SUBMISSION

Submission to Treasury — Implementing Royal Commission Recommendation 7.1: *Establishing a Compensation Scheme of Last Resort*

11 February 2020

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File: 2020/06

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Financial Sector Reform Taskforce

The Treasury

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PARKES ACT 2600

Via email: CSLR@treasury.gov.au

11 February 2020

Dear Sir/Madam

Discussion Paper: Implementing Royal Commission Recommendation 7.1 — Establishing a Compensation Scheme of Last Resort

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the discussion paper *Implementing Royal Commission Recommendation 7.1 — Establishing a Compensation Scheme of Last Resort* (discussion paper).

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its $2.9 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing almost 90 per cent of the 16 million Australians with superannuation.

If you have any queries or comments in relation to the content of our submission, please contact me on (02) 8079 0808 or by email gmccrea@superannuation.asn.au, or Julia Stannard, Senior Policy Advisor, on (03) 9225 4027 or by email jstannard@superannuation.asn.au. We would welcome the opportunity to discuss our submission and look forward to engaging with you throughout the process to establish the compensation scheme.

Yours sincerely

Glen McCrea
Deputy Chief Executive Officer and Chief Policy Officer

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A. Executive summary

ASFA agrees that consumer confidence in financial services is adversely impacted when a consumer does not receive the compensation due to them in relation to a dispute with their provider, and we are sympathetic to the plight of consumers who have been unable to obtain payment of compensation to which they are entitled. Appropriate arrangements are needed to deal with such cases.

However, in ASFA's view, basic considerations of equity require the cost of funding unpaid compensation to be substantially borne by the (sub)sectors of the industry that have generated that liability.

As identified by the 'Ramsay Review' of the financial services external dispute resolution (EDR) system[1], and acknowledged in the current discussion paper, the overwhelming majority of unpaid determinations relate to financial advice, with evidence of some unpaid compensation from the investment and credit sectors. It primarily appears the concerns relate to financial firms or financial services that are not prudentially regulated.

ASFA continues to have significant concerns regarding a 'broad-coverage' compensation scheme of last resort (CSLR), that would encompass all services provided by all financial firms that are required to be members of the Australian Financial Complaints Authority (AFCA)—including prudentially regulated superannuation services.

We consider that the CSLR should, at inception, be limited to those sub-sectors and services where there has been evidence of substantial uncompensated losses. We further consider that the scheme's coverage of advice services should be limited to *personal* financial advice. Given its nature, *general* financial advice does not give rise to claims by consumers.

Financial firms that provide covered services should have a liability to contribute to the scheme. However, that contribution should reflect the extent of their engagement in covered services and their regulated status—that is, whether they are prudentially-regulated or not. The levy methodology should not be based on a firm's scale/funds under management/'ability to pay'.

The APRA-regulated superannuation sector has not generated any of the historic unpaid determinations—there is no evidence that any determination made against an APRA-regulated fund has remained unpaid. The sector operates under prudential regulation and extensive legislative constraint—including the obligation to act in the best interests of members. Superannuation funds have substantial assets and even in cases of fraud or theft there are legislated arrangements to replenish assets through a sector-funded compensation scheme. Taking these factors into account, prior reviews into the need for a CSLR have accepted that it would be rare for an APRA-regulated superannuation fund to be unable to pay its obligations[2].

Despite this, the models contemplated in the discussion paper have the potential to include the APRA-regulated superannuation sector in a CSLR in a way that could result in it bearing an inequitable share of the burden of compensating consumers for failures that have occurred in other sectors of the financial system.

ASFA maintains our long-standing view that the appropriate model for any CSLR is one that avoids cross-subsidisation by the APRA-regulated superannuation sector of losses incurred within other sectors, or in relation to financial services that are not provided by the APRA-regulated superannuation sector.

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[1] Review of the financial system external dispute resolution and complaints framework, *Supplementary Final Report*, September 2017, para 2.44-2.45

[2] Richard St John, *Compensation arrangements for consumers of financial services*, April 2012, para 6.51; Review of the financial system external dispute resolution framework: *Consultation on the establishment, merits and potential design of a compensation scheme of last resort and the merits and issues associated with providing access to redress for past disputes - Supplementary Issues Paper*, May 2017 (Supplementary Issues Paper), para 122

However, we also recognise that the existence of the CSLR is likely to strengthen confidence in the industry overall. Reflecting this, we acknowledge that it might be appropriate for all sectors to contribute, *on a reasonable and capped basis,* toward the scheme's ongoing administration costs, its 'business as usual' annual compensation payments and a modest capital reserve to provide a buffer for those costs.

