Submission in response to 'Implementing Royal Commission Recommendation 7.1 – Establishing a Compensation Scheme of Last Resort' Discussion Paper, released 20 December 2019

SR Group

February 2020

SR GROUP
Rebuild your future

Glossary

ACL	Australian Credit Licence
ADI	Authorised Deposit-Taking Institution
AFCA	Australian Financial Complaints Authority
AFSL	Australian Financial Services Licence
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
CIO	Credit and Investments Ombudsman
CSLR	Compensation Scheme of Last Resort
EDR	External Dispute Resolution
FCS	Financial Claims Scheme
FOS	Financial Ombudsman Service
FSCS	Financial Services Compensation Scheme (United Kingdom)
FSRC	Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry
FSP	Financial Services Provider
NGF	National Guarantee Fund
SCT	Superannuation Complaints Tribunal
SIS	*Superannuation Industry (Supervision) Act 1993 (Cth)*
ToR	Terms of Reference

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Overview:

The SR Group is an advocacy and advisory company which assists consumers in financial distress, hardship or other unfortunate circumstances.

We welcome the opportunity to respond to the Discussion Paper *Implementing Royal Commission Recommendation 7.1 – Establishing a Compensation Scheme of Last Resort* released by Treasury on 20 December 2019.

The SR Group has advocated for the implementation of a Compensation Scheme of Last Resort, amongst other regulatory improvements, for a number of years. SR Group strongly believes that the existence of compensation schemes to cover gaps in consumer protection is vital to the efficient and trustworthy operation of the Australian financial operation. Our support for the CSLR is strongly influenced by our experience in advocating for over 5,000 clients who have suffered financial loss as a result of misconduct by a financial services provider (FSP).

Although we believe that the implementation of a CSLR is a vital initiative for the Australian financial system, we do not believe that the CSLR as currently proposed will solve all issues which currently exist with the external dispute resolution arrangements in Australia. Most concerningly, the lack of redress available to past disputes is considered by the SR Group to be highly inequitable.

Background:

In 2016/17, a panel appointed by the Government and chaired by Professor Ian Ramsay, reviewed External Dispute Resolution (EDR) and complaints arrangements in the Australian financial system. The panel delivered its final report in April 2017. In accordance with the panel's recommendations, a new EDR body, Australian Financial Complaints Authority (AFCA), was established to take the place of the existing EDR bodies, commencing operations in November 2018.

In February 2017, the Government extended the terms of reference of the panel reviewing the EDR and complaints framework to require the panel to make recommendations on the establishment, merits and potential design of a Compensation Scheme of Last Resort (CSLR) and to consider the merits and issues involved in providing access to redress for past disputes. In September 2017, the panel delivered a supplementary final report considering these issues.

On 21 December 2017, the Government announced that it would defer its consideration of the recommendations made in the supplementary final report until after the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (FSRC) had concluded.

The FSRC was conducted from December 2017 to February 2019, examining corporate wrongdoing in the period 1 January 2008 to 1 November 2018. The Royal Commission identified ubiquitous misconduct in Australia's financial services industry, which resulted in Commissioner Hayne making a total of 76 recommendations to improve the industry's operation, including the implementation of a CSLR:

> ***Recommendation 7.1 – Compensation Scheme of Last Resort***
>
> *The three principal recommendations to establish a compensation scheme of last resort by the panel appointed by the Government to review external dispute and complaints arrangements made in its supplementary final report should be carried into effect.*

Following the Final Report of the FSRC, the Government announced that it would implement each of the 76 recommendations of Commissioner Hayne, including the implementation of the Compensation Scheme of Last Resort. On 20 December 2019, the Government published a Discussion Paper regarding the Compensation Scheme of Last Resort, seeking stakeholder input on the design of the Compensation Scheme of Last Resort. This submission has been prepared in response to this Discussion Paper.

The Compensation Scheme of Last Resort

It is noted that the discussion paper outlines four separate aspects of the CSLR for consultation. Although these aspects are listed separately, it is imperative that they be considered in unison, as each segment is interrelated with the other aspects under consideration. For illustration, the coverage of the scheme will directly affect how much compensation the scheme is likely to pay, which in turn affects the scheme's funding model and how compensatory payments are to be paid. Accordingly, considering any item in isolation would be an improper approach.

It is also noted that although the CSLR is designed as an instrument to protect consumers, it will also provide some benefits to the industry participants. Consumer awareness of the existence of a CSLR will create greater consumer confidence about industry participation. Recent experiences in the financial services industry may have left consumers weary of re-entering the industry, however the knowledge that a CSLR exists should encourage consumers, which will in turn stimulate financial services businesses.

Coverage, Beyond Personal Advice

Q1) What is the appropriate coverage for the CSLR, beyond the provision of personal advice?

