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13 August 2021

Financial System Division
Risk Treasury
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By email: CSLR@treasury.gov.au

Dear Sir/Madam,

Financial Services Royal Commission – Compensation Scheme of Last Resort

Recommendation 7.1 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Royal Commission**) recommended that the three principal recommendations to establish a Compensation Scheme of Last Resort made by the Supplementary Final Report of the Review of the financial system external dispute resolution and complaints framework (**Ramsay Review**) should be carried into effect.

In its response to the Royal Commission, the Government committed to establish a forward-looking and industry-funded compensation scheme which extends beyond personal advice failures. The establishment of the Compensation Scheme of Last Resort will support ongoing confidence in the financial system's dispute resolution framework by facilitating the payment of limited compensation to eligible consumers who have received a determination for compensation from the Australian Financial Complaints Authority which remains unpaid.

The Government has released for public consultation exposure draft legislation that would establish the Compensation Scheme of Last Resort. The draft legislation contains the key features of the scheme, including the ability to authorise an operator of the scheme, eligibility requirements, compensation available for each eligible AFCA determination, the levying framework to fund the scheme, and the governance of the scheme.

To support the draft legislation, the Government has also released a proposals paper, which outlines the Government's proposals in relation to various aspects of the CSLR. These aspects include scope, payment arrangements, funding arrangements, governance and mechanisms to maintain the integrity of the scheme.

We make this submission in response to the Government's consultation process on the exposure draft legislation for the Compensation Scheme of Last Resort.

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Background to the SR Group

The SR Group is a consumer advocacy organisation based in Sydney, Australia that assists consumers in seeking redress for misconduct causing financial loss in the financial services sector. SR Group represents approximately 5,000 victims of financial services misconduct across a number of schemes, including the Prime Retirement and Aged Care Property Trust, the Premium Income Fund (MFS), the Pacific First Mortgage Fund (City Pacific Limited) and the Sterling Income Trust.

Through our work as a consumer advocacy organisation, SR Group has developed a thorough understanding of the issues facing consumers when accessing external dispute resolution mechanisms in the financial services sector, and more broadly, the issues facing consumers when seeking redress for financial loss. The external dispute resolution and redress mechanisms in the financial services industry have been the subject of significant reforms in recent years, noting the work of the Ramsay Review and the Royal Commission.

For many years, redress and compensation arrangements in the financial services have been inadequate, and generally, have failed to provide redress to consumers. Owing to a combination of flawed operational requirements and deficient legislation, consumers have seldom had access to redress for losses suffered in the financial services industry, despite in many cases, declarations of criminality and legislative breaches in a court of law.

It is noted that the consumers who seek to access redress, and subsequently the CSLR, are consumers who have suffered significant financial losses due to the misconduct of a licensed financial firm. These financial firms are issued licenses, and are regulated, by the Australian Securities and Investments Commission. Despite the regulation of ASIC, these firms can at times fail, following which ASIC at times initiates legal action in respect of the conduct of the financial firm. These ASIC legal actions often result in declarations of misconduct, legislative breaches and criminality in a court of law.

SR Group considers the implementation of the CSLR to be an important step in ensuring that financial services consumers have access to redress when suffering financial losses due to the misconduct of a financial services provider. SR Group also considers that the implementation of the CSLR is an important step in growing consumer trust in the financial services industry. Notwithstanding, we also consider that the CSLR as currently proposed has significant shortcomings that will detriment the consumers the Government is intending to benefit through the CSLR's establishment.

Scope:

We consider that the proposed scope for the CSLR as outlined in the proposal paper and draft legislation is prohibitively narrow and inadequate in its current format.

SR Group strongly consider that, to achieve the Government's stated purpose of supporting confidence in the financial system's dispute resolution framework, coverage be provided to all financial services covered by AFCA. We strongly consider that aligning the coverage scope of the CSLR with the coverage scope of AFCA provides certainty to consumers about whether their AFCA complaint is eligible for the CSLR. We note that an AFCA-aligned coverage for the CSLR is also considerably more understandable to consumers and less complex than the currently proposed scope.

