FINANCIAL ADVICE ASSOCIATION AUSTRALIA

28 February 2025

Director
Program and Redress Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via email: CSLRreview@treasury.gov.au

Dear Treasury,

Consultation – Post-Implementation Review: Compensation Scheme of Last Resort

The Financial Advice Association of Australia[1] (FAAA) welcomes the opportunity to make a submission to Treasury on the Post-Implementation review of the Compensation Scheme of Last Resort (CSLR).

Our members help empower Australians to build a better financial future. Financial advice delivers great benefits to those who are fortunate enough to have access to it. Financial advice delivers a plan for the future, a sense of confidence that delivers peace of mind and helps to guide financial behaviours to enhance the prospect for success and to avoid bad decisions. The significant financial consequences of the CSLR for the financial advice profession put this at risk for many Australians.

Financial advice is a profession that is under pressure, having declined significantly in numbers over recent years. It has also become highly fragmented: there are over 6,100 financial advice businesses in Australia, and 92% of advisers work in a business with 10 or fewer advisers. Further pressure, such as the significant contingent liability posed by the potential cost of the CSLR will only make this situation worse. It will also serve to further increase the cost of financial advice, putting it out of reach of more Australians.

The FAAA provided a very comprehensive submission on the CSLR to the Senate Economics References Committee Inquiry into Wealth Management Companies. We believe that it remains highly relevant and include it as an attachment. Our submission to the Senate Inquiry set out a great deal of analysis on what went wrong at Dixon Advisory and other corporate collapses, enabling these issues to be closely examined as part of the expected hearings. Regrettably that inquiry is yet to hear from witnesses, and these key issues are yet to be the subject of the intense scrutiny that is necessary to get to the bottom of what actually happened.

[1] The Financial Advice Association of Australia (FAAA) is the largest association representing the financial advice profession in Australia, with over 10,000 members. It was formed in 2023 following the merger of the two leading financial planning/advice bodies in Australia – the Financial Planning Association (FPA) and the Association of Financial Advisers (AFA). With this merger, a united professional association that advocates for the interests of financial advisers and their clients across the country was created.

In preparing this submission, we have placed less focus on what went wrong at Dixon Advisory and other wealth management companies, and more on what the underlying issues are with the design of the CSLR and what needs to be done to fix these problems.

This submission also sets out key developments that have occurred since our submission to the Senate Inquiry.

In our attached submission, we have addressed a number of key issues with the CSLR and made a large number of recommendations that we believe will go a long way to addressing the numerous flaws in the design of the CSLR. These include the following:

- The law needs to change so that financial advice is not taking full responsibility for product failures, when financial advice has been provided and a product fails. Neither should personal financial advice be forced to pay for general advice or wholesale client advice failures.
- The exposure of small business sectors, like financial advice, to a special levy, needs to be modified to ensure that it will never exceed the sector cap. The sector cap should be reduced to the original proposal of $10m.
- To remove the retrospective element of the scheme, which is contrary to the Ramsay Review and Hayne Royal Commission recommendations, the Government must pay for all claims received before the commencement of the CSLR scheme.
- Consistent with the Government's original commitment, they must pay for the first 12 months of the scheme.
- The CSLR should operate as a genuine scheme of last resort, with payments on the basis of capital loss, without interest and only after all potential recovery action has been concluded.
- An entity should be appointed to perform a role similar to the Fair Entitlements Guarantee Recovery Program that undertakes every possible effort to recover funds from responsible parties.
- Changes to insolvency laws should be made to enhance the prospect of recoveries and to better enable responsible parties to be prosecuted.
- ASIC should thoroughly review financial firms where CSLR payments are made to investigate misconduct and to consider broader issues such as product failure and inappropriate business models. ASIC should also consider any potential breaches of insolvency laws.

At the core of what has gone wrong, are issues directly related to the development and promotion of in-house investment products that were poorly managed, with unacceptable levels of conflicts of interest. This is compounded by insolvency laws that favour corporations over consumers, resulting in the CSLR creating a moral hazard for the profession, in that the consequences of poor behaviour are not borne by those who have perpetrated it, but by those who are innocent of wrongdoing.

Our members are extremely proud of the financial advice they provide, the businesses they work for and the role of the financial advice profession. Our members were some of the first to raise awareness of the problems at Dixon Advisory with ASIC, as well as concerns about other historic collapses, and will continue to call out misconduct and the risk of detriment for clients.

We would welcome the opportunity to discuss the matters raised in our submission further with Treasury. If you have any questions about our submission, please do not hesitate to contact either myself on (02) 9220 4500 or sarah.abood@faaa.au, or Phil Anderson, General Manager, Policy, Advocacy and Standards on phil.anderson@faaa.au.

Yours sincerely,

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Financial Advice Association of Australia

FINANCIAL ADVICE ASSOCIATION AUSTRALIA

Post-Implementation review: Compensation Scheme of Last Resort

Effective date: 28 February 2025
Submitted to: Treasury

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Introduction

We would like to make clear at the outset, that the FAAA and our members support the right for consumers to be fairly compensated for detriment suffered as a result of wrongdoing when the company in question no longer exists. The establishment of the Compensation Scheme of Last Resort (CSLR) was supported in principle by all major players in financial services including the FAAA. There is broad 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.

However, the FAAA has taken the lead in calling out serious defects in the design and implementation of the CSLR for some time. We have been particularly vocal on this since early 2024 and were central to the calls to undertake a public inquiry into the collapse of Dixon Advisory and the design of the scheme. We have also taken the lead in the investigation of situations that will or are likely to lead to material claims being made on the CSLR. The FAAA is committed to supporting both the Senate inquiry, and this review, in order to ensure that the CSLR can deliver on its critically important consumer protection objectives without creating unacceptable risk and unfair cost for other parties, including the vast majority of excellent advisers who have done nothing wrong, and their clients who will pay more as a result.

Our analysis of the issues relevant to the problems that we face now with the huge blow out in the cost of the CSLR goes beyond the design of the CSLR. It also addresses issues with the financial services regulatory regime, the treatment of misconduct and AFCA claims, insolvency laws, and the design and promotion of financial products.

The CSLR was designed as a sector-pays model, and due to the design and scope of the scheme, the largest proportion of its funding is expected to be provided by the financial advice sector. From the very early days of consultation on the implementation of a CSLR, the advice profession has been very concerned about the likely implications in the context of a “black swan” event – an unexpected large company failure with consequences that could wipe out the profession. Treasury guidance from as recently as a July 2021 Proposal Paper, anticipated a very different outcome to what we have seen in the real world. At that point, the guidance suggested that financial advisers could expect a levy of less than $300 per year and only around $458 in a year when the sector cap was fully utilised (please see extracted table below). This was a tolerable situation, however as we highlight below in our submission, this is very different to what we now appear to be facing.

Table 2: Estimated ongoing levies, without establishment costs and capital reserve contribution

Financial product or service	Features	Ongoing levy (mature scheme)	If subsector cap of $10 million fully utilised
Financial Advice	Minimum threshold (number of financial advisors)	4	3
	Per cent of firms that pay levy	34%	45%
	Cost per financial adviser	$291	$458
	Median levy	$2,039	$2,290
	Total levy on subsector	**$6,170,774**	**$10,000,000**

This much feared “black swan” event occurred in the form of the collapse of Dixon Advisory, that arose only six months after the release of this Treasury proposal paper. Even though the issues at Dixon Advisory occurred well before the scheme was legislated and had commenced, as a result of the retrospective nature of the design of the scheme, the conduct of this company alone will likely have a huge impact on all financial advisers who are left to cover the compensation payable to Dixon Advisory clients.