Compensation payable by the scheme for any large failures must, in ASFA's view, be funded by the (sub)sector(s) in which those events occurred and must not be spread more broadly across the industry. Equally, there is no expectation that financial firms outside the APRA-regulated superannuation sector should contribute to any compensation paid under the sector's existing compensation scheme in regard to fraud or theft.

ASFA also recognises the need for simplicity and for easily collected and auditable data to support a levy. On both equity and efficiency grounds, charging a uniform levy amount—say, for example, $1,000 per AFCA member per year—would be a workable approach.

B. General comments

ASFA agrees that it is vital to maintain consumer confidence in the financial services industry. Inevitably, that confidence is diminished when a consumer does not receive the compensation due to them in relation to a dispute with their provider.

While we are sympathetic to the plight of consumers who have been unable to obtain payment of compensation to which they are entitled, it is vital to recognise that the issue of unpaid compensation is not widespread across the industry—it is limited to particular sectors, most notably the financial advice sector. Any implication that the issues are wider spread has the potential to impact consumer confidence in the industry overall.

The potential introduction of a CSLR has been actively debated in Australia over the last decade, most notably through reviews by Mr Richard St John in 2011-12 and by the 'Ramsay Review' of the financial services external dispute resolution framework in 2017. The recommendations from the latter review were endorsed in 2019 in the final report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

ASFA agrees that there is a need to settle this matter, to provide certainty to both consumers and financial firms. We welcome the current consultation process and appreciated the opportunity to participate in recent stakeholder meetings including representatives of the Treasury and Australian Government Actuary.

It is critical to ensure that any scheme introduced into the Australian financial system is appropriate. This requires, at a minimum, careful consideration of the services and types of financial firms that should be within its scope, the manner in which it is funded, how it interacts with existing compensation regimes, its governance/structure, and the extent to which the Government continues to provide some element of support. The discussion paper is at a very high level, with many conceptual details regarding the CSLR model yet to be resolved, and accordingly ASFA has addressed the specific consultation questions only in broad terms.

We strongly encourage Treasury to continue to actively engage with stakeholders as it considers responses to this discussion paper and develops its proposals, including by releasing modelling of the potential liability under the model(s) identified for further development and, ultimately the model adopted.

C. Coverage of the scheme

C.1 What services and financial firms should be covered?

ASFA acknowledges that historic data as to the number, value, and source of unpaid determinations does not fully represent the likely future experience, as claims that would not have proceeded in the past—for example due to the insolvency of the financial services provider—will in future be heard by AFCA. However, that past experience provides the only data from which stakeholders can draw insight as to the potential future liability under the CSLR.

Stakeholders have been provided, as part of this consultation process, with only limited data in relation to the number and/or value of unpaid determinations. However, it has been indicated that the highest contributor to unpaid determinations is financial advice—around 70 per cent of the total value of unpaid determinations—with a significant portion arising from investments (such as managed investment schemes) and a lower portion from the provision of credit. This is consistent with the findings of the 'Ramsay Review' of the financial system external dispute resolution framework.

The experience of the APRA-regulated superannuation sector, in respect of payment of determinations by AFCA and its predecessor scheme the Superannuation Complaints Tribunal (SCT), is quite different. AFCA has confirmed that, since its commencement on 1 November 2018, no determination issued against an APRA-regulated superannuation fund has remained unpaid and, as noted by the Ramsay Review:

> In the case of superannuation disputes, as at 2 May 2017, **the SCT had no outstanding unpaid determinations**. This is due to the nature of prudential regulation in the superannuation system, which means it would be **rare for a superannuation fund to be unable to pay its obligations**.[3]

ASFA concurs with this assessment. Trustees of APRA-regulated superannuation funds are subject to extensive legislative and prudential requirements as well as overarching fiduciary duties designed to ensure that funds are operated in the best interests of members. 'Phoenix' behaviour, which has been observed within the broader financial advice sector, has not been a concern in the APRA-regulated superannuation sector and is unlikely, given the substantial regulatory barriers to securing registrable superannuation entity licensee status.