SR Group consider that the appropriate coverage for the CSLR is the broad-coverage approach described in the Treasury Consultation Paper. The broad coverage approach is the best approach for the CSLR for a number of reasons:

The Government has already committed to establishing a CSLR that provides coverage beyond the provision of financial advice. As such, the narrow-coverage approach outlined in the Ramsay Review is not appropriate for the CSLR.

The broad coverage approach is simple and uncomplicated. Consumers will understand that the CSLR will apply to the provision of all financial services and will take comfort from this knowledge. There is little room for confusion or misinterpretation under the broad coverage approach.

The CSLR will benefit the whole financial sector, so the whole financial sector should be covered. Consumers who know that there is a compensation scheme covering all financial services will be more inclined to participate in the financial services industry than they may previously have been. Increased consumer confidence will stimulate the industry and benefit all financial services. Accordingly, it is fair that all financial services are covered by the CSLR.

The primary criticism of the broad-coverage approach is that there are existing compensation schemes which cover the provision of some specific financial services; the FCS provides consumers with compensation should a bank or insurer fail; the NGF provides consumers with compensation for certain ASX losses; and Part 23 of the SIS Act allows financial assistance to be granted to Superannuants who suffered loss as a result of fraud and/or theft. These financial services are referred to as '*covered financial services*' for the purpose of this response.

These existing compensation schemes make it unlikely that the CSLR will be required to compensate consumers for the services covered by the existing compensation schemes, as these existing compensation schemes can be used to pay the necessary compensation. Accordingly, some argue that firms offering these '*covered financial services*' should be exempted from contributing towards the CSLR for the '*covered financial services*'. While that position is understandable, it creates an excessive and avoidable layer of complexity to the CSLR which will cause confusion to both consumers and industry participants alike. Similarly, financial firms are not required to pay for the FCS, NGF or SIS Act, and there is no suggestion that they are being 'doubly punished'.

Further, the providers of '*covered financial services*' generate a financial benefit from the increased consumer confidence derived by the knowledge that compensation schemes exist for these '*covered financial services*'. To illustrate, the existence of the FCS gives consumers confidence their bank deposits are secured and that they will be compensated should their bank collapse. Consumers have taken encouragement from this knowledge and more freely utilised these services, which in turn stimulates the earnings of these financial services providers. These firms have been profiting off these compensation schemes for years now and their contribution to the CSLR is justified.

It is highly necessary for the CSLR to develop clear and unambiguous guidelines which address the process to be followed in cases where the jurisdiction of the CSLR and the aforementioned compensation schemes overlap. Whether the payment of such claims is made by the CSLR

or the existing compensation schemes is effectively a debate of whether such claims are to be paid by industry (CSLR) or Government (existing compensation schemes).

Q2) Would there be any unintended consequences from initially excluding court and tribunal decisions or from excluding voluntary members of AFCA and the CSLR?

Excluding voluntary members may create confusion amongst consumers about whether the service they are receiving is covered by the CSLR. Customers knowing that they are receiving a service covered by the CSLR will promote consumer confidence and a more liberal attitude to participation in the financial services industry. Confusion about whether the service they are receiving is covered by the CSLR may impact consumers' confidence and their willingness for industry participation.

Another potential consequence of excluding voluntary AFCA members from the CSLR is that the effectiveness of AFCA in resolving disputes may be undermined. A voluntary member of AFCA has, in theory, little to no obligation to comply with the decisions of AFCA in its dispute resolution process. Voluntary members of AFCA have no AFSL or ACL which can be credibly threatened, and if AFCA was to make a determination for compensation against a voluntary member, that firm may simply refuse to pay the determination and renounce their AFCA membership, with little practical consequences available to AFCA to enforce the determination. It could therefore be argued that voluntary AFCA members have the highest likelihood not paying determinations as there is minimal punishment which can be delivered for failure to comply.

If services provided by voluntary AFCA members are not covered by the CSLR then determinations made by AFCA in respect of voluntary members are effectively meaningless. There is little obligation for a voluntary AFCA member to comply with the determination, and without a CSLR to take over the payment of said determination, the determination may never be complied with. To address this issue, the appropriate solution seems to be to include determinations made in respect of voluntary AFCA members in the coverage of the CSLR. It would therefore be appropriate for voluntary AFCA members to contribute financially to the CSLR. This will likely result in some firms discontinuing their voluntary AFCA membership, however, will also strengthen the integrity of AFCA and its determinations.

It is important for the CSLR to quantify its exposure to court and tribunal awards for compensation and how this exposure will impact the CSLR and its funding. However, initially excluding court and tribunal decisions from the CSLR for a period of three years will also constitute a significant deviation from the recommendations of the Ramsay Review. This deviation from the recommendations will create an inequitable situation whereby consumers who receive a court or tribunal award in the initial three years of the CSLR will not be eligible for compensation, while consumers who receive such an award from 2023 onwards will be compensated for the same conduct.