One thing that is fundamentally obvious from the two large collapses that we have seen so far (Dixon Advisory and United Global Capital) is that these large client losses are generated as a result of the collapse of inhouse or related party investment products. In this context, financial advice is used as a vehicle for the distribution of in-house investment products, facilitating product manufacturing companies obtaining funding for products that generate above average fees and/or fund projects of personal interest to those running the company. Covering the cost of this type of corporate misconduct is not how we expected the scheme to operate. Financial advice should not be forced to carry the cost of inhouse product failures or corporate misconduct. It is notable that not a single financial adviser has yet been sanctioned by ASIC in the matter of the Dixon Advisory failure, for example.

We envisaged that the CSLR might step in to address the failure of a small number of stand-alone financial advice firms where poor advice was provided with respect to external products. The financial advice profession should not be paying for the cost of product failure or corporate misconduct. That is at the core of the concerns of our members, while noting that there is much more that is wrong with the design and implementation of the CSLR, that we set out in detail in this submission.

Key Developments Since the Senate Inquiry Submissions

The key developments since 1 November 2024 have been as follows:

- Release of the judgement in the case ASIC prosecuted against Dixon Advisory director Paul Ryan.
- Confirmation that a missing $1m in the Libertas Financial Planning liquidation, was as a result of the declaration of a dividend in the final year of Libertas’ operation that was used to write off an intercompany loan owed by the parent company (Sequoia) to Libertas, which was placed into liquidation with outstanding AFCA cases.
- Release of the CSLR operator’s actuarial estimate of the CSLR Levy for the 2025/26 financial year and release of information to enable a projection of what the 2026/27 levy might look like.
- The release of the actuaries report highlighted the significant impact that the United Global Capital collapse will have on the CSLR in the 2025/26 year.
- Release of a discussion paper on “Addressing corporate misuse of the Fair Entitlements Guarantee” by the Department of Employment and Workplace Relations

Judgement in the Paul Ryan Case

The outcome of the case that ASIC prosecuted against Dixon Advisory director Paul Ryan for breaches of Director’s Duties is central to the interplay between insolvency laws and the CSLR. The case was directly related to resolutions by the Directors of Dixon Advisory to change its constitution so as to expressly permit the directors to act in the best interests of the holding company (E&P Operations), and the entry by the subsidiary into a deed of acknowledgment of debt between it and the holding company. ASIC argued that the resolutions materially prejudiced the subsidiary’s ability to pay its creditors, because the purpose and effect of the deed was to prevent a voluntary administrator of the subsidiary from calling on the approximately $19

million intercompany receivable that would otherwise have been available for its creditors. The judgement went against ASIC, where the argument appears to be that the director was entitled to rely upon the legal advice that he received. It is further suggested that Paul Ryan was entitled to rely upon the guidance of his CEO (who had been a long term senior insolvency executive, prior to commencing as CEO of E&P Financial Group some two years prior), and the advice of the CEO's former insolvency practice.

Further background to this case includes, that a management fee normally paid by Dixon Advisory to its holding company was waived in the accounts for June 2021. This avoided the risk of Dixon Advisory having negative net assets, which would create problems for the continuation of the AFSL. The waiving of this fee was seemingly used as the basis to later seek to avoid the repayment of the loan. It is difficult to understand how the existence of the loan could be relied upon to justify positive net assets, yet be denied in the event that the administrator would seek to recover it.

This judgement is difficult to understand, as seemingly it provides a precedent for similar actions to be repeated in the future - allowing parent companies to extinguish or deny intercompany loans in the lead up to a business going into administration. **We suggest that this outcome was contrary to the best interests of creditors, and is outside the expectations of Australians in terms of how the law should work. We further suggest that this may necessitate changes to the law**.

Insolvency

In our submission to the Senate Inquiry, we highlighted one case, where a financial advice licensee (Libertas Financial Planning) had been placed into liquidation, however an intercompany loan of nearly $800k and $1m of net assets had seemingly disappeared.

We have since been advised by the liquidator that the net assets had declined by $1m in the final partial year of operations, as a result of the declaration of a $1m dividend, that was used to extinguish the intercompany loan owed to Libertas. This had occurred at the time when 10 complaints had been made to AFCA, although these were not recognised in the company's books or disclosures until outlined in a liquidators report a number of months later. Whilst we don't have the full details, we would suggest that **the payment of this dividend could be considered an uncommercial transaction under insolvency laws and could be voidable.**

This case highlights our concern about issues with misconduct around insolvency matters and the importance of close scrutiny of every case of insolvency that may result in a claim being paid by the CSLR.

CSLR Levy Estimate for 2025/26 and Projection for 2026/27

The CSLR Operator released the initial estimate for the CSLR Levy for the 2025/26 year on 31 January 2025. Shortly afterwards, a legislative instrument was tabled in the Parliament that will enable - upon the passing of 15 sitting days - the issue of invoices to businesses impacted by the levy, including financial advice firms which will initially be levied $20m to cover the amount up to the sector cap.

Table 1.1 – Recommended Initial Estimate for the 3rd Levy Period

			3rd levy period estimate									
Type	No. AFCA complaints finalised	No. claims paid	Gross claim Payments ($000)	AFCA Fees ($000)	Recoveries ($000)	Capital Contribution ($000)	CSLR Operating Costs ($000)	ASIC Costs ($000)	Investment income ($000)	Expected payments by CSLR in 3rd Levy Period ($000)	Excess from FY24 (1st Levy Period) ($000)	CSLR Levy Estimate ($000)
Financial Advice - DASS	245	101	12,249	3,207	-							
Financial Advice - UGC	211	307	44,568	3,601	-							
Financial Advice - Other	48	28	2,773	1,193	(61)							
Financial Advice	504	437	59,590	8,001	(61)	417	2,936	625	(96)	71,412	(1,302)	70,110
Credit Provision	70	36	216	976	(1)	417	1,146	225	(53)	2,926	(127)	2,799
Credit Intermediation	19	10	1,030	210	(1)	417	1,117	225	(53)	2,945	(222)	2,723
Securities Dealing	18	9	762	222	(1)	417	1,115	225	(51)	2,688	(345)	2,343
Total	610	491	61,597	9,409	(64)	1,667	6,314	1,300	(253)	79,971	(1,996)	77,975

The striking news from this table is that the potential full cost for the advice profession in the 2025/26 year is just over $70m - an additional $50m above the $20m sector cap. One dominant feature in this table is the scale of the expected United Global Capital (UGC) claims in 2025/26, and the less-than-expected Dixon Advisory (DASS) cases.

On the basis of careful analysis of the number of Dixon Advisory cases to be dealt with and the expected ramp-up in the 2026/27 year, we have developed a projection of what the costs might be in the 2026/27 financial year. As set out in the following table, 2026/27 is even more disturbing than 2025/26. It is important to note that this is on the basis of known cases. A further financial firm collapse could lead to a substantial increase in costs in the 2025/26 and 2026/27 years.

CSLR Financial Advice Levy Costs

	2024/25	2025/26	2026/27
Dixon Advisory Cases	86	101	843
Dixon Advisory Claim Cost	9,431,190	12,249,280	103,163,811
Other Claims Cost	2,109,000	47,341,000	2,773,000
Total Claims Cost	11,540,190	59,590,280	105,936,811
AFCA Costs	1,978,000	8,001,000	13,989,000
Other Costs	5,044,000	2,519,000	3,404,000
Total Cost	18,562,190	70,110,280	123,329,811

A potential exposure of $193m across the 2025/26 and 2026/27 years, that would involve a cost of around $12,500 per financial adviser, highlights the extreme extent of the problems with the CSLR and the underlying reality that this has become hugely inequitable and unsustainable.