ASFA considers that there is **no evidence** to support a need for the 'broad-coverage' approach outlined in the discussion paper, that would include provision of prudentially regulated services, including APRA-regulated superannuation. This is particularly the case given the existence of the existing, sector-funded compensation scheme that applies where an APRA-regulated fund's ability to pay benefits is impacted by fraud or theft — see section C.2 below.

ASFA endorses the conclusion reached by the Ramsay Review that the CSLR should initially be targeted to those areas where there is significant evidence of uncompensated losses. As noted in the discussion paper, this would include financial advice, investment and credit. In relation to advice, ASFA further considers the CSLR should be limited to uncompensated losses arising from the provision of **personal** financial advice, as we do not consider the evidence supports its extension to general advice.

[3] Ibid., paragraph 122

Any future extension of the CSLR model beyond these sectors/services would, in ASFA's view, only be appropriate where there is compelling evidence of uncompensated losses. We recommend that, as soon as practicable, AFCA commences tracking of unpaid determinations. This might involve an amendment to AFCA's rules, requiring financial firms to make positive confirmation to AFCA when they have paid a determination. It should also involve AFCA actively recording details where consumers advise that their determinations have remained unpaid, even if the determination involved is not, at the time, within the scope of the CSLR. AFCA should provide a report to ASIC on an annual basis identifying the number and value of determinations that remain unpaid and a breakdown of the sub-sectors/services to which they relate.

ASFA supports the initial exclusion of unpaid court and tribunal decisions, given the lack of data available to quantify the exposure and identify the sector(s) and or class(es) of financial services to which that exposure relates. We agree that relevant unpaid court and tribunal decisions could be considered for later inclusion, once the necessary data has been collected. We recommend that the necessary data collection commences immediately upon establishment of the CSLR, so it is available to be considered when a post-implementation review of the CSLR's initial years of operation is undertaken.

ASFA has no objection to excluding voluntary members of AFCA from the scheme but recommend that there is close monitoring to identify any emerging issues in relation to the non-payment of determinations by these entities. To the extent such issues begin to emerge, it is in our view appropriate to consider whether overarching regulatory reform is required—in particular, requiring these entities and/or the services they provide—to be licensed by ASIC, prior to their potential inclusion in any CSLR.

C.2 The existing compensation scheme for superannuation is effective and should be retained

As acknowledged in the discussion paper, a compensation scheme already exists for the APRA-regulated superannuation sector.

Part 23 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) provides protection for members of a regulated superannuation fund (other than a self-managed superannuation fund) or an approved deposit fund, where there has been a loss as a result of fraudulent conduct or theft, causing substantial diminution of the fund leading to difficulties in the payment of benefits. Where an 'eligible loss' has been established, the Minister may approve a grant of financial assistance to the trustee of the impacted fund.

To date, Part 23 has been utilised only a handful of times since it was established in 1993, with levies raised to recoup grants of financial assistance that primarily relate to two main incidents of fraud or theft. These affected the members of superannuation funds formerly under the trusteeship of Commercial Nominees of Australia Limited and Trio Capital Limited. In each case, a levy was raised on all APRA-regulated funds to recoup the amount of the grant initially provided by the Government–that is, the compensation that was provided was entirely funded from within the APRA-regulated superannuation sector, with no contribution from other sectors.

ASFA is of the view that the Part 23 regime is an appropriate and effective means of providing compensation for losses due to fraud or theft within the APRA-regulated superannuation sector. We strongly support comments in the discussion paper indicating Part 23 will be retained, and that the CSLR would not pay any awarded amount that was covered by Part 23.

We note the recognition in the discussion paper that it is "unlikely there will be many circumstances where the CSLR interacts with" the existing compensation schemes such as Part 23[4] and welcome the indication that Part 23 will not be displaced.

[4] The Treasury, *Implementing Royal Commission Recommendation 7.1 — Establishing a Compensation Scheme of Last Resort, Discussion Paper* (Discussion Paper), December 2019, page 8

We acknowledge that Part 23 and the existing compensation schemes in other sectors are not all-encompassing, and there are some gaps in coverage, which it is intended that the CSLR would fill.