It is appropriate that, following the initial three-year quantification period, court and tribunal awards from this period be retrospectively compensated in line with the CSLR's approach to compensating court and tribunal awards. To illustrate, say that following the three-year quantification period, it is decided that the CSLR will compensate court and tribunal awards for compensation at a fixed percentage of 85% of the awarded value going forward. In order to ensure the equitable treatment of consumers, all court and tribunal awards for compensation made during the three-year quantification period should be retrospectively compensated at this same 85% level. It would also be appropriate to apply interest to these amounts.

Funding Arrangements

Q3) To what extent should the funding model be based on risk?

For the purpose of this response, risk is defined as the likelihood of an AFCA determination being unpaid by the relevant financial services provider and requiring payment by the CSLR.

Risk should certainly be accounted in the funding model of the CSLR. Some financial services have a higher rate of unpaid determinations, making such financial services inherently 'riskier' in the context of the CSLR. We propose that the funding model for the CSLR account for both risk and a firm's ability to pay and have prepared a hypothetical funding model using fictitious data.

Q4) How should risk be assessed?

Risk should be adjudicated at the financial service class level.

Risk can be assessed by collating data on the number of determinations for compensation issued over a specific period and segmenting these determinations by the type of financial service the determination relates to. Further data on the number of these determinations which remain unpaid is then collected and again segmented by the type of financial service they relate to.

The financial services with greater percentage of unpaid determinations should be deemed the riskier financial services, while those services with smaller percentages of unpaid determinations are adjudicated to be less risky. This approach to risk assessment will utilise basic and easily accessible data without being intrusive to a financial firm and will minimise the costs of data collection.

Q5) Should the funding model assess risks at the individual financial firm level or at the financial service class level?

Risk should be assessed at a financial service class level in order to minimise complexity and regulatory costs.

Q6) Should a risk-based funding model apply to all CSLR costs?

The costs of administering the CSLR will be positively related to risk, in that a higher number of claims paid out by the CSLR will highly likely result in higher administrative costs for the CSLR. Accordingly, it seems appropriate that the funding model applied to CSLR claims costs be applied similarly to the CSLR administrative costs. However, it is important to note that risk levels are subject to change year on year as new determinations are issued and paid (or unpaid). Accordingly, the risk factor of each financial service class should be re-calculated each year as new data is made available.

Q7) To what extent should the funding model be based on a firm's ability to pay?

In order to prevent the lessening of competition, the funding model for the CSLR should be heavily based on a firm's capacity to pay. The funding model should take into account firm size and market share in order to calculate the amount each financial firm should contribute to the CSLR, similar to the approach taken in the United Kingdom.

A levy imposed equally across all financial firms will be unaffordable for some smaller firms and will lead to reduced competition in the market, an undesirable outcome.

To ensure that the cost of the CSLR is borne by those financial firms providing financial services which are more likely to require the CSLR, the funding model should take into account both risk and firm size.

We have devised a hypothetical funding model using fictitious data which could be, with amendments, applied in the context of funding for the CSLR.

Q8) How should ability to pay be assessed?

A firm's ability to pay should be assessed by viewing the firm size and their relative market share.

Q9) What are suitable universally available metrics to assess a firm's ability to pay?

Gross profit has been used as the universally available metric in the below funding model, however it could be easily adapted to use gross revenue, net revenue, net profit, etc.

A Proposed Funding Model

The funding model would begin by collecting the following pieces of data:

1. The number of awards for compensation made in favour of consumers, over a specified period, segmented by the financial service the award was made in relation to.
2. The number of awards for compensation made in favour of consumers, over a specified period, which did not get paid by the relevant FSP. This data is again segmented by the financial service the determination was made in relation to.
3. The gross profit of each firm offering services covered by the CSLR.
    - From this point, information can be derived about the market size of the industry and each firm's relative market share.

Hypothetical Data:

Class of Service	Determinations Made ($)	Determinations Unpaid ($)	% of Determinations Unpaid	Risk Aggregator
Consumer Credit	500,000	50,000	10.0%	1.25
Deposit-Taking	250,000	2,000	0.8%	1.00
Derivatives Dealer	350,000	100,000	28.6%	1.75
Financial Technology	1,100,000	225,000	20.5%	1.50
Funds Management	440,000	40,000	9.1%	1.25
Housing Finance	850,000	75,000	8.8%	1.25
Investments	2,500,000	700,000	28.0%	1.75
Life Insurance	400,000	50,000	12.5%	1.25
Motor Vehicle Insurance	600,000	50,000	8.3%	1.25
Personal Financial Advice	1,250,000	500,000	40.0%	2.00
Superannuation	750,000	10,000	1.3%	1.00

We have created a hypothetical risk aggregator which is dependent on the proportion of awards for compensation which remain unpaid. Financial service classes with a higher percentage of unpaid awards are assigned a higher risk aggregator to reflect the riskier nature of that financial service class. The numbers for this risk aggregator are again fictitious.

