Stockbrokers and Investment Advisers Association
Serving the interests of investors

1 November 2024

Via upload

Committee Members
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Senators

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

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 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.

We have limited our comments to the concerns we have about the CSLR and its impact on our member firms.

Executive summary

- To fully understand the impact of the CSLR on the financial services sector, one must understand the pivotal role that AFCA plays in making the determinations that ultimately flow to the CLSR.
- The ability of AFCA to reclassify wholesale clients to retail and accept their complaints has the potential to impact significantly on the sustainability of the CSLR and those financial firms subject to CSLR levies if AFCA determinations brought by wholesale clients are unpaid and are referred to the scheme.
- The way in which fault is attributed under the law as well as the design of the AFCA scheme 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.
- SIAA has serious concerns about the way in which the 'but for' method has been used in the AFCA lead case for the Dixon Advisory matters as well as the qualifications of AFCA decision makers to make determinations involving a potential $135 million in claims[1] which will have a significant impact on the financial services industry.
- 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. It is particularly inequitable that a methodology resulting in a calculation of losses approximating $135 million is not subject to independent review when it cannot be disputed by a counterparty.

SIAA has the following recommendations:

- 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.
- An independent expert should be brought in to review the methodology for calculating losses in any lead case concerned with investment losses leading to a determination which will have a significant impact given the magnitude of the cases. This is of greater importance when the licensee in question is in administration and is unable to provide a counterfactual to give balance to AFCA's approach.
- To ensure equity and confidence in the system, all AFCA personnel determining damages for an AFCA Preliminary Assessment and Determination should have recognised qualifications and, more importantly, experience and/or strong knowledge of capital markets where the calculation is about investment losses, such as in the Dixon Advisory matters.

[1] Keith Ford, 'Concerns mount CSLR levy could hit $50 million', Independent Financial Adviser, 24 October 2024. 'But the practical reality is that we have around $135 million that will need to be paid for by the advice profession, or someone else on behalf of the advice profession, over the course of the next three or four years.'

- The time limit of 12 months for retention of membership of AFCA of a firm in administration should not be able to be extended by ASIC.
- ASIC should remain an impartial regulator and not become a consumer advocate in relation to client complaints to AFCA when a firm is in administration.
- Any changes to the CSLR should clarify that the government will cover the first 12 months of operating costs and claims as promised.

The role of the financial services regulatory regime in the context of how matters involving the collapse of an investment product promoted by a vertically integrated business are assessed and how fault is attributed.

The role of AFCA in the financial services regulatory regime

To fully understand the impact of the CSLR on the financial services sector, one must understand the pivotal role that AFCA plays in making the determinations that ultimately flow to the CSLR.

The requirement to be a member of an approved External Dispute Resolution scheme is a license condition imposed on an AFS licensee that provides advice to retail clients.

Section 912A (1) (g) of the Corporations Act provides as follows:

A financial services licensee must……..if those financial services are provided to persons as retail clients (our emphasis added):

(i) Have a dispute resolution system complying with subsection (2);

Section 912A (2) of the Corporations Act sets out the requirements for a complaint dispute resolution system as follows:

To comply with this subsection: a dispute resolution system must consist of:

(a) An internal dispute resolution procedure that:

> *(i) Complies with standards, and requirements, made or approved by ASIC in accordance with regulations made for the purposes of this subparagraph; and*
>
> *(ii) Covers complaints against the licensee made by retail clients in connection with the provision of all financial services covered by the licensee: and*

(b) [repealed]

(c) Membership of the AFCA scheme.

The interplay between section 912A (2) and section 912 (1) (g) of the Corporations Act requires licensees who provide financial services to retail clients to have a dispute resolution system that includes membership of the AFCA scheme.

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.

However, the AFCA scheme has been developed in a way that is no longer just a protection measure for small consumer complaints. AFCA is now a scheme where:

- Decisions can be made within AFCA by individuals that do not have the appropriate level of experience and/or expertise which can have detrimental effects on member firms.
- 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 within AFCA.
- 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.

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 recategorise 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 are 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.

The attribution of fault

The way in which fault is attributed under the law as well as the design of the AFCA scheme 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.

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 and that this 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).

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.

The 'but for' test

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 inappropriate financial advice has been provided, 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 in order to determine the loss. We consider that this not a role for which a scheme, originally intended to be a low-cost consumer complaint resolution service, is best suited.