United Global Capital and Global Capital Property Fund

The likely exposure of $48m for United Global Capital (UGC) and its related Global Capital Property Fund (GCPF) was an alarming message in the 2025/26 Initial Estimate document. This is a second black swan event that has emerged in only the first year of operation of the CSLR.

In many cases, the clients of UGC were recommended to establish an SMSF, rollover their super from APRA funds into the SMSF and then invest almost all their money into the related Global Capital Property Fund (GCPF). The GCPF lent money or invested money into 14 property development projects. The directors of

GCPF were also directly involved as shareholders or office holders of the companies responsible for five of these 14 projects.

The GCPF is not actually a managed fund. It is an unlisted company, that had previously run into a lot of trouble in 2022 due to the fact that it did not have a TMD. It has never paid a distribution and there was little means for clients to sell their GCFP investment. This is another case of a deeply flawed and highly conflicted inhouse product issue, where the financial advice profession is forced to pay the full cost of compensating clients through the CSLR.

The actuaries have estimated that there will be 346 UGC complaints in the next financial year, of which 334 will be successful, with an average cost of $145,000 each.

In a court action that ASIC took against UGC, there is a statement that “The AFSL did not authorise UGC to issue financial products”. UGC was issuing shares in GCPF to their clients without a licence to do so. This is a point that warrants careful investigation, given that this product had been in the market for a couple of years before ASIC first intervened in 2022. This must be a very serious matter, possibly warranting criminal action. A liquidator has been appointed to UGC, and another one has been appointed to GCPF. The GCPF liquidator’s report suggests the recovery exercise promises to be a challenging one. Whilst ASIC has banned the CEO of UGC, there is no evidence of further action against other directors so far. **The wrongdoing in this case should be the subject of extensive enforcement activity by ASIC.**

Addressing corporate misuse of the Fair Entitlements Guarantee and learnings for the CSLR

On 17 February 2025, the Department of Employment and Workplace Relations issued a Discussion paper titled “Addressing corporate misuse of the Fair Entitlements Guarantee”. The Fair Entitlements Guarantee (FEG) is another scheme of last resort that is designed to protect the interests of employees, when their employer goes into liquidation. There are some important parallels with the CSLR, although one key difference is that the Government funds the FEG, not the sector. The FEG has delivered $2 billion in advances to employees since it was established in 2012.

There is also a FEG recovery program, which pursues companies that have failed to pay employee entitlements, where they believe that there are grounds for taking action. The FEG recovery program includes the funding of liquidators to take action of this nature. Since the commencement of the Recovery Program in 2015, $470.8 million of FEG advances have been recovered by the Australian Government.

In the context of no evidence of any recovery action having been taken against any firm that is responsible for an unpaid AFCA claim and CSLR payment, we firmly believe that **something like the FEG Recovery Program is essential for the CSLR. A body should be responsible for the pursuit of these insolvent firms, their directors and related entities and have the capacity to fund recovery action. Funds from successful recovery action must be directed into the CSLR and to reduce the levies applied to the advice profession, not into Consolidated Revenue.**

The issues with the CSLR Design and Implementation

In the work that we have done to examine what has gone wrong with insolvent financial advice firms and the operation of the CSLR, we have identified a number of issues with the design and implementation of the CSLR. We have grouped these issues under the following categories:

- Design
- Scope
- Funding
- AFCA and Methodology
- Insolvency
- ASIC and Enforcement

We address each of these in more detail below (some issues may fit under multiple categories).

Design

- Financial advice complaints are within the scope of the CSLR, whereas product complaints are excluded. The current law and AFCA practice does not allow for the apportionment of responsibility across advice and product, for the majority of advice complaints. Even where there are multiple factors driving client loss, if there is an advice failing, it is all attributed to financial advice - even if the advice failing played a minor role in causing the consumer loss. Even if the law permitted the apportionment of advice complaints, it is only the advice sector that is covered under the CSLR, not products. As a result, strong incentives remain for all consumer losses to be attributed to advice – because if advice is at fault, the consumer may be compensated, whereas losses caused by product failure currently have no last resort compensation mechanism.

- Whilst the law describes what the Minister **can** do in the event of a sector having expected claims above the sector cap, there is no clarity on what they **should** do, leaving a complete lack of certainty with respect to any amount above the sector cap. Small business sectors, which dominate the financial advice sector, are currently potentially exposed all the way up to the overall $250m annual cap for the scheme.

- The law does not sufficiently define the client who is eligible for a CSLR claim. This has the potential to substantially increase the scheme's liabilities – for example, splitting cases by couples (increasing the maximum potential compensation to $300k even if the couple were advised as a single entity) and SMSFs being split to be treated as multiple complainants (increasing the maximum potential compensation to $900k, for the maximum of 6 members, even if the SMSF was advised as a single entity).

- We understand that the way Section 1067 of the Corporations Act has been drafted there is an impediment to offset payments from class actions against CSLR compensation.

- A complaint about an advice provider who provides general advice and is not authorised to provide personal advice, may be determined by AFCA as personal advice if the AFSL's licence includes

personal advice, even if the representative is not authorised as such. As a result, the AFCA complaint may be treated as a personal financial advice complaint, and thus payable under the CSLR.

- Equally in the case of a wholesale only adviser, if the licence includes personal advice a failing by a wholesale advice provider can be classified as personal advice to a retail client, even if they are not authorised to provide personal advice to retail clients. Financial advisers should not be required to pay compensation to the clients of those who were not authorised to provide personal advice.

- The CSLR does not have sufficient powers or an adequately defined role to pursue firms, directors and related parties that are responsible for unpaid determinations. We would also argue there is a strong disincentive for the CSLR to do so, as taking this action involves risk, whereas there is no risk in obtaining funding from financial advisers who must compulsorily pay the full cost of compensation via enforceable levies. There is currently no entity with the job of seeking to recover as much money as possible to compensate consumers.

- Once a financial firm goes into administration or liquidation, there is no one left to dispute claims or to manage the claims process. Neither is there anyone to challenge the views of the case manager or to question the loss calculation methodology. This undermines the entire EDR process, where claims are contested and are assessed on the relative merits of the positions and evidence provided. The role of the administrator is to act in the best interests of the creditors, and thus it has no interest in defending complaints lodged with AFCA. This significantly increases the risk of the payment of compensation in circumstances where it may not be warranted or on the basis of a flawed calculation of the loss attributable to the firm, and is inconsistent with the principle of natural justice that exists in Australia.

- There currently appear to be no negative consequences for entities, directors and others involved in a business being placed into administration or liquidation and leaving unpaid AFCA determinations.

- Businesses in administration are seemingly allowed to drop their PI insurance cover despite the fact that AFCA complaints are still being processed. This undermines the purpose of PI insurance. There is also no regular checking being done of the adequacy of the PI arrangements of financial advice licensees.

- The advice profession has reported cases of known or likely misconduct frequently, however often this has not been acted upon, or is not acted upon until many years after the report was made.

Scope

- The vast majority of CSLR cases that have been identified so far are product related client losses, where the business group distributed these products through an advice business and the entire failure has been attributed to the financial advice sector.

- Amongst products, Managed Investment Schemes in particular have been responsible for a significant amount of client losses and unpaid determinations over the years. However despite being considered for inclusion in the CSLR by a Senate Inquiry in early 2022, they have been entirely excluded from the scheme. AFCA's 2024 *Approach to determining compensation in complaints*

against Financial Advice Firms where the Responsible Entity of a Managed Investment Scheme has become insolvent indicates a practice of attributing all consumer losses in such cases to the adviser, regardless of the MIS's actions.

