Stockbrokers and Investment Advisers Association
Serving the interests of investors

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Dear Sir/Madam

Compensation Scheme of Last Resort post-implementation review

The Stockbrokers and Investment Advisers Association (SIAA) is the professional body for the stockbroking and investment advice industry. Our members are Market Participants and wealth management firms that provide securities and investment advice, execution services and equity capital-raising for Australian investors, both retail and wholesale, and for businesses. Practitioner Members are suitably qualified professionals who are employed in the securities and derivatives industry.

SIAA members represent the full range of advice providers from full-service and online brokers to execution-only participants and they provide wealth advice and portfolio management services.

Our member firms are a small but important group of firms that are members of the Australian Financial Complaints Authority (AFCA). Our member firms are also subject to the Compensation Scheme of Last Resort (CSLR) and the CSLR levies.

The history of the stockbroking profession in Australia can be found here.

Thank you for the opportunity to provide feedback on the post implementation review of the CSLR. SIAA previously provided a submission to the Senate Committee inquiry into matters relating to the reasons for the collapse of wealth management companies and the implications for the establishment of the CSLR and challenges to its ongoing sustainability. A link to that submission is here. In that submission we highlighted our concerns with the CSLR and its impact on our member firms. Since that submission was lodged the costs of CSLR have exploded and our concerns have been fully vindicated.

Executive summary

- Fundamental changes must be made to the scheme to improve its sustainability and fairness. This review must not be merely a cynical exercise designed to 'kick the can down the road'.
- The CSLR was never intended to underwrite investment risk or pay complainants hypothetical 'but for' gains they did not receive because of their investment decisions. Yet this is what is currently taking place with the CSLR essentially guaranteeing investment returns of complainants.
- The CSLR was built on the shaky foundations of moral hazard. The shortcomings of its various components are obvious now that the scheme is in operation.
- The way in which fault is attributed under the law results in financial advice firms bearing the full costs of failed or poorly performing managed investment schemes where advice has been provided.
- It is inequitable that a methodology used by AFCA in its determinations that results in a calculation of a large loss amount is not subject to independent review when it cannot be disputed by a counter party.
- The payment of compensation to wholesale clients is not the intended objective of the CSLR. It was always intended for retail client who could not afford redress through the courts, not wholesale clients who have that financial capacity. The ability of AFCA to reclassify wholesale clients and accept their complaints has the potential to impact significantly on the sustainability of the CSLR and those financial firms subject to the CSLR levies when AFCA determinations brought by wholesale clients are unpaid and referred to the scheme.
- The impact of both the CSLR and the ASIC Industry Funding Levy could force small advice licensees to close their doors. For larger licensees, it is likely to result in an increased cost of advice as they pass on the costs of these levies to their clients. This is in direct conflict with the policy of both the Labor and Coalition parties that seeks to make access to advice more affordable.
- The scheme does not allow either advisers or firms to manage risk or budgets. It is inequitable and unsustainable.

SIAA has the following **recommendations**:

- An independent expert should review the methodology used by AFCA to determine compensation amounts for the Dixon Advisory complaints.
- All AFCA personnel determining damages should have recognised qualifications and experience in and/or strong knowledge of capital markets where the loss calculation is about investment losses such as in the Dixon Advisory matters.
- An independent expert should review, on an urgent basis, the methodology that will be used by AFCA to assess and determine the United Global Capital complaints.
- AFCA's operating rules should be amended to ensure that it is unable to accept complaints from clients that have been classified by the relevant licensee as wholesale.

- The government should cover the costs and claims of the first 12 months of the scheme as originally promised.
- The scheme should be redesigned to take into account the fact that currently PI insurance does not respond in any meaningful way to complaints involving the failure of financial advice firms.
- AFCA fees should not be paid for by industry but should be met by government.
- The design of the scheme should include a mechanism that allows for the voice of those who are financially liable to pay for it to have input, either through industry appointment to the board or to an advisory committee.
- ASIC should be directed that it is not to extend the time limit for retention of AFCA membership of a firm in administration beyond a 12-month period.
- ASIC should be mandated to remain an impartial regulator and not become a consumer advocate in relation to client complaints to AFCA when a firm is in administration.
- Industry should not be required to pay ASIC's administration fees to issue levy invoices.

How the CSLR is delivering on its intended objectives

SIAA has been a long-time supporter of a genuine compensation scheme of last resort to address unpaid determinations awarded by AFCA to protect the interests of consumers whose claims against a financial advice firm are not met due to either misconduct or insolvency of the relevant financial firm.

It was never intended that the CSLR underwrite investment risk or pay complainants hypothetical 'but for' gains they did not receive because of their investment decisions. Yet this is what is currently taking place with the CSLR essentially guaranteeing investment returns of complainants. Because of the scheme's design, a small number of Financial Advisers are forced to pay for these hypothetical 'missed out on' investment returns.

The scheme was built on the shaky foundations of moral hazard. The shortcomings of its various components are obvious now that the scheme is in operation.

