FINANCIAL SERVICES COUNCIL

22 May 2026

Director
Programs and Redress Unit
Treasury
Langton Crescent
Parkes ACT 2600

By email: CSLR@treasury.gov.au

Dear Director,

RE: Feedback on the Compensation Scheme of Last Resort – reform options to support ongoing sustainability

The Financial Services Council (**FSC**) welcomes the opportunity to make a submission to Treasury's consultation on reform options to support the ongoing sustainability of the Compensation Scheme of Last Resort (**CSLR**).

About the Financial Services Council

The FSC is a peak body which sets mandatory Standards and develops policy for more than 130 member companies in one of Australia's largest industry sectors, financial services. Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, and financial advice licensees. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing more than $4 trillion on behalf of over 16.9 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is one of the largest pools of managed funds in the world.

Consultation Response and Consideration of Policy Trade-Offs

This consultation paper contains several sensible reform proposals that could meaningfully contribute to making the scheme more sustainable. In particular, the FSC supports the proposals to enable the CSLR to deduct payments from compensation, enhance the CSLR operator's subrogation rights, limit CSLR-eligible compensation to capital losses, account for where losses are offset by gains elsewhere in the relevant investment portfolio, and limit SMSF-related exposure such as through having SMSFs opt-in to CSLR eligibility. These reform proposals have the dual benefit of better aligning the scheme to its policy intent and bringing down its costs.

It is important to also consider the proposals in this consultation paper in light of Treasury's broader consultation package which deals with enhancing supervision and data-collection around managed investment schemes, curbing harmful lead generation activity and introducing trustee compensation obligations. In the FSC's view, these reforms rather than a repeatable waterfall levy model based on perceived "connection" to misconduct are what

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would create the genuine feedback loops and behavioural incentives needed to reduce future CSLR claims. A levy framework that distributes costs based on notions of "connection" risks becoming a proxy for fault attribution, despite Treasury's stated intention that they would not be. Once the broader reform package is taken into account, the already questionable policy rationale for embedding a permanent "connection"-based special levy framework is significantly diminished, and we encourage Treasury to take a pragmatic approach to the special levy that spreads the costs as widely as possible with the recognition that any entity caught, regardless of sector, is by implication paying into a scheme for wrongs that they have no connection to.

In terms of sequencing, the FSC recommends that the Government should prioritise enabling the CSLR to deduct payments from compensation (proposal #1), limiting CSLR-eligible compensation to capital losses (proposal #4) and excluding SMSFs by default (potentially allowing SMSFs to opt-in to CSLR eligibility) (proposal #6). These reforms should be progressed without delay, as costs continue to climb, placing significant and growing pressure on industry participants.

To be effective, these reforms should not be limited to future claims alone. They should also apply to claims that have already been lodged with the CSLR but have not yet been determined or paid. This includes the cohort of claims underpinning the CSLR Operator's initial levy estimate for FY 2027. Applying the reforms to this pipeline of claims is essential to ensuring the scheme delivers short-term and meaningful cost relief, consistent with its objective of operating as a sustainable scheme of last resort.

Finally, the FSC welcomes the paper's acknowledgement that industry requires certainty and cannot be expected to fund indeterminate liabilities in the form of special levies on an ongoing basis. This recognition underpins Treasury's proposed special levy framework. However, any such framework should be explicitly time-bound, with a clear cut off date based on the anticipated claims on the CSLR following the structural reforms taking effect. It is important that the next special levy is clearly accompanied by reforms to support the scheme's sustainability. Otherwise, it may simply entrench the expectation of ongoing levies, rather than ensuring that such levies remain genuinely exceptional.

We would be pleased to provide Treasury with additional information in support of this submission on request. If you would like to discuss this submission further, please contact Julia Hukka, Policy Manager for Superannuation and Investment Platforms at jhukka@fsc.org.au.

Yours sincerely,

Chaneg Torres
Executive Director, Policy

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1. Recommendations

The table below outlines the FSC's recommendations against the consultation paper's proposals.

Treasury Proposals	FSC Recommendations
Enabling CSLR to deduct payments from compensation	**Recommendation 1:** that the CSLR regulations should be updated to require the CSLR operator to calculate compensation on a net loss basis, taking into account all relevant recoveries connected to an AFCA determination. This should be supported by a principles-based framework that includes obligations for the claimant to disclose and notify relevant recoveries, allows the CSLR Operator to apply materiality thresholds, and supports timely compensation through the use of a limited clawback period. The ability for the CSLR operator to take relevant recoveries into account should also apply to existing claims progressing through the CSLR.
Expanding CSLR subrogation rights	**Recommendation 2:** that the CSLR framework should be amended to expand the CSLR operator's subrogation rights in line with Option 2, including removing legislative barriers to pursuing recoveries across a broader range of sources and ensuring consistency across jurisdictions. This should be complemented by a statutory obligation on the CSLR operator to use reasonable endeavours to pursue recoveries where viable, rather than merely conferring a discretionary right. To support the effective exercise of these powers, licensees with unpaid AFCA determinations should be required to provide the CSLR operator with relevant professional indemnity insurance information, and regulatory settings should facilitate appropriate information sharing (including via ASIC). The FSC also recommends Treasury investigate the merits of either giving CSLR operator debts priority unsecured creditor status or another means of streamlining the operation of subrogation rights.
Technical Improvements	**Recommendation 3:** that Treasury should prioritise amendments that ensure CSLR payments are limited to conduct and products within the scheme's intended scope, alongside reforms to align special levy liability with the qualifying period and exempt non-participants from future levies. These measures should be implemented concurrently to prevent avoidance behaviour and support equitable levy allocation.
	Recommendation 4: that Treasury recommend retaining the 15 sitting day disallowance period. Maintaining appropriate Parliamentary scrutiny is essential to ensuring accountability and oversight of decisions with significant financial implications.
Revising the treatment of counterfactual loss for CSLR-eligible financial	**Recommendation 5:** that the CSLR compensation framework should be amended to adopt a capital loss-only methodology, replacing the current counterfactual approach. This reform should be prioritised as one of the most effective means of achieving scheme sustainability and ensuring it operates as a genuine last resort. It should be supported by targeted safeguards to distinguish losses arising from misconduct from