- As referred to above, where cases of general advice are classified as personal advice by AFCA, they can be captured within the CSLR as a financial advice complaint, even when the individual or Corporate Authorised Representative was not authorised to provide personal advice to retail clients. General advice is not covered by the CSLR and does not contribute to its costs or client compensation.

- Equally, in cases where the client was treated as a wholesale investor and AFCA assessed this treatment as incorrect, the determination can be classified as personal advice and any CSLR claim can fall under the financial advice sector. We have been informed that some parties are encouraging wholesale investors to lodge such claims with AFCA in order to gain access to the CSLR. Similarly to our previous point, wholesale advice is not covered by the CSLR and does not contribute to its costs or client compensation.

Funding

- The Ramsay Inquiry proposed a prospective only scheme, which was a principle that was endorsed by the Hayne Royal Commission. However, the scheme was implemented retrospectively with financial advisers paying for claims that were the result of actions that arose well before the legislation had passed Parliament and the scheme commenced.

- The Government committed to pay for the first 12 months of operating costs and claims, however modified the law and then implemented the law in a manner that resulted in them paying for only three months (during which time as it transpires, no claims were actually paid).

- The Government increased the sector cap from the originally proposed $10m to $20m in the September 2022 version of the legislation, and thus significantly increased the scale of exposure of our sector at a time when our numbers were also in sharp decline.

- The Explanatory Memorandum to the CSLR Bill, as tabled in March 2023 (14 months after the collapse of Dixon Advisory), did not even refer to Dixon Advisory, and excluded any meaningful numbers on the likely cost of the scheme, resulting in the Parliament voting for a piece of legislation without disclosure of the regulatory impact.

- There is no mechanism to apply a special CSLR levy against a parent entity which has placed a financial advice subsidiary into liquidation and walked away from liability to pay AFCA complaints.

- In the face of potentially large levy obligations, there is no ability for a financial firm to spread payments across a longer time period, such as a number of months. This is a particular issue for our small business sector where cashflow can often be tight.

- The CSLR levy is calculated on the basis of the number of licensees and advisers in the prior year. To illustrate this, the levy for the 2025/26 year, that is expected to be issued in the second half of 2025, is based upon advice licensees and advisers as at 30 June 2024. This causes complications

for licensees who change materially in size and for advisers changing licensee during the course of the year. Growing firms pay much less than shrinking firms.

AFCA and Methodology

- As discussed above, the law and AFCA practices need to change to enable the apportionment of client losses between advice failings and product failings, so that financial advice is not held responsible for the entirety of client losses in cases where product failure is at least somewhat responsible.

- The utilisation of the 'But-for' methodology by AFCA[2] can result in clients being paid compensation when they have not suffered a capital loss, but have experienced a reduced investment return. While this may be appropriate where the responsible party is paying the compensation, it is not an appropriate methodology to be using for a scheme of last resort. Positioning the CSLR as a minimum return guarantee scheme is not the intent of the scheme, is not sustainable and risks the future viability of the scheme.

- Despite the CSLR being a scheme of Last Resort, clients are still eligible for interest between the date of the determination and the date of payment. This increases the cost of the compensation and the complexity of processing payments. Again, we assert that this is not an appropriate approach to use in a scheme of last resort.

- In the case of UGC and the GCPF, AFCA has assessed the likely recovery as zero and directed the firm (ultimately the CSLR) to pay the full amount of the investment. This is contrary to the view of the liquidator which believes material recoveries are likely. As a scheme of Last Resort, it should not be possible to award compensation whilst the client loss remains uncertain, particularly at an early stage of recovery by the liquidator. The calculation of the compensation should be delayed until the loss is confirmed.

- The membership of Dixon Advisory with AFCA was firstly extended by ASIC for 12 months. Then even after the expiry of the ASIC requirement, AFCA delayed the termination of membership again, from 8 April 2024 to 30 June 2024, resulting in a huge increase in complaints. Dixon Advisory remained a member of AFCA from January 2022, when it was placed into administration, until 30 June 2024. There should be a set period for which an insolvent firm should remain a member of AFCA (such as a year). This gives clients a reasonable opportunity to lodge complaints without leaving the financial advice profession with an unending and unknown liability.

- There is currently no requirement for an insolvent advice firm to maintain PI cover during the period it remains a member of AFCA. This significantly increases the potential liability of the CSLR.

- As discussed above, where a firm is insolvent, there is no one to defend a case, potentially resulting in invalid claims being approved and the methodology for calculation of loss not being appropriately challenged.

[2] The AFCA Approach to determining compensation in complaints against Financial Advice Firms where the Responsible Entity of a Managed Investment Scheme has become insolvent, January 2024

- The cost of AFCA processing complaints is high and there is little evidence that efficiencies are being obtained for processing a large number of similar complaints.

Insolvency

- There are insufficient obstacles to a parent company 'phoenixing' an advice subsidiary and distancing itself from responsibility to compensate consumers for wrongdoing. The design of the CSLR, by default, transfers the cost of such compensation to the rest of the financial advice sector. The existence of the CSLR creates a moral hazard in this regard; encouraging risk-taking and poor behaviour by financial firms, through reducing the penalties for them.

- In only the first year of operation of the CSLR, we have already seen two cases of listed parent companies walking away from advice subsidiaries and leaving it to others to pay the cost of client compensation with little consequences.

- In both cases, the businesses were able to transfer assets, advisers and clients, including fees paid under ongoing fee arrangements, to another subsidiary and continue operating without any payment for the value of these assets.

- In both cases the parent entity sought to avoid repaying intercompany loans.

- There are little or no consequences for an entity or the directors in putting an advice subsidiary into administration / liquidation.

ASIC and Enforcement

- Despite the receipt of 60 complaints against Dixon Advisory from 2008 to 2022, and undertaking a major surveillance exercise in 2015, the problems were not dealt with by the Regulator for many years and thus allowed to continue to grow.

- ASIC have not yet been successful in taking action against anyone related to Dixon Advisory or any other firm involved in unpaid determinations and CSLR payments.

- ASIC have tended to focus on poor financial advice, rather than to look at deeper more systemic issues with respect to product provider issues, corporate misconduct and conflict of interest issues.

- In August 2022, ASIC wrote directly to individual Dixon Advisory clients encouraging them to complain to AFCA. We are unsure why this step was taken in the Dixon Advisory case and not others, and it seems to be going beyond ASIC's role as regulator. Such communications are more typically facilitated through a media release and publication of notices on ASIC's website.

- ASIC facilitated the extension of the AFCA membership of Dixon Advisory for well over 2 years.

- Despite winning a case against Dixon Advisory, no fine or cost recovery was achieved and other than the unsuccessful Paul Ryan matter, ASIC has not further pursued the directors and senior management of this entity.

- There has been no ASIC action taken as yet against other parties including lawyers, insolvency advisers and auditors of the various insolvent companies.

- There is a lack of visibility of ASIC action and accountability when it comes to financial firms which have gone into administration/liquidation and left unpaid AFCA determinations.

Addressing the Terms of Reference

(a) How the CSLR is delivering on its intended objectives

We understand the objective of the CSLR to provide compensation to eligible consumers in circumstances where an AFCA determination awarding monetary compensation has been made in their favour, but which the relevant entity has not paid. It is also noted that the intention is to support confidence in the financial system's external dispute resolution framework is reliant upon the knowledge that the CSLR is working as intended and that it is sustainable into the future.

