated with the recovery;
- in relation to any compensation claim paid by the CSLR operator, whether the operator exercised its right of subrogation and pursued compensation under a relevant professional indemnity policy and, if not, a clear explanation as to why it did not take these actions.
- a balance sheet for each sub-sector to show whether there are any reserves attributable for each sector at the end of each levy period.

Noting concerns set out at recommendations 21-22 and 28-31 about the CSLR operator's administration costs and the advantages of the more aggressive use of subrogation powers, the FSC supports the introduction of greater transparency in the CSLR operator's annual reports.

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4.3. Recommendations regarding the role of the Government and the possible exercise of ministerial powers

Recommendation #25: The FSC supports a one-off injection of government funding to fund claims arising from the Dixon Advisory collapse.

Expectations that Government and the pre-CSLR levy would jointly pay for Dixon claims

In September 2022, the present Government indicated:

> "*The Government will contribute towards the costs of the scheme in its first year of operation,* ***which is proposed to commence from 1 July 2023****. The scheme will be fully industry funded through a levy on relevant financial service and credit licensees* ***in the subsequent years of the scheme's operation****.*"[146] (emphasis added)

The role of the Government funding was reflected in the Explanatory Memorandum to the package of legislation implementing the CSLR, which stated:

> "*The first levy period begins on the day specified in a determination made by the Minister and ends on 30 June 2024.*
>
> *"**The costs for the first levy period are to be funded by the Commonwealth**. For all subsequent levy periods, the levy amount for the levy period is required to be paid by parts of the financial services industry."*[147] (emphasis added)

The Explanatory Memorandum made it clear that the Government funding would be in addition to a pre-CSLR levy imposed on the 10 largest banking and general/life insurance groups. The explanatory memorandum explained the pre-CSLR levy as follows:

> "*Australia's ten largest banking and insurance groups (excluding health insurers and superannuation groups) are also required to pay a one-off levy* ***to fund the backlog of accumulated unpaid claims (and AFCA's unpaid fees relating to those claims) relating to complaints made to AFCA between 1 November 2018 and 7 September 2022."***[148]

The CSLR operator's actuaries determined that of 1,638 AFCA complaints made between 1 November 2018 and 7 September 2022, an estimated 95% (1,556) would be found eligible

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[146] The Hon Stephen Jones MP, Assistant Treasurer and Minister for Financial Services, Media Release: Hayne Royal Commission recommendations advanced, 8 September 2022.
[147] Parliament of Australia, Explanatory Memorandum, Treasury Laws Amendment (Financial Services Compensation Scheme Of Last Resort) Bill 2023; Financial Services Compensation Scheme Of Last Resort Levy Bill 2023; and Financial Services Compensation Scheme Of Last Resort Levy (Collection) Bill 2023, 8 March 2023, p.32.
[148] Parliament of Australia, Explanatory Memorandum, Treasury Laws Amendment (Financial Services Compensation Scheme Of Last Resort) Bill 2023; Financial Services Compensation Scheme Of Last Resort Levy Bill 2023; and Financial Services Compensation Scheme Of Last Resort Levy (Collection) Bill 2023, 8 March 2023, p.41.

for CSLR compensation.[149] Consequently, the pre-CSLR levy was set at $241 million, of which $203 million was earmarked for Dixon claims.[150]

However, complaints against Dixon continued to be received after the pre-CSLR levy period. This was anticipated by Treasury. Documents released under freedom of information processes indicate the Government nonetheless decided to retain the cut-off date of 7 September 2022 for the pre-CSLR levy period when designing the final version of the CSLR bills.[151]

By 30 June 2024, AFCA had registered a total of over 2,773 complaints against Dixon, meaning an additional 1,135 complaints had been received since 8 September 2022.[152] Since the pre-CSLR levy had been designed to raise funds for complaints lodged no later than 7 September 2022, the funds raised by the pre-CSLR levy are not expected to sufficiently fund the new complaints, a high share of which are – based on previous actuarial estimates – expected to be eligible for CSLR compensation. Indeed, according to the CSLR's actuaries "*pre-CSLR funds are anticipated to be substantially exhausted by the end of FY26.*"[153]

