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Ms Ly Reeve
Acting Assistant Secretary
Cross-Sector Regulation, Redress and Resilience Branch
Department of the Treasury
Langton Crescent
Parkes ACT 2600
Via email: CSLR@treasury.gov.au

Dear Assistant Secretary

COMPENSATION SCHEME OF LAST RESORT – REFORM OPTIONS TO SUPPORT ONGOING SUSTAINABILITY

The Australian Finance Industry Association (AFIA) is the only peak body representing the entire finance industry in Australia.¹ We appreciate the opportunity to respond to the Treasury's consultation paper on options to reform the Compensation Scheme of Last Resort (CSLR).²

We represent over 150 members, including bank and non-bank lenders, finance companies, fintechs, providers of vehicle and equipment finance, car rental and fleet providers, and service providers in the finance industry. We are the voice for advancing a world-class finance industry and our members are at the forefront of innovation in consumer and business finance in Australia. Our members finance Australia's future.

We collaborate with our members, governments, regulators and customer representatives to promote competition and innovation, deliver better customer outcomes and create a resilient, inclusive and sustainable future. We provide new policy, data and insights to support our advocacy in building a more prosperous Australia.

¹ [Australian Finance Industry Association \(afia.asn.au\)](http://afia.asn.au).

² Department of the Treasury, [*Compensation Scheme of Last Resort – reform options to support ongoing sustainability*](#), 7 April 2026.

INTRODUCTORY COMMENTS

AFIA supports the existence of a genuinely last-resort compensation scheme as part of Australia's financial system architecture. However, experience since the commencement of the CSLR in April 2024 demonstrates that the scheme, in its current form, is financially unsustainable, increasingly unpredictable for levy payers, and at risk of drifting materially beyond its original policy intent.

Without reform, escalating and recurring special levies will operate in practice as an open-ended and poorly targeted tax on well-regulated financial firms that have no connection to the underlying misconduct. This outcome is likely to undermine competition, increase costs for consumers, discourage investment, and ultimately weaken trust in the system the CSLR is intended to support.

AFIA therefore strongly supports targeted, structural and technical reforms that:

- Reinforce the CSLR's role as a *last resort* rather than a substitute compensation mechanism;
- Align levy incidence more closely with risk causation and connection to harm;
- Improve predictability, transparency and proportionality of levy outcomes; and
- Reduce moral hazard and unintended incentives across the financial services ecosystem.

In particular, AFIA:

- Supports limiting CSLR compensation to net capital loss at the portfolio level (Proposal 4);
- Supports the exclusion of SMSFs from the CSLR (Proposal 6);
- Does not support extending CSLR coverage to managed investment scheme (MIS) losses, including the exclusion of financial advice complaints relating to MIS losses from CSLR eligibility (Proposal 7); and
- Supports the majority of technical reforms, except for proposals that would reduce parliamentary scrutiny of CSLR levy instruments.

Taken together, these reforms would materially improve the sustainability, fairness and predictability of the CSLR while preserving essential consumer protections and confidence in the financial system.

AFIA's detailed views on the consultation proposals are set out below.

The first levy period (FY24) was funded entirely by the Australian Government. However, that Government funding covered only the final quarter of FY24 — just eleven weeks — before full funding responsibility shifted permanently to industry from FY25 onwards. This truncated contribution has meant that industry has been left to carry the overwhelming bulk of costs, including for failures and complaints that substantially predate the scheme. AFIA's position is that the Government should extend its funding commitment to cover at least one full levy year — consistent with the original policy intent of a genuine transitional period — before industry levies take effect. A full-year Government contribution would provide a more principled and proportionate foundation for the scheme, reduce the retrospective burden on compliant firms, and better reflect the public interest character of a safety net.

Effective CSLR reform cannot be achieved through funding mechanisms alone — it requires ASIC to deploy its supervisory powers in a way that actively reduces the pipeline of claims reaching the scheme in the first place. The trajectory of CSLR levies reflects, in part, a pattern of cases where misconduct was visible well before consumer harm became widespread, yet intervention came too late to prevent large-scale compensation obligations falling on industry. AFIA's position is that ASIC should publish and maintain clear, risk-calibrated supervisory priorities explicitly linked to CSLR exposure — concentrating attention on sectors, business models, and conduct patterns most likely to generate future claims. This means earlier intervention where redemption failures, valuation irregularities, or high-pressure superannuation switching patterns emerge, and proportionate use of stop orders, licence conditions, and enforceable undertakings before losses crystallise. A more proactive ASIC posture would reduce the volume and scale of AFCA determinations flowing into the CSLR, making levy estimates more predictable and the scheme more sustainable. Regulatory prevention is, in this sense, the most cost-effective form of CSLR reform available.

