
SUBMISSION TO TREASURY

COMPENSATION SCHEME OF LAST RESORT

AUGUST 2021



Victorian Aboriginal
Legal Service

About Us

Consumer Credit Legal Service (WA) Inc

Consumer Credit Legal Service (WA) Inc. (CCLSWA) is a not-for-profit charitable organisation which provides legal advice and representation to consumers in WA in the areas of credit, banking and finance. CCLSWA also takes an active role in community legal education, law reform and policy issues affecting consumers.

CHOICE

CHOICE is the leading consumer advocacy group in Australia. CHOICE is independent, not-for-profit and member-funded. Our mission is simple: we work for fair, just and safe markets that meet the needs of Australian consumers. We do that through our independent testing, advocacy and journalism.

Consumer Action Law Centre

Consumer Action is an independent, not-for-profit consumer organisation with deep expertise in consumer and consumer credit laws, policy and direct knowledge of people's experience of modern markets. We work for a just marketplace, where people have power and business plays fair. We make life easier for people experiencing vulnerability and disadvantage in Australia, through financial counselling, legal advice, legal representation, policy work and campaigns. Based in Melbourne, our direct services assist Victorians and our advocacy supports a just marketplace for all Australians

Financial Counselling Australia

Financial Counselling Australia (FCA) is the peak body for financial counsellors in Australia. Financial counsellors work in community organisations and provide advice and support to people experiencing financial hardship.

Financial Rights Legal Centre

The Financial Rights Legal Centre is a community legal centre that specialises in helping consumers understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the National Debt Helpline, which helps

NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies, and the Mob Strong Debt Help services which assist Aboriginal and Torres Strait Islander Peoples with credit, debt and insurance matters. Financial Rights took over 21,000 calls for advice or assistance during the 2019/2020 financial year.

Indigenous Consumer Assistance Network

The Indigenous Consumer Assistance Network (ICAN) provides consumer education, advocacy and financial counselling services to Indigenous consumers across the nation.

Super Consumers Australia

Super Consumers Australia (Super Consumers), formerly known as the Superannuation Consumers' Centre, is an independent, not-for-profit consumer organisation formed in 2013. Super Consumers was first funded in 2018. We work to advance and protect the interests of low and middle income people in the Australian superannuation system.

During its start up phase Super Consumers has partnered with CHOICE to deliver support services. CHOICE is the leading consumer advocate in Australia, established over 60 years ago, it is an independent voice, ensuring consumers get a fair go

Uniting Communities Consumer Credit Law Centre SA

The CCLCSA was established in 2014 to provide free legal advice, representation, legal education, advocacy, and financial counselling to consumers in South Australia in the areas of credit, banking, and finance. The CCLCSA is managed by Uniting Communities who also provide general community legal services, as well as a range of services to low income and disadvantaged people including mental health, drug and alcohol, and disability services.

Victorian Aboriginal Legal Service

The Victorian Aboriginal Legal Service Co-operative Limited (VALS) was established as an Aboriginal Community Controlled Co-operative Society in 1973. VALS is the only dedicated, multidisciplinary legal and support service for Aboriginal and Torres Strait Islander peoples in the State of Victoria. VALS plays a vital role in supporting Aboriginal people in custody and providing referrals, advice/information, duty work and case work assistance across criminal, family, civil and strategic litigation matters.

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INTRODUCTION

Consumer groups welcome the Federal Government's commitment to establish a compensation scheme of last resort ('**CSLR**').

Uncompensated losses arising from financial misconduct can cause a range of lasting impacts on people, including the loss of a family home, bankruptcy, the collapse of the family business, mental and physical ill-health, and relationship breakdown. When ASIC investigated the impact of monetary loss in 2011, it found that almost one in six people affected by uncompensated losses were living below the poverty line and had either lost their home or were perilously close to losing it.¹ These impacts are likely to be even more acute in the current economic climate, in which many people continue to suffer from the impact of losing work due to the COVID-19 pandemic.

A well-designed CSLR is a missing link in the financial services architecture in Australia. Casework organisations witness first-hand the impact of the lack of a CSLR on people and the Australian community. It is a disillusioning and unjust experience for families who suffer a loss to go through the lengthy dispute resolution process and have compensation awarded in their favour, only to be told they won't receive any money.

