

Inquiry into Wealth Management Companies

CSLR submission to the Senate Economics Reference
Committee Inquiry

November 2024



Table of Contents

About the CSLR.....	3
Incorporation of the CSLR	3
Purpose and operations of the CSLR	3
Reasons for the collapse of wealth management companies	4
CSLR's experience	4
Individuals impacted	4
Financial firms involved	4

About the CSLR

Incorporation of the CSLR

The Compensation Scheme of Last Resort (CSLR) is an independent not for profit Australian Public company, limited by guarantee which was incorporated on 5 July 2023. The CSLR is not a regulator or a government agency.

On 22 June 2023 the Australian Federal Parliament passed the following bills:

- the *Treasury Laws Amendment (Financial Services Compensation Scheme of Last Resort) Bill 2023*;
- the *Financial Services Compensation Scheme of Last Resort Levy Bill 2023*; and
- the *Financial Services Compensation Scheme of Last Resort Levy (Collection) Bill 2023* (collectively, the CSLR Acts) which together established the CSLR regime.

Separately, the CSLR made an application to be authorised to operate the financial services compensation scheme of last resort, in accordance with the CSLR Acts. On 13 September 2023, the responsible Minister authorised CSLR to be the CSLR scheme operator.

Purpose and operations of the CSLR

The CSLR was established to enhance the Australian community's trust and confidence in the dispute resolution framework in the Australian financial system, to safeguard consumer trust and confidence, and to ensure the system continues to meet the needs of its users. It is a vital part of Australia's financial ecosystem, stepping in to provide relief to victims of financial misconduct, who may otherwise struggle to obtain compensation. Its existence supports confidence in the financial services sector.

The establishment was recommended by the Financial Services Royal Commission and the Ramsay Review, as it was observed that the existing arrangements were insufficient to compensate persons who have been impacted by conduct which fell below regulatory standards and expectations.

The CSLR provides compensation to consumers as a last resort, and only after all other avenues have been exhausted. Specifically, compensation is available in circumstances where AFCA have made a determination in favour of the consumer who has experienced financial misconduct, and the financial institution in the dispute has not paid the consumer in accordance with the AFCA determination - typically because of insolvency. This last resort approach underscores the importance of the CSLR in safeguarding consumers when other options have been exhausted or unavailable.

The CSLR will facilitate the payment of up to \$150,000 in compensation to eligible consumers in relation to financial complaints pertaining to:

- Personal financial advice provided to retail clients on relevant financial products
- Securities dealing for retail clients
- Credit intermediation
- Credit provision

The CSLR, based in Melbourne, Australia, has been operational since April 2024.

Reasons for the collapse of wealth management companies

CSLR's experience

Considering the CSLR's limited operational scope and its emerging stage, it does not have sufficient information or experience to comment on the cause of the collapse of wealth management companies.

As a compensation scheme of last resort, the CSLR is aware of the potential for moral hazards inherent in financial misconduct by financial firms, particularly in instances of phoenixing. This troubling practice not only erodes the integrity of the financial system but also leaves victims without adequate recourse for their losses. The CSLR acknowledges the significant challenges in detecting such conduct in real-time. Where it observes the need for greater accountability, CSLR will refer the relevant conduct and/or financial firm to regulatory bodies for consideration and action. These mechanisms are essential to ensure that those responsible for the financial harm inflicted upon victims are held accountable, thereby safeguarding the interests of consumers, and reinforcing trust in the financial system.

Individuals impacted

The CSLR has received a total of 202 claims related to AFCA determinations concerning personal financial advice. Of these, 90 claims have been processed, resulting in compensation payments amounting to \$8,950,118. Notably, the value of the AFCA awards associated with the determinations relevant to these processed claims is approximately \$18,923,944, highlighting the significant impact of these decisions on affected individuals.

Financial firms involved

The 202 claims related to AFCA determinations concerning personal financial advice involve 24 financial firms. Claims related to AFCA determinations concerning personal financial advice represent 80% of all claims received by CSLR to date.

While the CSLR's mandate primarily focuses on assessing and processing compensation payments, it has nonetheless identified the following recurring themes of misconduct:

- Inappropriate advice to use an SMSF to borrow and/or invest in property (90% of all personal financial advice claims were linked to superannuation in some way)
- Misleading, deceptive advice or unauthorised transactions
- Advice that was not aligned to risk profile, personal circumstances or best interests of client(s)
- Failure to:
 - conduct proper analysis or oversee investment strategy
 - implement a statement of advice
 - regularly review investment strategies

Of the 202 claims related to 24 firms, five firms account for 10 or more claims. Below are the key issues identified that have given rise to a claim:

- Firm One (69 claims): Claims primarily involve misclassification of consumer risk profiles and incorrect categorisation of property as “defensive and growth,” resulting in overly aggressive risk

profiles and lack of diversification. Additionally, there were recommendations for related entity products.

- Firm Two (18 claims): Claims focus on advice to establish self-managed superannuation funds (SMSFs) that were often not in the consumer's best interest, particularly when balances were too low to be cost-effective. High-risk, geared property investments were also a concern.
- Firm Three (13 claims): Claims involve inappropriate advice to set up SMSFs with balances below recommended thresholds, leading to significant risks associated with geared property investments and lack of portfolio diversity. Note that several unpaid deeds of settlement for failure to provide ongoing advice are outside the CSLR's scope.
- Firm Four (11 claims): Claims highlight overexposure to property within SMSFs, focusing on a single asset class without considering the consumer's situation or associated risks.
- Firm Five (11 claims): Claims vary, including failures to provide ongoing advice or implement recommendations (generally under \$10,000), inappropriate SMSF setup advice due to low balances, and instances of dishonest conduct, such as inducing unaffordable loans and improperly controlling consumer accounts.

It is important to recognise that more detailed evaluations of these issues would be more appropriately handled by specialised bodies that can provide a deeper analysis.

The data and information presented in this submission are accurate as of 31 October 2024.