advice complaints	those driven by broader market movements, and should apply to existing claims progressing through the CSLR as well as future claims.
	Recommendation 6: that if the actual loss methodology is adopted, the CSLR Operator should be responsible for recalculating compensation amounts by removing the counterfactual component from AFCA determinations.
	Recommendation 7: that if a counterfactual component is retained, it should be based on CPI as a simple benchmark that preserves the real value of capital without introducing elements of hypothetical investment return or opportunity cost. This approach would better align with the CSLR's role as a last resort compensation scheme.
Embedding greater certainty in the special levy framework	**Recommendation 8:** that Treasury should prioritise structural reforms to address the underlying cost drivers of the CSLR - particularly removing the counterfactual component, enabling deduction of offsets, and excluding SMSFs by default but potentially allowing SMSFs to opt-in to the CSLR, before embedding any enduring special levy framework.
	Recommendation 9: that any special levy should, as a matter of principle, be applied on a broad-based basis across the financial services sector, reflecting the collective benefit of the CSLR and avoiding attempts to allocate costs based on perceived "connection" to misconduct or regulatory effort.
	Recommendation 10: that if a "waterfall" levy framework is adopted, it should be explicitly time-bound with a clear cut-off date after which it should be subject to review, and should not established as a permanent or repeatable feature of the CSLR funding model.
	Recommendation 11: that if trustees are required to hold or maintain access to capital for the purposes of a new trustee compensation mechanism (as proposed in Treasury's consultation paper on *Enhancing member protections in the superannuation system*), then they should either be exempt from CSLR special levies relating to the same underlying conduct or receive a proportionate reduction in levy obligations.
Considering responses to the role of SMSF losses in reducing pressure on the CSLR	**Recommendation 12:** that Treasury should proceed with excluding SMSFs by default, with a potential opt-in model for SMSF participation in the CSLR, ensuring that only those SMSFs that actively elect to be eligible for the scheme are subject to levy obligations.
	Recommendation 13: that Treasury should review the appropriateness of the current $10 million threshold for classifying SMSF trustees as retail clients for the purposes of AFCA and CSLR eligibility, to ensure it better aligns with the policy intent of the scheme and appropriately reflects investor sophistication and capacity to pursue alternative remedies.
	Recommendation 14: that SMSFs should contribute to the next CSLR special levy recognising that SMSFs form part of the broader financial system ecosystem that have already been called upon to fund the scheme.

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Facilitating levying of Managed Investment Scheme (MIS)-related losses	**Recommendation 15:** Lower-risk MISs being excluded from any special levy for MIS-related losses can be supported as a principle, however noting the difficulty of defining risk in a clear objective legal way, and noting our previous objections about levies being based on the 'connectedness' of a sector. If apportionment of the levy on MISs based on risk is pursued, ASIC should determine which MISs are lower risk using existing regulatory data and supervisory insights, with the assessment refined over time as ASIC's MIS data collection and analytical capability improves.
Improving recovery of unpaid AFCA determinations within corporate groups	**Recommendation 16:** that Treasury should continue to explore and consult on reforms to strengthen recovery from related entities that have benefited from firms generating CSLR liabilities; however, these measures should be progressed as a medium-term workstream and should not delay or be made a precondition for the timely implementation of more immediate reforms to reduce CSLR costs.
	Recommendation 17: that Treasury should explore and consult on targeted enhancements to existing corporate and insolvency frameworks to strengthen the ability to prevent and unwind asset and value shifting prior to the crystallisation of AFCA liabilities.
	Recommendation 18: that Treasury should explore and consult on the design of a targeted related-entity liability mechanism that enables recovery from entities that have derived a clear and material economic benefit from the activities giving rise to CSLR liabilities.

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2. Proposal 1: Enabling CSLR to deduct payments from compensation

Question 1: Do you support allowing the CSLR operator to reduce compensation payments by considering all relevant amounts that a claimant may receive in connection with the matters covered by an AFCA determination?

The FSC supports Treasury's proposal that regulations be made under paragraph 1067(b)(iii) of *the Corporations Act 2001* (Corporations Act) to enable the CSLR to reduce the compensation payable by any other amounts received by the claimant connected to the underlying matter. This is a sensible reform that better situates the CSLR as a scheme of 'last resort'.

The consultation paper proposes that the compensation payable could take account of:

- any payment or asset received or retained by the claimant in relation to, or in connection with, the matters covered by the AFCA determination, including (for example) insurance payouts, class action settlements, and distributions received under a DOCA process or during liquidation/receivership; and/or
- the value of retained assets where the AFCA determination required those assets to be transferred to another entity.[1]

Some other amounts that were not discussed in the paper but should also be deducted from the compensation payable includes: settlements with related entities (e.g. parent companies), payments arising from private litigation settlements, or any other remediation received in connection to the underlying misconduct. The regulations should also include a residual catch-all empowering the CSLR operator to deduct any other payment or benefit reasonably connected to the matters covered by the determination.

Where complainants have been restored to their pre-loss financial position, regardless of the avenue through which that remediation has occurred, they should not be eligible for additional compensation under the CSLR. CSLR compensation should be contingent on a net-loss position, after taking into account all relevant recoveries.

The regulations should be sufficiently flexible to enable the CSLR operator to take a practical approach in identifying and applying deductions to the compensation payable. This flexibility is important, as there may be instances where the administrative cost of identifying or verifying minor recoveries would outweigh their value, making strict application inefficient.

[1] Treasury, Compensation Scheme of Last Resort (CSLR): Reform options to support ongoing sustainability, April 2026, p.10

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Proposal 5 in Treasury's consultation paper on *Enhancing member protections in the superannuation system* contemplates introducing a compensation model under which platform trustees would remediate consumers in circumstances of theft and fraud.[2] While the FSC's position on that proposal is set out separately (in our submission to the aforementioned consultation paper), the interaction between any such mechanism and the CSLR will be critical. Where a claimant has been fully remediated under a trustee-led compensation framework (or indeed, remediated in full for the underlying misconduct via any avenue), they should not be eligible to access additional compensation through the CSLR for the same loss. Clear rules will be required to ensure the effective coordination between the schemes and the categorisation of trustee remediation as a 'relevant offset'.

This proposal to reduce the compensation payable by any other amounts received by the claimant connected to the underlying matter should also apply to claims that have already been lodged with the CSLR but have not yet been determined or paid. Where consumers have already been made whole through alternative avenues such as trustee-led remediation, access to the CSLR should not be available in respect to the same loss. Allowing additional claims in these circumstances would be inconsistent with the CSLR's design as a last resort mechanism and risks outcomes of over-compensation at the expense of industry participants.

More broadly, ensuring that compensation reflects net loss, after taking into account all relevant recoveries, will help contain scheme costs, reduce the likelihood of recurrent special levies, and support confidence that the scheme is operating as intended.

Question 2: What factors should the Government consider in terms of timing?

2.1. How should the reform balance ensuring timely payment of claims to consumers with ensuring accurate information about other payments?

2.2. Should the CSLR have a clawback mechanism for cases where deductible amounts were not known at the time of payment?

The implementation of this proposal needs to strike a balance between timeliness, accuracy and cost-effectiveness. The FSC proposes the following principles be considered when building the framework to allow for relevant offsets to be deducted from compensation payable.

- Upon applying to the CSLR, claimants should be required to disclose any current or anticipated recovery processes (e.g. insurance claims, insolvency proceedings, class actions or private litigation), and provide updates to the CSLR Operator as those processes progress.
- Claimants should be subject to a continuing obligation to notify the CSLR Operator of any recoveries received (related to the underlying misconduct) after receiving CSLR compensation, within a reasonable timeframe.

[2] Treasury, Enhancing member protections in the superannuation system, April 2026, p.49.

  - If placing the notification burden on claimants is considered impractical, Treasury could also explore the feasibility of establishing information-sharing arrangements between the CSLR Operator and insurers, liquidators, administrators and other relevant counterparties, to facilitate the timely exchange of accurate and up-to-date information regarding recoveries.
- The CSLR Operator should be permitted to apply a materiality threshold when identifying and verifying offsets, so that minor recoveries do not delay compensation or create disproportionate administrative burden.
- Where recovery outcomes are uncertain or delayed (e.g. insolvency distributions), the CSLR should prioritise making timely payments to consumers based on the best available information, rather than deferring payment indefinitely pending final outcomes.
- A clawback period of 2 years should apply, with a limited ability for the CSLR operator to extend this period in exceptional circumstances (e.g. where a material recovery process is clearly underway but not yet finalised). A clawback period of two years strikes an appropriate balance between capturing material recoveries and providing certainty to claimants.
- The primary responsibility for identifying and notifying recoveries should rest with the claimant, rather than requiring the CSLR Operator to independently verify all potential sources, which would be costly and impractical.