It is essential that the Government gets the design of the CSLR right in the first instance to ensure that the Australian community is protected and trust is restored to the financial sector. This is the opportunity to set a strong and fair foundation that works for the Australian community.

When the Government announced in its response to the Banking Royal Commission that it would establish a compensation scheme that extended beyond financial advice, we welcomed it. In order to deliver on the spirit of that commitment, consumer groups recommend the scope of the scheme be expanded to include all financial services products and services that come within AFCA's jurisdiction, including funeral expenses providers, managed investment schemes and debt management firms.

We also support expanding the scheme to include court and tribunal decisions and to include voluntary Australian Financial Complaints Authority ('**AFCA**') members. The purpose of the CSLR is to stop people from falling through the cracks, so we must not design a system with cracks from the outset.

This submission has a number of recommendations that will strengthen the design and operation of the compensation scheme of last resort.

¹ ASIC 2011, 'Rep 240: Compensation for retail investors: the social impact of monetary loss', p.43

RECOMMENDATIONS

1. The Government should establish a ‘broad-coverage’ CSLR that captures any financial services and products that come within AFCA’s jurisdiction.
2. If the Government chooses a narrower CSLR, the scheme needs to prioritise financial products and services with clear evidence of uncompensated losses, especially for those in communities experiencing vulnerability. The following three industries should be prioritised to be included in the scheme:
 - a. funeral expenses policies;
 - b. managed investment schemes; and
 - c. debt management firms.
3. The Government should expand the scope of the CSLR to include unpaid compensation awards from court and tribunal decisions. If the Government decides to not include court and tribunal decisions in the original design, it must commit to collect data on the number and amount of unpaid determinations.
4. The Government should expand the scope of the CSLR to include voluntary AFCA members.
5. If the Government chooses to not include voluntary AFCA members in the CSLR, a special exemption should be made to include the Aboriginal Community Benefit Fund given it became a member of AFCA as a result of regulatory action.
6. The minimum scope of financial products and services captured by the CSLR should be included in the Act.
7. The Government should amend s1065 of the *Treasury Laws Amendment (Measures for Consultation) Bill 2021: Compensation Scheme of Last Resort* to align the CSLR compensation cap with AFCA’s compensation cap.
8. If the Government chooses a compensation cap lower than AFCA’s cap, then the cap should be subject to indexation. This indexation should be included in *s1065(1)(a) of the Treasury Laws Amendment (Measures for Consultation) Bill 2021: Compensation Scheme of Last Resort* and in the rules of the CSLR operator.
9. The CSLR operator should be granted broad discretion to interpret when a firm is “unable to pay” compensation, including when a firm delays or ignores payment to a claimant. ASIC should be empowered to cancel the licence of a firm that delays or ignores payment of compensation to a consumer or small business as determined by AFCA.

10. The CSLR operator and AFCA must have a duty to be proactive in contacting people who are owed compensation.
11. The CSLR operator should establish clear processes that mean claimants face minimal barriers to receiving compensation.
12. The CSLR operator should have the discretion to waive the 12-month notification requirements in special circumstances, especially when people have experienced or are experiencing vulnerability.
13. The Government should amend the regulations to state that people should be eligible for compensation through the CSLR only if there is no other statutory scheme that is able to pay all of the determination.
14. In the event of a funding shortfall, the Minister should only have the power to increase levies or determine that a class of claims be spread over more than one financial year. If a class of claims are required to be paid over more than one financial year, then:
 - the maximum time period should be three years; and
 - payments should be prioritised to people in hardship.
15. The Minister should have the power by regulations to increase the annual scheme cap above \$250 million
16. The Government should amend s1061(3)(f) of the draft legislation to state that the board of the CSLR operator must have an independent chair, with an equal number of consumer and industry directors.

