28th 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

**SMSF ASSOCIATION SUBMISSION: COMPENSATION SCHEME OF LAST RESORT POST IMPLEMENTATON REVIEW**

The SMSF Association welcomes the opportunity to provide this submission to the *Compensation Scheme of Last Resort post-implementation review*.

The SMSF Association supports the objective of the compensation scheme of last resort (CSLR). Consumers should have access to financial compensation where they suffer a financial loss from poor or negligent financial advice. However, the current design of the CSLR is inequitable and unsustainable and poses a serious risk to the retail financial planning sector.

For a subsector where more than 80 per cent of all financial advice firms are small businesses with less than 10 financial advisers[1], not large corporates or even listed entities, the current model threatens both the viability of the CSLR and the retail financial planning sector itself. This is due to several factors, including that CSLR funding model is adjusted annually for the number of financial advisers during the relevant levy period.

Importantly, when the legislation was first introduced into Parliament in 2021 there were approximately 16,500 financial advisers, in 2022 just over 15,800 and in 2023 when the legislation passed, just over 15,600. Today, there are 15,571[2] financial advisers servicing an Australian population of nearly 27 million.

A special levy was also built into the design of the CSLR 'to fund the payment of a large body of eligible claims made against the scheme following a large failure or 'black swan' event'[3].

[1] 2024 Australian Financial Advice Landscape Report p.30
[2] https://wealthdata.com.au/adviser-movement-fast-facts
[3] Compensation Scheme of Last Resort (CSLR) - Proposal Paper p.14

Of serious concern is that since the CSLR commenced operation on the 2nd of April 2024, we have now seen not one but two 'black swan' events, and a third potentially waiting in the wings[4].

92% of the expected claims of $70.1 million for the 3rd levy period are from just two failed financial advice firms, being Dixon Advisory Superannuation Services Limited (Dixon Advisory) and United Global Capital Pty Ltd (UGC) [5].

The estimate of $70.1 million for the 3rd levy period significantly exceeds the sub-sector cap of $20 million, meaning the special levy will have to be implemented to fund the estimated magnitude of consumer losses. For comparison, the 3rd levy estimate is almost four times the 2nd levy period cost of $18.5 million.

Holding a sector accountable for the failures of firms who intentionally prioritise profit to the detriment of their clients, is not only unsustainable, but unjust. It also demonstrates that the current design is resulting in moral hazard contributing to the increasing scale of potential CSLR liabilities being burdened on the personal financial advice sector.

The now unpredictable contingent liability of the CSLR coupled with the similar unpredictable annual costs of the ASIC Industry Funding model, which notably adds a further $1,500 for each financial advice firm and $2,691 for every financial adviser in 2023/24, is placing substantial pressure on many financial advice firms. Importantly, regardless of the quantum or scale of financial advice provided – all financial advice firms are levied in the same manner.

This is forcing many financial advice firms offering financial advice on a part-time basis, such as those with a limited Australian Financial Services (AFS) licence or restricted scope to provide financial advice, to question if they can viably continue to offer financial planning advice to their clients.

This is despite client demand and the value their financial planning advice is providing to their clients.

It is also a significant deterrent to new entrants into the personal financial advice, noting AFS licensees who only provide wholesale advice are not required to participate in the CSLR and only paid a flat ASIC funding levy of $812 in 2023/24.

This outcome appears to be at odds with separate Government reforms to 'ensure Australians have access to quality and affordable advice'[6].

The current CSLR model must be amended to ensure both it and the financial planning sector are viable well into the future. As an example, if a financial adviser lodges a report with ASIC about a financial adviser or financial advice firm, as was the case with Dixon Advisory, and ASIC chooses to not act, or substantially delays any action, the financial planning sector should be indemnified from any future CSLR claims, not expected to foot a bill they tried to prevent.

---

[4] https://asic.gov.au/about-asic/asic-investigations-and-enforcement/enforcement-activities/shield-master-fund/

[5] Initial Estimate for 2025/25 (3rd Levy Period) CSLR p. 5

[6] New legislation to increase the accessibility and affordability of financial advice The Hon Stephen Jones MP, Assistant Treasurer and Minister for Financial Services 27 March 2024

ASIC must also build stronger engagement channels with the sectors it regulates. This could include establishing dedicated working groups to provide industry insights and share information more readily, including alerting the regulator to potential red flags. Importantly, this must be genuine two-way communication for this measure to be effective.

Another important factor to support the viability of the CSLR is to ensure that all AFS licensees continue to hold appropriate Professional Indemnity Insurance (PII) cover. It is our understanding that ASIC currently only assesses if PII cover is appropriate for an AFS licensee at time of application or as part of a surveillance activity.