TARGETED REFORM PROPOSALS

Proposal 1: Enabling CSLR to Deduct Payments from Compensation

AFIA supports reforms that enable the CSLR operator to deduct all relevant payments and offsets connected to an AFCA determination when calculating compensation.

Allowing full recognition of insurance proceeds, class action settlements, DOCA distributions, retained assets or other recoveries is essential to maintaining the integrity of the scheme and avoiding over-compensation. Without such deductions, the CSLR risks compensating beyond actual loss and undermining its sustainability.

AFIA supports:

- Regulations clarifying deductible categories; and
- A limited and well-defined clawback mechanism where material offsets emerge after payment, balanced against certainty and timely payment to claimants.

Proposal 2: Expanding CSLR Subrogation Rights

AFIA supports strengthening CSLR subrogation rights to improve recoveries and reduce reliance on levies. In particular, AFIA supports:

- Expanding subrogation beyond Chapter 5 body corporates;
- Enabling recovery from relevant professional indemnity insurance where cover exists; and
- Removing unnecessary legal and procedural barriers that currently render recovery largely theoretical.

AFIA notes, however, that subrogation reform alone will not materially solve CSLR sustainability challenges. Recovery prospects will remain limited where firms are insolvent and underinsured. Structural reform to compensation calculation and levy design remains essential.

Proposal 3: Technical Reform Proposals

AFIA supports the vast majority of the technical improvements proposed by Treasury, noting that many of these changes are sensible, non-controversial refinements that would improve the administration, fairness and internal consistency of the CSLR framework, subject to the specific exception outlined below.

In particular, AFIA supports the proposed technical amendments to:

- Allow CSLR compensation payments to be made to multiple accounts where appropriate, improving flexibility for claimants and reducing administrative complexity;
- Ensure that entities that have exited or been deregistered from a sub-sector are consistently exempt from annual, further and special levies, aligning levy liability with participation and benefit;
- Correct technical anomalies in minimum levy calculations to ensure the levy framework operates as intended; and
- Clarify that CSLR compensation should be limited to authorised, in-scope conduct and products, preventing payments for unauthorised activity or matters falling outside the scheme's intended scope.

However, AFIA does not support the proposal to shorten the parliamentary disallowance period for CSLR levy instruments. AFIA considers that CSLR levies — particularly special levies — impose material, and in some cases significant, financial obligations on regulated entities across the financial system. Given their scale, unpredictability and potential impact on firm viability, appropriate parliamentary scrutiny remains essential.

Maintaining the existing disallowance period:

- Preserves an important accountability and oversight mechanism for levy instruments that effectively operate as industry-imposed taxes;
- Supports confidence in the legitimacy and transparency of CSLR levy decisions; and
- Helps ensure that levy settings are subject to appropriate scrutiny where they have economy-wide implications.

While AFIA acknowledges the operational desire to accelerate levy collection, it considers that certainty and scrutiny should not be traded off against speed. Any delays associated with the existing disallowance framework should instead be addressed through earlier signalling, improved forecasting, and clearer levy design rather than by reducing parliamentary oversight.

STRUCTURAL REFORM PROPOSALS

Proposal 4: Revising the Treatment of Counterfactual Loss

AFIA supports limiting CSLR compensation to net capital loss assessed at the portfolio level.

AFIA considers this approach to be the most conceptually sound, administratively practical and sustainable method of aligning CSLR compensation with its role as a scheme of last resort. Limiting compensation to net capital loss restores consumers to their pre-misconduct financial position without embedding speculative or open-ended assumptions about foregone investment returns.

In contrast to counterfactual return methodologies, a portfolio-level capital loss approach:

- Provides materially greater predictability for levy payers;
- Avoids the need for complex and contested assumptions about alternative investment strategies;
- Reduces volatility and tail-risk in CSLR liabilities; and
- Better aligns with community and industry expectations of a last-resort, industry-funded scheme.

AFIA considers that implementing this reform at the CSLR payment stage, through legislative amendment, is the most robust and durable implementation pathway.

Proposal 5: Embedding Greater Certainty in the Special Levy Framework

AFIA supports the introduction of a rules-based, three-tier special levy 'waterfall' framework.