The CSLR is utterly unsustainable without a significant re-design of the scheme and changes to the way in which AFCA operates.

The role of AFCA

To fully understand how the CSLR has significantly and fundamentally exceeded its objectives and scope, one must understand the pivotal role that AFCA plays in making the determinations that ultimately flow to the CSLR.

While our members fundamentally support an external dispute resolution service for retail consumers that is:

- free for complainants,
- resolves complaints informally and in a timely fashion,
- available to consumers who would not otherwise afford court proceedings or whose complaint would not justify going to court,

the AFCA scheme is no longer just a protection measure for small consumer complaints.

AFCA is a scheme where:

- Decisions are not binding on complainants but are binding on member firms and published publicly at Determination. If a complainant does not like the decision, it can progress it further through the AFCA system or commence court proceedings (after a cost-free 'dry run' through the AFCA system).

- AFCA members are required to pay the costs as the complaint progresses through the system. Currently, the AFCA costs of a single case proceeding to Determination exceeds $11,000 (excluding systemic issues fees which range from $8,500 to $31,000 and are an additional charge.)

- Complainants can be awarded up to $631,500 in compensation and make claims for amounts up to $1,262,000. It is important to note that the Supreme Court of NSW, which is the state's highest court handles claims of more than $750,000. So, AFCA claimants can make claims that exceed the Supreme Court jurisdiction.

- **Member firms can have a binding award of up to $631,500 made against them with no practical recourse to appeal unlike the legal system where firms would have rights to appeal decisions**

- The rules of evidence do not apply and can lead to issues with procedural fairness whereby robust and transparent reasoning for findings are not provided. AFCA does not always reference all findings to specific legal principles, codes, guidance or industry practice in a way that enables member firms to understand AFCA's application of standards.

- Hindsight analysis is often used when AFCA's assessment (including loss calculation) should only be based on the information readily available at the time the conduct took place.

- Complainants can bring claims even though they are wholesale investors with financial capacity to seek redress through the courts.

- Decisions are currently being made that will total hundreds of millions of dollars by individuals that do not have the appropriate level of experience and/or expertise which can have detrimental effects on the provision of financial advice to Australians, given member firms cannot manage the risk or budget for AFCA's costs.

- AFCA is not a court of law and the panel members are not judges.

Of considerable concern is that AFCA has recently issued a series of decisions that treat all self-managed superfunds with less than $10 million in assets as retail clients notwithstanding that they have been treated as wholesale by the relevant licensee.[1] We provide more detail on the significant consequences of these AFCA determinations later in this submission.

[1] Sanlam Private Wealth Pty Limited AFCA determination 12-00-923475; Royal Financial Trading Pty Limited AFCA determination 12-00-1080719; Dealership Services Pty Limited AFCA Determination 12-00-768719.

If AFCA was making decisions against individual licensees in isolation their impact on the industry would not be so profound. The CSLR essentially concentrates the effect of these decisions so that they have a profound impact on the whole industry.

The attribution of fault

The way in which fault is attributed under the law results in financial advice firms bearing the full costs of failed or poorly performing managed investment schemes where advice has been provided. This is an unintended outcome of the AFCA scheme and is having enormous impacts on the CSLR.

In January 2024, AFCA issued an approach paper clarifying how it would approach liability and loss when a financial advice firm has been found to have breached its obligations to a complainant, in circumstances where the managed investment scheme that the complainant invested in subsequently became insolvent (*The AFCA Approach to determining compensation in complaints against Financial Advice Firms where the Responsible Entity of a Managed Investment Scheme has become insolvent).*

The approach paper was a response to various managed investment scheme collapses, that resulted in investors losing their money but being unable to claim due to the managed investment scheme becoming insolvent.

As the approach paper noted, breaches of the best interests duty and failure to give appropriate advice are classified as "**non-apportionable**" claims under the proportionate liability statutes which is consistent with how AFCA has always determined financial advice complaints, where there is more than one financial firm that has contributed to the loss.

This means that if AFCA determines that the financial advice firm breached its obligations to provide appropriate advice and act in the best interests of the complainant and this breach caused loss to the complainant, the financial advice firm is held liable for the entirety of the complainant's losses irrespective of any breaches of obligations committed by the managed investment scheme (absent any contributory negligence by the complainant). If these claims flow through to the CSLR this approach results in the risk of investing in managed investment schemes being concentrated to the financial advice subsector. Essentially every managed investment scheme underperformance or failure is paid for by the financial advice subsector where the complainant has sought advice on that product.

Ironically, the managed investment scheme, the subject of the Dixon Advisory matter, has not collapsed and continues to operate. However, all losses suffered by complainants (absent any contributory negligence by them) will be attributed to the member firm, Dixon Advisory. It is not the managed investment scheme that has collapsed in this instance but the financial advice firm itself. All losses determined by AFCA resulting from the underperformance of the URF products have flowed through to the CSLR with complaints lodged on or after 8 September 2022 to be paid for by the financial advice subsector. This means that the financial advice subsector must pay for 1,092 Dixon Advisory complaints which could total over $135 million.