1. Scope

Consumer groups welcome the current scope of CSLR going beyond disputes that relate to personal advice failures. We strongly support the proposed inclusion of personal advice on relevant financial products to retail clients, credit intermediation, securities dealing, credit provision, and insurance product distribution within the draft scope of the scheme.² These are industries where there has been historical evidence of unpaid determinations.³

Consumer groups support a broad-coverage scheme that captures all financial services and products that come within AFCA's jurisdiction. Broad coverage will provide clarity for consumers and small businesses. A person who has been awarded compensation deserves to receive that money. Consumers are likely to lose faith in a system if after being awarded compensation they are told they are not eligible to receive compensation in the scheme because the firm's risk of failure was low". Expanding the scope will ensure there is fairness and redress across the entire financial sector.

Low risk industries should be accounted for in the funding model - not in the scheme's coverage. If the risk of unpaid determinations for a specific industry is low, then the fees required to be paid by the industry should reflect that. The CSLR is a safety net—that means all disputes must be covered. The intent of the compensation scheme of last resort is to stop people falling through the cracks, so we must not design a system with cracks from the outset.

As stated by Commissioner Hayne,

*'it is time to start reducing the number and the area of operation of special rules, exceptions and carve outs. Reducing their number and their area of operation is itself a large step towards simplification. Not only that it leaves less room for 'gaming' the system by forcing events or transactions into exceptional boxes not intended to contain them.'*⁴

Including low risk industries and linking contributions to demonstrated level or risk would also create a 'virtuous circle'. This would encourage specific industries to improve standards in order to lower contributions to the scheme.

However, if the Government chooses a narrower scope, then the scheme needs to prioritise industries with clear evidence of uncompensated losses, especially for those in communities experiencing vulnerability. For that reason, the following three financial products or services should be prioritised to be included in the scheme:

- funeral expenses policies;
- managed investment schemes; and
- debt management firms.

² Compensation Scheme of Last Resort: Proposal Paper, p.7

³ AFCA, 2020, 'Submission to Treasury Consultation on a Compensation Scheme of Last Resort', p. 3

⁴ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2018, Final Report, p16-17

Funeral expenses policies

Consumer groups are deeply concerned that the Aboriginal Community Benefit Fund (ACBF) (now trading as Youpla) is not captured in the scope of the CSLR. Youpla is a predatory funeral expenses insurer that targets First Nations communities with incredibly poor value insurance products. AFCA has determined 25 complaints against the ACBF since the completion of the Banking Royal Commission and has awarded compensation to the consumer in every case. If this pattern continues, as is likely, we are concerned that ACBF will go under, leaving Indigenous people who have paid tens of thousands of dollars in premiums with no access to compensation.

Funeral expenses policies sold by Youpla are of extremely poor value. According to evidence heard before the Banking Royal Commission, ACBF's claims payout ratio of 13.9% was the lowest percentage of insurers ASIC surveyed.⁵ ASIC also found that products were poorly targeted with 50% of funeral insurance products sold to Aboriginal people under 20 years old.⁶ At the time of the Banking Royal Commission, the Aboriginal Community Benefit Fund had 16,190 policies where customers potentially will pay more than the benefit amount and 754 policies where customers had already paid more than the benefit amount.⁷

Until the passage of recent reforms, providers of funeral expenses policies were not covered by the financial services licensing and conduct regime of the *Corporations Act 2001* (Cth) (Corporations Act) due to their exemption as financial products pursuant to section 765A of the Corporations Act and regulation 7.1.07D of the *Corporations Regulations 2001* (Cth).⁸

This licensing loophole meant that funeral expenses providers have not been compulsory members of AFCA, and would not be required by law to join until the licensing obligations come into effect under the reforms, and any providers seek and obtain a licence. Even at that time, there are no guarantees that previous and existing policyholders affected by past misconduct by providers of funeral expenses policies will be compensated. If, for example, ACBF goes out of business, it may leave claim holders facing the loss of past contributions and no future coverage for the costs of their funerals. It would be a perverse outcome if communities were to bear the cost of poor legal drafting, and inappropriate legal loopholes.

It is also important to note that the ACBF did not in reality join AFCA on a voluntary basis. ACBF is only a member of AFCA based on agreement following an ASIC 'no action' letter decision.⁹ ASIC imposed on ACBF a condition that they "became and remained a member of an external dispute resolution scheme".

⁵ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2018 Interim Report, p.456

⁶ ASIC, 2015, 'Rep 454: Funeral insurance: a snapshot'

⁷ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Witness Statement of Mr Bryn Jones, WIT.0001.0054.0001

⁸ Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2019 Measures)) Act 2020 (Cth).