Risk Aggregator Data

Percentage of Determinations Unpaid:	Applicable Risk Aggregate:
0.00 - 5.00%	1.00
5.00 - 15.00%	1.25
15.00 - 25.00%	1.50
25.00 - 35.00%	1.75
35.00% +	2.00

Following the collection of each firm's gross profit, the market size of the industry and each firm's relative market size can be derived. Each firm's original gross profit is uplifted by its risk aggregator to arrive at a revised profit figure. Using these revised profit figures, which now account for risk, each firm's market share is recalculated. Financial firms are then required to contribute to

the CSLR in line with their revised market share, which has been adjusted to account for the relative riskiness of the financials service(s) the firm offers.

Hypothetical Data:

Firm	Financial Service Class	Gross Profit ($m)	Market Share	Aggregator	Revised Profit	Revised Market Share
Firm 1	Personal Financial Advice	2.5	0.63%	2.00	5.000	0.99%
Firm 2	Investments	5.0	1.25%	1.75	8.750	1.73%
Firm 3	Personal Financial Advice	5.0	1.25%	2.00	10.000	1.98%
Firm 4	Consumer Credit	7.5	1.88%	1.25	9.375	1.85%
Firm 5	Investments	10.0	2.50%	1.75	17.500	3.46%
Firm 6	Investments	10.0	2.50%	1.75	17.500	3.46%
Firm 7	Life Insurance	10.0	2.50%	1.25	12.500	2.47%
Firm 8	Motor Vehicle Insurance	12.5	3.13%	1.25	15.625	3.09%
Firm 9	Consumer Credit	15.0	3.75%	1.25	18.750	3.70%
Firm 10	Consumer Credit	15.0	3.75%	1.25	18.750	3.70%
Firm 11	Derivatives Dealer	15.0	3.75%	1.75	26.250	5.19%
Firm 12	Life Insurance	20.0	5.00%	1.25	25.000	4.94%
Firm 13	Consumer Credit	25.0	6.25%	1.25	31.250	6.17%
Firm 14	Housing Finance	27.5	6.88%	1.25	34.375	6.79%
Firm 15	Deposit-Taking	30.0	7.50%	1.00	30.000	5.93%
Firm 16	Housing Finance	32.5	8.13%	1.25	40.625	8.02%
Firm 17	Superannuation	32.5	8.13%	1.00	32.500	6.42%
Firm 18	Financial Technology	35.0	8.75%	1.50	52.500	10.37%
Firm 19	Funds Management	40.0	10.00%	1.25	50.000	9.88%
Firm 20	Deposit-Taking	50.0	12.50%	1.00	50.000	9.88%
Total:		**400.0**	**100.00%**		**506.25**	**100.00%**

Q10) How should the funding model address unexpected costs?

We consider that establishing a capital base in line with the method outlined in the Treasury Consultation paper is a superior approach to collecting additional ad-hoc levies as required.

Establishing a capital base, although enforcing financial firms to contribute to a capital base which may not be utilised for some time (if at all), will allow the CSLR to respond effectively and quickly to unexpected costs and reduce the volatility of levies payable by financial firms. Collecting additional funding from firms as required may create a situation where firms are not in a position to meet the additional requests for funding. Having a capital base will result in a better outcome for consumers, for whom the CSLR is being implemented for.

Q11) Is it better to avoid levy volatility or funds being tied up in a capital base that may not be often used?

We consider that it is a better outcome for funds to be tied up in a capital base that may not often be used.

- Although FSPs will be required to contribute funding to a capital base that may never be used, firms will be able to better predict and account for the levies they

must pay each year. Establishing this capital base will mitigate, at least to some degree, the volatility in levy cost for FSP's each year.

- The existence of the capital base will reduce the likelihood that additional fundraising will be required by the CSLR and will minimise the administrative costs associated with such.
- The existence of the capital base will ensure that the CSLR will, generally, have sufficient funding to meet the claims of consumers in a timely manner, and without the need to delay payment of claims in order for the CSLR to raise additional funding.

Q12) If a CSLR capital base is to be established, what is a suitable minimum capital requirement?

A suitable minimum capital requirement will be best derived after reviewing the relevant data regarding unpaid determinations. Without access to this data, it is hard to provide other than an arbitrary figure.

Notwithstanding the above, we consider that the $10 million figure suggested in the Treasury Consultation paper is **grossly inadequate.** To illustrate, the collapse of a funds' management company or Responsible Entity of a managed investment scheme would create massive losses for the underlying consumers, potentially in the hundreds of millions. Having collapsed, the FSP would be in no position to compensate consumers and the CSLR will be required to step in. Although this situation is unlikely, that is precisely what constitutes an unexpected cost.