Further, an AFCA-aligned coverage scope for the CSLR will generate confidence amongst consumers with the knowledge that, should misconduct be committed against them causing financial loss, an avenue exists from which they can seek, and obtain, redress from. Similar to the implicit funding benefit provided to the major banks through the Financial Claims Scheme[1], an AFCA-aligned coverage scope for the CSLR will generate greater consumer confidence in the financial services industry as a whole, which in turn benefits industry participants through greater consumer participation and engagement with the industry.

The CSLR coverage scope as currently proposed may also discourage consumers from engaging with certain sectors of the financial services industry due to fear or uncertainty about the lack of coverage provided for those financial services.

We strongly consider that the scope of the CSLR as currently proposed, wherein only five specific financial products and services are within the scope of the CSLR, is prohibitively narrow, will create confusion for consumers about what constitutes a 'covered' financial service, and fails to meet the Government's purported overarching purpose of supporting confidence in the financial system dispute resolution framework.

Voluntary AFCA members

We consider that voluntary AFCA members should be covered within the scope of the CSLR and contend with the representation that the inclusion of voluntary AFCA members in the CSLR would add to its complexity.

Conversely, we consider that aligning the coverage of the CSLR to include claims against all AFCA members reduces the complexity of the scheme, as it mitigates the need for further criteria in deciding whether to accept or reject a claim. Further, a CSLR scope that is aligned with AFCA's scope provides clear, unambiguous guidance to consumers about whether their AFCA complaint is eligible to access the CSLR, if required.

Excluding claims against voluntary AFCA members from the CSLR may also simply discourage consumers from engaging with voluntary AFCA members firms that are offering financial products and services.

[1] RBAFOI-151609

We also consider that excluding voluntary AFCA members from the CSLR creates a clear disincentive for a voluntary AFCA member to honour any determination for compensation awarded in favour of a consumer through the AFCA process.

To illustrate, consider a situation where a consumer receives a determination for compensation from AFCA in respect of a complaint lodged against a voluntary AFCA member. Following the compensation award, the voluntary AFCA member may elect not to honour the payment of the AFCA determination. As the voluntary AFCA member is not obligated to hold AFCA membership pursuant to any licence conditions, expulsion from AFCA provides no credible threat to the firm. The consumer who was awarded compensation would have no ability to recover the awarded amount and AFCA would have no remit to take further action against the financial firm, aside from expulsion.

To prevent this situation, we consider that complaints made against voluntary AFCA members must be included in the coverage of the CSLR.

Court and tribunal decisions

As noted in the proposal paper, court and tribunal decisions were directly recommended by the panel overseeing the Ramsay Review to be included as within the scope of the CSLR. We note that this recommendation was delivered as part of the Ramsay Review concluded on 6 September 2017, approximately four years ago.

We further note that, on 4 February 2019, following the Final Report of the Royal Commission, the Federal Government committed to implementing a CSLR that *"will be designed consistently with the recommendations of the Supplementary Final Report*[2]*"*, approximately two and half a years ago. The proposed scope of the CSLR is therefore in direct contradiction with the recommendation of the Ramsay Review and the Government's own representation.

Clearly, the Ramsay Review recommendation to include court and tribunal decisions within the coverage scope of the CSLR has been known since at least September 2017 and has been committed to from February 2019 onwards. That no data currently exists on the number and amounts of court and tribunal decisions that remain unpaid exists reflects a clear failure by the Federal Government to perform crucial work required for the CSLR.

Why has, in the two and a half years since the Federal Government committed to establishing a CSLR, wherein the recommended design features have been clear from the outset, the Federal Government failed to quantify the data of unpaid court and tribunal decisions?

Failure to include unpaid court and tribunal decisions from the coverage of the CSLR is a direct function of the Federal Government's failure to quantify data that was clearly required. Due to its own failure to perform this crucial work, Treasury is proposing to re-shape the CSLR away from the recommendations of the Ramsay Review, and further limit the access of consumers to the CSLR.

We do not consider that re-shaping the CSLR away from the recommendations of the Ramsay Review for this reason to be adequate, fair, appropriate or prudent public policy. The outcome of this decision is that, again, consumers are forced to bear the consequence, through the further limitation of their access to redress for misconduct that has been proven in a court or tribunal.