⁹ ASIC, 2005, 'Overview of decisions on relief applications from financial service providers', p11

As a principle, we support the inclusion of voluntary AFCA members in the CSLR. If the Government decides to not include voluntary AFCA members, the ACBF should still be captured in the scheme given its membership came about as a result of regulatory action. Given the historic evidence of widespread harm and the targeting of First Nations communities, a special exemption should be made to include the Aboriginal Community Benefit Fund in the CSLR.

Managed investment schemes

Consumer groups strongly support the inclusion of managed investment schemes (MIS) in the scope of the CSLR.

A 'narrower' CSLR should be targeted to areas of greatest evidence of harm for uncompensated losses. There is historical evidence of unpaid determinations in collapses of managed investment schemes that have left families uncompensated with many in severe financial hardship. The Ramsay Review found that operators of managed investment schemes were the second highest category of non-compliant financial firms at the Financial Ombudsman Service (FOS).¹⁰ AFCA also acknowledged that unpaid determinations occur and are outstanding for the managed investment scheme industry.¹¹

We are particularly concerned that victims of the recent Sterling First collapse will go uncompensated if the MIS industry is excluded from the CSLR.

The collapse of Sterling First

Over 100 people have been left in financial ruin and uncompensated by the collapse of the property investment scheme Sterling First in 2019. Many of the victims of Sterling First are elderly Australians who have lost their entire life savings and are facing homelessness. Research provided by the Sterling First Action Committee found that over 82% of Sterling Victims lost over \$100,000 in the scandal. Here are their stories:

Marsha, 80, and her husband lost most of their life savings in the collapse of Stirling First:

"We've lost \$126,000 roughly. Emotionally it became very difficult for me because my husband had developed Alzheimers and he could not understand what was going on. So I pretty well coped with things alone and looked after him at the same time."

¹⁰ Ramsay Review, 2017, 'Review of the financial system external dispute resolution and complaints framework: Supplementary Final Report', pg 40

¹¹ AFCA, 20220, 'Submission to Treasury Consultation on a Compensation Scheme of Last Resort', p. 3

Anette Taylor, 69, lost her entire nestegg of \$220,000 and now lives on the age pension, half of which goes to rent. Before going into the scheme, she owned her home. Now she struggles to make ends meet and can no longer afford internet access:

“Our money was supposed to be in a trust fund, protected. That was my impression of what a trust fund is. Where was our money going? That’s what I’d like to know. To do this to pensioners, some in their 80s and 90s. It’s just shocking, and the government has done absolutely stuff-all to help us. It has destroyed me. I just want the money back and to get on with my life.”

Grame and Sheryl Sofield lost their entire life savings of about \$155,000. Sheryl says:

“Our anxiety was just through the roof. Sleepless nights. Devastation. If it wasn’t for our two children helping us out, I don’t know how we would have survived. It’s been a very hard two years. “

Peter Holden, 69, lost \$154,000 and says he’ll probably file for bankruptcy soon to get out from under his credit card debts. He bought into the scheme after he retired. Peter says:

“It’s very stressful, it’s very worrying. Some people were fortunate enough to have some money in reserve, but I put everything I had into it with the understanding that I could take it out whenever I wanted. That’s what they promised in the paperwork.”

Source: CHOICE and the Sterling First Action Committee

The Government’s apparent rationale for excluding managed investment schemes is the risk of moral hazard. We disagree with this assumption. The Ramsay Review thoroughly considered the risks of moral hazard for a CSLR and concluded,

“the Panel does not consider that the risks of moral hazard in the instance of establishing a CSLR have been substantiated.”¹²

The Ramsay Review found there is a “very small risk” of a moral hazard given there are other significant disincentives and protections in place, such as:

- *“a firm which does not have compensation arrangements is in breach of the financial services laws and could be subject to regulatory and enforcement action by ASIC;*

¹² Ramsay Review, 2017, ‘Review of the financial system external dispute resolution and complaints framework: Supplementary Final Report’, pg 49

- *there are a number of regulatory improvements underway or that have been undertaken in recent years to improve the professionalism and quality in financial advice.*
- *consumers are generally unable to assess a financial firm's compliance history or identify which firms are more likely to become insolvent;*
- *for a consumer or small business to access a CSLR, they need to first suffer a loss and then spend considerable time going through the dispute resolution process, which involves uncertainty for consumers and small businesses about whether they will be successful*¹³

In fact, a strong case can be made that rather than creating a moral hazard, the establishment of a CSLR would improve industry conduct. More responsible firms will want to ensure that the scheme is called on as rarely as possible and will have an incentive to advocate to improve industry conduct and report non-compliant businesses to regulators.