However, if (as we recommend) the CSLR is limited to personal advice, investments and credit, the new scheme would have a very narrow role in relation to APRA-regulated superannuation. This role would effectively be limited to a scenario in which:

- a substantial compensation liability existed in relation to determinations made against an APRA-regulated fund for defective personal advice provided under its licence
- the fund was unable to honour that liability because it was effectively insolvent.

The likelihood of this scenario arising is, in ASFA's view, extremely low.

D. Funding of the scheme

D.1 The 'costs' of the scheme and the role of a capital reserve

While stakeholders have not been provided with any modelling of potential liability under the scheme which makes use of likely administration or compensation costs, it is clear that the costs of the CSLR will involve:

(i) annual administration/operating costs — ASFA expects that these would be modest, given economies should flow from integration of some aspects with AFCA's EDR scheme

(ii) compensation-related costs in a 'typical' year — in recent stakeholder roundtables, representatives of the Treasury and the Australian Government Actuary's Office indicated that these might be in the order of $6 - $10 million per year

(iii) compensation-related costs for years in which one or more major failures has occurred — these are unquantified and unquantifiable.

The 'costs' in items (i) and (ii) above might be described as representing the scheme's 'business as usual' funding needs, and ensure that the scheme stands ready to meet 'business as usual' compensation costs that may arise in relation to unpaid determinations against firms in any sub-sector that provides services covered by the scheme.

While it will be necessary to set an appropriate threshold, the costs in item (iii) might be described as relating to 'large failures'. We consider these should arise only in extraordinary circumstances; they do not represent the 'business as usual' operation of the industry or the scheme. Given the unquantifiable exposure they represent, we consider it critical that these large failures are treated quite separately when considering what contribution might reasonably be expected from financial firms.

The discussion paper questions whether the CSLR should hold a capital reserve. ASFA is of the view it would be appropriate for the scheme to hold a **modest** capital base for the purpose of smoothing volatility in its 'business as usual' costs on a year to year basis. Significant volatility in the annual levies charged to fund the CSLR from year to year should be minimised to the extent possible, to provide certainty to the levied population.

The capital reserve should be progressively funded, over three to five years, to a level that represents two years' worth of 'business as usual' anticipated CSLR claims, then maintained at that level. This modest capital reserve should, in ASFA's view, be funded through an increment to the annual levy, paid by all financial firms that provide services covered by the scheme.

ASFA would not be supportive of the scheme holding a substantial industry-funded capital buffer. This might involve a significant amount of monies effectively being withdrawn from the financial system and tied up in a pool that may not ultimately be used, and has the potential to appreciably impact on the returns derived by the customers and members of the financial firms called upon to fund that reserve. If it is considered necessary to hold more than two years' worth of 'business as usual' costs as a buffer, we are of the view the Government would need to play a role in funding that reserve.

The capital reserve should not be utilised to address large failures. We have considered issues in relation to 'large failures' at section D.3 below.

D.2 Who should fund the 'costs' of the scheme, and on what basis?

Establishing an equitable funding base for any compensation scheme is inherently difficult however it is critical to ensure the CSLR does not impose an inequitable burden on those financial firms that have not contributed and will not contribute to the issue of unpaid compensation—or, indirectly, to their customers/members.

ASFA is of the view that a contribution toward the 'business as usual' costs of the CSLR could be viewed—in a very loose sense—as akin to participation in a group insurance policy covering the risk that a financial firm is unable to honour determinations made against it. The reality is that the overwhelming majority of financial firms in the industry will never generate an unpaid determination and accordingly their customers/members would never derive any benefit from this 'insurance'.

ASFA strongly believes that this assessment is particularly relevant for the APRA-regulated superannuation sector. If participation in the CSLR were based purely on the likelihood that a particular financial firm (or the sub-sector in which it operates) will generate unpaid determinations which fall to be compensated from the scheme, there is in ASFA's view no justification to include the APRA-regulated superannuation sector. We consider that there are ample grounds to support the exclusion of APRA-regulated superannuation from the CSLR.

However, we acknowledge that the Government has expressed a strong preference for ensuring the scheme has broad financial support and some stakeholders are strongly of the view that all financial firms should contribute to the scheme in some way, in order to foster confidence in the industry.

ASFA considers that if the Government resolves to proceed with a CSLR that requires ex ante funding of the scheme's costs and seeks to spread the funding contribution beyond the sub-sectors contributing to the compensation liability, this should be both reasonable and capped. In particular, it should be limited to the 'business as usual' costs of the scheme and must not extend to compensation payable in relation to large failures.