Recommendation 1: that the CSLR regulations should be updated to require the CSLR operator to calculate compensation on a net loss basis, taking into account all relevant recoveries connected to an AFCA determination. This should be supported by a principles-based framework that includes obligations for the claimant to disclose and notify relevant recoveries, allows the CSLR Operator to apply materiality thresholds, and supports timely compensation through the use of a limited clawback period. The ability for the CSLR operator to take relevant recoveries into account should also apply to existing claims progressing through the CSLR.

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3. Proposal 2: Expanding CSLR subrogation rights

The FSC supports exploring the expansion of the CSLR's subrogation rights to reduce the cost burden on levy payers and improve the cost effectiveness of CSLR recovery. Through previous submissions in response to the CSLR Post-Implementation review, including the consultation on *Enhancing the effectiveness of financial services professional indemnity insurance*, the FSC has made recommendations to support such expansion.

Question 1: Do you support Option 1 or Option 2 to expand the CSLR operator's subrogation rights?

In line with previous submissions on this topic, the FSC prefers Option 2 which would remove barriers to the extension of subrogation to additional recovery sources, removing current limitations.

The FSC considers it important for the CSLR operator to be obliged to thoroughly assess whether funds may be recovered through its subrogation powers. This should be framed as a duty to use reasonable endeavours to achieve cost recovery, rather than a right to pursue it.

Where there may be practical and legal limitations on the CSLR operator's subrogation rights and powers, the FSC is supportive of amendments to remedy legal issues which we understand the operator has identified with the subrogation powers conferred upon it. The Consultation Paper alludes to a lack of consistency across Australian jurisdictions nationally where legislation can allow a third party to take court proceedings against an insurer directly to recover a claim. On the basis of expanding the CSLR operator's subrogation rights, the FSC supports expanding this legislation to all States. Ideally, however, the CSLR operator would have standing to pursue a claim against an insurer outside of the court application process similar to insolvency practitioners.

The FSC supports the expansion of the CSLR's subrogation rights as described in paragraphs 24-25 of the consultation in relation to Option 2. It is an important clarification that "any expansion in relation to PII would be limited to enabling CSLR to pursue recoveries where cover exists and the relevant legal pathway permits, rather than altering insurers' substantive liability under policy terms." (paragraph 25)

With respect to Option 1, the FSC questions whether this may lead to a change in approach to the underlying policy with respect to the CSLR, possibly expanding its remit beyond that which was initially contemplated. As a last resort scheme the CSLR is limited to paying, and therefore recovering, $150,000 per determination. As a 'backstop' the CSLR is therefore not the only recovery mechanism for consumers who may be also be eligible for payment from other recovery sources, including above the CSLR cap. The FSC's primary concern is to ensure there is structural change to reduce the extent of losses eligible for payment rather than expanding the base of the scheme itself to address the expectation for burgeoning

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future losses. We understand the thinking behind this Option, however, we believe there are higher priorities for reforming the scheme.

In previous submissions the FSC has also recommended Treasury investigate the merits of either giving CSLR operator debts priority unsecured creditor status or another means of streamlining the operation of subrogation rights. Under the Corporations Act, the CSLR Operator may only exercise subrogated rights once compensation has been paid. This can result in substantial delays, many of which are outside of the CSLR operator's control and may prejudice the CSLR operator's standing in any insolvency. While the FSC suggests the CSLR operator's priority should increase, any such priority should not supersede existing PI insurance claims given this is, and should remain, the first line of protection.

Question 2: Are there sufficient benefits to pursuing legislative reforms in the context of limited recoveries?

As discussed in the consultation paper, the CSLR operator's experience to date indicates that recoveries under the current subrogation framework are very limited having received only one distribution of $18,129. We expect that the Operator would like to have greater scope to pursue greater recoveries but we understand this is stymied by legislative barriers and inconsistencies across jurisdictions. The FSC believes it is worth considering the expansion of the operator's subrogation rights to test how effective it can be in recovering these losses, and we expect industry would support the operator's future recovery efforts.

In addition to legislative change to align the Operator's subrogation rights across jurisdictions, the CSLR operator should be obliged to thoroughly assess whether funds may be recovered through its subrogation powers. Changes to frame its obligation as a duty to use reasonable endeavours to achieve cost recovery, rather than a right to pursue it, would encourage the Operator to make greater use efforts to pursue these activities.

To facilitate the exercise of these rights, licensees with unpaid AFCA claims should also be legally required to disclose a copy of their professional indemnity insurance policy to the CSLR operator. Alternatively, ASIC should be authorised to provide the CSLR operator with the latest copy of a PI insurance policy provided to them during the AFS licence registration/renewal process.

Recommendation 2: that the CSLR framework should be amended to expand the CSLR operator's subrogation rights in line with Option 2, including removing legislative barriers to pursuing recoveries across a broader range of sources and ensuring consistency across jurisdictions. This should be complemented by a statutory obligation on the CSLR operator to use reasonable endeavours to pursue recoveries where viable, rather than merely conferring a discretionary right. To support the effective exercise of these powers, licensees with unpaid AFCA determinations should be required to provide the CSLR operator with relevant professional indemnity insurance information, and regulatory settings should facilitate appropriate information sharing (including via ASIC).

The FSC also recommends Treasury investigate the merits of either giving CSLR operator debts priority unsecured creditor status or another means of streamlining the operation of subrogation rights.

4. Proposal 3: Technical Improvements

Question 1: Do you support the additional technical improvement proposals?

Overall, the FSC supports the majority of the proposed technical improvements with minor qualifications:

#	Proposed improvement	FSC View
1	Allow payments to multiple accounts.	The FSC supports this change as it will likely improve claimant satisfaction, with no foreseeable impact on CSLR costs.
2	Non-participant exemptions for further special levies.	The FSC supports this change, however, recommends that it be implemented in conjunction with the proposal to align the special levy imposition with the qualifying period. That way, liability is determined by participation during the qualifying period and so entities that have exited can still be exempt from future levies, but not from levies relating to periods in which they were active.
3	Minimum levy imposition for special levies	The FSC supports this change.
4	Define entity metric for market participants	The FSC supports this change.
5	Prevent payments being made for unauthorised conduct and for products/services that fall outside scope of CSLR.	The FSC supports this change as it aligns the CSLR with its intended scope and ensures the scheme does not fund the components of claims relating to unlicensed activity and unauthorised products.
6	Disallowance period	The FSC **does not** support reducing the disallowance period from 15 to 5 sitting days. Given that the CSLR levy represents a significant charge on industry imposed through the exercise of Ministerial discretion, it is important that appropriate Parliamentary scrutiny is maintained. Reducing the disallowance period would limit Parliament's ability to effectively review and, where necessary, challenge the exercise of these powers. As the levy operates in substance as a form of industry-

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		funded expenditure, it is critical that the Executive remains appropriately accountable to Parliament for decisions that have material financial implications for levy payers.
7	Align special levy imposition with qualifying period	The FSC supports this change.

