FINANCIAL ADVICE ASSOCIATION AUSTRALIA

KEY FACTS on the CSLR

15 things to know about the Compensation Scheme of Last Resort funding scandal

1. Proposals to establish a Compensation Scheme of Last Resort (CSLR) go back as far as the Ramsay Review (in 2017), and the proposal was supported by the Hayne Banking Royal Commission in 2019. Legislation was introduced by the former Coalition government in October 2021 but not passed. After the change of government in 2022, legislation enabling the scheme was eventually passed in June 2023 after multiple delays.

2. Establishment of the scheme was supported in principle by all major players in financial services including the FAAA. There is general agreement that the CSLR is an important mechanism to ensure consumers who have suffered a loss have recourse, and it gives consumers greater confidence in engaging with the financial services sector.

3. The CSLR, launched in April 2023, provides compensation to consumers of up to $150,000 per claim, if they have an unpaid determination from the Australian Financial Complaints Authority (AFCA - the external dispute resolution provider to the financial sector). Not all sectors covered by AFCA are part of the CSLR; the scheme only covers financial advice, credit provision, credit intermediation, and securities dealing.

4. Managed investment schemes (MISs) are a notable and problematic exclusion from the scope of the CSLR, as failures of these products are responsible for substantial consumer harm that currently has no recourse if the firm fails. Our sector is also concerned that product failures will be re-defined as advice failures in cases where product failure has contributed to consumer harm, because otherwise consumers will not receive compensation. While in opposition, the current government argued for the inclusion of MISs in the CSLR, however they reverted to the previous Government's position to exclude them, when in government.

5. Despite the Ramsay Inquiry, the Banking Royal Commission and the Government's initial response all suggesting that the scheme would be forward looking, in fact the scheme is weighed down by substantial legacy complaints, particularly as related to Dixon Advisory ("Dixons"), which went into administration in January 2022, more than two years before the scheme commenced.

6. Dixons was a subsidiary of the large, listed E&P Financial Group (which reported revenues of $173m in the 2023 financial year). The collapse in the value of a related-party product, the US Masters Residential Property Fund (URF), generated huge growing losses from 2017, and consumer complaints against Dixons mounted. When Dixons was put into administration in January 2022, a number of advisers (and presumably clients) were transferred to another entity in the group, Evans and Partners. ASIC is currently taking legal action against a Dixons' Director alleging failures in directors duties. No other director, senior manager or financial adviser has been prosecuted or banned by ASIC in relation to the product or advice related issues with this matter. It is not clear to us that everything has been done that could be, to recover funds from the Dixon Advisory and related businesses. The URF continues to operate and earn fees for its parent group.

7. ASIC announced in April 2022 that Dixons was required to remain a member of AFCA until 8 April 2023. This was later extended until 8 April 2024, however AFCA did not eventually cease their membership until 30 June 2024. It is unclear why these extensions were granted.

8. As at 30 June 2024, Dixons membership of AFCA has ended and AFCA has received a total of 2,773 Dixons complaints. The Dixons Administrator, in November 2022, suggested there were 4,606 Dixons clients who were recognised as having lost $368m on the URF, and were therefore creditors. A class action led by Shine Lawyers was concluded in April 2024 with a payment of $16m (of which $12m was paid by the professional indemnity insurer) – a tiny fraction of the estimated losses.

9. The former Government set a per-sector cap for the CSLR of $10m in the initial legislation – which was the maximum amount that any one sector can be levied by the scheme without the direction of the Minister. However, this was doubled to $20m by the current Government in September 2022. We question whether this was done in light of information coming to hand about the costs of the Dixons matter. Neither this information, nor any reference to Dixons or claims costings information was provided in the Explanatory Memorandum to the Bill tabled in March 2023. Neither was there a regulatory impact statement prepared.

10. The ten largest financial institutions (excluding super funds and health insurers) are paying compensation for complaints received by AFCA up to 7 September 2022, which are eligible for the CSLR (irrespective of when they are processed). This amounts to $241m and is referred to as the pre-CSLR levy.

11. The Government promised to pay for the first 12 months of claims and operating costs of the CSLR. However, in fact they are only paying for three months of operations from 2 April to 30 June 2024. In total the Government will pay only $4.8m towards the scheme, of which $2.4m relates to financial advice and covers only one Dixons complaint.

12. The financial advice profession will be paying for all financial advice compensation payments issued after 30 June 2024. In practice this will include all of the Dixons' complaints received by AFCA after 7 September 2022, other than the single claim the government will pay, as AFCA had paused processing these matters until the legislation was passed and progress has been slow given the huge volume. In fact, AFCA expects that it will take three more years to process all of the Dixons complaints.

13. The financial advice sector will be levied $18.6m for the second period (2024/25). However, given the scale of the Dixons matter it will likely take several years to process the remaining claims. Our current estimate is that the total cost of this matter to the advice profession will be approximately $135m (using the actuarial estimates that each Dixons complaint will entail approximately $120k in compensation, and a total of 1,134 claims that we will need to cover).

14. It is deeply unfair that small business financial advisers are being asked to pay compensation to the clients of a large listed entity, one which continues to profitably operate after simply putting one subsidiary into administration and moving advice operations to another subsidiary. There appears to be nothing stopping other firms using this strategy in the future.

15. It is also completely unjust that new advisers entering the profession now could be paying for the past misdeeds of Dixons for many years to come – some of whom had not finished high school when Dixons failed.