The 'but for' test

It is not just capital losses that flow through to the CSLR.

AFCA determines compensation in accordance with the 'but for' test outlined in its approach paper *The AFCA Approach to calculating loss in financial advice complaints.* Where AFCA determines that inappropriate financial advice has been provided (for example, where there is an underperforming managed investment scheme), AFCA's approach to compensation is to place the consumer in the financial position they would have been in if the financial adviser had provided appropriate financial advice.

In other words, the 'but for' test requires a comparison between the complainant's actual portfolio (which would include losses from managed investment schemes) and the complainant's **hypothetical portfolio** they would have been invested in 'but for' the inappropriate advice.

This requires AFCA to develop a hypothetical portfolio of investments to determine the loss. This is not a role for which a scheme, originally intended to be a low-cost consumer complaint resolution service, is best suited. It is not unreasonable to suggest that the use of the 'but for ' methodology by AFCA may result in an increased number of financial firm collapses in future. And of course, when an advice firm goes into administration all of these 'but for' losses flow through to the CSLR and must be paid for by the financial advice subsector.

The CEO of the scheme, David Berry, recently revealed that about 80% of amounts paid out of the scheme to Dixon Advisory complainants are 'but for' losses, leaving just 20% as involving an actual capital loss.

This is incredibly concerning, particularly when taken with SIAA's concerns about the use of the 'but for' methodology in the lead AFCA decision in the Dixon Advisory complaints.

The lead decision

Decision 716627 dated 6 February 2024 involving Mr and Mrs D is the lead decision for the Dixon Advisory complaints and involves the 'but for' method of loss calculation. AFCA determined that Mr and Mrs D be awarded the sum of $254,312.72 plus interest. The panel that decided the lead case comprised an ombudsman, a member with significant experience in consumer and small business advocacy and a member with extensive experience as a financial planner. No one with experience in capital markets was on the panel.

We have serious concerns about the way in which the 'but for' method has been used in this case and the qualifications AFCA decision makers have to make decisions involving a potential $135 million in claims which will have a significant impact on the financial services industry.

It is important to note that the method of calculating client losses adopted by the expert appointed by the Dixon Advisory Administrator in the Deed of Company Arrangement and endorsed by the Federal Court was to determine only the capital losses incurred in holding investments in the URF. In other words, the losses were calculated as capital investment in URF less URF distributions less value of URF at Administrator Appointment date.

Our particular concerns with the lead decision include the following:

Whole of portfolio 'but for' calculation

- AFCA has applied a 'but for' calculation to the **whole of the complainant's portfolio** which suggests that AFCA has deemed the entire portfolio to be inappropriate rather than the URF which appears to be the basis of the complaint. We would expect a 'but for' calculation on the URF only would result in a significantly lower loss calculation compared to a whole of portfolio approach.
- AFCA has not provided an explanation as to why each investment in the portfolio should not have been held by the complainant and was not in line with their objectives based on the information readily available at the time, except to say they were related party products.
- AFCA has also not provided an explanation or evidence to support its finding that the fees charged on the related products were excessive without reference to comparable products.
- This approach by AFCA sets a dangerous precedent for the wealth management industry and assumes any vertically integrated business recommending a related product has given inappropriate advice on the entire portfolio if just one related product does not perform.

The use of a benchmark fund

- AFCA selected the Vanguard Balanced Managed Fund as the benchmark fund as the basis for its 'but for' calculation.
- The complainant would have engaged the financial services firm for active management of their portfolio which is contrary to the selection of a passive index fund for a 'but for' calculation.
- Chosen with what appears to be the benefit of hindsight, the Vanguard Balanced Managed Fund was one of the best performing index funds amongst its peers over the relevant period (2012-2019).
- Based on its latest factsheet, the Vanguard Balanced Managed Fund has a 20% allocation to Australian shares, 27% allocation to international shares, 3% to emerging markets shares, 35% to international fixed interest and 15% allocation to Australian fixed interest. Given its very high exposure to international securities and Australian shares, the Vanguard Balanced Managed Fund benefited from one of the strongest equity markets bull runs in history, augmented by the strong macroeconomic backdrop of low interest rates and low volatility.
- AFCA assumed the portfolio was always fully invested, which disregarded ad hoc, regular and mandated withdrawals of a self-managed super fund in pension phase. A general industry rule for self-managed super fund liquidity is maintaining a minimum of two years' worth of pension payments in cash at any time. This cash requirement and consequential cash drag is not accounted for in the Vanguard Balanced Managed Fund.
- This approach by AFCA sets a precedent that financial firms must outperform the highest performing index fund or otherwise underwrite their client's portfolio.

Inappropriate end date

- The end date used to calculate the complainants' losses (30 June 2022) is nearly three years after they terminated their relationship with the financial firm. AFCA's rationale for this decision was that due to the illiquidity of certain investments, the complainants were not able to dispose of their investments until July 2022.

- The determination contained no analysis of whether the complainants could have actually liquidated their holdings at an earlier time. This approach sets a precedent that unduly punishes financial services firms who are no longer in a position to provide advice or mitigate any loss to the complainants' portfolio.