Question 2: Which technical improvements should be prioritised?

Treasury should prioritise implementing measures to prevent payments being made for unauthorised conduct and for products or services that fall outside the scope of the CSLR, as this goes directly to ensuring the scheme operates as intended.

In addition, the proposals to exempt non-participants from further special levies and to align special levy liability with the qualifying period should be progressed concurrently. These reforms are interdependent, and implementing one without the other would risk creating avoidance opportunities and undermining the equitable allocation of levy costs.

Recommendation 3: that Treasury should prioritise amendments that ensure CSLR payments are limited to conduct and products within the scheme's intended scope, alongside reforms to align special levy liability with the qualifying period and exempt non-participants from future levies. These measures should be implemented concurrently to prevent avoidance behaviour and support equitable levy allocation.

Recommendation 4: that Treasury recommend retaining the 15 sitting day disallowance period. Maintaining appropriate Parliamentary scrutiny is essential to ensuring accountability and oversight of decisions with significant financial implications.

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5. Proposal 4: Revising the treatment of counterfactual loss for CSLR-eligible financial advice complaints

Question 1: Do you support Option 1 or Option 2 to support scheme sustainability?

1.1. If not, are there alternative options that would better balance certainty, fairness and sustainability?

The FSC strongly supports Option 1 (limiting CSLR-eligible compensation to capital losses only) and its efficient adoption. AFCA's counterfactual loss approach has been a key driver of the cost blowouts of the scheme, with Treasury's modelling on a sample of cases reflecting that a capital loss approach could have reduced the costs of the scheme by ~ 43.4%.[3] FSC-commissioned research found that changing the CSLR compensation methodology from 'but for' to 'actual losses' would have historically reduced costs to the CSLR by approximately 57% under ordinary circumstances. Reforming the compensation methodology is the most immediate and effective way to address the scheme's cost pressures and restore alignment with its intended role as a true scheme of last resort.

The FSC also supports the proposed approach described in paragraph 41 to assess capital losses across all investments that were subject to the relevant advice. Where losses on those investments are more than offset by gains elsewhere in the portfolio of investments subject to the advice, a portfolio-level assessment should not result in compensation. This is an appropriate measure to ensure that compensation reflects net detriment rather than isolated losses and is consistent with the CSLR's policy intent as a scheme of 'last resort'.

One important consideration when reforming the compensation methodology is the need to incorporate appropriate safeguards in the event of a severe market downturn, such as the Global Financial Crisis. In such circumstances, a pure capital loss methodology could result in disproportionately high compensation payouts, even where losses are largely attributable to broader market movements rather than misconduct.

Consideration should therefore be given to introducing mechanisms that appropriately distinguish between losses arising from misconduct and those driven by systemic market events, to ensure the CSLR remains targeted and sustainable.

Given the current pipeline of claims and the scale of anticipated future liabilities, it is also critical that any reform to the compensation methodology applies not only prospectively but also to claims currently progressing through the CSLR. Limiting the application of this reform to future claims would significantly dilute its effectiveness in addressing near-term cost pressures.

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[3] Treasury, Compensation Scheme of Last Resort (CSLR): Reform options to support ongoing sustainability, April 2026, p.25.

Recommendation 5: that the CSLR compensation framework should be amended to adopt a capital loss-only methodology, replacing the current counterfactual approach. This reform should be prioritised as one of the most effective means of achieving scheme sustainability and ensuring it operates as a genuine last resort. It should be supported by targeted safeguards to distinguish losses arising from misconduct from those driven by broader market movements, and should apply to existing claims progressing through the CSLR as well as future claims.

Question 2: What considerations should the Government have for choosing an implementation pathway (fairness, time to implement, cost saving)?

The FSC strongly supports the implementation pathway that vests responsibility in the CSLR Operator to remove the counterfactual component from the unpaid AFCA determination amount.

This function is more appropriately performed by the CSLR Operator rather than AFCA. AFCA's role is to resolve disputes between parties, with a mandate to provide fair and reasonable outcomes in individual cases, which may rightly include a counterfactual component. By contrast, the CSLR operates as a statutory, last-resort compensation scheme with system-wide funding implications, requiring a different calibration that balances consumer redress with the scheme's sustainability.

Recommendation 6: that if the actual loss methodology is adopted, the CSLR Operator should be responsible for recalculating compensation amounts by removing the counterfactual component from AFCA determinations.

Question 3: Is CPI or Government Bond rate a more appropriate basis for calculating the counterfactual position?

3.1. What alternative rate could be used?

The FSC's strong preference remains that the counterfactual component should be removed entirely, with compensation under the CSLR limited to actual capital losses. This is the most effective way to align the scheme with its intended role as a scheme of last resort and to improve its long-term sustainability.

However, in the event that Treasury proceeds with retaining a counterfactual component, the FSC considers that CPI would be a more appropriate benchmark than a Government bond rate. CPI provides a simple, objective and widely understood measure of inflation, ensuring that compensation preserves the real value of a complainant's capital without introducing elements of hypothetical investment return or opportunity cost.

Recommendation 7: that if a counterfactual component is retained, it should be based on CPI as a simple benchmark that preserves the real value of capital without introducing elements of hypothetical investment return or opportunity cost. This approach would better align with the CSLR's role as a last resort compensation scheme.

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6. Proposal 5: Embedding greater certainty in the special levy framework

Question 1: Do you support introducing a rules-based three-tier special levy waterfall to manage funding shortfalls when scheme costs exceed one or more sub-sector caps? Are there alternative tier structures that would better balance certainty, fairness and sustainability?

The FSC has consistently supported measures to introduce greater certainty for industry in relation to CSLR special levies. While this proposal is a step in that direction, it risks providing certainty of outcome without addressing the underlying cost drivers of the scheme. In its current form, it may simply entrench the expectation of ongoing levies, rather than ensuring that such levies remain genuinely exceptional.

As outlined in our previous submissions, the FSC is strongly opposed to the “special levy” becoming a recurring feature of the CSLR funding model. Such an outcome would undermine confidence in the scheme and risk transforming what was intended to be a last resort funding mechanism into a de facto annual tax on industry.

In principle, the FSC’s preference is for any special levy to be applied pragmatically on a broad-based basis. This approach is ultimately the most equitable and administratively coherent option available under the current framework. It is also consistent with the Minister’s approach to distributing the FY26 special levy and the consultation paper’s acknowledgment that the CSLR is not predicated on fault or misconduct attribution across sub-sectors.[4]

All levy-paying entities are, by design, not responsible for the underlying harm, and so attempting to draw distinctions based on perceived “connection” to the misconduct risks introducing artificial and difficult-to-sustain boundaries. Treasury should instead approach the issue pragmatically and recognise that all levy-paying entities are ultimately in the same position regardless of sector: they are contributing to the scheme despite having committed no fault. The notion that a sub-sector is “connected” to a loss does not establish causation or justify greater responsibility for that loss, and risks transforming the CSLR into a quasi-liability allocation regime despite it not being designed for that purpose.