With regard to the basis on which any contribution to 'business as usual' costs should be charged, ASFA is of the view that optimally an equitable levy model would incorporate both risk-based and activity-based metrics. In our view, it should reflect:

- the regulatory status of the financial firm

  Assessing risk at the individual financial firm level would be an extensive and onerous exercise. However, assessment of risk only at the sector or financial service class level is overly simplistic and would not recognise the substantial variation in type—and risk level—of providers that may offer the same class of financial service.

  The scheme should reflect the fact that some sectors, or types of financial firms, are subject to more stringent regulatory requirements and that their risk of contributing toward a failure requiring compensation is, therefore, inherently less than that applicable to other sectors. In particular, it should be noted that:

    - trustees of APRA-regulated superannuation funds are subject to extensive legislative and prudential requirements as well as overarching fiduciary duties
    - there is no recorded case of an AFCA or SCT determination against an APRA-regulated superannuation fund remaining unpaid.
- the extent to which a financial firm participates in the delivery of services covered by the scheme

  A relevant, activity-based metric should be adopted. For example, to capture the provision of personal advice services by an APRA-regulated superannuation fund, an appropriate metric might be based on the number of statements of advice issued or the number of (full time equivalent) financial advisers employed by the fund in the provision of personal advice. The latter approach would be similar to the levy metric adopted for the ASIC industry funding model for Australian Financial Services licensees that provide personal advice to retail clients on relevant financial products.
- the relative risk of the covered services undertaken by a firm, which can be informed by:
  - ASIC's estimated regulatory/supervisory activity for particular sectors, as reflected in its industry funding model
  - complaints outcomes data reported by AFCA and granular analysis of historic unpaid determinations.

An equitable levy methodology would **not**, in ASFA's view, be based on 'ability to pay'. We consider the discussion paper's suggestion of a metric based on a financial firm's 'ability to pay'–essentially, a synonym for scale—to be inappropriate. The risk that a 'large' financial firm will be unable to pay determinations to consumers is significantly less than for a 'small' firm, yet a heavy weighting on 'ability to pay' will result in large firms bearing an inequitable share of the costs of the CSLR.

In particular, it is important to note that a superannuation fund's funds under management (FUM) or scale represents retirement savings held in trust for its members. Assuming the 'broad-coverage' CSLR model is not adopted and the scheme does not cover prudentially regulated superannuation services, a fund's FUM will not hold any direct or indirect relationship to the provision of services covered by the CSLR. For example, an APRA-regulated fund might hold $10 billion in funds under management, but the volume and value of personal advice services it provides might be tiny in comparison.

However, we recognise there are concerns regarding the:

- relatively modest estimated 'business as usual' funding needs;
- completeness/suitability of the currently available data to support a sophisticated levy methodology;
- cost-benefit outcomes of undertaking extensive data collection; and
- lead-time to implement any new data collection.

On this basis, another option would be to adopt a simplified levy model in the initial years of the CSLR, with:

- a flat levy—for example, of say $1,000 per year per AFCA member that provides services covered by the scheme; or
- a flat amount per year for each AFCA membership class, with the sub-sectors or classes responsible for generating the most uncompensated losses incurring a higher levy amount.

The scheme could over time move toward a more sophisticated model—encompassing the risk-based attributes noted above—if it appears appropriate, as more data is accumulated in relation to the types of activities and financial firms generating claims to the scheme.

We note that this is predicated on the estimates of ‘business as usual’ compensation costs in the range of $6 - $10 million per year as provided to stakeholders during recent roundtables with representatives of Treasury and the Australian Government Actuary’s Office. Should modelling indicate that materially higher ‘business as usual’ costs are anticipated, a flat levy would not be appropriate and ASFA is of the view it would be necessary to immediately implement an equitable risk and activity-based methodology as we have outlined above.

The liability to contribute toward the cost of unpaid compensation relating to a ‘large failure’ should be more targeted and should be imposed only on financial firms in the sub-sector(s) in which that failure occurred. The following section outlines our views in relation to large failures.

To ensure that stakeholders can be confident that the scheme is operating in a fair and transparent manner, it is critical that there is a robust, consultative process for the setting of all funding contributions to the scheme—for both ‘business as usual’ levies and those to fund ‘large failures’.