No adjustment for self-directed orders

- AFCA does not appear to have taken into consideration that the client may have made their own decisions and made self-directed orders which should be omitted from any loss calculation. As a result, the decision assumes that financial services firm must underwrite any investment decisions of the complainant, regardless of whether advice is provided or not.

- The determination does not take account of fees and costs (taxes, insurance premiums, accounting and advice fees) which form part of the administrative costs of any self-managed super fund.

We have even greater concerns about the way in which AFCA will deal with future matters when one considers the limitations of the AFCA scheme that SIAA has highlighted since its formation.

The limitations of AFCA

Australia has an adversarial system of law that enables parties to contest claims in court. Decisions are made by judges. This does not occur in matters dealt with by AFCA.

AFCA is not a court. It does not apply laws of evidence. It does not call eyewitnesses or expert witnesses to give evidence. Its decision makers are not judges. Nor are they informed by the expertise of expert witnesses, essential when dealing with complex damages calculations.

This approach may be appropriate when dealing with small and simple disputes. It is unsatisfactory when dealing with a suite of cases that may result in determinations exceeding $135 million that will be passed onto the financial advice subsector to pay.

If a court was hearing a claim such as that brought by Mr and Mrs D, expert witnesses would be called to provide evidence on the appropriate methodology to be used to calculate the losses incurred, particularly important when a hypothetical 'but for' approach is adopted. The expert witnesses would be tested via cross examination. If a party disagreed with the court's decision it could lodge an appeal. None of this applies when complaints are bought before AFCA.

We note that the administrators for Dixon Advisory were involved to an extent in the AFCA lead case. However, we understand that the administrator no longer attends Dixon Advisory matters at AFCA and as such, these cases will be undefended going forward. Accordingly, there is no counter party to dispute the methodology of the calculation of losses. A counter party is common for complaints against parties in administration.

We consider that the absence of a counter party is even more reason why an independent expert is required to review AFCA's methodology and calculations. It is inequitable that a methodology resulting in a calculation of a large loss amount is not currently subject to independent review when it cannot be disputed by the counter parties. It appears likely that each Dixon Advisory case determined by AFCA will use the same flawed methodology as the lead case, leading to significantly inflated compensation amounts.

SIAA recommended to the Senate Committee inquiry that in the case of the calculation of losses in the lead case in the first Dixon Advisory complaint, given this will be used as the framework for all cases on which AFCA will make a determination, an independent expert with relevant qualifications should be brought in to review the methodology for the calculation of losses.

We suggested that the independent expert could be an asset consultant as they sit outside the system of financial advice, AFCA and CSLR, but have expertise in investments and markets. Such vetting of the lead case calculation methodology will increase confidence in the AFCA determination and in turn its impact on the CSLR and its levies.

SIAA also recommended, in order to ensure equity and confidence in the system, all AFCA personnel determining damages for the purpose of an AFCA determination involving investment should have recognised qualifications and, more importantly, experience and/or strong knowledge in capital markets where the calculation is about investment losses, such as in the Dixon Advisory matters. Expertise in financial planning where advice is provided on taxation and superannuation, as well as asset allocation, with investment decisions outsourced to fund managers or stockbrokers, is very different from advice provided by stockbrokers and investment advisers who provide scaled advice on specific investments.

United Global Capital

Since SIAA's recommendations to the Senate Committee inquiry the CSLR has released its initial estimate for FY 2026 that estimates a total levy of $78 million, $70 million of which will be charged to the financial advice subsector as a result of claims from Dixon Advisory ($12,249,000) and United Global Capital (nearly $45 million). The liquidation of the relevant assets relating to these claims in in its infancy and there is limited information about the total number of clients who will claim. AFCA has received 144 complaints relating to United Global Capital thus far. The scheme CEO recently announced that he expects the FY27 levy for the financial advice subsector to likely exceed $120 million due to both Dixon Advisory and United Global Capital complaints.

The enormous number of these complaints highlights the importance of our original recommendations. **We recommend** that an independent expert be brought in as a matter of urgency to review the methodology that will be used to assess and determine the United Global Capital complaints.

Future issues impacting the CSLR: AFCA's acceptance of claims from wholesale clients

SIAA has objected to AFCA accepting complaints from wholesale clients from its establishment. Our view is that the exercise of jurisdiction to hear complaints from wholesale clients is not the basis upon which the External Dispute Resolution framework was legislated by Parliament and is an issue of fundamental unfairness to member firms.

The matter that goes to the heart of the issue of fairness and to the concerns of our members is that wealthy and sophisticated clients are able to avail themselves of a dispute resolution service that Parliament never intended to apply to them. AFCA is meant to provide a mechanism for low-cost access to justice to consumers who may not otherwise have the resources to bring such complaints through other legal channels such as a court. Wholesale investors have the means to pursue complaints through the court system. It is not uncommon for wholesale investors who lodge a complaint with AFCA to have legal representation or retain legal advice, which shows such complainants are financially capable of undertaking court proceedings. It is not only unfair to member firms for AFCA to re-categorise a client from wholesale to retail, but runs counter to the legislative scheme underlying Chapter 7 of the Corporations Act. It is not uncommon for high-net-worth clients to follow higher risk strategies in the pursuit of higher returns (such as options trading, alternative investments etc), that are not open to retail clients. This is one of the features of being a wholesale client – they are able to avail themselves of a greater array of financial products and services than retail clients and in so doing may take greater risks.

