28 February 2025

Director
Programs and Redress Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: CSLRreview@treasury.gov.au

Dear Sir/Madam,

Compensation Scheme of Last Resort Post Implementation Review

The Institute of Financial Professionals Australia (**IFPA**) welcomes the opportunity to provide this submission on the post implementation review of the Compensation Scheme of Last Resort (**CSLR**).

In principle, IFPA supports the core objective of the CSLR, which is ensuring consumers can access financial compensation when they suffer losses due to poor or negligent financial advice. However, we believe the scheme's current design and implementation contains fundamental flaws that make it both unfair and unviable. Without urgent amendments, the CSLR poses a significant risk to the future of the financial advice sector.

To provide clear and constructive feedback, we have outlined our key concerns below, followed by our recommendations and responses to the review's terms of reference.

Key concerns with the CSLR

The CSLR was established as an industry-funded model, with the financial advice profession bearing the largest share of costs. From the outset, the industry warned about the potential for a "black swan" event, where the collapse of a large financial firm could impose an overwhelming financial burden on the profession. Unfortunately, in the short time since the CSLR's launch on 2 April 2024, this concern has already materialised.

The failures of Dixon Advisory Superannuation Services Limited (**DASS**) and United Global Capital Pty Ltd (**UGC**) have led to significant consumer losses, primarily due to the collapse of in-house or related-party investment products. Alarmingly, 92% of the expected $70.1 million in claims for the third levy period stem from these two firms alone. Forcing an entire sector to bear the financial burden of two firms that put profits ahead of their clients' best interests is both unreasonable and unsustainable.

When Treasury released the CSLR Proposal Paper[1] for consultation in July 2021, it estimated that financial advisers would pay an annual levy of $291 with a potential increase to approximately $458 in years when the sector cap was fully utilised. This projection was widely regarded as reasonable within the industry. However, the actual levies financial advisers now face are significantly higher, diverging sharply from these initial expectations.

The escalating levy figures for the financial advice sector illustrate this problem:

- First levy period (FY24): $2.4 million
- Second levy period (FY25): $18.5 million
- Third levy period (FY26): Estimated $70.1 million

This nearly fourfold increase from FY25 to FY26 is deeply concerning. With the financial advice sector's levy cap set at $20 million, advisers will likely face an additional special levy to cover the $50 million shortfall, placing further strain on an already pressured profession.

The financial advice sector has been shrinking in recent years, and the rising costs associated with the CSLR may further accelerate this decline. This has far-reaching consequences, such as:

- Rising costs for consumers – pushing financial advice further out of reach for everyday Australians.
- Increased financial burden on existing advisers – penalising those who have done nothing wrong for the failures of others.
- Deterring new entrants to the profession – making financial advice a less attractive career path.

This outcome directly contradicts the government's *Delivering Better Financial Outcomes* reforms, which aim to improve access to quality and affordable financial advice.

At the heart of this issue is the business model of vertically integrated firms, which prioritised in-house investment products over their clients' best interests. Insolvency laws further exacerbate the problem by prioritising corporation interests over consumer protection. As a result, the CSLR creates a **moral hazard** – where those responsible for the failures are shielded from accountability, while shifting the financial burden onto those who have acted ethically and in good faith.

With superannuation assets now exceeding $4 trillion, the sector plays a fundamental role in Australia's economy. As this pool continues to expand, strong governance and access to high-quality financial advice are essential to delivering effective retirement outcomes for all

[1] Compensation Scheme of Last Resort: Proposal Paper, Financial Services Royal Commission Recommendation 7.1, July 2021

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Australians. Without appropriate advice, consumers face greater financial risks, which could have broader implications for the sector.

To ensure the CSLR remains fair, sustainable, and aligned with its intended purpose, urgent reforms are needed. We welcome the opportunity to contribute to discussions on solutions that protect consumers while preventing undue financial burdens on the financial advice profession.

Our key recommendations

1. **Government commitment to initial funding** – the government must uphold its original promise to fully fund the scheme's first 12 months. Amending the legislation to reduce this coverage to just three months from 2 April to 30 June 2024, especially when no claims were paid during that period, was an unjustified shift in responsibility.

2. **No retrospective application** – the CSLR was never meant to be applied to past cases and was designed as a "last resort" for consumer compensation. Imposing it on legacy complaints contradicts the Ramsay Review and Hayne Royal Commission recommendations. Financial advisers should not bear the cost of failures that predate the scheme, such as the DASS collapse in early 2022. If the government wants to support financial advice businesses and encourage new entrants, it must take responsibility for funding claims tied to legacy complaints.

3. **Restore the financial advice sector cap** – the financial advice sector cap should be reinstated to the originally proposed $10 million. The decision to double this cap to $20 million in the legislation[2] was unwarranted and should be reversed.

4. **Limit compensation to actual losses** – the CSLR should not be used to compensate for hypothetical "but-for" or "what-if" investment returns/gains that complainants may have missed due to specific investment decisions, yet this is now occurring. It must remain a true last-resort safety net, strictly covering actual capital losses.

5. **Extend CSLR funding to product issuers** – financial product issuers and manufacturers, particularly managed investment schemes (**MIS**), must contribute to the scheme. This will ensure they are held accountable for the failure of their own financial products. Their exclusion leaves consumers without recourse when these firms collapse. There is also concern that product failures may be misclassified as financial advice failures simply to enable compensation, unfairly shifting costs onto advisers. Financial advisers should not be responsible for product failures when the issue lies with the product itself.