It is important to note that as set out above, a clear expectation was set by the Government that most claims from the Dixon collapse would be paid out from 1 July 2023[154] to 30 June 2024[155] and be covered jointly by the pre-CSLR levy and Government funding.[156] This expectation was made clear on 8 September 2022,[157] and materials released through freedom of information processes show that the Minister was advised by a submission dated 12 August 2022 that it was "*possible, though unlikely*" Dixon costs end up "*exceeding $250 million*", which would "*expose the Government to increased costs in the first levy period (2023-24)*".[158] Such wording clearly demonstrates the Government intended to contribute to the costs of the Dixon cohort.

An unexpected burden on financial advice licensees

A series of delays pushed the processing of Dixon complaints into levy periods which were technically no longer covered by the Government's commitment to jointly fund the first year of the scheme:

- the legislation was not passed until June 2023;
- the enabling regulations were not created until 31 January 2024;[159]

[149] Finity, Pre-CSLR Complaints Initial Estimate, December 2023, p.24.
[150] Finity, Pre-CSLR Complaints Initial Estimate, December 2023, p. 32.
[151] Treasury, Treasury submission MS23-000300 to the Minister,17 February 2023, p.8.
[152] Australian Financial Complaints Authority, Dixon Advisory and Superannuation Services Pty Ltd (Subject to Deed of Company Arrangement), September 2024.
[153] Finity, Pre-CSLR Complaints Initial Estimate, December 2023, p. 60.
[154] The start date of the scheme originally announced by the Government.
[155] The end date of the first levy period specified in the legislation.
[156] Chris Dastoor, 'Deep concern' as govt sidesteps Dixon-related CSLR liabilities, *Professional Planner*, 19 March 2024.
[157] The Hon Stephen Jones MP, Assistant Treasurer and Minister for Financial Services, Media Release: Hayne Royal Commission recommendations advanced, 8 September 2022.
[158] Treasury, Treasury submission MS23-000300 to the Minister,17 February 2023, p.3.
[159] Treasury, Financial Services Compensation Scheme of Last Resort Levy (First Levy Period) Determination 2024, paragraph 5.

- AFCA did not publish its lead determination to guide the assessment of Dixon cases until 6 February 2024;[160]
- the CSLR's first levy period did not commence under the regulations until 2 April 2024;[161] and
- AFCA paused the processing of complaints until 2 April 2024.[162]

Consequently, the period of Government funding was limited to 2 April 2024 to 30 June 2024. This period was too short to resolve the outstanding Dixon claims. In fact, during this period the CSLR paid out zero Dixon claims.[163]

As a result of these delays, the prospect of the Government providing financial support to the CSLR to assist with the Dixon cohort appears to have receded. Yet delays had been anticipated by Treasury: advice released under freedom of information laws was that a minimum of 8 months would be required after the passage of the CSLR legislation for the scheme to become operational.[164] This expectation and its implications for joint Government funding of Dixon claims was not made clear to industry.

While much of the $203 million collected from the 10 largest banking and general/life insurance groups earmarked for Dixon claims remains available to compensate the 1,638 Dixon cohort members who lodged their AFCA complaints by 7 September 2022, on the back of the subsequent 1,135 complaints the CSLR operator has indicated that the $20 million sub-sector cap for financial advice licensees will be exceeded in FY26.[165] This raises the likely prospect of a special levy on licensees and/or other sub-sectors to pay for further Dixon compensation.