Different provisions in the Corporations Act apply to clients depending on whether they are retail or wholesale. For example, wholesale clients are not subject to the statement of advice requirements that retail clients are. Financial advisers who advise wholesale clients are not subject to the best interests duty obligations. This is because the Parliament has decided that wholesale clients don't require the consumer protections that are afforded retail clients. It is not uncommon, however, for a client to suddenly 'transform' from a wholesale to a retail client when an investment does not perform as well as was hoped, and for them to lodge a complaint with AFCA to reimburse them for the market risk they took. For more complex investments, the facts underlying such disputes and trading strategies can be very complex. They often extend to a period of trading spanning years. In the past, SIAA has communicated its concerns to AFCA about the abilities of AFCA adjudicators to hear such disputes, or to obtain all of the evidence and documentation necessary to properly determine the matter. This is another reason why wholesale client complaints should not be dealt with by a consumer dispute resolution scheme that is not bound by the rules of evidence.

As a result of a Treasury review undertaken in 2021, AFCA revised its rules concerning wholesale clients. However, AFCA retains the right to accept complaints from those clients qualified as high-net-worth clients if, in AFCA's view, they have been *misclassified* as wholesale clients.

SIAA has consistently argued that what constitutes a retail client and a wholesale client is not subject to discretion, but is clearly set out in the Corporations Act. A client either provides a qualified accountant's certificate that attests to the fact that they have net assets exceeding the asset threshold of $2.5 million or have had a gross income for each of the last two financial years of at least $250,000 or they do not. We consider that AFCA's acceptance of wholesale client complaints sets a dangerous precedent as it exceeds the scope of the category of clients that are subject to the licensing provision in the Corporations Act and represents administrative overreach and a lack of due process.

The ability of AFCA to reclassify wholesale clients and accept their complaints also has the potential to impact significantly on the sustainability of the CSLR and those financial firms subject to the CSLR levies if AFCA determinations brought by wholesale clients are unpaid and referred to the scheme. By way of example:

- A group of wholesale clients invest large amounts in a riskier class of investment aimed at wholesale investors.
- The investments perform badly and the clients incur losses.
- AFCA accepts the clients' complaints even though they were originally classified as wholesale investors for the purpose of the investment.

- AFCA decides in the clients' favour and awards substantial amounts of compensation.
- The financial firm, the subject of the determination, is unable to pay the determination amounts and goes into administration.
- The financial losses are then borne by the CSLR.

The CSLR does not have the ability to reassess the merits of the AFCA determination. Accordingly, the scheme is required to pay unpaid determinations brought by wholesale clients, even though the scheme is meant to compensate retail not wholesale clients. This is an unfair result for firms required to contribute to the scheme and highlights the importance of AFCA 'staying in its lane' lest its determinations undermine the sustainability of the model.

Treatment of self-managed superfunds as retail

A worrying and significant issue for the financial advice industry is the spate of recent decisions by AFCA that it will treat self-managed superfunds as retail clients unless they hold at least $10 million in net assets. AFCA has stated that it will hear and determine these complaints even where the self-managed superfund has been treated as a wholesale client by the relevant licensee and the self-managed superfund has invested in wholesale financial products.

SIAA has raised these issues with Treasury and highlighted the potential impact on the CSLR of AFCA's approach to categorising wholesale self-managed superfunds as retail. Self-managed superfunds typically hold net assets well below the $10 million threshold, due to the contribution rules, so we are of the view that these determinations will impact close to 100% of wholesale self-managed superfunds. The result of AFCA's determinations is that any self-managed superfund client in an underperforming wholesale-only product could claim that the investment was not appropriate and bring a claim to AFCA that it will accept. If a series of these complaints flow through to the CSLR, the impact on the personal advice subsector will be profound.

The determination by AFCA that a self-managed super fund holding net assets of less than $10 million as retail is in direct conflict with the corporate regulator's position. Previously, ASIC had expressed the view that generally, for financial services provided to the trustee of a self-managed super fund, a $10m net fund value threshold applied before the trustees could be dealt with as 'wholesale' clients. ASIC then revised this view and stated via media release that they will take "no action" where a trustee with net assets of $2.5m or more is treated as a wholesale client, and where the product or service provider has obtained an accountant's certificate to this effect. This is a 'no action' statement from ASIC. https://asic.gov.au/about-asic/news-centre/find-a-media-release/2014-releases/14-191mr-statement-on-wholesale-and-retail-investors-and-smsfs/.