Whether the CSLR is delivering on its intended objective cannot be solely measured by the number of claims it has paid to date. For the scheme to deliver on its intended objectives it must be sustainable. Sustainability is the fundamental issue with the CSLR. An unsustainable scheme will result in a drop in consumer confidence in the financial system's EDR framework and put at risk the availability of compensation for consumers in the future.

Given the estimates released to date and the excessive levies to potentially be recovered from the financial advice profession, the sustainability of the CSLR is highly questionable. This lack of sustainability will not only impact consumer compensation and confidence in the EDR framework, but also have a likely impact on the sustainability of the advice profession, which is predominantly small business operators.

We do not believe the current CSLR model is achieving its necessary objective of being sustainable.

(b) How the CSLR funding model is formulated, including its potential impacts on businesses who fund the industry levy

There are deep flaws in the funding model for the following reasons:

- Financial advisers are paying for the misconduct of others outside the sector, including product providers, general advice providers and wholesale client advisers.

- There is huge uncertainty with respect to the treatment of any CSLR costs above the sector cap. This uncertainty is impacting the intention of some advisers to remain part of the profession.

- There is no mechanism to effectively control the potential cost to a small business sector like financial advice. The rationale previously expressed by Treasury suggested that it was reasonable to have the advice profession pay for the cost of the CSLR as they had the ability to identify and deter misconduct, reducing the potential exposure. However, this is simply not the case. Advisers do indeed report suspected misconduct to ASIC, however there is no guarantee that timely action will be taken by the Regulator. The costs of delays and inaction are fully borne by our sector, which has no ability to control them. Small business financial advisers are working hard to provide the best

services that they can to their clients. They have no influence over or ability to avoid the types of collapses we have seen with groups like Dixon Advisory and United Global Capital, where the underlying problem was a flawed business model based upon huge conflicts of interest within the broader corporate group.

The exposure of the financial advice profession is demonstrated in the following table. It shows costs over the three year period 2024/25 to 2026/27, where the estimated potential cost is $212m in total and approximately $13,816 per adviser.

$	2024/25	2025/26	2026/27	Total
Total Cost	18,562,190	70,110,280	123,329,811	212,002,281
Standard Levy	1,186	1,295	1,295	3,776
Potential Special Levy		3,275	6,765	10,040
Total Levy	1,186	4,570	8,060	13,816

We are not only concerned about the likely impact that this will have on existing financial advisers who are faced with such a large contingent liability for the misconduct of others. We are also critically concerned about the impact of this contingent liability on new entrants to the financial advice profession. Why would a person at the start of their career agree to become a financial adviser, knowing that there is this huge contingent liability that they will be expected to pay in their initial years in the profession? With the numbers joining the sector already far too low, there is a huge problem here and it must be fixed and fixed quickly.

There is no point in the Government seeking to reduce the cost and complexity of providing financial advice through the Delivering Better Financial Outcomes reforms, when at the same time they are responsible for the introduction of the CSLR, which is having the opposite effect of substantially pushing up the cost of providing financial advice. This is an existential threat to the profession, and thus the ability of consumers to access professional financial advice.

(c) How the powers of the CSLR Operator interact with delivery of the scheme

The powers of the CSLR operator are not something that we have observed in close proximity, however we appreciate that they have been working very hard to bed the scheme down and to assist the impacted sectors to understand what the picture looks like.

Through our discussions with the CSLR Operator, we appreciate that they have little to no flexibility in the application of the rules. It is only the Minister and Government who can address the issues we have raised.

The CSLR Operator has not yet pursued firms which have gone into administration/liquidation. We understand that whilst the payment of a claim by the CSLR gives them rights of subrogation, that this does not enable them to pursue those who do the wrong thing. We would like to see more focus placed on the pursuit of those responsible for misconduct and the recovery of funds from these entities and individuals, and have suggested in this document a structure such as that used in the FEG should be instituted, with both the incentive and the power to do this.

Another area where we believe that the CSLR should have greater powers is in their ability to negotiate with AFCA and ASIC on the fees that they charge the CSLR. In our view there should be strong prospects of achieving substantial economies of scale in AFCA's processing of complaints in the event of large-scale

collapses like Dixon Advisory and UGC. The CSLR should be able to negotiate their own pricing model and seek to drive improvements in the efficiency of AFCA. Likewise, the CSLR should be able to negotiate downwards the high fees that are being paid to ASIC for the processing of invoices.

(d) The current scope of the CSLR and any related matters

The narrow scope of the CSLR creates problems at two important levels:

- It excludes clients from obtaining compensation for misconduct with respect to Managed Investment Schemes, general advice and wholesale advice. The fact that these areas are not in scope for the CSLR, incentivises a range of parties to define failures in these areas as financial advice failures, increasing the costs of the scheme without an ability to recover from the sectors responsible.

- Those financial services sectors which are currently outside the scope of the CSLR also have a strong incentive to distance themselves from paying any special levy (above the sector cap), which is at the discretion of the Minister.

Together, these two points increase the costs of the scheme while reducing the number of sectors who pay for it. This is completely inconsistent with the principles of fairness and equity in the EDR framework. Urgent legislative change is necessary to fix this problem.

Previous evidence on collapses and unpaid determinations points to MISs being a key source of client losses. We also note the important role they have played in the losses sustained by Dixon Advisory (URF) and UGC (GCPF) clients.

We recommend the inclusion of MISs in the scope of the CSLR, along with general and wholesale advice, and we suggest that law change needs to happen to fairly apportion loss between advice failings and product failure, where both have contributed to consumer loss.

Recommendations

Based on the issues the FAAA has presented in this submission, we provide the following recommendations for the consideration of Treasury and the Government.

Design

1. **Amend the "non-apportionable claims" classification under the proportionate liability statutes to allow AFCA to consider and apportion liability of complaints involving financial product failures and financial advice matters, including in circumstances involving potential breaches of the best interests duty and failure to give appropriate advice obligations.**

We seek a review of the law with respect to the apportionment of claims, so that the law better enables a fair allocation of responsibility in situations where there are both advice and product failings. We seek this as a broader improvement to the regulatory regime that we operate under and as a mechanism to ensure that the CSLR operates on a fairer and more sustainable basis. It is not reasonable for an individual financial adviser to be held fully responsible for a product failing, where they could not have reasonably understood the risk of

negligent conduct by the product provider, simply because they made a relatively minor error in the provision of financial advice.

2. **Provide greater certainty on what the Minister will do in the event of a special levy being required and limit the exposure of the financial sector to the original sector cap of $10m.**

At present, our sector could be exposed to a special levy for up to the additional amount between the sector cap of $20m and the overall annual cap of $250m. Specifically, the financial advice profession faces an additional exposure of $50m for the 2025/26 financial year and then potentially as much as $100m in 2026/27.

This is a huge level of uncertainty that could be left unresolved for many months or even over a year. It is not appropriate to have such a large contingent liability held over the heads of a small business sector like the financial advice profession. We argue that the law needs to change to avoid such a large exposure for any sector, however particularly with respect to a small business sector.

We propose firstly that the sector cap be reduced to $10m, and that any amount above the cap be shared equally across all ASIC regulated sectors.

3. **Review the definition of 'person' in s1067 of the Corporations Act to ensure that the CSLR's $150,000 cap is applied in an appropriate manner to any AFCA claim to avoid the risk of duplication of compensation payments by the CSLR.**

A couple is often treated as one client by the financial adviser – where the circumstances and advice relate to the couple as one client who want to achieve one set of shared goals. In addition, singular advice is generally provided to a trustee and member of an SMSF. However, there is a risk of the CSLR's $150,000 per claim cap being applied in multiple capacities relevant to the one client. For example:

- a complainant's claim being lodged twice – both as a trustee and as a member of an SMSF
- a couple being treated as two separate claims, even though the advice was provided to the couple as one client.