We also note that the effect of precluding court and tribunal decisions from coverage in the CSLR also serves to reduce the value of claims likely to be paid out by the CSLR, in turn likely reducing the

[2] Restoring trust in Australia's financial system (treasury.gov.au)

size of the levy to be paid by industry participants. We submit that this does not balance the interests of consumers and industry, and clearly prioritises the interests of industry by diverging from the recommendations of the Ramsay Review.

Finally, we note the concerns raised by the panel overseeing the Ramsay Review in respect of not including court and tribunal decisions in the CSLR, including the creation of incentives to utilise EDR arrangements over a court or tribunal, and the undermining of public confidence in court and tribunal decisions.

General comments on scheme coverage

With respect to the narrow scope of the CSLR; the decision to exclude voluntary AFCA members from coverage in the CSLR; the decision to reject the recommendations of the Ramsay Review and exclude court and tribunal decisions from coverage in the CSLR; the decision to reject the findings of the Royal Commission and impose compensation caps on the CSLR considerably below the compensation caps applicable to AFCA; it is clear that the cost of funding the CSLR is a primary concern of Treasury when designing the CSLR. SR Group appreciate the need to balance the interests of consumers and industry, and more saliently, the need to ensure funding levies are at a level that is achievable for industry participants.

The ideal operation of the CSLR, for all parties, is that the scheme is only required to make payment to a small number of unpaid AFCA determinations, and that the majority of compensation payments are made directly by the financial firm party to the AFCA complaint. This is ideal for a number of reasons, most saliently; it ensures the financial firm responsible for the misconduct is the party responsible for paying the compensation; it provides redress to consumers in a timelier manner; and it mitigates the size of the levy charged to the financial firms.

In considering how to mitigate the number of claims paid via the CSLR, we refer to the findings of the Ramsay Review, as well as excerpts from the Richard St. John Report (**RSJ Report**) as they are reproduced in the Ramsay Review.

The recommendations of the RSJ Report provide a number of suggestions to better monitor the actions of financial services providers prior to the lodgement of any AFCA complaint, to ensure that the financial firm has sufficient arrangements in place to respond to potential complaint liabilities that may arise.

> **Recommendation 2.1:** requiring licensees to provide ASIC with additional assurance that their professional indemnity insurance cover is current and is adequate to their business need;
>
> **Recommendation 2.2:** attention being given, on a risk targeted basis and in conjunction with the level of their insurance cover, to the adequacy of licensees' financial resources to enable better management of risks and unexpected costs such as compensation liabilities;
>
> **Recommendation 2.3:** ASIC taking a more pro-active approach in monitoring licensee compliance with the requirement to hold adequate professional indemnity insurance cover and any new requirement in regard to financial resources, and in targeting licensees who are most at risk.

The Ramsay Review panel considered that these constitute important reforms, though concluded the view that these reforms alone will not solve the problem of uncompensated losses. We agree with this view taken by the panel overseeing the Ramsay Review.

SR Group consider that, to minimise costs of the CSLR scheme, the Government must direct greater resources into the regulatory activities undertaken by ASIC, in ensuring that financial firms are operating effectively and that adequate arrangements are in place to meet financial obligations. Further, as part of their regulatory activities, ASIC should ensure that financial firms have adequate professional indemnity insurance policies in place and adequate funding arrangements in place in order to pay the excess on such insurance policies and ensure the insurance policies are utilised.

We note the rather scathing comments made in the Final Report in relation to ASIC's performance of its regulatory duties. Clearly, there is significant room for improvement in the performance, and effectiveness of performance, of the corporate regulator.

We consider that, rather than reducing consumers access to the CSLR and therefore redress, greater effort be placed into preventative regulation. Inadequate regulation inevitably leads to greater levels of misconduct, and further, greater levels of uncompensated losses. Again, consumers are being forced to wear the consequences of inadequate regulation through minimised access to redress. We strongly consider that, rather than disadvantaging consumers by limiting their access to the CSLR, the Governments focus should be on stronger regulation.

Payment of Claims

Requirement for consumer to notify AFCA within 12-months

SR Group agree that a limit should be imposed on the time limit for consumers to be able to claim payment from the CSLR following an unpaid AFCA determination.