To address this, we recommend AFS licensees be required to submit a copy of their PII Certificate of Currency when lodging their annual FS 70 and FS 71 forms. We understand ASIC may not have the resources to review each individual certificate of currency for compliance. However, ASIC could analyse samples from each relevant sector to confirm compliance or identify any emerging risks that may need early intervention.

Finally, the responsibility for funding unpaid consumer losses should be shared evenly across the sector. The CSLR does not reflect this shared responsibility as it excludes product manufacturers, including managed investment schemes (MISs). We believe this is a significant flaw in the scheme, given that manufacturers whose products are poorly designed and improperly fail do not contribute to the CSLR, yet they have caused significant consumer detriment in the past.

Our detailed responses to the post-implementation review terms of reference are contained in the Attachment.

If you have any questions about our submission, please do not hesitate to contact Tracey Scotchbrook, Head of Policy and Advocacy via email traceyscotchbrook@smsfassociation.com

Yours sincerely,

Peter Burgess
Chief Executive Officer

**ABOUT THE SMSF ASSOCIATION**

The SMSF Association is the peak body representing the self-managed superannuation fund (SMSF) sector which is comprised of over 1.1 million SMSF members and a diverse range of financial professionals. The SMSF Association continues to build integrity through professional and education standards for practitioners who service the SMSF sector. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial advisers, tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them with access to independent education materials to assist them in the running of their SMSF.

**ATTACHMENT**

## How the CSLR is delivering on its intended objectives

According to the explanatory memorandum to *the Treasury Laws Amendment (Financial Services Compensation Scheme of Last Resort) Bill 2023*, 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.*[7]"

We believe that the CSLR is seeking to deliver its intended objectives. However, in doing so the current design and operation is creating an unacceptable level of risk and an unpredictable contingent liability for those AFS licensees who continue to comply with their obligations and provide quality and valuable advice to their clients.

Further, the vast majority of these AFS licensees are small businesses and cannot sustain paying for the often deliberate or negligent, failures of others, including those that are subsidiaries of ASX listed corporations.

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

The CSLR funding framework was largely modelled on the ASIC Industry Funding Model (IFM), which itself has been largely criticised by the sector for some time for not being fit for purpose. While the IFM was formally reviewed in 2022/23, the review failed to deliver any tangible outcomes or address the concerns of stakeholders.

A key concern raised during the development of the CSLR funding model (as with the ASIC IFM) is that those who give rise to the claims (or regulatory costs) may not be contributing to the levy, depending on a range of factors, including the timing of when they held or ceased to hold their AFS licence.

Dixon Advisory Superannuation Services Limited and United Global Capital Pty Ltd are responsible for 92 per cent of the expected claims for the 2025/26 levy period. However, Dixon Advisory had their AFCA membership cancelled on the 30 June 2024 and UGC entered voluntary administration on the 9th of August 2024, meaning neither firm will contribute towards the levy to fund their estimated millions of dollars in unpaid claims. Proving this concern is in fact a reality.

In the case of Dixon Advisory, thousands of clients collectively have lost millions of dollars, many of them retired or nearing retirement. Yet, no one has been held accountable. This includes the directors and senior management who were ultimately responsible for the running of the business at the time, nor the financial advisers who provided the financial product advice.

This is not just an issue of a few financial advisers providing poor financial advice to their clients.

---

[7] Financial Services Compensation Scheme of Last Resort Levy Bill 2023 – Parliament of Australia, Explanatory Memorandum P. 9

The collapse of Dixon Advisory highlights the concerning ability of large listed corporates to place a subsidiary firm into liquidation to avoid paying client compensation. Of further concern is the fact that E&P Financial Group successfully wound-up Dixon Advisory but retained 78% of Dixon Advisory clients (who may have benefited from the scheme) and appointed 39 of its financial advisers.

On face value it could be seen as internal phoenixing, given the redistribution of resources and the retention of customers, resulting in the maintenance of business continuity for E&P Financial Group but only being held accountable for a fraction of the liabilities Dixon Advisory did or was likely to incur.

This sets a concerning precedent that must be addressed.

We acknowledge that insolvency laws are complex, however, consideration must be given to how parent companies of financial advice firms can be held accountable to deter and prevent this behaviour being repeated in the future.

This event also highlights the pending yet unquantifiable contingent liability that perpetually now hangs over the head all financial advice firms, following not one, but two black swan events since the CSLR commenced.

The collapse of Dixon Advisory and UGC alone validate the need to change the current scope and funding model for the CSLR.

This includes that funding the CSLR should be a shared responsibility by all across the sector, including product manufacturers.

Consumers, particularly direct investors and SMSF trustees, should also have a right to be protected and have recourse where losses are incurred due to misconduct, misrepresentation or fraud by a product issuer or manufacturer.