A complaint should not be split into two separate compensation claims for the one piece of advice.

4. **Amend the law to ensure that there is certainty with respect to the proceeds of class actions being offset against claims against the CSLR.**

We have been advised that the law does not provide sufficient certainty with respect to the treatment of the proceeds of class actions. The prominent case in this regard is the Dixon Advisory Shine Lawyers class action. It is essential that any payment as a result of a class action can be offset against the amount owed under an AFCA Determination, and therefore reduce the claim payable by the CSLR.

5. **CSLR claims made as a result of an AFCA Determination where they have assessed general advice as being personal advice, despite being provided by a person who is not authorised to provide personal advice, should be charged to the General Advice sector.**

Cases have already come to light where a person who was only authorised to provide general advice was judged by AFCA to have provided personal advice, and compensation then awarded on the grounds of poor

personal advice. Where the licensee is authorised to provide both general advice and personal advice, such claims are processed against the personal financial advice sector and could result in the payment of a claim from the CSLR in the event that the firm becomes insolvent. There are already cases of this (i.e. APT Strategy).

It is not right that financial advisers could pay for the misconduct of others, such as the general advice provider in the example above. The cost of these claims should be applied to the general advice sector.

6. **CSLR claims made as a result of an AFCA Determination where they have assessed advice provided by a wholesale only adviser as being personal advice to a retail client should be charged to the Wholesale Advice sector.**

We are aware of a current case of a business that was run as a wholesale advice business, that has since collapsed, where the clients are arguing that they should have been treated as retail to be eligible for the CSLR.

It is not right that financial advisers could pay for the misconduct of wholesale client advice providers. The cost of these claims should be applied to the wholesale advice sector.

7. **Ensure that resources are made available to the CSLR, or another appropriately appointed entity, to pursue action against firms, related entities and directors when an advice business is placed into administration with unpaid AFCA determinations. We envisage that this could operate similar to the Fair Entitlements Guarantee Recovery Program and should be Government funded.**

As noted above, the FEG Recovery Program has managed to recover $470m where advances have been paid to employees of liquidated businesses. The FEG Recovery Program has a strong reputation and track record for pursuing entities and individuals. This regime includes the FEG Recovery Program funding litigation by liquidators. We envisage a similar approach could apply with respect to financial advice firms which have been placed into administration/liquidation and are the subject of an AFCA determination and a CSLR claim. Taking this approach will play an important deterrent role.

The Government should ensure that every effort is made to investigate, sanction and recover against corporate misconduct that results in the payment of a claim by the CSLR.

Such a function would require appropriate funding and resourcing. The Government should make funding available for an entity to serve this purpose.

8. **Ensure that resources are made available to appropriately defend AFCA complaints subject to the CSLR, including Dixon Advisory and UGC.**

Every complaint should be adequately investigated and defended by a suitable party as a matter of process and natural justice to determine the most appropriate outcome is reached.

Failure to adequately defend cases may result in additional and unnecessary costs being added to the already unreasonable burden being imposed on financial advisers who are doing the right thing. Where a financial firm has been put into administration or liquidation, the administrator or liquidator has no incentive to defend the claim, as it will ultimately be paid by the CSLR, and any payment is likely to benefit their creditors.

The Government should make funding available for an entity to serve this purpose.

9. **Increase the penalties for entities and directors that refuse to pay compensation under an AFCA determination.**

If a firm refuses to pay compensation under an AFCA Determination, and the complaint is eligible under the CSLR Rules, the complainant can lodge a claim with the CSLR for payment. While the firm will lose their AFS licence for refusing to pay the compensation, it is apparent that this is insufficient penalty to deter such refusals, in the context of the CSLR. Knowing the CSLR will likely cover unpaid Determinations may incentivise non-payment by some firms, particularly those with other advice entities in the group to which the assets (including clients and advisers) can be transferred.

In relation to Dixon Advisory, we have seen little evidence (other than the Paul Ryan case) that the actions of directors and senior management is being investigated or prosecuted. This is likely to embolden those who are considering this path. It is likely that some believe that they can get away from this responsibility, particularly when the law allows them to put a subsidiary into administration with relative impunity. Some options we would recommend for consideration include the following:

- The CEO of a company that places a subsidiary into administration with unpaid AFCA determinations should be forced to face a parliamentary inquiry to answer questions.
- The CSLR levy regime should allow for special levies to be applied to parent entities or other related businesses to pay a penalty levy to the CSLR.
- Law change to make the parent entity more responsible for the conduct of subsidiaries.
- Stronger regulatory action to prevent phoenixing activity.

10. **Review the responsibility of parent companies and ensure they are required to maintain professional indemnity insurance for related entities that are placed into administration.**

As noted above, we believe that a parent entity that places an advice subsidiary into administration should retain some responsibility for the clients of that business and as such should be required to retain existing Professional Indemnity insurance for the remaining term that the financial firm is required to be a member of AFCA. (Alternatively, they could be required to purchase run-off cover for at least three years).

11. **A formal review of the affordability, availability and adequacy of professional indemnity insurance for AFSLs should inform a policy decision on run-off insurance.**

Financial advice firms are required to have PI insurance, however as has been illustrated many times, it does not always work and serve to protect consumers. The former Government commenced a review of PI insurance arrangements, however this review was never completed and no surveillance is currently being done to ensure the adequacy of existing arrangements. We recommend that further work be done to ensure that PI insurance cover for financial advice firms is fit for purpose.

12. **If financial advisers are expected to pay for the misconduct of their peers and others, then they should have greater capacity to report misconduct and obtain some level of protection in the event that they have reported a matter that is not adequately investigated by ASIC.**

Where misconduct that occurs in the financial advice profession and broader financial services industry is identified and reported to ASIC, it is important that ASIC takes appropriate action. Should ASIC receive one or more actionable reports of misconduct, and then fail to take the necessary action, financial advisers should not be liable for CSLR claims related to that firm. We would further suggest that as part of ASIC's reporting on insolvent firms that are the subject of a CSLR claim, ASIC should disclose whether they had received any complaints or reports of misconduct with respect to that firm.

Scope

13. Extend the scope of the CSLR to cover all AFCA members, but particularly Managed Investment Schemes (MISs).

Substantial consumer harm has been caused by product failure rather than advice failure, harm that currently has no recourse (eg Sterling etc). People have lost their homes and life savings.

The current situation encourages inappropriate risk-taking and higher risk products to be launched, sometimes targeting older consumers with insufficient financial resilience to withstand losses. These consumers then become entirely dependent on the social security system.

Without any coverage for product failure, our concern is that all future product and MIS failures where financial advice was provided, will be defined as advice failures, even though many (including Dixon Advisory and UGC) are caused or substantially contributed to by product failures.

Funding

14. Remove the retrospectivity from the Compensation Scheme of Last Resort.

Retrospective laws are flawed in principle. They breach the reasonable expectations of citizens that future laws will not be passed that affect their conduct or obligations today. This principle goes back to Roman times – it is unjust to legislate for the past.

When originally proposed, the CSLR was announced as a prospective scheme, however in practice, financial advisers are paying for collapses that occurred before the scheme commenced and for cases that were submitted to AFCA before the legislation was passed and well before the CSLR commenced.

To address this, we propose that the Government pay for all cases submitted to AFCA prior to 2 April 2024, being the date the CSLR commenced.