While we submit that it is unlikely that consumers would seek to allow long passages of time to pass between receiving their AFCA determination and redeeming their funds from the CSLR, such behaviour should be discouraged in order to provide certainty to the financial firms required to fund the CSLR, and to ensure that AFCA still has some ability to seek recovery of the funds from the financial firm. We note the inherent assumption that AFCA's ability to recover funds from the financial firm decreases with the passage of time after the determination is made.

To discourage such behaviour and further incentivise consumers to seek timely payment of their unpaid determination from the CSLR, we suggest that a timeframe be stipulated for when consumers should begin to contact AFCA in relation to the unpaid determination.

Hypothetically, this may be an instruction that if after six months your AFCA determination remains unpaid by the financial firm, you should contact at this junction to initiate the process of recovery through the CSLR.

Payments be expedited, where possible

We also consider that, where possible, payments from the CSLR be made to consumers as expeditiously as possible, to minimise the period of time for which consumers are without funds. For many consumers seeking redress for financial losses, the impacts of their financial losses are severe and wide reaching, and the CSLR should look to reduce the period of time that consumers are without funds wherever possible.

In some complaints, it is likely to be apparent at the time the AFCA determination is made that the financial firm will be unable to make payment of the awarded compensation to the consumer. For complaints lodged against financial firms that enter liquidation prior to complaint resolution and the issuance of an AFCA determination, it is reasonably likely that the firm will be unable to make payment of the awarded compensation. The ability of a financial firm in liquidation to make such a payment can be verified relatively simply through liaising with the relevant insolvency practitioners.

In situations where AFCA can be satisfied that the financial firm is unable to make payment of the awarded compensation, we submit that the payment of such claims be expedited to mitigate delays to consumers receiving their awarded compensation.

Clear process for consumers

With respect to the 12-month deadline for consumers contacting and notifying AFCA that the financial firm has not made payment of the awarded compensation, there should be clear guidelines in place to ensure this process is straightforward and easily understood by consumers.

Consumers accessing the CSLR are likely to have had no interactions with the CSLR or its operating process prior to seeking payment of their awarded determination. As such, the CSLR process must be clear and straightforward such that consumers are able to easily able to understand their obligations in the CSLR process, and more importantly, receive their awarded compensation.

We strongly suggest that AFCA or the CSLR operating company prepare and publish clear guidelines to consumers about the CSLR and their obligations within it. Instructions should be provided to consumers around any expectations of them held by AFCA and the CSLR prior to receiving compensation, such as when and how frequently the consumer is to contact the financial firm in relation to their compensation, and when the consumer should refer the matter to AFCA and the CSLR for intervention.

Hypothetically, this may include a 'milestone roadmap' wherein consumers are instructed to contact the financial firm at monthly intervals to seek payment of their awarded compensation until payment is received. If, after a certain number of months compensation has not been forthcoming, or if the financial firm does not respond and/or has indicated that they will not honour the determination, the consumer is subsequently instructed to contact AFCA.

We consider that any situation that may arise where a consumer receives an award for compensation from AFCA that is eligible for compensation from the CSLR but is precluded from receiving compensation from the CSLR due to operational or time limit issues, to be a poor policy outcome that should be avoided at all costs.

Payment plans

The CSLR proposal refers to the discussion of a reasonable payment plan between AFCA and a financial firm ordered to pay compensation to a consumer in relation to an AFCA complaint. Unless specifically agreed to by a consumer, we do not consider that there should be any situation where the consumer is forced to accept a payment plan in order to receive their awarded compensation.

The financial firm has already been found by AFCA to have committed misconduct causing financial loss to the consumer, and to subsequently force the consumer to wait further for their awarded compensation is unfair and inappropriate. Further, the discussion of a payment plan occurs between the financial firm and AFCA, without reference to consumer involvement and we consider this to be a defective approach to providing redress to consumers.

Compensation cap

The imposition of a compensation cap of $150,000 is inadequate and requires amendment. We refer to the recommendations of the Ramsay Review which clearly state that the compensation cap of the CSLR should be aligned with the AFCA compensation cap, which is currently $542,500. The proposed compensation cap is in direct contradiction with the Ramsay Review recommendation, and the Government's own representations in responding to the Royal Commission's Final Report.

The issue of financial firms that are not responsible for the misconduct giving rise to the compensation being claimed but are nonetheless required to pay for it is a moot point.