Debt management firms

Consumer groups consider that the CLSR should cover debt management firms. From 1 July 2021, all debt management firms will be required to obtain a credit licence and will need to be a member of AFCA. In line with Treasury's recommended approach that licensed businesses should be covered by the CLSR, this should extend to debt management.

Regina's story

In early October 2014 Financial Rights helped a consumer in severe financial stress obtain an order for the repayment of more than \$12,884 through FOS (FOS determination 307408). Regina [name has been changed for privacy reasons] had engaged the services of a Debt Management Firm. The Debt Management Firm (DMF) was a voluntary member of FOS. The DMF was contracted to negotiate with her unsecured creditors to reduce her debts of \$75,500 to a reasonable amount for a fee.

Regina was in severe financial stress and was sleeping in her car, she however made payments totaling \$9,850. The DMF provided her almost no assistance, and her debts were sent on to debt collectors. Regina finally got some assistance from a free financial counsellor but by then various creditors had listed defaults on her credit file and threatened to commence court proceedings. FOS in reviewing the matter found the conduct unconscionable.

The FOS determination included compensation for non-financial loss, in part as a result of offensive comments made by the DMF during the dispute that Regina should have

¹³ Ramsay Review, 2017, 'Review of the financial system external dispute resolution and complaints framework: Supplementary Final Report', pg 49

sold her car to pay her debts, despite the fact the DMF was aware she was living in it. FOS found she was entitled to \$9,850, compound interest of \$1,034 and non-financial loss of \$2,000 to the total of \$12,884.

Regina's joy of winning in FOS was short-lived. She did not receive payment. It was not until 79 days after acceptance that she received a part payment of \$2,000 after several excuses about delays with insurance claims on their professional indemnity insurance. Financial Rights assisted her by following up with the DMF, the Ombudsman and the regulators. All who could not do anything. It took 388 days for the DMF to make additional part payment in sporadic \$250 and \$100 instalments which required the assistance of a community lawyer to track and catch. Regina was not paid the interest awarded.

Regina was invited to apply to the unpaid EDR determination scheme established 1 July 2019 in response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. We provided all the receipts of payments of the \$11,500 and were advised 12 months after submitting the application Regina was not eligible as she had been paid her entitlement. Regina is considering her position on the decision but believes she is entitled to at least the \$1,384 from the scheme, but understandably she is completely fatigued by the process.

Source: Financial Rights Legal Centre

Debt management and credit repair companies target people concerned about bills, debts, home repossession or their credit report. They typically offer quasi-legal and quasi-financial advice often starting with a 'free' consultation and then providing services including negotiating with creditors, repairing credit reports, arranging formal or informal debt agreements or bankruptcy, managing money and budgets, and everything in between.

While the promises of a 'life free from debt' or a 'clean' credit report made by these companies can initially be appealing to people in financial difficulty, the reality is often very different.

Problems can include:

- bad advice that can leave people worse off
- high, hidden, upfront fees for services of little value, or that the consumer could do themselves for free
- unfair, predatory and unconscionable conduct
- spruiking services with overblown claims about what their services can do, or downplaying the consequences of particular debt options
- failure to inform clients of the free options that can assist, such as creditor's hardship programs, ombudsman schemes and financial counselling

Some of the providers in this sector are highly predatory and their liquidity is unknown. It is important that people trust that if their debt advisor does them wrong, and goes bust, there will be a safety net. The number of firms is not large – there are currently 66 firms on ASIC's

published list of applicants. But their potential reach is huge, particularly with so many people struggling financially with the impact of Covid-19 right now.