15. Government to pay for first 12 months of claims and operations of the CSLR.

The Government originally committed to paying for the first 12 months of the CSLR scheme, including operating costs and claims when the legislation was first tabled in October 2021 by the Morrison Government and then again when it was first tabled by the Albanese Government in September 2022. It was later changed in the March 2023 version of the legislation to be a period defined by the Minister, without any consultation with the financial advice profession and without any disclosure of the likely regulatory impact. This change resulted in the period covered by the Government being reduced to less than 3 months and them paying just $4.8m, when the later periods have proved to be excessively more expensive. In our view this is a serious breach of trust by the Government. Where the scale of the exposure has rapidly grown as a

result of groups like Dixon Advisory and UGC, that pain should be shared by the key stakeholders, not handballed by the Government to the small business financial advice sector.

To ensure that the Government meets its original commitment to pay for the first 12 months of the scheme, we propose that the Government pay for all cases submitted to AFCA between 1 July 2024 and 1 April 2025 (thus ensuring that they are paying for the first year of operation, from 2 April 2024 to 1 April 2025).

16. Sector cap to be reduced to $10m.

Consistent with the original version of the legislation, and when taking into account the potential consequences of a scheme of this nature, the sector cap should be reduced back to the originally proposed $10m. As recommended above, we have also suggested that any amount above the sector cap should be share across the broader financial services sector.

17. Legislate to enable a special CSLR cost to be levied against an integrated financial group that has placed a subsidiary entity into administration/liquidation to avoid paying compensation to consumers.

Whilst the 'corporate veil' seems to serve to protect parent entities and related entities in the context of a business being placed into administration with unpaid determinations, this should not prevent the CSLR levy regime from imposing a special levy on a parent entity or a related entity. This might also be achieved through changes to the AFCA Constitution such that a parent company was a deemed member of AFCA.

In the case of Dixon Advisory, in the context of the scale of losses incurred, E&P Financial Group (or its subsidiary Evans and Partners) should pay a special levy to contribute to the cost of claims, particularly given that around 80% of the clients and advisers were transferred to this entity from Dixon Advisory, and the broader group earned substantial fees from the URF in the years prior to Dixon Advisory being put into administration.

It is deeply unjust that advisers are being asked to fund compensation for the clients of a large listed (until December 2024) entity, like E&P Financial Group, that continues to operate and in fact has retained many of the clients under advice and their associated fees. This equates to allowing phoenixing activity to occur to the detriment of consumers. It is particularly egregious that this group will invest and earn fees from the compensation paid to its clients by the CSLR.

While insolvency law might be hard to change, the government has broad power to expropriate and has used that power already for the CSLR, against the 10 largest financial institutions, to fund claims made before 22 September 2022 to the tune of $241m.

The government could establish a principle in the legislation based on common ownership and/or directorships, that a given proportion of revenue be levied against the parent entity if any subsidiary company has caused its customers to have recourse to the CSLR. This would be a tangible disincentive to future phoenixing activity.

The CSLR Levy legislation should be amended to allow a penalty of some form to be applied against the parent entity of a subsidiary that is placed into administration. This penalty should be attributed against the total levy payable for the relevant sector. This penalty should not be paid into Consolidated Revenue.

18. **Fines and penalties resulting from ASIC action taken against financial firms for wrongdoing causing consumer detriment, should be allocated to cover the cost of the CSLR.**

Currently any fines and penalties that are generated as a result of cases undertaken by ASIC, are paid to Consolidated Revenue. In the case of Dixon Advisory, a penalty of $7.2m was awarded for their breaches of the law. Although this was never collected, if it had been collected and the firm then later went into administration with unpaid determinations, then the penalty should be transferred from Consolidated Revenue into the CSLR to help cover the costs of those claims.

19. **We are seeking a commitment that the Minister will not levy the financial advice profession for more than the current $20m annual sector cap for the 2025/26 year.**

Any excess above the sector cap should be shared more broadly across other sectors of the financial services industry, which also benefit from increased consumer confidence in the financial sector. Impacted clients would not miss out on compensation, and the funding load would be shared more fairly.

In the absence of this commitment, the financial advice profession faces an existential threat that could serve to create another major exit of financial advisers and severely limit the flow of future new entrants into the profession. The impact this will likely have on the cost of advice for consumers is counter to the government's agenda to improve access and affordability of financial advice for Australians.

Last Resort

The following AFCA related recommendations have been placed under a separate heading of Last Resort, which is a set of recommendations to ensure that the CSLR is operating as a genuine scheme of last resort.

20. **There are a range of measures that should be taken to ensure that the CSLR is genuinely operating as a last resort, including the following:**

    - **Paying compensation on the basis of capital loss, not the 'but-for' methodology used by AFCA with respect to ongoing firms.**
    - **Not including interest in the calculation of any CSLR claim.**
    - **In the case of frozen funds or where an investment is in liquidation and a distribution is unknown, then the assessment of loss should wait until the fund is unfrozen or the distribution from the liquidation is finalised.**

AFCA and Methodology

21. **As proposed in recommendation 1, amend the "non-apportionable claims" classification under the proportionate liability statutes to allow AFCA to consider and apportion liability of complaints involving financial product failures and financial advice matters, including in circumstances involving potential breaches of the best interests duty and failure to give appropriate advice obligation.**

22. **Limit membership of AFCA to the period specified by ASIC, and no more than 12 months after the licence is suspended/cancelled.**

Dixon Advisory was placed into administration in January 2022. In April 2022, ASIC announced the suspension of the Dixon Advisory licence and noted that Dixon Advisory was required to remain a member of AFCA until April 2023. This was later updated to April 2024 through nothing other than a foot-note to the previous media release. Despite ASIC's stipulated end date of 8 April 2024, AFCA did not formally cease the membership until 30 June 2024.

AFCA should not be able to extend the membership any further than that required by ASIC, and the Board should be able to meet in advance of that deadline to agree to the cessation of the membership.

Whilst we believe that it is appropriate for clients to have a reasonable opportunity to make a complaint, this should not be open ended and uncertain. It should not be subject to unexplained delays and confusion. There should be a fixed period that clients can be told and then acted upon.

23. As discussed in recommendation 8, a body should be appointed and resources should be made available to appropriately defend AFCA complaints subject to the CSLR, including Dixon Advisory and UGC.

24. AFCA should be required to deliver case decisions for insolvent firms in the most efficient manner possible, and the CSLR Operator should have the power to negotiate a different pricing regime than applies to standard AFCA cases.

We believe that it should be possible for AFCA to complete the review of cases for large scale matters like Dixon Advisory in a much more efficient manner than may be possible in stand-alone cases. A better mechanism should be available to hold AFCA accountable for their costs.

The CSLR Operator should also have the powers to negotiate a separate fee model for CSLR complaints.

Insolvency

25. Government to undertake a review to assess potential changes to the insolvency law to make it more difficult for a parent company to walk away from a subsidiary and leave it to the broader profession to cover the cost of unpaid determinations.

Not only was E&P Financial Group able to walk away from Dixon Advisory with limited complications, despite the scale of the client losses, they were also able to take steps to avoid any payment for the transfer of advisers and clients to another wholly owned subsidiary (Evans and Partners). What is more, the efforts of ASIC to challenge some of this conduct through the action taken against Director Paul Ryan proved unsuccessful.

This is not right, and as a result it is essential that the law is assessed to see the extent to which this conduct was allowed by the law and whether changes are necessary.

26. Government should consider law changes to enable recovery of fees received by the parent or related entity of a product entity that later failed.