The implementation of a CSLR has been recommended through a number of reviews and its importance to the financial system and redress arrangements is critical. That firms that are not responsible for the misconduct giving rise to the compensation being but are nonetheless required to pay for it is, and always has been, an integral design feature of the CSLR. This design feature was considered when the Ramsay Review made its recommendation to implement the CSLR and was further considered by the Royal Commission when corroborating this recommendation. The fact that financial firms must pay for the misconduct of others was also considered by the Ramsay Review when recommending that its compensation cap be aligned with AFCA's.

As such, we consider that the issue of financial firms paying for the misconduct of other firms has already been considered, and in light of that consideration, the recommendation to implement a CSLR was made.

Misleading example – United Kingdom Financial Services Compensation Scheme

The comparison of the CSLR's compensation cap of $150,000 to the United Kingdom's Financial Services Compensation Scheme (FSCS) compensation cap of £85,000 is misleading and incorrect.

The FSCS operates with a far broader, retrospective remit than the proposed CSLR and the two schemes are vastly different in their coverage, operations, and eligibility criteria. Comparing the proposed CSLR compensation limit with the FSCS compensation limit, without consideration of the significant differences between the two schemes' operations, is misleading and mistaken.

Notably, the FSCS is a retrospective scheme that compensates claims dating back to 1988, whereas the CSLR is specifically a prospective scheme that compensates claims from November 2018 onwards. The FSCS also provides coverage for a far broader range of financial services than the CSLR does as currently proposed.

Further, the FCSC operates independently of the Financial Ombudsman Service, the relevant financial services external dispute resolution provider. Claims can only be made to the FSCS after the relevant financial firm has collapsed. To access the CSLR in Australia, complaints must first be made to AFCA, and AFCA complaints cannot be made against collapsed firms and can only be made about firms that are current AFCA members. As such, there is an enormous difference in the scope, timeframe, and coverage of the FSCS when compared to the proposed CSLR.

To illustrate, unit holders in the failed managed investment scheme Premium Income Fund, formerly managed by MFS Investment Management Limited, lost collectively more than $600 million following the collapse of the MFS Group in 2008. Under the terms of the FSCS, each investor could, today, lodge a claim and receive compensation for their losses, up to a compensation cap. Further, investors in the Prime Retirement and Aged Care Trust, the Pacific First Mortgage Fund and all other registered managed investment schemes that have collapsed could also seek and obtain redress through the FSCS, under its terms. Under the Australian external dispute resolution arrangements, no investors in any of these schemes can access redress. Since 2001, the FSCS has paid out over £26 billion in compensation to consumers.

Clearly, the coverage of the FSCS and the coverage of the CSLR are not comparable, and we consider the attempt to compare the proposed CSLR compensation cap with the FSCS cap to be misleading and erroneous. The FSCS is a far broader scheme than the CSLR in respect of its coverage, scope and remit, and accordingly, is expected to have a significantly lower compensation cap per complaint to accommodate the far greater volume of claims paid out.

We fail to see why the Ramsay Review's recommendation for the compensation cap to be aligned with AFCA's has not been applied. SR Group strongly considered that the CSLR compensation cap be aligned to AFCA's compensation cap.

Other payment issues

SR Group considers that the ability of the Minster to lower the compensation amounts available to consumers to be inadequate. We understand the need to balance the interests of consumer and

industry and accept that situations may arise where the compensation amount required to be paid out in one year is higher than the levied amount for that year.

Notwithstanding, that the Minister can decide to reduce the compensation amount payable to affected consumers creates a significant lack of certainty to consumers about what level of coverage the CSLR actually provides them.

Further, the fact that two separate complainants who access the scheme can receive vastly different compensation amounts for the same level of financial losses, creates inequitable outcomes across consumers and constitutes deficient public policy. As noted in the Ramsay Review, access to redress should be considered on the grounds of fairness, equity, and access to justice. When the Minister has discretion to vary compensation amounts across years, these grounds of fairness and equity are voided.

We submit that the compensation cap should remain constant throughout the CSLR, and only be revised during the periodic reviews of the CSLR and its suitability. We further submit that, if the ability to vary compensation between years occurs, a minimum cap of $120,000 (80%) be established.