The current ad hoc approach to special levies creates unacceptable uncertainty for industry and weakens confidence in the CSLR's funding model. A structured waterfall framework would:

- Improve predictability and transparency;
- Reduce arbitrary cross-subsidisation; and
- Better align levy incidence with connection to harm rather than broad regulatory footprint alone.

AFIA supports:

- Clearly defined tier caps to preserve viability of affected sub-sectors;
- Retention of Ministerial discretion to address extreme or unforeseen circumstances; and
- Strong governance and evidentiary standards for identifying 'connected' sub-sectors.

Proposal 6: Treatment of SMSFs

AFIA acknowledges the significant role SMSF-related advice failures have played in CSLR costs to date and supports addressing this sustainability risk.

AFIA notes that Option 2 in the consultation paper proposes that SMSFs be excluded entirely from the CSLR.

AFIA supports this approach. Excluding SMSFs from the CSLR provides the clearest and most effective way to address the disproportionate sustainability risks associated with SMSF-related advice failures, while reinforcing the CSLR's role as a scheme of last resort rather than a broad compensation or investment protection mechanism.

AFIA considers that exclusion of SMSFs:

- Provides certainty and predictability for levy payers;

- Avoids ongoing scope expansion and cost volatility linked to SMSF advice and investment decisions;
- Preserves an appropriate distinction between misconduct-based compensation and investment risk; and
- Reduces administrative and compliance complexity for regulators and industry.

AFIA recognises that exclusion of SMSFs would require clear transitional arrangements and communication to ensure consumer understanding. However, AFIA considers that alternative models that retain SMSF access to the CSLR risk perpetuating the very sustainability challenges this proposal seeks to address.

Proposal 7: Treatment of MIS-Related Losses

AFIA does not support the inclusion of managed investment schemes (MISs) within the ongoing CSLR funding or compensation framework.

AFIA considers that expanding the CSLR to capture MIS-related losses would materially blur the boundary between compensation for misconduct and protection against product performance or market risk. This would represent a fundamental expansion of the CSLR beyond its intended role as a scheme of last resort for unpaid determinations arising from misconduct. The CSLR should not function to insure investment outcomes

In particular, AFIA does not support providing CSLR access for financial advice complaints that relate to losses arising from MIS performance or failure, including where advice is provided in connection with MIS investments.

AFIA supports explicitly excluding financial advice complaints relating to MIS losses from CSLR eligibility.³ This exclusion is necessary to:

- Preserve the distinction between misconduct-based compensation and investment or product risk;
- Avoid embedding implicit product or market risk insurance within the CSLR; and
- Prevent further escalation of CSLR costs unrelated to adviser or firm insolvency.

AFIA considers that losses arising from MIS performance or failure are more appropriately addressed through existing regulatory, disclosure, product governance and enforcement mechanisms, rather than through an industry-funded compensation scheme of last resort.

³ AFIA, [*Submission to Enhancing oversight and governance of Managed Investment Schemes*](#), 27 February 2026.

Proposal 8: Improving Recovery Within Corporate Groups

AFIA supports targeted reforms to deter asset shifting and value leakage that leaves AFCA determinations unpaid while value remains elsewhere in a corporate group. AFIA supports:

- Enhancing existing corporate and insolvency frameworks; and
- Exploring proportionate related-entity liability mechanisms with clear benefit tests, safeguards and procedural fairness.

Any reform should avoid undermining legitimate corporate structuring, restructuring, or adviser mobility.

CLOSING COMMENTS

AFIA supports decisive reform to ensure the CSLR becomes more sustainable, targeted and aligned with its intended role as a scheme of last resort.

The reforms canvassed in this submission represent important and necessary initial steps to address key shortcomings in the current framework, including excessive cost growth, weak alignment between levy incidence and harm, and growing unpredictability for levy-paying firms.

However, AFIA considers that these measures should be viewed as part of a broader reform trajectory. Even with the proposed changes, the CSLR may continue to face structural pressures that undermine its long-term sustainability and risk further drift from its original policy intent.

AFIA therefore encourages Government and Treasury to consider, over time, whether a more comprehensive and holistic overhaul of the CSLR framework is required to ensure the scheme remains financially sustainable, proportionate, and genuinely last-resort, while continuing to provide appropriate protections for consumers who suffer uncompensated loss as a result of misconduct.

AFIA and its members stand ready to work constructively with Treasury, Government and regulators to support both the immediate reform agenda and any future work necessary to secure the CSLR's long-term effectiveness and credibility.

Should you wish to discuss our submission or require additional information, please contact AFIA Senior Policy Advisor, David Delprat, at david.delprat@afia.asn.au.

Yours sincerely



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