6. **General and wholesale advice failures** – financial advisers should not fund compensation claims tied to general or wholesale advice failures. AFCA's ability to reclassify these types of

[2] *Financial Sector Reform Act 2022*

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advice as personal advice creates a risk that financial advisers will be unfairly burdened with claims from sectors that do not contribute to the CSLR. To address this imbalance, general and wholesale advice providers should also contribute to the scheme.

7. **Reform insolvency laws** – changes are needed to improve fund recovery and ensure responsible parties can be held to account. Additionally, safeguards must prevent listed companies from liquidating subsidiary firms to avoid paying client compensation. Strengthening these laws will improve accountability and deter future misconduct.

8. **Strengthen ASIC oversight** – ASIC must take a more proactive approach in investigating firms reported for misconduct, particularly those linked to CSLR claims. Delayed action from the regulator increases financial losses, ultimately shifting costs onto those funding the scheme. If ASIC fails to act or significantly delays intervention after receiving a report, the financial planning sector should not be liable for future CSLR claims arising from that inaction. Financial advisers should not be forced to cover failures they had no role in or attempted to prevent.

We now consider the questions contained in the post-implementation review terms of reference.

Terms of reference questions

a) How the CSLR is delivering on its intended objectives

The objective of the CSLR is to *"provide compensation to eligible consumers in circumstances where an AFCA determination awarding monetary compensation has been made in their favour, but which the relevant entity has not paid* [3] *"*

While the scheme may seem to be fulfilling its purpose by processing claims, the real concern is whether it can do so in a manner that is both fair and financially sustainable. Given the sharp rise in costs and the excessive third levy estimate, it is increasingly doubtful that the CSLR is achieving its objectives without placing an unreasonable burden on the financial advice sector, particularly for small financial advice firms.

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

We believe the CSLR funding model is flawed. As highlighted earlier, the rapid escalation in levy costs over recent periods, along with the likelihood of even higher levies in 2026/27, places an unsustainable financial burden on existing advisers. These rising costs not only

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[3] *Treasury Laws Amendment (Financial Services Compensation Scheme of Last Resort) Act 2023*, Explanatory Memorandum, page 9

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deter new entrants to the profession but also drive up the cost of financial advice, making it less accessible for consumers.

Currently, financial advisers are being forced to bear the financial consequences of misconduct by others outside their sector, such as product providers. The estimated third levy of $70.1 million will have a devastating effect on financial advice businesses, particularly small firms, potentially pushing many to the brink of closure or even bankruptcy.

Another key issue is the delays caused by the regulator. For instance, there was a significant delay between when DASS was reported to ASIC and any action being taken. The lack of timely intervention allowed financial losses to grow, leading to a higher volume of unpaid compensation claims. These delays not only increase the financial harm to consumers but also shift the mounting costs onto those funding the scheme.

To create a fairer and more sustainable funding model, we recommend the following key changes:

- The government must honour its original commitment to fully cover the scheme's costs and claims for the first 12 months, including funding all legacy complaints that predate the CSLR.
- The financial advice sector cap should be reduced to the originally proposed $10 million.
- Compensation payments should be strictly limited to actual capital losses, ensuring the CSLR is a true last-resort mechanism.
- The funding burden should be shared more equitably across the financial services industry by including product issuers and manufacturers in the scheme. This would ensure they are held accountable for the failures of their own financial products.
- The financial advice sector should not be forced to cover compensation for failures in general advice or wholesale client advice, as these areas are outside its direct responsibility.

Without these critical reforms, the CSLR risks becoming an unsustainable and unfair financial burden on financial advisers, ultimately harming both the profession and the consumers it aims to protect.

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

We are unable to provide comments on the powers of the CSLR Operator, as we have not had access to relevant information on this matter.

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d) The current scope of the CSLR and any related matters

We believe the CSLR's scope should be expanded to ensure a more equitable distribution of responsibility across all participants in the financial services sector. As previously mentioned, product issuers and manufacturers, such as MISs and vertically integrated firms offering in-house investment products, should also contribute to the scheme. These entities play a significant role in the financial ecosystem, and their inclusion would help address the imbalance in how compensation costs are allocated.

Additionally, the general advice and wholesale advice sectors should be considered for inclusion. Currently, financial advisers are at risk of being unfairly held accountable for compensation claims stemming from these areas. This is particularly concerning if AFCA reclassifies general or wholesale advice as personal advice, shifting financial liability onto financial advisers for matters beyond their responsibility. Expanding the CSLR's scope would help prevent this misallocation and ensure that compensation costs are borne by those directly responsible for financial failures.

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If you have any questions in relation to this submission, please contact Natasha Panagis on (03) 8851 4535 or n.panagis@ifpa.com.au

Yours faithfully,

Natasha Panagis
Head of Technical Services

About the Institute of Financial Professionals Australia

The IFPA is a not-for-profit membership association (originally known as Taxpayers Australia, then more recently Tax & Super Australia) and has been serving members for over 100 years. With a membership and supporter base of over 22,000 practitioners, our association is at the forefront of educating and advocating on behalf of independent tax, superannuation and financial services professionals.

This submission is made by us on behalf of our members' interests.