AFCA has advised SIAA that it is of the view that as a decision-making authority it is charged with making legal decisions based on their interpretation of the law, that is, they believe they can set a legal precedent. We query whether a complaints authority has the power to set a legal precedent, which we believe is the purview of the courts.

For the CSLR to be sustainable going forward AFCA will need to limit its determinations to retail clients in accordance with the original legislative intention. If AFCA continues to accept wholesale client complaints it is inevitable that wholesale client determinations will flow through to the CSLR. The payment of compensation to wholesale clients is not the intended objective of the CSLR.

SIAA recommends that AFCA's operating rules be amended to ensure that it is unable to accept complaints from clients that have been classified by the relevant licensee as wholesale.

How the CSLR funding model is formulated, including its potential impacts on businesses who fund the industry levy

In October 2022 SIAA provided feedback to the Senate Standing Committees on Economics inquiry into the CSLR bills. The link to that submission is here.

We raised a number of issues in our submission that were never addressed in the design of the CSLR. Failure to address these issues has contributed to the current problems with the scheme.

The flawed design of the CSLR levies

When Treasury issued its Discussion Paper on establishing the scheme in December 2019, historic data indicated that unpaid claims per annum would be in the range of $0.5 million to $5 million. Initial concerns were to ensure the scheme was as simple and cost effective as possible as it was considered unlikely that it would paying out many claims. In fact, the levies for the scheme were assumed to be so low that in its July 2021 Proposal Paper, Treasury suggested a minimum levy threshold of $1000 to avoid licensees being sent levy notices for immaterial amounts.

Fast forward to 2025 and there has been a CSLR levy blow out.

The scheme has been designed so that the annual levy is payable by those who are members of a subsector within the meaning of the ASIC Industry Funding Model framework. Amounts payable by individual firms are worked out in a manner that draws on concepts in place for similar calculations. Weaknesses in the ASIC Industry Funding Model framework therefore flow through to the levy framework of the CSLR.

The previous government undertook a review of the ASIC Industry Funding Model to address the many issues that have arisen since its introduction. Unfortunately, none of the recommendations from that review have been implemented and the levy framework for the ASIC Industry Funding Model has remain unchanged.

One of the biggest flaws in the ASIC Industry Funding Model is that levies imposed on the financial advice subsector are calculated according to the number of Financial Advisers on the financial adviser register (FAR). This model may work well when the number of Financial Advisers on the FAR and the amounts to be levied remain stable. However, the decline in the number of Financial Advisers has been precipitous. Adviser numbers on the FAR have fallen from 25, 484 in 2017 to **15,565 as at 21 February 2025**. A reduction in adviser numbers resulted in the levy amount per adviser increasing each year in a manner that was so unsustainable that the former government froze the levy amount for the 2020-21 and 2021-22 financial years.

Licensees that provide personal advice to retail clients paid a total of $45.014 million in ASIC levies for FY24 calculated at **$1500 per licensee plus $2,691 per adviser.**

Due to the flaws in the ASIC Industry Funding Levy and the possibility that a continued fall in Financial Adviser numbers will result in event higher levies, SIAA recommended to the Senate Committee inquiry that the regulations determining how the levies for the CSLR are to be calculated not be finalised until the ASIC Industry Funding Model Review took place.

This recommendation was not accepted and the current levy framework for the CSLR was implemented. Unsurprisingly, Financial Advisers are now faced with unsustainable levies under both the CSLR and the ASIC Industry Funding Levy.

The government's contribution to the scheme

When the former government introduced the scheme, it said historic claims would be met by the major financial institutions (who have paid $241 million), while the government itself would fund the scheme's establishment and costs for the first year.

The bill lapsed with the calling of the election but was soon reintroduced by the Assistant Treasurer with some changes. The first, government-funded levy period was shortened so that it applied for only six months.

However, the decision on when the government's liability started was up to the Minister, who decided that the scheme would commence on 1 April 2024. What was meant to be a year's worth of government funding ended up being a quarter of it.

SIAA and its members were deeply disappointed that the government promised it would cover the operating costs and claims of the first year of the CSLR, yet it ended up only contributing to the costs of the first three months. Farcically, the recent actuary report published by the scheme shows that the government's contribution of $4.8 million has not even been used to pay a single complaint due to the lower volume of claims determined by AFCA during the first levy period and the time needed by CSLR to process a claim to payment after it has been lodged.

The government's reneging on its promise has exacerbated the negative consequences of the design of the scheme.

No regulation impact statement was provided to explain this decision. It can only be assumed that the government saw exactly what was coming and deftly sidestepped having to contribute to it.

SIAA is strongly of the view that the government should cover the costs and claims of the first 12 months of the scheme as originally promised. Any changes to the scheme should encompass the government covering the remaining nine months of operating costs and claims of the first year of the CSLR.

SIAA recommends that any changes to the CSLR should require the government to cover the first 12 months of operating costs and claims as originally promised.

Impact of levies on businesses who fund the levy

The impact of both the CSLR and ASIC Industry Funding Levy could force small advice licensees to close their doors. For larger licensees, it is likely to result in an increased cost of advice as they pass on the costs of these levies to their clients.