D.3 How should ‘large failures’ be treated?

ASFA considers that ‘large failures’ in a sector of the financial system, or in relation to a particular class of financial service, may occur in two relevant ways:

1. there may be a failure of a single financial firm that results in unpaid compensation above a threshold designated as ‘large’
2. there may be multiple failures of smaller firms in the same sub-sector that are responsible for unpaid determinations that, in combination, exceed the threshold designated as ‘large’.

In ASFA’s view, any discussion of ‘large failures’ must consider both scenarios, as both have the potential to impose a substantial funding burden on the CSLR, potentially threatening its sustainability. Unless handled appropriately, both scenarios also carry the substantial risk of imposing an inequitable funding burden on the financial firms that may be called upon to fund the compensation.

Given this, we consider it is **not** appropriate to treat ‘large failures’ as simply an extension of the scheme’s ‘business as usual’ operations.

While it is regrettably foreseeable that ‘large failures’ will occur from time to time, their frequency and scale, and the sectors in which they will occur is not capable of prediction with any level of accuracy. This makes it impossible, at this time, to estimate the potential exposure of particular sectors of the financial industry or of individual financial firms.

While ASFA acknowledges the need to promote confidence in the industry, we do not believe that can be achieved by spreading an unquantified but significant financial liability across sectors that have not been involved in the generation of that liability. Rather, ASFA considers it critical to ensure that the liability for funding compensation for ‘large failures’ is borne by the sub-sector(s) in which the failure occurred.

We consider it would not be inappropriate for the Government to provide the scheme’s immediate funding in respect of ‘large failures’. This cost could then be recouped ex post from financial firms in the relevant sub-sector(s), via the addition of a special increment to their annual levy in the following year or years (depending on the amount to be recouped). An effective precedent for this approach already exists, as it is the model adopted for the ‘financial assistance funding’ regime that can be invoked where an APRA-regulated superannuation fund’s ability to pay benefits is impacted by loss as a result of fraud or theft (Part 23 of the SIS Act)—see our comments at C.2 above.

E. Compensation to be paid

E.1 Compensation limits and spreading of compensation payments

ASFA considers it appropriate that the compensation limits for the CSLR are aligned with the monetary limits applicable for AFCA's EDR scheme, for both 'business as usual' claims and claims in relation to 'large failures'. This will minimise potential confusion for consumers. As noted in the discussion paper it also will, once unpaid court and tribunal decisions are brought into the scope of the CSLR, remove any incentive for consumers to pursue court or tribunal proceedings rather than seeking EDR through AFCA.

The suggestion in the discussion paper that the CSLR might apply an additional compensation limit to unpaid determinations associated with a large failure contemplates reducing the compensable amounts for all consumers impacted by the event. This would reduce the burden on the scheme, firms required to contribute to the scheme, and the customers of those firms who will ultimately fund firms' contributions to the CSLR through reduced earnings/distributions or higher fees and charges. However, it would deliver a different outcome for individual impacted consumers depending on whether a loss event is classified as 'large' or not.

In ASFA's view, this approach introduces the potential for inequity and subjectivity. We consider it would be preferable to spreading the payment of full compensation over a period of years—we would suggest a maximum of three years might be appropriate. It is important, however, that the scheme is able to expedite compensation payments to affected consumers who are in demonstrable financial hardship.

E.2 Legal and professional costs

In ASFA's view, it would be appropriate for the CSLR's rules regarding payment of compensation for legal and professional costs to be aligned with the $5,000 limit currently imposed under the Rules for AFCA's external dispute resolution (EDR) scheme[5]. We consider the recommendation of the Ramsay Review recommendation, that complainants should be permitted to recover their 'reasonable legal costs' through the CSLR, to be too subjective.

ASFA strongly agrees with the Ramsay Review recommendation that litigation funders should not be able to directly access the CSLR.

F. Managing scheme evolution

ASFA agrees that there is a trade-off between providing stakeholders with the certainty that flows from a scheme based in legislation and ensuring that the scheme is sufficiently flexible that it can evolve to reflect experience.