The collapse of such an FSP would result in significant losses for consumers for which the FSP would be unable to compensate. This is where the CSLR is expected to step in, however sufficient funding is required in order to so. In order to ensure the CSLR is able to perform its function at all times, the minimum capital base should be sufficiently large enough to satisfy claims against the largest FSP's.

Q13) If levies are to be collected after the CSLR becomes aware of unexpected additional costs, how will financial firms manage this?

If levies are to be collected by the CSLR due to higher than expected costs, firms must be given adequate notice that an additional levy will be charged. It would be undesirable if the collection of additional levies was to force some FSP's into undue financial hardship.

An alternative approach could be, in the event that the CSLR needs to raise additional unexpected costs, the CSLR could inform financial firms that an additional levy would be required and give them a period of time to make said payment. During this period of time, the CSLR could borrow the necessary funding to meet the additional costs. As firms begin to make the additional levy payment, the CSLR can repay their borrowings. Firms which make their additional levy payment in a timely manner should pay comparatively less than firms which take a long time to make this payment (i.e. interest paid by the CSLR should be passed onto FSP's). This approach would allow FSP's sufficient time to manage their additional costs without prejudicing the consumers requiring funds.

Another alternative approach could be to get FSP's to contribute to an annual insurance cover for the CSLR, additional to their annual levy payments. The insurance cover would be used in the event the CSLR had higher than unexpected costs in a given year and would mitigate the need for additional levying. Additionally, the payment of an insurance premium by each firm would reduce volatility and uncertainty about the level of the payment required, as the insurance premiums charged to each firm would be a relatively predictable figure.

Q14) Should a maximum cap apply to the annual levies that can be imposed on participating financial firms?

A cap should be applied to the annual levies that can be imposed on financial firms, so that financial firms may have an element of certainty as to their maximum potential exposure to the CSLR. It would be undesirable if high levy costs were to have an undue impact on the industry, such as substantially lessening the competition amongst financial firms.

However, it is also noted that the CSLR exists as a mechanism to compensate consumers and not as a mechanism to minimise costs for financial firms. The primary function is to compensate consumers, while costs to financial firms should be minimised wherever possible. Consumers interests are to be given priority to the interests of financial firms at all times.

It may be appropriate for the CSLR to impose a maximum levy cap at a level that is unlikely to be reached. In the event that multiple large failures were to occur in a short period of time, it may be appropriate for the Government to step in and assist the CSLR in compensating consumers for these losses.

Q15) If a maximum cap is imposed, what is an appropriate metric for this cap (for example, gross revenue from covered financial services)?

Net profit would seem to be an appropriate metric for this cap, to ensure that the levy does not render a profitable firm, unprofitable. However, as those in the financial services industry are aware, metrics such as net profit can be 'malleable' to a degree, which may cause issues as firms present themselves as less profitable in order to minimise the CSLR expenses.

Q16) If a maximum cap is imposed, what should the maximum cap be?

A suitable maximum cap will be best derived after reviewing the relevant data regarding the CSLR's required level of funding and the financial information of FSP's. Without access to this data, it is difficult to provide anything other than an arbitrary figure.

Should the metric for this cap be net profit, it would seem appropriate that the maximum amount the CSLR could levy from an FSP should not exceed 100% of net profit.

Q17) If a maximum cap is imposed, what mechanisms should the CSLR have to avoid going into deficit (for example, an ability to raise further levies from financial firms that are yet to reach the maximum cap and/or to further limit compensation so that expenditure is kept under the effective annual maximum for the scheme)?

The suggestions outlined in question 13 should be applied to prevent the CSLR going into deficit.

Compensation to be Paid

Q18) How should compensation limits be used by the CSLR to balance the interests of consumers and those funding the scheme?

The primary function of the CSLR is to compensate consumers who are unable to receive compensation from the financial firm which owes it to them. The purpose of the CSLR is not to ensure that it is affordable for the financial firms which fund it. This is a secondary consideration. The interests of consumers should, at all relevant times, take priority to the interests of financial firms.

The CSLR should have compensation limits established in line with the compensation limits applied by AFCA. Aligning the compensation limits of the CSLR and AFCA will minimise complexity of the scheme and assist ease of interpretation for all stakeholders. This ensures that a consumer who receives an unpaid determination from AFCA can reasonably expect to receive the full amount owed to them from the CSLR and will not be disadvantaged by the insolvency of the perpetrating firm. This is an important aspect because the solvency (or lack thereof) of a perpetrating firm is beyond the control of the consumer and such a consumer should not be disadvantaged.

Q19) If the CSLR compensation limits are to be lower than AFCA's claim limits, what limit would be appropriate?

The appropriate CSLR compensation limit is in line with the AFCA claim limits and we do not consider implementing a CSLR limit lower than the AFCA claim limit to be appropriate.

Q20) How should the CSLR manage claims associated with large unexpected failures?

The CSLR should have the ability to spread compensation payments over time in order to manage large unexpected failures.