Importantly, the special levy mechanism was never intended to be used to fund Dixon claims. The Explanatory Memorandum indicates:

> "*Given the forward-looking nature of the CSLR levy framework (that is, that the levy is based on estimates of costs for the upcoming levy period), it is appropriate and necessary for the Minister to be able to intervene in situations where the CSLR operator requires additional funding to meet higher than expected costs for the levy period, such as where a large financial services provider becomes insolvent, or where a "black swan" event occurs in the financial services industry. These types of events may lead to a significant increase in the number and size of compensation payments required to be made under the CSLR. As these circumstances are often not foreseeable, a Ministerial determination is necessary to ensure that the CSLR*

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[160] Australian Financial Complaints Authority, Determination, Case Number: 716627, 6 February 2024.
[161] Treasury, Financial Services Compensation Scheme of Last Resort Levy (First Levy Period) Determination 2024, paragraph 5.
[162] Australian Financial Complaints Authority, Dixon Advisory and Superannuation Services Pty Ltd (Subject to Deed of Company Arrangement), 2 September 2024.
[163] Compensation Scheme of Last Resort, CSLR Impact Report, 2024, p.13.
[164] Treasury, Treasury submission MS23-000300 to the Minister,17 February 2023, p.14.
[165] Compensation Scheme of Last Resort, Compensation Scheme of Last Resort hosts first financial industry forum, 23 October 2024.

operator has the funds needed to make compensation payments to consumers as quickly as possible."[166]

A historical company collapse which predates the existence of the CSLR itself cannot be construed as an unanticipated "*black swan*" event.

In light of the Government's previous representations about contributing to the CSLR during its first year of operation, the FSC strongly supports a one-off Government contribution to the CSLR to resolve legacy Dixon issues and place the CSLR on a sustainable, future-focused foundation. This will be essential for the CSLR to face anticipated future challenges, such as further claims from the United Global Capital cohort as well as other collapses such as the SIT and the SMF (whose CSLR eligibility is indeterminate as at the date of this submission).

Recommendation #26: The FSC recommends that, in addition to a one-off injection of government funding, the Minister stagger the CSLR levies or charge the levies by instalments to assist advice licensees in bearing the costs when there are large-scale incidents that are to be covered by the CSLR levies such as the Dixon and UGC claims.

In addition to direct Government funding (see recommendation 25), in order to help smooth payments, the Government could loan the CSLR operator further capital required for Dixon payments. This loan could be repaid incrementally from future annual levies paid by financial advice licensees. This would smooth out the impact of the Dixon and UGC cohort on CSLR levies payable by financial advice licensees.

Recommendation #27: The FSC recommends that, in the event that CSLR levies cannot be staggered for financial advice licensees, the Minister stagger the payment of individual compensation awards across multiple years to smooth the impact of one-off large-scale insolvencies.

Strain on the CSLR might also be further reduced if the CSLR operator could spread out the payment of compensation lump sums over time. Such a power is provided to the Minister by section 1069H(3) of the *Corporations Act*, but is limited to circumstances where a revised estimate for a specific levy period has been provided to the Minister by the CSLR operator.

The existence of a broader discretion in the hands of the CSLR operator would give it more flexibility to manage its cash flows. It would also enable the CSLR operator to respond proactively to the collapse of financial services companies and large anticipated cohorts of future claims (such as the SIT and the SMF cohorts). For example, where a large cohort of

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[166] Parliament of Australia, Explanatory Memorandum, Treasury Laws Amendment (Financial Services Compensation Scheme Of Last Resort) Bill 2023; Financial Services Compensation Scheme Of Last Resort Levy Bill 2023; and Financial Services Compensation Scheme Of Last Resort Levy (Collection) Bill 2023, 8 March 2023, p.55.

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future potential claims is identified, the CSLR operator might expedite the processing of other on-hand claims and plan to stretch out the processing of anticipated new claims, with the objective of smoothing out its cashflows and minimising the likelihood of special levies being imposed.

Staggering the payment of CSLR compensation would also help to mitigate some of the moral hazards associated with the scheme. For example, a longer payment timeframe will give ASIC, AFCA and the CSLR more time to detect fraudulent complainants who are attempting to defraud the scheme, while also deterring carelessness by consumers of financial products.