We believe excluding financial product manufacturers is a significant flaw in the scheme. Manufacturers whose financial products are poorly designed and improperly fail do not contribute to the CSLR, yet they have caused significant consumer detriment in the past.

This includes vertically integrated firms who fail to appropriately manage the inherent conflicts of interest and prioritise in-house product, regardless of performance, over client interests.

The challenges of failing to appropriately manage conflicts of interest within vertically integrated financial firms are not new, they have been the focus of previous inquiries, including the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* in 2019 which noted in its Final Report:

> *It is not surprising that, despite the breadth of approved product lists, more than two-thirds (by value) of the investments made by clients of vertically integrated institutions were made in in-house products. And that is not surprising because*

*experience shows, and has shown for decades, that, more often than not, interest trumps duty.* [8]

A further relevant observation from the Final Report was that:

> *Scandals dating back to the GFC began to shed light on the conflicts and culture in the financial advice industry. Regulatory responses, however, focused on the remediation of specific instances of poor advice, rather than seeking to identify root causes within institutions and the industry. Those responses set the tone for future approaches to misconduct by financial advisers, that is, to compensate customers according to arrangements negotiated with ASIC while requiring few changes to the business itself*[9].

We believe that this is a commanding observation and goes to the heart of the challenges the financial planning sector continue to face.

There is also the risk that future product failings may be deemed to be a "financial advice failure", placing further pressure on not only the sustainability, but the viability, of the CSLR.

A further concern is that if AFCA determines that either general or wholesale advice is in fact personal advice, neither of these subsectors will be required to contribute to the CSLR meaning personal advice licensees will be covering compensation for these sectors as well.

The SMSF Association recommends that:

- the scope of the CSLR is expanded to include financial product providers
- the current funding model is amended to ensure the funding model is equitable, just and sustainable, and importantly
- measures are taken to prevent listed corporates from placing a subsidiary firm into liquidation to avoid paying client compensation.

Whilst not directly related to the how the funding model is formulated, there is a further concern with how compensation is being awarded by AFCA, which appears to be a direct cause to the level of funding required for unpaid determinations.

AFCA currently determines the amount of compensation using a 'but for' test, meaning compensation is awarded on hypothetical unrealised gains not actual capital losses. There are also concerns in how the 'but for' test is being applied, including the comparison products selected and applying the comparative investment to a client's entire portfolio, rather than only the product in question.

We are concerned that compensating consumers beyond the actual losses they have incurred is not aligned with the intention of the CSLR being a true compensation scheme of last resort.

---

[8] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 2019, Volume 1, Page 168

[9] Ibid. Page 127

The SMSF Association recommends that method for awarding compensation to consumers should be revised and based on actual consumer losses, rather than hypothetical losses.

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

We do not have any specific comments regarding the powers of the CSLR Operator.

Our primary concerns lie with how the scheme is scoped and funded.

Also of relevance is the lag in action taken by regulators. This has a direct impact on the number of unpaid compensation claims, with protracted delays increasing consumer detriment in both the number and size of financial loss, which is then ultimately borne by those funding the scheme.

## The current scope of the CSLR and any related matters

AFCA recently stated in its submission to the *Scam Prevention Framework Bill 2024*, that it considers it essential that the liability regime applies consistently across all sectors[10] and that a 'shared responsibility framework' means that each participant has a role to play to support timely and comprehensive resolution of complaints[11].

The SMSF Association believes the same approach should be applied to the CSLR, in that it should be a shared responsibility across all participants in the retail financial advice sector, not just AFS licensees providing personal financial advice.

The exclusion of MISs from the CSLR regime for example has created a significant consumer protection gap in the current regulatory settings. This must be addressed to protect those who choose to invest in such products without seeking professional financial advice – either by choice or because they may not realise, they are directly investing in a financial product.

Often MISs can be high-risk and / or complex products that are marketed directly to the Australian public, such as:

- Trio Capital (2012): Australia's largest superannuation fraud where Australians lost approximately $176 million from two fraudulent managed investment schemes[12], and
- Sterling Income Trust (2019): marketed as a 'rent-for-life scheme' which was actually a complicated organisation of MIS products that were ultimately mismanaged costing 527 investors more than $30 million and even more concerning, leaving many senior Australians homeless[13].

[10] AFCA's submission to the Senate Economics Legislation Committee into the Scams Prevention Framework Bill p. 7.
[11] Ibid p.8
[12] Report: Inquiry into the collapse of Trio Capital
[13] Sterling Income Trust Final Report

Excluding MIS products from the CSLR continues to encourage the creation of inappropriate high-risk products being marketed directly to Australians, including those near retirement who are not able to sustain any incurred financial losses, as in the case of Sterling Income Trust.