On balance, we are of the view that an approach similar to that adopted for AFCA's EDR scheme would be appropriate for the CSLR. This would involve:

- Legislative prescription of important aspects of the scheme—including:
    - The key principles that underpin the operation of the scheme
    - A requirement that the minister determine, via legislative instrument, the financial services covered by the scheme
    - The framework for the funding of the CSLR

[5] Australian Financial Complaints Authority (AFCA) *Complaint Resolution Scheme Rules*, 1 October 2019, Rule D.5.10

    - A requirement for the scheme to publicly and transparently report, on an annual basis, on the number and value of claims made to and paid by the scheme, including clear indication of the sub-sectors/services to which the claims relate
- ASIC oversight of the scheme's operation and performance
- Rules made by AFCA as the scheme operator, following a consultation process with stakeholders and subject to approval by ASIC.

To ensure stakeholders can be confident in the scheme's operation, clear mechanisms for accountability and transparency should be provided, including detailed reporting of all contributions collected from industry and the amounts of compensation paid.

There should also be a clear and direct obligation for the scheme operator to consider, and report to government on, any deficiencies in the regulatory framework that caused, facilitated or contributed to, the events which resulted in the payment of compensation under the scheme.

G. Other matters

G.1 Implementation timeframe

The Government has indicated its intention that the CSLR will be established by no later than December 2020. We understand that this potentially involves the scheme commencing to accept claims from 1 July 2021.

We acknowledge that the introduction of a CSLR has been under discussion for many years and understand the desire to resolve the issue and provide certainty for both consumers and financial firms. However, we note that at this point in time, the CSLR proposal remains at a very high level, with no detailed model for stakeholders to assess.

Many key aspects of the scheme remain entirely unclear. In particular, its potential coverage is unknown and so, therefore, is the potential liability that financial firms may be required to bear.

ASFA strongly urges a measured approach to implementation of the CSLR, ensuring adequate time is provided, as key decision points are reached in the consultation process, to engage with stakeholders. It is, in ASFA's view, important to ensure the necessary time is taken to ensure the details of the scheme are appropriate and that financial firms are able to gain a full and timely understanding of their potential liability.

If necessary, to achieve this ASFA would support a deferred commencement date for the scheme—potentially to 1 January 2022—with the scheme's scope still effectively back-dated to cover those determinations made by AFCA, since 1 November 2018, that relate to covered financial services and remain unpaid due to the insolvency of the financial firm.

G.2 Governance of the scheme

While ASFA has previously advocated any CSLR should be independent of government and industry and should not form part of the industry's EDR arrangements, we note the Government's decision that the scheme will be operated by AFCA.

Notwithstanding this, we maintain the view that it is critical for the EDR and compensation schemes to operate independently, as the triggering of the compensation scheme may highlight deficiencies in the EDR framework which need to be comprehensively and independently reviewed.

While we accept that efficiencies can be gained through integration of some aspects of the CSLR with AFCA's EDR scheme (particularly in terms of 'back-office' administration), we consider it important that the CSLR is independent, in terms of its function, structure and governance, from the EDR scheme.

G.3 Professional indemnity insurance

We note that issues in relation to professional indemnity insurance (PII) are to be considered outside the scope of this consultation process.

ASFA accepts that PII, as a product, is not designed to ensure the payment of compensation to customers of a policy holder and therefore should never be expected to fill the role of a CSLR. However, we do consider it important to ensure that ASIC maintains close oversight to ensure AFS licensees are meeting their current obligation to hold an appropriate level of PII in relation to the financial services activities they conduct. To the extent it appears there is an issue in relation to compliance with this obligation, ASFA would support a strengthening of licensing conditions in this respect.

G.3 An appropriate name for the scheme

During recent stakeholder roundtables, Treasury roundtables sought input on an appropriate name for the CSLR.

ASFA considers that, given the lack of clarity around the coverage of the scheme, consideration of its name is premature.

We note that the CSLR that operates in the United Kingdom is called the Financial Services Compensation Scheme, and this is in our view an appropriately descriptive name. However, the UK's scheme is extremely wide in coverage and that name would be misleading and/or confusing for consumers if the scheme adopted in Australia has a narrower coverage, as ASFA has submitted should be the case.

Regardless of the coverage ultimately adopted, we suggest that including the concept of 'last resort' in the name will not be meaningful for consumers. Communication of the last resort nature of the scheme will need to be achieved through appropriate messaging, including by:

- AFCA, when making a final determination in relation to a complaint
- Financial firms, as part of their communication with consumers in relation to complaints and, in particular, the EDR process
- ASIC, via the MoneySmart website.