The viability and the sustainability of the CSLR is a highly important consideration and there is no benefit to any parties if all funds are exhausted before all consumers have been paid the requisite compensation. Accordingly, it is appropriate that, in the event of a large, unexpected failure, the CSLR be given the ability to spread compensation payments over a period of time, within reason.

Further, while spreading payments, the CSLR should also be allowed to exercise discretion in assisting consumers experiencing hardship by making such payments over a single or smaller number of instalments.

As a representative of approximately 5,000 financial service misconduct victims, we are highly confident that for the vast majority of consumers, receiving an initial compensatory payment followed by further instalments of compensation would be an acceptable outcome in the event of a large unexpected failure.

Q21) Should the CSLR be able to spread compensation payments over time and, if so, what would an appropriate maximum time period be?

Yes, the CSLR should be able to spread compensation payments over time. How the spreading of payments is performed in practice will depend on the size of any large unexpected failures and the level of funds available to the CSLR.

An appropriate maximum time period would be five (5) years. A five-year payment period allows the CSLR to make payments in instalments as low as 20% of the total compensation amount. Anything exceeding five years would be excessively long and may result in undue hardship and other unintended consequences.

Hypothetical Payment Structure 1		Hypothetical Payment Structure 2	
Year:	**Compensation Paid:**	**Year:**	**Compensation Paid:**
Year 1:	50.0	Year 1:	20.0%
Year 2:	12.5	Year 2:	20.0%
Year 3:	12.5	Year 3:	20.0%
Year 4:	12.5	Year 4:	20.0%
Year 5:	12.5	Year 5:	20.0%
Total:	**100.0%**	**Total:**	**100.0%**

Q22) Should the CSLR be able to impose an additional compensation limit to unpaid determinations associated with a single specific large failure and, if so, what would an appropriate limit be?

No, the CSLR should not be able to impose additional compensation limits on single specific large failures. This is an inequitable situation whereby some consumers have compensation limits placed upon them while others do not due to circumstances beyond their control. In the event of a large single failure, arrangements should be made in order to satisfy the claims. As outlined in the Funding section of this submission, this could be through the existence of an insurance policy, the borrowing of additional funds, and/or the raising of additional funding through supplementary levies.

Q23) How should compensation for legal and professional costs be limited?

It is appropriate to apply a standardised cap to the level of legal and professional costs which can be claimed for under the CSLR. This will prevent the unnecessary incurrence of legal and professional costs by a consumer and manage the level of funding required to be paid by financial firms for conduct which is not their own.

There appears to be no issue with following the recommendations of the Ramsay Review regarding litigation funding. We agree with the Panel that only consumers and small business should be allowed to access the CSLR. We also agree that, once a consumer has accessed the CSLR, they should be allowed to use their compensation or part thereof to honour any litigation funding agreement they entered into prior to receiving compensation. On principle, consumers must be allowed to deal with their compensation monies as they please once they have received them.

A counter-argument is that consumers who incur professional and legal costs in the course of their recovery process and are ultimately compensated by the CSLR will receive compensation for their costs additional to their financial losses, while a consumer who incurs costs as a result of litigation funding will be required to pay their own costs out of their compensation. This however is a choice made by the consumer which must be borne by the consumer.

It is also noted that, for the initial three years of the CSLR's operation, the CSLR will only compensate consumers with AFCA determinations, and court and tribunal determinations for compensation will be implemented three years after the CSLR is established. This three-year period is to ascertain a greater understanding of how court and tribunal determinations will affect the CSLR. It is important that, as the CSLR progresses and more information about these court and tribunal

determinations will work in respect of the CSLR, that changes are made to the CSLR as required in order to ensure that the scheme works efficiently.

Ultimately, we consider that the most appropriate method of limiting legal and professional costs is to apply a standardised compensation limit similar to that applied by AFCA. However, we consider that the AFCA compensation limit of $5,000 is insufficient, as legal and professional costs are generally high. We suggest that the compensation limit be raised to $10,000, to be paid for "reasonable professional and legal costs incurred". Reasonable costs should be defined as:

- Costs incurred specifically for the purpose of seeking redress;
- Costs for which the consumer has sought to minimise, where possible; and
- Costs which are consistent with what a reasonable person would incur in the conduct of the same recovery action.

Managing Scheme Evolution

Q24) What aspects of the design and operation of the CSLR should be determined by the CSLR and what aspects should be prescribed in legislation?

The Treasury consultation paper notes that while there is some historic data available on unpaid determinations, ultimately this data is not exhaustive and a full understanding of the CSLR operation will only be acquired once the scheme has been established. Due to this, it would be imprudent to legislate too many aspects of the CSLR before a greater understanding of the CSLR has been acquired. Further, to preserve flexibility of the CSLR and ensure its adaptability, it may never be prudent to fully legislate the operations of the CSLR.