The SMSF Association recommends that the scope of the CSLR is amended to specifically include MIS products.

It is also important to remember that the vast majority of financial advisers abide by their obligations under the corporations and financial services regulation framework that notably 'is no longer fit for purpose'[14], incurring significant costs to understand and comply with their legal obligations. These costs are ultimately passed on to clients, further impacting the provision of affordable and accessible quality financial advice to the Australian community.

In addition, they must fund a CSLR to compensate unfortunate clients of financial advisers and/or financial advice firms who choose to neglect or avoid their responsibilities under the same corporations and financial services regulation framework.

Not only do complying financial advice firms fund the payment of unpaid compensation claims, they also fund the ASIC investigation costs though the annual ASIC Industry Funding levy, another annual unknown cost in the thousands of dollars. Finally, they must also fund the payment of any unpaid fees incurred by AFCA in assessing and awarding the unpaid compensation claim, which will also be in the thousands of dollars.

These rising and unquantifiable annual costs seem to be at odds with separate reforms the Government is pursuing to 'ensure Australians have access to quality and affordable advice'[15]. In fact, the current CSLR cost recovery model, coupled with the ASIC Industry Funding model, question the viability of both the CSLR and the retail financial planning sector.

**ASIC's role investigating corporate collapse and the appropriateness of any regulatory intervention that may reduce scale of loss for consumers**

We note that ASIC's approach to investigation and enforcement has been reviewed many times over many years, including most recently by the Senate Standing Committee on Economics *Australian Securities and Investments Commission investigation and enforcement Report* July 2024[16].

Key concerns raised have included the effectiveness and efficiency of ASIC's approach to handling reports of alleged misconduct, including the ability to respond to issues in timely manner to reduce the scale of loss for consumers.

We acknowledge that ASIC's resources are finite, yet its role and remit has grown significantly over time, likely challenging its ability to be an effective and efficient regulatory agency. As such, we believe consideration should be given to exploring recommendation 2 from the above report[17]:

---

[14] Summary Report Confronting Complexity: Reforming Corporations and Financial Services Legislation Australian Lw Reform Commission November 2023 Page 5
[15] New legislation to increase the accessibility and affordability of financial advice The Hon Stephen Jones MP, Assistant Treasurer and Minister for Financial Services 27 March 2024
[16] https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/ASICinvestigation/Report
[17] Ibid Page 23

*The committee recommends that the Australian Government should recognise, based on the finding of recommendation one, that the Australian Securities and Investments Commission's regulatory failures call into question whether its remit is too broad for it to be an effective and efficient agency, and the government should strongly consider separating its functions between a companies regulator and a separate financial conduct authority.*

Importantly, the only mechanism a financial adviser currently has to prevent future potential CSLR costs is to report any problems they become aware of to ASIC. However, ASIC only investigate approximately one per cent of misconduct reports it receives[18] and has no obligation to report back to the financial planning sector how many complaints it has received, actioned or final outcomes.

Yet, ASIC do not bear the risk of no or slow action, rather this is borne by the client/s and financial advice firms through not only the CSLR, but also the ASIC Industry Funding Levy.

We believe that if a report has been lodged with ASIC about a financial adviser or financial advice firm and ASIC choose to not act, or substantially delay any action, the financial planning sector should be indemnified from any future CSLR claims.

There are also limited options for enforcement action or consumer redress that can be taken once a company has collapsed. However, should ASIC be successful in recovering any fines or penalties from an insolvent entity, we believe any recovered funds should be paid to the CSLR to fund client compensation, rather than continue to go into consolidated revenue.

We also believe that ASIC could be taking a more proactive approach to regulating the sector.

ASIC should build stronger engagement channels with the sectors it regulates. This could include establishing dedicated working groups to provide industry insights and share information more readily, including alerting the regulator to potential red flags. Importantly, this must be genuine two-way communication for this measure to be effective.

Another important factor to ensure the viability of the CSLR is to ensure that all AFS licensees continue to hold appropriate PII cover. It is our understanding that ASIC currently only assesses if PII cover is appropriate for an AFS licensee at time of application or as part of a surveillance activity.

The SMSF Association recommends that ASIC requires AFS licensees to demonstrate, on an annual basis, that they continue to hold appropriate PII that meets their statutory obligations.

This could be achieved by requiring AFS licensees to submit a copy of their PII Certificate of Currency when lodging their annual FS 70 and FS 71 forms. While ASIC may not have the resources to review each individual certificate of currency for compliance, it could analyse samples from each relevant sector to confirm compliance or identify any emerging risks that may need early intervention within a sector.

[18] Ibid Page 17