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.

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 a 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 decisions of the complainant.
- 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 services sector 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. This is common for complaints against parties in administration.

We consider that this 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 recommends 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 have 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 ensure there is confidence in the AFCA determination and in turn its impact on the CSLR and its levies.

SIAA has also recommended to government that, in order to ensure equity and confidence in the system, all AFCA personnel determining damages for the purpose of an AFCA determination 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.

Assessment of the period for which wealth management companies can remain a member of AFCA

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.

The implications of the collapse of wealth management companies on the establishment of the CSLR, including with respect to design considerations and the potential implications for future matters.

The impost of the CSLR levies on financial advice firms

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 2024 and there has been a CSLR levy blow out.

The scheme has issued a levy framework summarising the various levies and levy periods:

- The pre-CSLR levy of $241 million will be funded by the top 10 largest APRA-regulated financial institutions (other than private health insurers and superannuation funds) and

covers approximately 1,914 claims. 1,556 of these claims are against Dixon Advisory lodged with AFCA between 1 November 2018 and 7 September 2022. This levy is essentially on a claims made basis.

- For complaints lodged on or after 8 September 2022, levies are determined annually (noting that the first levy period runs only from 2 April 2024 to 30 June 2024) on a claims paid basis. The levy for the first levy period of $4.8 million is funded by government and covers approximately 11 claims (of which only one is a complaint against Dixon Advisory).
- The second levy period is from 1 July 2024 to 30 June 2025. The levy for the second levy period of $24.1 million is funded by industry. Licensees that provide advice to retail clients will pay the lion's share of this levy: **a minimum levy of $100 plus $1,186 per adviser.**
- Levy Period three is from 1 July 2025 to 30 June 2026. The scheme is currently formulating this levy estimate. It anticipates that due to the number of Dixon Advisory and other complaints the upcoming levy will exceed the $20 million sub-sector cap for personal financial advice.

As at 30 June 2024, AFCA has registered 2,773 complaints against Dixon Advisory since AFCA's establishment on 1 November 2018. While this is less than the administrator's estimate of 4,606 investors, this is still a significant number of complaints that will likely take years to process.

The scheme could very well be unsustainable and, on top of the ASIC industry funding levy, force smaller advice licensees to close their doors. It is important to realise that those subject to the CSLR are not only paying to compensate complainants – they are also paying for AFCA's costs of dealing with the complaints.

In addition to the CSLR levy, SIAA's members are subject to an increasing level of costs including:

- **ASIC industry funding levies.** For the Financial Year ended 30 June 2024 levies for the personal advice subsector will amount to a minimum of **$1,500 per licensee plus $2,878 per adviser** - an increase of around 208% per adviser since the industry funding model was introduced in 2017.
- ASX fees.
- **AFCA registration fees, user fees and complaints charges.** All members pay a single annual registration fee. In the 2024-25 financial year, this fee will be $388.69 for financial firm members. There is also a user charge fee applied to members who receive six or more complaints in the financial year. In addition, members with complaints lodged against them pay complaint fees depending on the stage the complaint progresses to. As stated previously, the costs of a single case proceeding to determination exceeds $11,000 (excluding systemic issue fees). Details of AFCA fees and charges can be found here https://www.afca.org.au/members/funding-model

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.

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 are deeply disappointed that the government promised it would cover the operating costs and claims of the first year of the CSLR, yet the final legislation finds it responsible to only cover the costs of the first three months. This has resulted in it covering payments of only a single Dixon Advisory complaint. 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.

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 include clarification that the government will cover the first 12 months of operating costs and claims as promised.

The legislation has a loophole that is creating a moral hazard 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 the 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 current CSLR legislation does not allow either advisers or firms to manage risk. The moral hazard we pointed to when consultation took place on the establishment of the CSLR is now evident from the very start of the scheme. It is inequitable and unsustainable. Mandating that sound financial services businesses fund consumer compensation for those businesses which have failed is moral hazard writ large.

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.

We understand that our recommendations in this submission relate to AFCA and ASIC rather than the CSLR, but those two parties and their decision-making are irrevocably entwined with whether the CSLR is sustainable and therefore their decision making needs to be taken into account in order to ensure both confidence in the scheme and its capacity to fulfil its intent.

Conclusion

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