Given the amount of time which has elapsed for pre-CSLR levy claims, the FSC would support applying such a change on a prospective basis.

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4.4. Recommendations regarding the CSLR's subrogation powers

Recommendation #28: The FSC recommends the scheme operator should enforce subrogation rights to backdated claims. This includes the CSLR operator, or ASIC, using reasonable endeavours to pursue recovery under the financial services provider's professional indemnity insurance policy for the benefit of investors.

Section 1069A of the *Corporations Act* provides for the subrogation of rights and remedies against the entity in respect of which compensation was paid, provided the entity is a "*Chapter 5 body corporate*",[167] a description which captures:

> "*a body corporate:*
>
> *(a) that is being wound up; or*
>
> *(aa) that is a CCIV of which one or more sub - funds is being wound up; or*
>
> *(b) in respect of property of which a receiver, or a receiver and manager, has been appointed (whether or not by a court) and is acting; or*
>
> *(c) that is under administration; or*
>
> *(d) that has executed a deed of company arrangement that has not yet terminated; or*
>
> *(da) that is under restructuring; or*
>
> *(db) that has made a restructuring plan that has not yet terminated; or*
>
> *(e) that has entered into a compromise or arrangement with another person the administration of which has not been concluded.*"

The Explanatory Memorandum clarifies in relation to subrogation that:

> "*The purpose of this provision is to enable the CSLR operator, in certain circumstances, to recover some or all of the compensation paid on behalf of the relevant entity. It is also intended to prevent situations where the consumer is paid more than the amount specified in the relevant AFCA determination by receiving a compensation payment under the CSLR and a payment as a creditor to an insolvency process.*"[168]

The FSC notes with concern the CSLR operator's actuaries have indicated that no recoveries have yet been achieved through subrogation.[169] In addition, the FSC is not aware

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[167] Definition at *Corporations Act* at s 9.
[168] Parliament of Australia, Explanatory Memorandum, Treasury Laws Amendment (Financial Services Compensation Scheme Of Last Resort) Bill 2023; Financial Services Compensation Scheme Of Last Resort Levy Bill 2023; and Financial Services Compensation Scheme Of Last Resort Levy (Collection) Bill 2023, 8 March 2023, p.23.
[169] Finity, Pre-CSLR Complaints Initial Estimate, December 2023, p. 32.

of any legal proceedings which have been brought by the CSLR operator to attempt to achieve recoveries through subrogation.[170]

The FSC strongly supports the proactive use of subrogation powers by the CSLR operator to recover funds delinquent firms and their insurers.

Recommendation #29: The FSC supports enhancements to the CSLR operator's subrogation rights and powers.

The FSC understands there are practical and legal limitations on the CSLR operator's subrogation rights and powers. The CSLR's actuaries have indicated "*The ability to recover through subrogation has been explored by CSLR in a considered manner but no recoveries have been received to date under this power.*"[171]

The FSC is supportive of amendments to remedy legal issues which we understand the operator has identified with the subrogation powers conferred upon it.

Recommendation #30: The FSC recommends the Government should consider strengthening the CSLR's subrogation rights, by imposing an obligation to use reasonable endeavours (ie not solely providing the CSLR operator a right) to pursue recovery. Consideration should also be given to imposing a legal requirement for financial services providers to provide a copy of their professional indemnity insurance policy to the scheme operator where the financial services providers have unpaid AFCA claims.

The FSC considers it important for the CSLR operator to be obliged to thoroughly assess whether funds may be recovered through its subrogation powers. This should be framed as a duty to use reasonable endeavours to achieve cost recovery, rather than a right to pursue it.

This is because – in line with the CSLR's objective of enhancing accountability – the first port of call for CSLR funding should be the entity responsible for a claim, or failing this, its insurer.

To facilitate the exercise of these rights, FSPs with unpaid AFCA claims should also be legally required to disclose a copy of their professional indemnity insurance policy to the CSLR operator. Alternatively, ASIC should be authorised to provide the CSLR operator with the latest copy of a PI insurance policy provided to them during the AFS licence registration/renewal process.