If a waterfall type levy were to proceed, such framework should be explicitly time-bound with a clear cut off date and subject to review, rather than being embedded as a permanent or repeatable feature of the CSLR. This is particularly important in light of the broader reform agenda currently under consideration, which is intended to address the root causes of the scheme’s cost escalation. Embedding a repeatable levy mechanism in advance of these

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[4] Treasury, Compensation Scheme of Last Resort (CSLR): Reform options to support ongoing sustainability, April 2026, p.33.

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reforms risks normalising elevated levy levels and reducing the imperative to deliver structural change.

Accordingly, the FSC could lend conditional support to a special levy framework (including the waterfall method), but only if it is accompanied by timely implementation of measures that materially reduce the cost and frequency of CSLR claims. In particular, priority should be given to:

- Proposal 1: Enabling CSLR to deduct payments from compensation
- Proposal 4, (Option 1): Revising the treatment of counterfactual loss for CSLR-eligible financial advice complaints by limiting CSLR-eligible compensation to capital losses only.
- Proposal 6, (Option 1): Excluding SMSFs from eligibility by default, but potentially allowing SMSFs to opt-in to the CSLR, and pay the special levy

The implementation of these reforms would significantly reduce both the likelihood and scale of special levies, ensuring they remain genuinely “special” rather than a de facto annual tax on industry.

Recommendation 8: that Treasury should prioritise structural reforms to address the underlying cost drivers of the CSLR - particularly removing the counterfactual component, enabling deduction of offsets, and excluding SMSFs by default but potentially allowing SMSFs to opt-in to the CSLR, before embedding any enduring special levy framework.

Recommendation 9: that any special levy should, as a matter of principle, be applied on a broad-based basis across the financial services sector, reflecting the collective benefit of the CSLR and avoiding attempts to allocate costs based on perceived “connection” to misconduct or regulatory effort.

Recommendation 10: that if a “waterfall” levy framework is adopted, it should be explicitly time-bound with a clear cut-off date after which it should be subject to review, and should not established as a permanent or repeatable feature of the CSLR funding model.

Question 2: Is ‘connection’ an appropriate basis for allocating costs across tiers in a repeatable framework?

2.1. If not, what alternative approach should be used, and how could it be implemented effectively in a way that is sustainable and facilitates timely payments of compensation to consumers?

2.2. How should ‘connected’ sub-sector/s be identified in practice?

Question 3: What evidence or data should be used to establish ‘connection’ to the losses (recognising the challenges of attributing fault across a value chain)?

3.1. What governance or assurance steps would improve confidence in the classification of a sub-sector as ‘connected’?

The FSC does not consider “connection” to be an appropriate basis for allocating costs across sub-sectors in a repeatable CSLR framework. All levy-paying entities are, by design, not responsible for the underlying harm, and so attempting to draw distinctions based on perceived “connection” to the misconduct risks introducing artificial and difficult-to-sustain boundaries. In practice, a “connection”-based framework risks evolving into a proxy for fault attribution, despite Treasury’s stated intention that it would not operate in that manner.

Importantly, the proposed special levy framework should also be considered in the context of Treasury’s broader consultation package which deals with enhancing supervision and data-collection around managed investment schemes, curbing harmful lead generation activity and introducing trustee compensation obligations. In the FSC’s view, these reforms, rather than a repeatable waterfall levy model based on perceived “connection” to misconduct, are what would create the genuine feedback loops and behavioural incentives needed to reduce future CSLR claims. Once those broader reforms are taken into account, the already questionable policy rationale for embedding a repeatable “connection”-based levy framework is significantly diminished.

Accordingly, the FSC encourages Treasury to adopt a pragmatic approach to any special levy by spreading costs as broadly as possible, recognising that any entity captured by the levy, regardless of sector, is ultimately contributing to a scheme for conduct with which it had no direct involvement.

The interaction between the special levy framework and Treasury’s proposed trustee compensation mechanism should also be carefully considered. If trustees are ultimately required to either demonstrate access to, or hold a dedicated pool of capital for the purposes of a new compensation framework under Proposal #5 of Treasury’s consultation paper on *Enhancing member protections in the superannuation system*, then those same trustees should not also be required to fund CSLR special levies without appropriate offset or adjustment. Otherwise, trustees would effectively be funding two overlapping compensation mechanisms aimed at addressing similar consumer harm outcomes, resulting in duplicative cost burdens that would ultimately be borne by members.

Finally, the FSC welcomes Treasury’s position that managed investment schemes (MISs) are not proposed to be included within the annual levy framework.[5] This appropriately recognises the risks of permanently expanding the funding base of the CSLR in a way that could introduce further moral hazard into the scheme and effectively underwrite investment risk.

Recommendation 11: that if trustees are required to hold or maintain access to capital for the purposes of a new trustee compensation mechanism (as proposed in Treasury’s consultation paper on *Enhancing member protections in the superannuation system*), then

[5] Treasury, Compensation Scheme of Last Resort (CSLR): Reform options to support ongoing sustainability, April 2026, p.47.

they should either be exempt from CSLR special levies relating to the same underlying conduct or receive a proportionate reduction in levy obligations.

Question 4: Are the proposed special levy caps appropriately calibrated to provide certainty and support sub-sector viability, while enabling timely compensation payments?

4.1. If not, at what level should special levy caps be set for each tier, and how do they produce a better overall outcome for the financial system?

The FSC is concerned with the potentially unviable impost on the financial advice subsector with the proposed special levy framework, even with the $40m cap in place.

With the upcoming Shield and First Guardian claims, it is highly likely that (unless reforms are applied to claims currently coming through the CSLR) financial advisers will be called upon to pay levies up to the full $40m cap.

This pressure is occurring against a backdrop of a significantly shrinking advice profession, with adviser numbers declining from 27,953 in 2018 to 15,125 as of April 2026. [6,7] This effectively means that each adviser will be called upon to pay $2,645 for FY27 in CSLR levies. This is in addition to their ASIC levy of $2,315 per adviser for the FY25 year (and another levy for FY26 to be announced towards the end of the year).[8] Collectively, these rising regulatory costs exacerbate the unaffordability of financial advice, place pressure on the viability of smaller practices, and risk further discouraging entry into the profession at a time when Australia's ageing population is increasing demand for accessible financial advice.

This disproportionate impost on the financial advice sector strengthens the case for a broad-based special levy over a waterfall framework, particularly given that the CSLR is not designed to operate as a fault-based regime and, by its nature, relies on cross-subsidisation by firms that were not responsible for the underlying misconduct.

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[6] Adviser Ratings, Australian Financial Advice Landscape, 2024, p.26.
[7] Padua Wealth Data, Financial Adviser Market Insights, April 16, 2026.
[8] ASIC, ASIC industry funding

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7. Proposal 6: Considering responses to the role of SMSF losses in reducing pressure on the CSLR

The FSC is strongly supportive of reforming the treatment of SMSFs under the CSLR. As Treasury acknowledges, the establishment of an SMSF represents an active decision to move outside the APRA-regulated environment (where governance and conduct risks are more actively overseen) and into a self-directed structure in which the individual assumes the role of trustee and bears greater responsibility for governance and investment decisions.[9] In this context, it is appropriate that the policy settings for the CSLR reflect the fundamentally different nature of the SMSF sector and the greater degree of autonomy and responsibility borne by SMSF trustees.