A fully legislated scheme would be a highly transparent one, as participants are aware of the scheme's operations at all times with infrequent change. However, transparency can be achieved without legislating all aspects of the CSLR, through thorough communication and a concentrated effort to ensure that any changes to the scheme are effectively communicated to all stakeholders.

The approach taken by AFCA as outlined in the Treasury paper is an appropriate framework for the CSLR to follow. This approach will allow the CSLR to respond effectively to changes in the market, industry and legislation with relative ease and efficiency. As with AFCA, Government and regulatory oversight of the scheme will ensure that the CSLR's operations remain consistent with the key objectives of the scheme as detailed in the legislation.

Other Issues

Predecessor Schemes

There is a significant dichotomy between the current AFCA Rules and the Terms of Reference (ToR) of AFCA's predecessor EDR providers. The division between the operating guidelines of the current and historical EDR schemes has created significant inequity resulting in many victims 'falling between the cracks' and risks creating a dysfunctional compensation scheme if the issues which currently exist are not promptly rectified.

Under the FOS ToR, disputes between an FSP and a consumer were closed if the FSP entered liquidation. For a consumer, this means even though the complaint was lodged while the company was active, the case was closed prior to a determination being reached. As the consumer did not receive a determination, the consumer is not eligible for Government compensation for unpaid determinations. As the FSP entered liquidation prior to AFCA's establishment, the FSP is not an AFCA member and the consumer therefore cannot have their complaint considered through AFCA.

The situation this creates is that the consumer has never had their complaint considered, and unless changes are made, will never have that opportunity in the future. The practical consequences are such that the consumer has never had realistic opportunity at obtaining redress to date, and unless changes are made, will not have that opportunity in the future.

Under the current AFCA Rules, active disputes between an FSP and a consumer remain open should the FSP enter liquidation. Additionally, the FOS ToR precluded any dispute exceeding $500,000 in value from FOS consideration, whereas AFCA can consider complaints valued up to $1 million.

Illustration – Anquan Securities & Investments Pty Ltd (In Liquidation)

The severity of the inequity created by this dichotomy is illustrated by the victims of Anquan Securities & Investments Pty Ltd (In Liquidation)("Anquan"). SR Group represents 13 Anquan victims.

In early 2018, the SR Group lodged disputes with FOS on behalf of 13 Anquan victims. FOS closed two claims on the basis that the claim values exceeded $500,000, meaning FOS was unable to consider the disputes. Each of these rejected claims is between $500,000 and $1 million, meaning the claims would be eligible for consideration under the current AFCA Rules.

Of the remaining 11 Anquan disputes lodged with FOS, three received positive determinations for compensation. Each of the successful applicants received determinations that awarded them compensation for the entire amount invested through Anquan, plus interest.

Following these positive determinations, Anquan entered administration, and subsequently liquidation. The remaining eight Anquan disputes, although lodged at the same time as the above referenced disputes which received favourable determinations, had not yet received a FOS determination. Under the FOS ToR, these claims were then closed, without a determination being handed down by FOS.

The three successful complainants were awarded compensation on the grounds that Anquan was operating an unlawful, unregistered, managed investment scheme. FOS also adjudicated that Anquan had misled the complainants as information contained in the Information Memorandum issued to scheme members was misleading and deceptive.

The grounds for FOS to award compensation to the three successful complainants apply fully to the remaining complainants. Each of the remaining complainants was a member of the same unlawful managed investment scheme. Similarly, each of the remaining complainants also relied on the misleading Information Memorandum.

Clearly, the unsuccessful complainants were excluded from FOS due to administrative and timing issues beyond the control of the complainant. The division between the ToR of the current and previous EDR providers and their interaction with the CSLR has created an inequitable situation whereby consumers are being excluded from accessing redress due to the **timing** of their complaint rather than the **circumstances** of their complaint.

We are unsure how to illustrate the inequity in this situation any clearer. It appears incomprehensible that any compensation scheme would find this outcome acceptable. To allow such situations of clear inequity is to undermine the integrity and purpose of the CSLR.

