CPA Australia Ltd
ABN 64 008 392 452

Level 20, 28 Freshwater Place
Southbank VIC 3006 Australia

GPO Box 2820 Melbourne
VIC 3001 Australia

T 1300 737 373
Outside Aust +613 9606 9677

cpaaustralia.com.au

7 February 2020

Manager, Redress and Accountability Unit
Financial Sector Reform Taskforce
The Treasury
Langton Crescent
PARKES ACT 2600

By email: CSLR@treasury.gov.au

Dear Mr Lyon

Implementing Royal Commission Recommendation 7.1 – Establishing a Compensation Scheme of Last Resort

CPA Australia represents the diverse interests of more than 164,000 members working in 150 countries and regions around the world. We make this submission on behalf of our members and in the broader public interest.

CPA Australia does not support the establishment of a compensation of scheme of last resort (CSLR) We believe it is potentially fraught with complexities and uncertainties including it may introduce an unacceptable element of moral hazard to the system. Further, it should be the responsibility of the entity that gives rise to the consumer loss to pay for the compensation.

However, we understand that the Government is committed to the establishment of a scheme and it is therefore important to ensure that these potential complexities are addressed to ensure the sustainability and effectiveness of the scheme and avoid where possible market distortion.

Further, we believe the financial services sector collectively has a responsibility for upholding and lifting the professionalism of the sector to improve the quality of advice being provided to consumers, and in turn trust and confidence in the advice and products they seek. This includes identifying and reporting misconduct and poor performance, which will drive higher standards of conduct and should over time reduce the number of consumer complaints that require compensation and in turn the funding needs of the CSLR.

A core feature of the CSLR should therefore be a broad-coverage approach to provide greater protection and clarity for consumers and small business, while also promoting sustainability and resilience of the scheme.

If you have any queries do not hesitate to me 03 9606 9816 or keddie.waller@cpaaustralia.com.au

Yours sincerely

Keddie Waller
Head of Public Practice
CPA Australia

CPA Australia submission: Establishing a Compensation Scheme of Last Resort

Coverage beyond personal advice

CPA Australia recommends the ‘broad-coverage’ approach as outlined in the Discussion Paper.

We believe that it is in the public interest to ensure the CSLR provides greater protection and clarity for consumers who would be covered under the CSLR in respect of all activities requiring a financial firm to hold AFCA membership.

Importantly while many of the current unpaid determinations relate to the provision of financial advice, there are also unpaid determinations by other participants in the sector. Further, implementing a broad-coverage approach would prevent financial firms potentially restructuring their services to avoid obligations, as well as ensure the CSLR could cover any future or emerging areas of non-compliance that may arise due to the ever-changing nature of the financial services sector.

CPA Australia recommends that the broad-coverage approach also includes prudentially regulated activities.

While we understand that there is a low risk that prudentially regulated entities may have an unpaid determination, we believe that all participants in the financial services sector are responsible for upholding and lifting the professionalism of the sector to improve the quality of advice being provided to consumers, and in turn trust and confidence in the advice and products they seek. This includes identifying and reporting misconduct and poor performance, which will drive higher standards of conduct and should over time reduce the number of consumer complaints that requirement compensation and in turn the funding needs of the CSLR.

This approach would also support the sustainability of the financial services sector, which is another important consideration given the significant level of reform and cost currently being borne by all participants but felt most by small financial services business.

However, it should be noted that taking a broad-coverage approach will also include managed investment schemes. Given the risk and potential volatility of the MIS sector, we believe that this should be monitored to ensure there is a balance between the need to have a broad coverage scheme while also maintaining the sustainability of the CSLR and the advisory sector.

CPA Australia also supports the initial exclusion of court and tribunal decisions from being covered by the CSLR. It is currently unclear the extent to which court and tribunal decisions from financial firms are unpaid, therefore time is necessary to collate and analysis this data to fully understand the potential impact of including such decisions in the CSLR, such as equity, fairness and sustainability.

Should court and tribunal claims be included in the CSLR in the future, the compensation payable should be aligned to the AFCA compensation limits. This will avoid complexity and remove any potential incentive to pursue legal action instead of a compensation resolution through AFCA.

RECOMMENDATIONS:

CPA Australia recommends:

- **a ‘broad-coverage’ is adopted for the CSLR, including prudentially regulated firms, and**
- **the inclusion of MIS should be monitored to ensure its inclusion does not impact the sustainability of the CSLR and advisory sector.**

Funding arrangements

CPA Australia recommends the funding arrangements should be as simple as possible to reduce administrative complexity and yet reflect the broad risks aligned to each subsector covered by the CSLR. However, we do not believe there is currently an accurate and cost-effective way to measure the risk of a firm.

An alternative approach could be to replicate an existing funding model, such as the ASIC Industry Funding levy.