In addition to the CSLR and ASIC Industry Funding Levy, SIAA's members are subject to an increasing level of costs including ASX fees and AFCA fees.

Our members are experiencing increasing operating costs across the board with service inflation resulting in higher staff and vendor costs. SIAA's members are also subject to increasing legal, compliance and information technology costs of complying with increasingly complex and onerous regulatory obligations as well as regulatory reforms such as those arising from the Delivering Better Financial Outcomes package. In addition, Market Participants are incurring significant costs in preparing for CHESS replacement, ASX Services Release 15 and Cboe proposed listings framework. These reforms require system changes and IT spends as well as staff training.

The legislation has a loophole that is imposing an unsustainable liability on the advice community. Insolvency laws set up for a proper purpose have resulted in a listed entity with a subsidiary placing that subsidiary into administration. As a result, any determinations arising from complaints lodged with AFCA are unable to be paid by the subsidiary and are referred to the CSLR. The financial advice profession then has to cover the compensation costs.

The scheme does not allow either advisers or firms to manage risk. It is inequitable and unsustainable.

The advice sector has seen the terrible consequences of poor public policy unfold before. The FASEA debacle had to be unwound and continues to need to be unwound simply to ensure that the number of advisers in Australia does not dwindle to almost zero at a time when Australians need access to financial advice more than ever before.

The ballooning and unsustainable costs passed to the financial advice profession under the CSLR will see more advisers quit, fewer be attracted to the profession and the numbers available to assist Australians in need of financial advice continue to decline. Australians deserve public policy that assists them to obtain financial advice. However, the costs of the CSLR will inevitably be passed onto consumers thereby increasing the costs of that advice and making advice less accessible.

How the powers of the CSLR Operator interact with delivery of the scheme

We understand that the scheme operator will be providing feedback to the review on this point and we look forward to reading this submission.

The current scope of the CSLR and any related matters

The role of professional indemnity insurance

SIAA highlighted to the Senate Committee when it was reviewing the CSLR bills that it was vital to understand the source of unpaid determinations both to reduce the risk to consumers of unpaid determinations and clarify if the design of the CSLR is actuarially sound. We pointed out that the scheme design did not recognise ASIC's role in ensuring companies have sufficient capital adequacy and appropriate Professional Indemnity Insurance (PI insurance) to meet their internal and external dispute compensation obligations. The previous government announced in October 2021 that it would consult on proposals to enhance the effectiveness of PI insurance in responding to compensation claims and we argued strongly that the consultation needed to take place before the bills establishing the CSLR were passed, given its importance in clarifying the source of unpaid determinations and reduction of risk to consumers. Unfortunately, that consultation never took place.

An important aspect of the Dixon Advisory complaints is how little PI insurance has contributed to payment of complaints particularly after the deduction of costs. This has left the CSLR to cover these claims. Clearly, there is an issue with how PI insurance has not responded to these complaints. What has happened is that a small group of Financial Advisers has been left with a huge levy to pay for failures to which PI insurance has not responded. Clearly the scheme is not operating as a true scheme of 'last' resort.

ASIC's expectation of PI insurance contained in Regulatory Guide 126 is that licensees with total revenues from financial services provided to retail clients greater than $2 million should have minimum cover approximately equal to actual or expected revenue from financial services provided to retail clients (up to a maximum of $20 million). In reality, the insurance market has been very hard for the past 3 years, with many underwriters cautious to cover financial services post the Hayne Royal Commission. As a result, the cost of PI insurance has been high. It is likely that PI cover over $20 million would be rare and/or expensive. It is also not uncommon for AFCA claims to erode PI insurance cover.

SIAA recommends that the scheme be re-designed to take into account the fact that currently PI insurance does not respond in any meaningful way to complaints involving the failure of financial firms. Continuing to impose liability for payment of these claims on the financial advice subsector is unworkable.

Payment of AFCA fees

SIAA also raised our concerns to the Senate Committee that the scheme was paying AFCA's complaint handling fees incurred in dealing with a claim against an insolvent firm. We pointed out that it was important that the scheme was as streamlined and simple to operate as possible to reduce administrative costs. We could not understand at that time why a scheme set up to compensate claimants of insolvent firms was collecting levies to pay AFCA, creating an unnecessary 'round robin' of money. We argued that there is an element of public good in a scheme of last resort and unpaid AFCA fees should be borne by government.

Our concerns have proven to be correct. AFCA's administration costs are uncapped. The CSLR actuarial report estimates that the cost of AFCA processing each claim will increase substantially from an estimate of approximately $12,450 in FY25 to $21,334 per claim in FY26. Accordingly, on top of paying for the Dixon Advisory and United Global Capital claims, it has been estimated that the financial advice subsector will be paying $8 million in AFCA fees for the FY26 levy period. The scheme is essentially 'robbing Peter to pay Paul'

SIAA repeats its original recommendation that the scheme be re-designed so that that AFCA fees are not paid for by leviable entities but are met by government.