Complaint	Complaint Lodged	Outcome of Complaint	Reasoning for Outcome	Outcome Received
1	5/02/2018	**Claim excluded from FOS consideration.**	Claim value exceeded $500,000 threshold[1].	18/05/2018
2	6/03/2018	**Claim excluded from FOS consideration.**	Claim value exceeded $500,000 threshold[2].	8/06/2018
3	5/02/2018	**FSP must compensate the consumer.**	FSP was operating an unlawful scheme.	06/07/2018
4	5/02/2018	**FSP must compensate the consumer.**	FSP was operating an unlawful scheme.	06/07/2018
5	5/02/2018	**FSP must compensate the consumer.**	FSP was operating an unlawful scheme.	24/08/2018
6	5/02/2018	**Claim excluded from FOS consideration.**	FSP entered liquidation on 20/08/2018.	27/08/2018
7	5/02/2018	**Claim excluded from FOS consideration.**	FSP entered liquidation on 20/08/2018.	27/08/2018
8	5/02/2018	**Claim excluded from FOS consideration.**	FSP entered liquidation on 20/08/2018.	27/08/2018
9	5/02/2018	**Claim excluded from FOS consideration.**	FSP entered liquidation on 20/08/2018.	27/08/2018
10	5/02/2018	**Claim excluded from FOS consideration.**	FSP entered liquidation on 20/08/2018.	27/08/2018
11	5/02/2018	**Claim excluded from FOS consideration.**	FSP entered liquidation on 20/08/2018.	27/08/2018
12	5/02/2018	**Claim excluded from FOS consideration.**	FSP entered liquidation on 20/08/2018.	27/08/2018
13	5/02/2018	**Claim excluded from FOS consideration.**	FSP entered liquidation on 20/08/2018.	27/08/2018

[1] Total Claim Value = $517,181.10.
[2] Total Claim Value = $508,769.73.

Unpaid Determinations – Court & Tribunal Awards for Compensation

The findings of the Panel and Royal Commission have been somewhat overlooked regarding the payment of historical unpaid determinations. In the Final Report of the Royal Commission, Commissioner Hayne wrote:

> *"Cases in which redress has been directed or ordered but not paid stand apart from all other cases of redress for past disputes. Where a claimant has not been paid the amount that an EDR body (or court) found should be paid, the central issue becomes whether Government or industry should now pay what was owing" (Final Report, page 487)*

Plainly, Commission Hayne has grouped past determinations for compensation from both EDR providers and courts together. Similarly, the CSLR will compensate future consumers who receive awards for compensation from both EDR providers and courts.

Following the FSRC, the Government announced that it will compensate consumers who have previously received an award for compensation but have not been compensated to date. However, the Government has stated it will compensate consumers who received such an award from an EDR provider only. The Government has not announced any intention to compensate consumers who have received an award for compensation from a court or tribunal, even though these are more legally binding adjudication bodies than a now defunct EDR body.

In order to ensure equity and comparability of outcomes for consumers who are awarded compensation by a court or tribunal, retrospective compensation should be paid to consumers who have an eligible court or tribunal compensation award. An eligible court or tribunal compensation award is defined as one in which the circumstances giving rise to the claim would have been eligible for consideration under AFCA.

Providing Access to Redress for Past Disputes

The CSLR discussion paper, and the Government in general, have neglected key aspects of the findings of the Panel in the Ramsay Review, in respect of providing access to redress for past disputes which have not previously been considered.

As part of the ToR of the Ramsay Review, the Panel was asked to consider the merits and issues involved in providing access to redress for past disputes. The Panel was asked not to make recommendations on this area. The findings of the Panel were that there is substantial merit in providing access to redress for past disputes. The Panel also noted that there are a number of complexities which make providing such access to redress somewhat challenging.

Obviously, the CSLR as currently proposed will not provide consumers with access to redress for past disputes. While some aspects of the Ramsay Review have been addressed by the establishment of the CSLR, this section remains unaddressed and a significant issue for large number of consumers.

The Panel notes:

> *"The Panel's view, with regard to the Review Principles and the submissions received, is that there is merit in considering providing access to redress in the following circumstances, where at the time of the dispute:*
>
> - *the financial firm was no longer operating, having ceased trading or, become insolvent or being otherwise uncontactable or unable to pay;*

- *the financial firm was not a member an EDR body, because it was either trading while unlicensed or had been expelled by an EDR body;*
- *the monetary value of the dispute exceeded the EDR body's monetary limits and the consumer or small business lacked the resources to access the courts, tribunal or other dispute resolution bodies; and/or*
- *the consumer or small business was not in a position to pursue their dispute with the EDR body due to exceptional circumstances. (Ramsay Review para 49)"*

The Panel continues on to state that although the access to redress is merited and important, there are complexities which exist surrounding the quantification of compensation required and the funding of such redress. Ultimately, the Panel concluded that:

> *"The Panel noted that access to redress is critical. If consumers and small businesses are unable to access redress for past disputes, this can lead to severe financial hardship and, more broadly, subsequent loss of trust and confidence in the EDR framework and the financial system" (Ramsay Review para 39).*

As noted by the Panel, access to redress for past disputes is critical and the unavailability of such can lead to severe financial hardship. This is precisely why the impetus for establishing a mechanism for consumers to access redress for past disputes is so high. This aspect of the Ramsay Review, although perhaps the most challenging to address and implement, is of paramount importance and subject to significant time pressure. The SR Group has prepared a proposal to address this section of the Ramsay Review which has been included as an attachment.

Further information regarding this submission and its contents can be obtained by contacting Mali De Castro of the SR Group. By email: mdecastro@srgroup.com.au.