The case for reform is further reinforced by Treasury's observation that SMSF-related claims account for 93.1 per cent of all paid and pending CSLR claims, making SMSFs the predominant driver of scheme costs.[10] At present, however, advised SMSF trustees are able to access the benefits of the CSLR without contributing to the funding of the scheme. Meanwhile, other superannuation trustees have borne some of the costs of the FY26 levy; costs which inevitably get passed onto their members.

The FSC therefore supports a policy direction that progressively removes SMSFs from the CSLR framework on a forward-looking basis, unless they actively elect to participate in the scheme. Such an approach would better align the CSLR with its original intent as a last resort consumer protection mechanism for retail consumers within the regulated financial system, while also improving the long-term sustainability of the scheme and reducing the burden on other levy-paying sectors.

A related issue not directly addressed in the paper is the current treatment of SMSF trustees with balances below $10 million as retail clients.[11] This creates a scenario in which individuals with very substantial assets (potentially up to $10 million) may still access AFCA and, by extension, the CSLR. This threshold is difficult to reconcile with the underlying policy intent of the scheme, particularly where such individuals are likely to have both the financial sophistication and capacity to pursue private legal remedies.

Recommendation 12: that Treasury should proceed with excluding SMSFs by default, with a potential opt-in model for SMSF participation in the CSLR, ensuring that only those SMSFs that actively elect to be eligible for the scheme are subject to levy obligations.

Recommendation 13: that Treasury should review the appropriateness of the current $10 million threshold for classifying SMSF trustees as retail clients for the purposes of AFCA

[9] Treasury, Compensation Scheme of Last Resort (CSLR): Reform options to support ongoing sustainability, April 2026, p.41.
[10] Treasury, Compensation Scheme of Last Resort (CSLR): Reform options to support ongoing sustainability, April 2026, p.41.
[11] ASIC, Statement on wholesale and retail investors and SMSFs, August 2014.

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and CSLR eligibility, to ensure it better aligns with the policy intent of the scheme and appropriately reflects investor sophistication and capacity to pursue alternative remedies.

Question 1: Do you see merit in levying a subset of SMSFs to support CSLR special levy funding pressures?

The FSC sees merit in levying a subset of SMSFs to support the CSLR's special levy funding pressures. This reflects the practical reality that the broader financial system ecosystem, including superannuation trustees and other retail-facing sectors, has already been called upon to contribute to the FY26 special levy despite many entities having no direct connection to the underlying conduct giving rise to the claims.

SMSFs have been the predominant beneficiaries of the scheme to date, with Treasury modelling indicating that 93.1 per cent of all paid and pending CSLR claims relate to SMSFs.[12] While the FSC does not support the special levy adopting a 'connected entity' approach, if Treasury were nevertheless to proceed with such an approach, this would provide a further basis for SMSFs to contribute to the special levy.

Recommendation 14: that SMSFs should contribute to the next CSLR special levy recognising that SMSFs form part of the broader financial system ecosystem that have already been called upon to fund the scheme.

Question 2: Two sub-options are provided to define the SMSF cohort subject to the levy (that is, an opt-in or an opt-out mechanism). Which option do you think best balances the need for scheme sustainability with the risk of imposing costs onto SMSFs with no relevant connection to advice-related misconduct? Or is there an alternate option that would best balance these factors?

> **2.1.** What factors should be considered for an opt-in or opt-out model to minimise the regulatory burden for SMSFs?

The FSC's view is that of these two 'sub-options' the 'opt-in' model is preferable for several reasons.

Firstly, an opt-in model would likely result in a smaller cohort of SMSFs participating in the CSLR. This would have a material impact on reducing scheme costs and reinforces the principle that SMSF trustees bear primary responsibility for their investment and governance decisions.

[12] Treasury, Compensation Scheme of Last Resort (CSLR): Reform options to support ongoing sustainability, April 2026, p.40.

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Secondly, around 85% of SMSFs are not receiving personal financial advice and therefore unlikely to benefit from the scheme.[13] An opt-in model would more closely align participation in, and funding of, the scheme with those SMSFs that actively engage with the regulated advice sector and are therefore more likely to derive benefit from the availability of last resort compensation.

Thirdly, the 'opt-in' approach reduces the regulatory burden for the trustees of SMSFs. Rather than having to make an active decision to 'opt-out' of paying a potentially annual bill, they only have to make an active decision if they want to participate in the CSLR.

Finally, an opt-in model is more practical to implement. Imposing a levy across the entire SMSF sector or attempting to carve out a subset through an opt-out model, would require identifying, monitoring and administering a very large population of funds. By contrast, an opt-in model confines the levy to a clearly defined and self-selecting cohort, making the framework simpler and more workable in practice.

7.1. Option 1 – SMSFs contributing to the special levy

Imposing the levy alongside an opt-out mechanism

Question 3: Would allowing SMSFs to opt-out from the levy and CSLR compensation eligibility be an appropriate means to target the levy? What benefits and risks might this approach entail?
Question 4: When should an SMSF be required to opt-out or begin paying?
Question 5: Should an SMSF be able to revoke their decision?

As expressed above, within Option 1 the 'opt-in' model is more appropriate. The FSC does not support an opt-out model as an appropriate means of targeting the levy. While the model may appear to better assist in the funding of the CSLR through applying to a broader base, in practice it introduces a number of risks.

Firstly, an opt-out model would likely result in a large proportion of SMSFs remaining within the CSLR by default, including those with no connection to financial advice. This would undermine the objective of targeting the levy to those who derive a genuine benefit from the scheme.

Secondly, an opt-out model creates a misalignment between participation and informed consent. Many SMSF trustees may remain within the scheme simply due to inertia or lack of awareness, rather than an active decision to participate. This is particularly problematic given the potential for ongoing levy obligations, and may lead to outcomes that are not well understood or intended by trustees. Conversely, in an opt-in model, an SMSF trustee is

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[13] Vanguard, New SMSF trustees propel uptake of financial advice, but $1 trillion sector still has significant advice gaps, 28 May, 2025.

making a conscious decision to include themselves in the eligibility of the scheme and to contribute accordingly.

Finally, from an implementation perspective, an opt-out model would require the identification, communication and ongoing administration of a very large SMSF population, as well as systems to track opt-out elections over time. This introduces significant complexity relative to an opt-in model, which relies on a clearly defined and self-selecting cohort.

For these reasons, the FSC considers that an opt-in model provides a more appropriate and targeted approach, as it ensures participation is based on a clear and informed decision-making, better aligns costs with benefit, and is more workable in practice.

Consistent with this position, questions regarding the timing of opt-out elections and the ability to revoke such decisions do not arise.

Imposing the levy alongside an opt-in mechanism

Question 6: Would allowing SMSFs to opt-in to the levy in order to maintain CSLR compensation eligibility be an appropriate means to target the levy? What benefits and risks might this approach entail?
Question 7: When should an SMSF be required to opt-in?
Question 8: Should the timing of opting in impact their eligibility for a claim from the CSLR?
Question 9: If SMSFs were included within the CSLR Special Levy Framework, what do you see as a reasonable and sustainable maximum annual levy per SMSF?

The FSC's view is that the 'opt-in' model is preferable for the reasons detailed in our response to Question 2.