E&P Financial Group extracted hundreds of millions of dollars from the URF over a number of years, on the basis of a highly conflicted business model and, potentially, non compliance with the original URF PDS. The way that they were able to do this, and then later pass the responsibility to the financial advice profession is

appalling, and should warrant consideration of the adequacy of the law including consideration of laws that would enable the recovery of fees that were paid by clients with respect to failed products in the years leading up to a collapse.

27. The law should stipulate minimum asset values for the transfer of advisers and clients.

E&P Financial Group publicly confirmed in their June 2022 financial results announcement that they had transferred 78% of Dixon Advisory clients to Evans and Partners. ASIC in response to Senate Estimates Questions on Notice confirmed that 3,280 clients transferred to Evans & Partners. It is quite possible that the transfer of these clients had commenced earlier than the business going into administration. These clients and the fees that they would generate in the future, were an asset of the business. As we understand, Evans & Partners did not pay anything for the transfer of these clients. The creditors of Dixon Advisory, who were the clients of Dixon Advisory, were deprived of their own value in the windup of Dixon Advisory.

We would therefore suggest that there should be a minimum value attributed to the value of a client book in such circumstances and that power should vest with the CSLR to ensure that this is paid.

There is also an important legal principle being violated here, that a wrongdoer should not benefit from their wrongdoing. It should not be possible for the same parent entity that avoided paying compensation to its own clients, to ultimately receive and benefit from that compensation paid by others.

28. Government should establish a body similar to the Fair Entitlements Guarantee Recovery Program to ensure that all possible avenues are pursued to maximise the return from any liquidation for the benefit of creditors/clients. Every effort should be given to the recovery of funds from parent entities, directors, lawyers and auditors.

Every option must be considered with respect to the recovery of funds from parent companies, related entities, directors, auditors and lawyers involved in a transfer of liabilities to the CSLR. In the case of Dixon Advisory, there were lawyers and insolvency experts involved. The same auditor was responsible for the audit of the URF and other group companies over a number of years. It is essential that consideration is given to any option to take action against these parties for the recovery of funds.

29. Consistent with the Fair Entitlements Scheme consultation, legislation should be put in place to enable a court to issue a contribution order to a parent or related party of a business that walks away from meeting its commitments to pay AFCA determinations.

The Department of Employment and Workplace Relations has commenced a consultation with respect to the Fair Entitlements Guarantee. The consultation paper has proposed a number of recommendations that are potentially equally relevant to the CSLR. One of these is the suggestion that related and parent entities be forced to make a contribution to compensation owed by another entity in the group.

30. Consistent with the Fair Entitlements Scheme consultation, consider law reform to enable other group entities to be held jointly and severally liable. This definitely should be the case where another entity in the group has been able to extract a significant amount of fees from the impacted clients.

The consultation noted above has also canvassed the concept of group entities being held jointly and severally liable for compensation owed to the clients of another group entity.

31. **Ramp up regulatory oversight of insolvency practitioners to ensure that they are held accountable for maximising recoveries for the creditors/clients of insolvent financial firms.**

In the context of the operation of the CSLR, it is critical that each insolvency practitioner appointment be subject to a proper investigation, including full consideration of matters such as the appropriate investigation of transfer of assets for less than market value, other uncommercial transactions and the extinguishment of intercompany loans. ASIC are responsible for the oversight of the insolvency profession, and will need to step up in terms of the activity that they undertake in this space.

ASIC and Enforcement

32. **If our sector has reported a financial firm or adviser of concern, and ASIC has chosen not to take any action, or has substantially delayed action, the financial advice sector should be indemnified against having to pay for any future CSLR claims resulting from that firm's activities.**

The only action advisers can take to protect themselves against future CSLR costs is promptly reporting any problems they are aware of to ASIC, to minimise any potential consumer loss. Advisers in any case already have an obligation to report suspected wrongdoing to ASIC, and are doing so.

However financial advisers have no control over whether or how quickly ASIC will act on reports of potential wrongdoing. ASIC is only acting on approximately 1% of the reports it receives (Senate Economics Committee report – July 2024).

ASIC has no requirement to report back to the financial advice sector or publicly on how many matters they have been alerted to and whether they have actioned any of those reports. ASIC currently holds no risk in not taking action, or delaying action, against wrongdoers. All their costs get paid by each sector via the ASIC Industry Funding Levy, whether or not ASIC takes action, and whether or not that action is successful.

33. **ASIC should be required to report annually on its investigations, findings and regulatory action taken in relation to reports of misconduct that ultimately ends up with insolvent businesses, where clients are being compensated by the CSLR.**

We seek greater visibility of and accountability for how ASIC responds to reports of misconduct that ultimately end up with the clients being compensated via the CSLR. This should include annual reporting covering what was discovered and what regulatory action was taken. ASIC reporting is more than likely to be after the investigation is complete or at least public. Such reporting should focus on what ASIC have done with respect to firms that are the subject of a CSLR payment. Such firms would most likely already be in administration or liquidation. Some reasonable exemptions from the reporting would be required for matters that are still subject to investigation, however only for a limited period.

34. **Review ASIC's powers and investigation processes to ensure the Regulator provides appropriate oversight of firms that provide financial advice and financial products. This should include a requirement to look beyond the financial advice client files. Where there is significant consumer detriment impacting a material number of clients, ASIC should be required to investigate the financial services value chain, including product development, research and performance, the entity's investment committee considerations of in-house products and any associated fees, and potential conflicts arising with related entities.**

There were significant and systematic conflicts of interest evident within the management of Dixon Advisory and related entities, particularly between the advice entity and its related in-house products. Based on publicly available information, these matters were seemingly not investigated by the Regulator. The apparent focus of the ASIC investigation was on the financial advice – via the client advice files – rather than the business model. This allowed these practices to continue despite ASIC's 2015 surveillance of Dixon Advisory, to the detriment of consumers.

Given that it has evidently not been tested, we are uncertain as to whether the law is clear enough and ASIC has sufficient power to pursue matters involving misconduct on the part of a funds management business such as the URF, or where there are systemic conduct issues that are encouraged and condoned by directors and senior management.

35. Establish an obligation on the product provider to obtain independent research when distributing in-house products. Advice licensees that recommend related party products should also have increased disclosure obligations, including annual reporting on updates to independent research, the percentage of that product that the licensee's clients have invested in and data on the extent to which the product is illiquid

It appears that neither Dixon Advisory, nor any other entity in the Dixon business group, ever sought independent research on its in-house product, the URF (and presumably other in-house products). Given the extent to which the URF was almost exclusively distributed via the in-house advice arm to the clients of Dixon Advisory, and the consumer detriment caused by the poor performance of the product, there should be rules to place an obligation on the product provider entity to seek independent research on in-house products. This research should also consider the potential consequences of a high percentage of the fund being held by the clients of just one licensee.

Research should always be the product provider's responsibility. Where a vertically integrated group plans to distribute an in-house product via a related entity advice licensee, independent research must be provided to both the AFSL investment committee and the financial advisers.

We would further recommend that licensees which recommend related party products, particularly those that predominantly comprise unlisted assets, should be subject to additional disclosure obligations to help clients to understand the additional risks that they face. Many clients of Dixon Advisory, who owned units in the URF did not appreciate that Dixon Advisory clients made up between 85% and 95% of URF investors. They assumed that it was a broadly distributed product. This level of concentration also meant that it would have been extremely difficult for Dixon Advisory to place the product on 'sell', as the resulting run on the fund would have precipitated the very losses to their clients and potentially the collapse of the fund, that they were trying to avoid.