[170] Finity, Pre-CSLR Complaints Initial Estimate, December 2023, p. 4.
[171] Finity, Pre-CSLR Complaints Initial Estimate, December 2023, p. 32.

Recommendation #31: The FSC recommends Treasury investigate the possibility of increasing the priority given to the CSLR operator's creditor claims in liquidation or other means of streamlining subrogation rights to ensure the CSLR operator's claims are not prejudiced by statutory processes.

The FSC notes that under section 1069A of the *Corporations Act*, the CSLR operator may only exercise subrogated rights once compensation has been paid. In practice, this means that before the CSLR operator may exercise its subrogation rights, it is first necessary for:

1. AFCA to award compensation;
2. the complainant to file a request for compensation with the CSLR operator;
3. the CSLR operator to be satisfied that the complainant is eligible for compensation;
4. the CSLR operator to offer the complainant compensation;
5. the complainant to accept the offered compensation; and
6. the CSLR operator to pay compensation.

This can result in substantial delays, many of which are outside of the CSLR operator's control. This may prejudice the CSLR operator's standing in any insolvency. For example, the CSLR operator may, depending on the relevant proof of debts cut-off date, be forced to file out of time and accordingly receive a lower level of priority (or share of the insolvency assets) over the remaining assets of a Chapter 5 body corporate than otherwise would have been the case for an unsecured creditor in its shoes. This would place greater, unnecessary pressure on other CSLR funding sources.

The FSC recommends the Treasury investigate this concern and if it is well-founded, consider the merits of either giving CSLR operator debts priority unsecured creditor status or another means of streamlining the operation of subrogation rights. The FSC notes that while CSLR operator claims should increase in priority, it should not supersede existing PI insurance claims. Maintaining PI insurance claim priority is crucial as it represents the first line of protection and primary risk management tool. Any streamlining of subrogation rights should maintain focus on pursuing the perpetrators of misconduct and their parent companies.

4.5. Recommendations relating to preventative measures to reduce the impact of insolvencies on the CSLR

Recommendation #32: The FSC recommends ASIC should be encouraged to exercise its power under section 915H of the *Corporations Act* to require an AFS licensee to hold PI insurance for the same length of time as ASIC requires the licensee to maintain AFCA membership after its licence is cancelled, and at a minimum no less than 12 months after the cancellation of their AFS licence.

ASIC should be encouraged to exercise its power under section 915H of the *Corporations Act* to require a licensee to hold PI insurance for the same length of time as ASIC requires the licensee to maintain AFCA membership after its licence is cancelled. ASIC typically requires an AFS licensee to maintain AFCA membership for 12 months after the AFS licence cancellation to allow clients a reasonable time to bring a complaint. ASIC should require licensees to maintain their PI insurance until their AFCA membership is ceased.

Furthermore, ASIC should make allowance for the possibility that in line with recommendation 15 above, AFCA may proactively decide to expel the licensee, in which case the PI insurance should still be maintained for the balance of the 12 months after the AFS licence cancellation.

This will strengthen the likelihood of insurance cover being available to meet the costs of any AFCA determination and reduce reliance on the CSLR.

Recommendation #33: The FSC recommends ASIC should be encouraged to exercise existing powers under s920A(1)(j) and (ja) of the *Corporations Act* to ban a person linked to an AFSLs refusal or failure to pay AFCA determinations.