For example, a fee payable for each financial adviser would be a reliable and simple measure, notwithstanding the need to avoiding the current inequity in the ASIC Industry Funding Model where a sole practitioner or small firm contributes the same flat levy as a larger scale provider.

Further benefits of this approach include:

- it is simple and reliable, reducing the cost of administration
- removes the need to develop new benchmarks
- removes the risk that participants may restructure their operations to potentially reduce the levy they would otherwise be liable to pay
- applies the costs of the scheme equitably across this group of participants
- in part addresses the financial burden on smaller firms, which may otherwise lead to further consolidation and less competition in the advisory sector, and
- can be verified against data held by ASIC.

To protect against the risk of having to meet unexpected costs, a buffer should be built into the annual levy so the CSLR can accumulate additional funds until such time that it has established a suitable capital base for the scheme. CPA Australia recommends that the CSLR should establish a $10M capital base.

The additional levy should be spread over a minimum of five years to reduce any potential financial burden on the sector, given the current high costs of regulatory change especially on smaller firms and the additional set-up costs and estimated backlog of claims that also need to be funded in the first year of operation.

Any new cost will also have an impact on the cash flow for a firm and therefore consideration should be given to providing a level of certainty and predictability around the annual cost, as well as timing in respect of other existing regulatory costs such as the ASIC Funding levy, to help businesses plan their cashflow and expenses.

If during this period any significant unexpected costs were incurred, the additional levy should be collected over a longer period to again reduce any potential financial burden on the broader sector.

This approach will avoid potential volatility in the costs being borne by participants if additional levies were only collected at the time unexpected costs were incurred, noting such a model could give rise to significant one-off costs being collected from participants risking the sustainability of the scheme and the advisory sector.

To further support sustainability and affordability, a maximum cap should be imposed on the levies that can be raised by the CSLR in any one year. If the funding model is based on authentic metrics, this should reduce any potential complexity that would otherwise be experienced if the model was instead based on a risk component for example.

The CSLR should also explore alternative measures of risk protection and access to funding such as insurance, to also protect against any large unexpected costs.

RECOMMENDATIONS:

CPA Australia recommends:

- **for the advice sector, the funding model should be based on a fee payable for each financial adviser**
- **a buffer should be built into the annual levy over a minimum period of five years until a capital base of $10M has been accumulated by the CSLR, and**
- **a maximum cap should be imposed on the levies that can be raised in any one year by the CSLR.**

Compensation to be paid

CPA Australia recommends that the compensation limits, including legal and professional fees, payable by the CSLR align with those imposed by AFCA.

The benefits of this approach are that it ensures fairness by providing comparable outcomes for consumers and small business, while also promoting sustainability of the scheme should there by a large number of claims at any one time.

To manage unexpected failures and ensure the resilience of the scheme, we also recommend that the CSLR should have the ability to spread compensation payments over a period of time to manage potential losses associated with large failures. This would allow the CSLR to pay determinations in instalments, where provisions could be made to bring forward payments in the case of financial hardship for example.

The CSLR should have the autonomy to also determine the appropriate period to spread compensation payments in the event of unexpected failures, taking into consideration the key considerations of ensuring the scheme is resilient and sustainable, yet fair to all participants.

In the event of large unexpected failures, the CSLR should also have the discretion to determine if a compensation limit should be imposed to prevent the scheme's funding potentially being exhausted after a single loss event. This discretion should only be permitted in specific circumstance, for example where the aggregate claims reach an agreed minimum value of $50M, to ensure the sustainability and resilience of the scheme.

RECOMMENDATIONS:

CPA Australia recommends:

- **the compensation limits, including legal and professional costs, payable by the CSLR align with those imposed by AFCA**
- **the CSLR has the autonomy to determine an appropriate period to spread compensation payments payable in the event of unexpected failures, and**
- **where aggregate claims for a single loss event reach an agreed minimum value, for example $50M, the CSLR has the discretion to limit the total compensation payable.**

Managing scheme evolution

While it is important that the CSLR have a level of autonomy to ensure that it can evolve and adapt to an ever-changing financial services sector, it is also important for the scheme has prescribed design and operational parameters to provide clarity and certainty to participants of the scheme.

CPA Australia recommends that legislation enabling the establishment of the CSLR take a more prescriptive approach, including detailing in the legislation key elements such as:

- size and metrics used as the basis of the annual levies for firms
- the potential level of capital to be held by the CSLR
- the maximum cap that can be applied by the CSLR in respect of annual levies for firms
- that compensation caps should align with AFCA imposed caps
- the ability to pay compensation over a period of time, and
- the discretion to limit total compensation in the event of a single large loss event.

RECOMMENDATION:

CPA Australia recommends that legislation enabling the establishment of the CSLR take a more prescriptive approach, including detailing in the legislation key elements such as metrics for the annual levy and capital level to be held by the CSLR.