Governance of the scheme

SIAA argued that there needed to be a vehicle by which parties who were liable to pay CSLR levies had a voice in how the scheme was administered. We provided the National Guarantee Fund Advisory Committee as an example of how this could be achieved. This Advisory Committee includes nominees from Market Participants and affords some degree of industry voice to the Securities Exchange Guarantee Corporation in its management of the fund which acts as a compensation scheme of last resort in the event of failure of Market Participants.

We consider that the voice of leviable entities is vital in the scheme due to the enormous impact that the scheme has on them.

SIAA repeats its original recommendation that the scheme be redesigned to include a mechanism that allows for the voice of those who are financially liable to pay for the scheme to have input, whether through industry appointment to the board or by an advisory committee.

Periodic reviews

The Compensation Scheme of Last Resort was legislated to be reviewed every five years to evaluate the effectiveness and efficiency of the scheme. Our original recommendation, in light of the many concerns we had about the fairness of the scheme, was that it be reviewed after the first two years of its operation. The fact that the scheme has only been operating for less than a year before a review has been called into its fairness and sustainability highlights that the scheme is fatally flawed in its design.

A review is only useful if the recommendations which arise from it are implemented. It is vital that, unlike the Treasury review into the ASIC Industry Funding Levy, fundamental changes are made to the scheme to improve its sustainability and fairness. Otherwise, this review is merely a cynical exercise designed to 'kick the can down the road'.

The role of ASIC

When an AFSL is cancelled, one would expect the licensee's membership of AFCA to cease. Despite Dixon Advisory being placed into administration in January 2022, ASIC made a policy decision that its membership of AFCA would continue for another two years, so that complaints relating to Dixon Advisory could be dealt with by the CSLR.

While we understand that ASIC has been granted the discretion to ensure administrators retain an entity's membership of AFCA for 12 months, to allow for client complaints to be lodged despite the failure of the financial advice firm, at no point in the multiple public consultations on the design of the CSLR was there any consultation on ASIC having the capacity to enforce membership of AFCA of a firm in administration for longer than 12 months or another unspecified period.

We understand that ASIC's decision to have Dixon Advisory retain membership of AFCA over two years was so that claims could be lodged with the CSLR, as it had not yet been established. However, we also note that ASIC acted as a consumer advocate, with public notices encouraging clients to lodge complaints and directing the administrator to write to clients to lodge complaints. This consumer advocacy has led to the magnitude of the complaints lodged with AFCA. Again, ASIC taking on a role of consumer advocate in relation to entities that go into administration was not subject to public consultation and the decision has not been subject to parliamentary oversight.

ASIC's unilateral policy decisions have had and will continue to have a significant impact on whether the CSLR is sustainable.

To ensure confidence in the CSLR the 12-month limit that ASIC can invoke for retention of the membership of AFCA of a firm in administration should not be exceeded. Furthermore, the regulator should also remain impartial and not become a complainant advocate as it did in the case of Dixon Advisory.

SIAA recommends that the time limit of 12 months for retention of membership of AFCA of a firm in administration not be able to be extended by ASIC. This provides clients with sufficient time to lodge a complaint while also providing certainty to those funding the CSLR that liability for complaints arising from a firm in administration is not uncapped, as it is at present.

SIAA also recommends that ASIC be mandated to remain an impartial regulator and not become a consumer advocate in relation to client complaints to AFCA when a firm is in administration.

ASIC fees

The Third Levy Period estimate includes the amount of $1.3 million for ASIC costs to issue the levy notices to leviable entities using the machinery of the ASIC Industry Funding Model. It is difficult to understand how ASIC could incur such large costs to essentially issue an invoice. This highlights the lack of accountability in the current scheme. Entities like ASIC and AFCA can essentially bill the scheme whatever they like in the knowledge that the four subsectors are required by law to pay for it. An of course the financial advice subsector pays the lion’s share of this amount – it is estimated that this subsector will be required to pay $625,000 towards ASIC’s administrative costs. The fact that ASIC would be billing such large amounts to administer the scheme was never considered during the consultation on the scheme design.

SIAA recommends that without proper accountability, ASIC administration fees must not be passed on to those subsectors that are subject to the CSLR levies.

Conclusion

AFCA, in its current form, is not fit for purpose. What was meant to be a dispute resolution scheme has instead become a de facto free legal aid service, incentivised to accept as many complaints as possible. This is at the heart of the shaky foundations of the CSLR. AFCA has a conflict of interest in that it generates more revenue the more complaints it accepts.

There is no right of appeal, no oversight mechanism, and no accountability in relation to AFCA determinations, which in turn flow to payments that the CSLR must make. AFCA prides itself on making ‘fair’ decisions, yet the financial advice subsector has no recourse when those decisions are flawed. Significant checks and balances need to be put in place on AFCA’s powers. This is an essential component of any redesign of the CSLR.

If you require additional information or wish to discuss this submission in greater detail please do not hesitate to contact SIAA’s policy manager, Michelle Huckel, using the contact details in the covering email.

Yours faithfully

Judith Fox
Chief Executive Officer