Participation in the CSLR should remain at the sole discretion of SMSF trustees. There should be no requirement for SMSFs to opt-in, reflecting the self-directed nature of the SMSF structure and the principle that trustees actively determine their level of engagement with the regulated system.

The timing of opting in should, however, have a direct impact on eligibility for compensation. Consistent with analogous arrangements in insurance markets, a minimum participation period (for example, 12 months) should apply before an SMSF becomes eligible to make a claim. This would mitigate the risk of opportunistic participation and support the integrity of the scheme.

The key risk of the opt-in model is the likely low-participation rate resulting in a smaller levy base and consequently higher levies for the few SMSFs that decide to participate in the CSLR. If Treasury is minded to proceed with this model and have SMSFs included within the CSLR Special Levy Framework, any maximum annual amount should be reasonable and aligned with capacity to pay.

A flat levy applied uniformly across all SMSFs is unlikely to be appropriate, given the significant variation in fund balances and trustee circumstances. A progressive approach would be better, with levy amounts calibrated by reference to fund balance bands.

7.2. Option 2 – Excluding SMSFs from CSLR Eligibility

Question 10: Excluding SMSFs from CSLR eligibility may help to alleviate funding pressures on the scheme. How do you think this option compares to the sub-options in option 1 above in terms of scheme sustainability and risks for the SMSFs?

The FSC would not oppose Treasury excluding SMSFs from CSLR eligibility. Of all the options presented in the paper, this option is the most likely to materially reduce the costs of the scheme and promote the scheme's sustainability. As expressed above, the establishment of an SMSF represents an active decision to move outside the APRA-regulated environment (where governance and conduct risks are more actively overseen) and into a self-directed structure in which the individual assumes the role of trustee and bears greater responsibility for governance and investment decisions.[14]

That said, the FSC considers that an opt-in model may represent a more equitable and proportionate long-term approach than outright exclusion. An opt-in framework would preserve access to the CSLR for those SMSFs that actively engage with the regulated financial advice sector and wish to retain the protection of the scheme, while ensuring those trustees also contribute toward its funding. This better aligns participation in, and benefit from, the scheme with the entities that are most likely to rely upon it.

By contrast, a blanket exclusion may capture SMSFs that continue to engage heavily with licensed financial advisers, notwithstanding that they remain outside the APRA-regulated system. An opt-in model therefore provides a more targeted mechanism that recognises the diversity within the SMSF sector and avoids excluding trustees who may still reasonably expect access to external dispute resolution and compensation arrangements linked to the regulated advice framework.

Importantly, an opt-in approach would also reinforce personal responsibility and informed choice. SMSF trustees would be required to actively elect participation in the scheme, rather than receiving access to CSLR protections by default. This would create a clearer connection between contribution, benefit and risk assumption, while still materially reducing scheme costs by limiting participation to a smaller and more relevant cohort of SMSFs.

Accordingly, while the FSC acknowledges the policy rationale for excluding SMSFs from the CSLR, our preference remains for an opt-in participation model as a more balanced and

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[14] Treasury, Compensation Scheme of Last Resort (CSLR): Reform options to support ongoing sustainability, April 2026, p.41.

equitable approach that improves scheme sustainability while preserving proportionality and choice.

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8. Proposal 7: Facilitating levying of Managed Investment Scheme (MIS)-related losses

Question 1: If proposal 5 were implemented, should the Government identify a 'lower-risk' segment of the MIS sector that would not be subject to the special levy?

> **1.1.** If so, what indicators do you consider should be used to identify a MIS as low risk?
>
> **1.2.** If additional data were required to be collected to implement risk informed levying, would this option create any additional regulatory burden for the MIS sector?

The FSC's broader preference remains that any CSLR special levy should be applied on a broad-based basis across the financial services sector, rather than through a repeatable waterfall model based on perceived "connection" to misconduct.

However, if Treasury proceeds with a framework under which MIS-related losses are separately levied, the FSC supports the principle of excluding lower-risk MISs from any future special levy for MIS-related losses. Any segmentation within the MIS sector should be risk-based, pragmatic and ASIC-led, rather than relying on rigid legislative classifications. We also note the inherent difficulty in defining in an objective legal manner what a 'low risk' vs a 'high risk' MIS is.

Whether a MIS is lower-risk or higher-risk is not just a function of investment risk. A MIS may have a higher risk investment strategy, but may be well governed and appropriately distributed. Conversely, an MIS may be marketed as a lower risk strategy, but is governed by an RE that does not have appropriate experience and resourcing, and therefore bears greater governance risk that may be more likely to lead to detrimental loss than a high investment risk MIS that is well governed.

The FSC has recommended in the Treasury consultation on MISs that ASIC should use existing regulatory data, supervisory information and scheme-level characteristics to assist in undertaking risk-based surveillance. This would not require an objective binary categorisation of MISs as high risk vs low risk, but would allow for flexibility in accounting for a variety of complex factors that go into risk. The categorisation of risk should not be based on rigid legislative categories. ASIC should apply a risk-based supervisory assessment and refine the relevant factors as its MIS data collection improves.

Relevant factors may include:

- governance and compliance history;
- breach reporting patterns;
- complaints and AFCA outcomes;
- operating history and experience managing similar schemes;
- scheme complexity;
- liquidity profile;
- leverage;

- valuation practices;
- related party exposure; and
- the nature and concentration of underlying assets.

Operating history may be relevant, but should not be determinative. Newer operators may warrant closer scrutiny where they have not yet demonstrated governance capability or a compliance track record. Established operators should not automatically be treated as low risk if other indicators point to elevated risk.

New licensee applications and new product registrations should also inform ASIC's assessment over time. These processes can provide early supervisory signals about scheme complexity, governance arrangements and risk profile.

As ASIC's MIS data collection regime develops, the framework should become more targeted. Enhanced data could allow ASIC to better assess factors such as portfolio diversification, leverage, liquidity alignment with redemption periods, valuation governance and related party exposure.

A risk-informed special levy framework may require additional data collection and create additional regulatory burden. That burden may be justified as long as it is minimised and it clearly enables a fairer and more proportionate special levy framework. Any additional data requirements should use existing data where possible, align with broader MIS data reforms and be consistent with the Government's "tell us once" principle. ASIC could also establish a transparent review process so that a lower-risk assessment can be maintained, reassessed or revised over time, having regard to changes in the operator's governance, conduct history, scheme profile and other relevant risk indicators.

Given that the uplift required by ASIC in its data collection and analytical capability through the 2026-27 Budget measure, and associated risk-based supervision approach, we underline the need in the meantime to pragmatically spread the special levies as widely as possible.

Question 2: What do you consider the consequences would be of excluding low-risk MISs from the special levy?

If Treasury proceeds with a special levy that is focused on MIS-related losses, excluding lower-risk MISs would improve proportionality within the MIS sector by recognising that CSLR claims are more likely to arise from particular conduct, governance and distribution risks rather than from the MIS sector uniformly.

The trade-off is that ASIC would need to apply supervisory judgement and maintain an appropriate data framework. This is manageable and consistent with the broader direction of MIS reform, including enhanced data collection and risk-based supervision.

The FSC's preferred position remains a broad-based special levy framework across the financial services sector, rather than a repeatable waterfall approach based on perceived connection.