Section 920A(1)(j) of the *Corporations Act* empowers ASIC to take action against licensees who do not comply with their financial obligations, including banning or suspending those who fail to meet AFCA's compensation rulings at least twice.[172] ASIC announced on 19 August 2024 that for the first time, it had exercised its power to cancel an AFS licence following the payment of funds by the CSLR.[173] In addition, on 11 October 2024 ASIC announced it had cancelled a further two AFS licences on grounds including failure to be a member of AFCA.[174]

By more consistently and publicly exercising such powers, ASIC could significantly deter non-compliance, ensuring that licensees either meet their compensation obligations or are

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[172] Treasury, Attachment 1: Disciplinary Process – ASIC and the FSCP, 2021.
[173] Australian Securities and Investment Commission, ASIC cancels licence of Libertas Financial Planning,19 August 2024.
[174] Australian Securities and Investment Commission, ASIC cancels two Australian financial services licences and 11 Australian credit licences, 11 October 2024.

removed from the market. This would enhance the integrity of the financial advice sector and reinforce the idea that regulatory bodies will not tolerate firms that attempt to evade financial responsibility, ultimately protecting consumers and encouraging higher standards across the industry.

Incorporating this enforcement mechanism would also reduce the burden on the CSLR, as it would prevent bad actors from failing to meet obligations in the first place. This proactive measure helps shift responsibility back to licensees, ensuring that compensation determinations are paid, and reducing the need for the CSLR to step in to resolve unpaid claims.

Recommendation #34: The FSC recommends Treasury explore the viability of professional indemnity and capital adequacy requirements for advice licensees to reduce the burden on the CSLR.

Strengthening regulatory licensing settings for financial advice is an important element that should be considered in reducing the burden on the CSLR by proactively addressing financial risks before they impact consumers. Introducing greater oversight of Professional Indemnity (**PI**) insurance requirements and imposing appropriate capital requirements for advice licensees could ensure that firms are better positioned to meet compensation obligations.

Currently, ASIC's cash needs requirements only mandate that licensees hold enough cash to cover 12 weeks of liabilities (see ASIC Regulatory Guide RG 126), which is potentially inadequate for addressing potential compensation claims, especially in cases involving PI insurance excesses.[175] By introducing minimum capital or liquid asset requirements, advice licensees would have the financial stability necessary to meet claims against them, reducing the likelihood of unpaid determinations. Importantly, introducing appropriate capital requirements does not need to result in prudential supervision. Rather, it can simply require minimum cash or liquid capital requirements as part of licence conditions. These assets are then available to meet any consumer claims. This can be built up over time to streamline the introduction of such requirements. The appropriate amount of capital and PI insurance should be the subject of consultation with industry.

Furthermore, stronger regulatory oversight by ASIC would ensure that licensees are operating within a framework that aligns PI insurance excesses with minimum cash requirements, ensuring firms can effectively meet their financial obligations. By enforcing these measures, the overall risk of unpaid determinations would decrease, directly alleviating the pressure and improving the sustainability of the CSLR.

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[175] Australian Securities and Investment Commission, Regulatory Guide 166: AFS licensing: Financial Requirements, September 2023, p.17.

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Consideration of capital adequacy requirements should be subject to further consultation with industry, so that risk mitigation is balanced with the already significant regulatory cost burdens borne by licensees.

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4.6. Other recommendations

Recommendation #35: The FSC recommends clarifying the application of special levies in circumstances where financial service providers have divested themselves of leviable entities.

Section 18 of the *Financial Services Compensation Scheme of Last Resort Levy Act 2023* and sections 28 and 29 of the *Financial Services Compensation Scheme of Last Resort Levy (Collection) Act 2023* operate to ensure that levies can be charged to their overarching corporate group instead of the relevant leviable entity in its own right.

The FSC understands that under one interpretation of the CSLR's enabling legislation, there is the possibility that any special levy imposed in FY26 would be based on data as at 30 June 2024.

The FSC has been informed that this has the potential to create issues for large FSPs which have in the intervening period divested themselves of their leviable entities (or the underlying assets which made them meet the definition of a leviable entity). For instance, an FSP which divested itself of a financial advice licensee effective from 1 January 2025 might still find itself paying the licensee's special levy in November 2025, because the relevant financial advisers were on its books on 30 June 2024.

The FSC therefore urges ASIC to ensure that it directs levies towards the appropriate entities and strongly recommends the Treasury support changes to the underlying legislation to clarify the operation of special levies in such circumstances.