However, if Treasury proceeds with a targeted MIS levy model, the FSC considers that an ASIC-led risk-based supervisory approach would be preferable to rigid legislative categorisation or blunt sector-wide levies within the MIS sector itself.

Question 3: How should the Government weigh the trade-off between minimising administrative costs with the benefits of a more targeted approach?

The FSC considers that, as a matter of principle, special levies should be applied pragmatically across the broader financial services sector rather than allocated through repeatable "connection"-based waterfall mechanism.

However, if Treasury proceeds with a targeted MIS levy framework, the Government should balance administrative simplicity against the need for proportionality within the MIS sector. A broad-based special levy may be simpler to administer, but it risks treating all MISs as presenting the same risk profile, despite material differences in governance, conduct history, distribution model, liquidity, leverage and scheme complexity.

ASIC should use existing data and supervisory insights to apply a risk-based lens from the outset. As ASIC's MIS data collection improves, the framework should be further refined to support a more proportionate and evidence-based approach.

Recommendation 15: Lower-risk MISs being excluded from any special levy for MIS-related losses can be supported as a principle, however noting the difficulty of defining risk in a clear objective legal way, and noting our previous objections about levies being based on the 'connectedness' of a sector. If apportionment of the levy on MISs based on risk is pursued, ASIC should determine which MISs are lower risk using existing regulatory data and supervisory insights, with the assessment refined over time as ASIC's MIS data collection and analytical capability improves.

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9. Proposal 8: Improving recovery of unpaid AFCA determinations within corporate groups

The FSC supports reforms that strengthen the ability to recover from related entities that have benefited from the insolvent firm generating CSLR liabilities. Both Option 1 (refinements to existing frameworks that deter asset shifting) and Option 2 (a related-entity liability mechanism) are directed toward this objective.

However, these reforms raise complex legal and practical design considerations and may take time to develop and implement effectively. In this context, the FSC considers that more immediate and readily implementable reforms such as changes to the compensation methodology should be prioritised and progressed independently, rather than being made contingent on the development of a related-entity framework.

While more complex to implement in the short term, reforms aimed at improving recovery from related entities remain an important medium-term policy objective and should continue to be explored in parallel, and subject to further detailed consultation at a later point once the other CSLR reforms are implemented.

Recommendation 16: that Treasury should continue to explore and consult on reforms to strengthen recovery from related entities that have benefited from firms generating CSLR liabilities; however, these measures should be progressed as a medium-term workstream and should not delay or be made a precondition for the timely implementation of more immediate reforms to reduce CSLR costs.

Question 1: To what extent are AFCA determination liabilities avoided through misuse of corporate and insolvency frameworks, shifting CSLR costs onto the broader sub-sector?

> **1.1:** To what extent does this include transactions between solvent entities? Do transactions which result in the evasion of these liabilities also occur between unrelated entities?

The FSC considers that there is a real risk that AFCA determination liabilities can be externalised onto the broader sub-sector where value is transferred out of the entity against which complaints are ultimately made, particularly in the period leading up to insolvency or business closure. In these circumstances, the legal entity that becomes responsible for unpaid AFCA determinations may be left as an undercapitalised shell, while economically valuable parts of the business (such as advisers, client relationships, recurring revenue streams, or other assets) continue elsewhere within a broader corporate group. This can have the practical effect of shifting the cost of misconduct away from those who benefited from the relevant business activity and onto the wider advice subsector through the CSLR.

The FSC does not seek to characterise any particular transaction as unlawful phoenixing or asset-stripping. However, the Dixon Advisory matter illustrates the policy concern. Significant controversy arose from the fact that between 1 January 2021-10 May 2022, 27 Dixon advisers were appointed to another subsidiary within the broader E&P group, while the

parent group continued to operate (Note: Dixon Advisory was placed into administration on 19 January 2022).[15,16] In those circumstances, there is a legitimate question as to whether economic value associated with the failed business was preserved elsewhere in the corporate group while AFCA-related liabilities remained with the insolvent entity. Even where such arrangements are legally permissible, they can undermine confidence that the CSLR is operating as a true last resort and that all recovery efforts have been made.

In the FSC's view, this risk is likely to arise most acutely in transactions between related entities, particularly where there is common ownership or continuity of staff, clients or revenue streams. Related-party dealings create an obvious opportunity for business restructuring in a manner that preserves enterprise value while isolating legacy liabilities in the failed entity. That said, the FSC does not exclude the possibility that liability avoidance can also occur through transactions with unrelated entities - for example, where a solvent third party acquires selected assets, client books or advisers from a distressed firm without assuming corresponding AFCA or remediation liabilities. While the risk may be more evident in intra-group restructures, the relevant policy issue is not limited to formal related-party dealings, but more broadly to any transaction that has the practical effect of divorcing the economic benefits of the business from the liabilities arising from misconduct.

Question 2: Are there any gaps or limitations in the current corporate and insolvency frameworks that may allow assets or value to be shifted away from the respondent firm? How might the existing provisions be enhanced to increase their deterrent effect to help prevent the occurrence of the underlying transactions and conduct?

In the context of AFCA liabilities and the CSLR, there are practical limitations in how the current corporate and insolvency frameworks operate which may allow assets or economic value to be shifted away from a respondent firm prior to those liabilities crystallising.

A central limitation is the timing gap between when misconduct occurs, when a complaint is lodged, and when an AFCA determination is made. By the time AFCA makes a determination, the relevant entity may have already transferred key assets or restructured its operations.

Additionally, AFCA determinations attach to the legal entity that provided the advice or service, and liabilities do not automatically transfer with the movement of advisers or client books. This creates a structural disconnect where the economic benefit of the business can continue in another entity, while the originating entity retains the liability but lacks the capacity to meet it.

In terms of deterrence, the FSC is supportive in principle of Treasury's proposal to introduce targeted reforms to enhance the effectiveness of existing corporate and insolvency law frameworks, such as enhancements to related party transaction approval requirements or

[15] ASIC, ANSWERS TO QUESTIONS ON NOTICE, Senate Economics Legislation Committee.
[16] ASIC, Dixon Advisory penalised $7.2 million for breaches of best interest obligations, 19 September, 2022.

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voidable transactions. However, these proposals should be consulted on once they are more concrete to avoid unintended consequences of undermining established corporate law principles.

Recommendation 17: that Treasury should explore and consult on targeted enhancements to existing corporate and insolvency frameworks to strengthen the ability to prevent and unwind asset and value shifting prior to the crystallisation of AFCA liabilities.

Question 3: If a new related-entity liability mechanism was established (Option 2), how should it be designed to appropriately share responsibility for AFCA liabilities where related entities are benefiting from the respondent firm's business or activities, while ensuring it remains proportionate, builds in appropriate safeguards and preserves long-standing corporate principles?

The FSC is supportive in principle of the introduction of a related entity liability mechanism and considers it complementary to Option 1 in addressing the issue of asset shifting and phoenixing.

However, the proposal lacks the requisite detail to be able to comment on how it might work in practice. As noted above, the FSC considers that all the options put forward under Proposal 8 should be consulted on separately and in more detail at a later date and other CSLR reforms should be prioritised at this stage.

Recommendation 18: that Treasury should explore and consult on the design of a targeted related-entity liability mechanism that enables recovery from entities that have derived a clear and material economic benefit from the activities giving rise to CSLR liabilities.