The CLSR will cover financial advisers. Debt management firms are similar to financial advisers. However, instead of advice on how to build and manage wealth, debt management firms give advice on how to manage and resolve debt. It would be highly inequitable for the CLSR to cover financial advice but not debt advice.

Recommendations 1 - 2

1. The Government should establish a 'broad-coverage' CSLR that captures any financial services and products that come within AFCA's jurisdiction.
2. If the Government chooses a narrower CSLR, the scheme needs to prioritise financial products and services with clear evidence of uncompensated losses, especially for those in communities experiencing vulnerability. The following three industries should be prioritised to be included in the scheme:
 - a. funeral expenses policies;
 - b. managed investment schemes; and
 - c. debt management firms.

Court and tribunal decisions

The compensation scheme of last resort should include unpaid compensation awards from court and tribunal decisions. Access to effective redress should not depend on which forum heard a dispute. Excluding court and tribunal decisions risks distorting a well-functioning dispute resolution system in Australia. The Ramsay Review recommended that the scheme include unpaid court and tribunal awards, stating,

“the current dispute resolution framework in the financial system is underpinned by the principle that consumers and small businesses should have a choice about whether to pursue their claim through an EDR body, a court or a tribunal.”¹⁴

When the Government announced its response to the Banking Royal commission, it gave a clear commitment to include unpaid compensation arising from court decisions within the scope of the CSLR. The draft proposals are a direct repudiation of the Government's clear and public commitments.¹⁵

Excluding court and tribunal decisions from the CSLR may distort consumer choice about dispute resolution forums. While it is less common that consumers will take their dispute to court

¹⁴ Ramsay Review, 2017, 'Review of the financial system external dispute resolution and complaints framework: Supplementary Final Report', pg 69-70

¹⁵ Australian Government 2019, 'Restoring trust in Australia's financial system. The Government response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry', p.36

rather than to EDR, there are reasons why consumers may prefer to have their matter heard in a court. For example, the Ramsay Review found that some people would prefer having their case heard in the courts because, “the process is more transparent and based on formal rules of laws and evidence”.¹⁶

The Treasury’s rationale for excluding court and tribunal decisions is due to “lack of data” on the number and amount of unpaid determinations.¹⁷ This problem has been known for years by policymakers. If the Government does not include court and tribunal decisions in the original design of the scheme they must at least commit to collecting data on unpaid court and tribunal decisions. A failure to collect data will result in policymakers being faced with the same issue at the next CSLR review process.

Recommendation 3

The Government should expand the scope of the CSLR to include unpaid compensation awards from court and tribunal decisions. If the Government decides to not include court and tribunal decisions in the original design, it must commit to collect data on the number and amount of unpaid determinations.

Voluntary AFCA members

On balance, we support voluntary AFCA members being captured by the CSLR and a requirement that they financially contribute to the scheme. Consumers should have effective access to redress, irrespective of whether a firm is a voluntary or mandatory member of AFCA. If a voluntary firm wants to take their obligations as being part of AFCA seriously, then they should be required to be part of the CSLR.

While it is important to encourage emerging industries to voluntarily join AFCA, firms who join also obtain the benefit of appearing to be trustworthy and ‘good’ industry players. For example, the Australian Finance Industry Association, the lobby group responsible for the buy-now, pay-later (BNPL) industry, has been in the media claiming their new code requiring AFCA membership “goes above and beyond existing laws by increasing safeguards for customers.”¹⁸ However as it’s a voluntary requirement to be part of AFCA, BNPL providers will not be part of the CSLR. Such firms should have no concerns around making a small contribution to the CSLR. Firms should not get the benefit of improved trust and confidence in its services without the corresponding obligations.

While not within the scope of this consultation, consumer groups support bolstered regulatory requirements for firms to be legally required to be AFCA members. In particular, we support

¹⁶ Ramsay Review, 2017, ‘Review of the financial system external dispute resolution and complaints framework: Supplementary Final Report’, pg 70

¹⁷ Compensation Scheme of Last Resort: Proposal Paper, p.8

¹⁸ J. Fernyhough, 2020, ‘Buy now, pay later firms to cap late fees’, Australian Financial Review, available at: <https://www.afr.com/companies/financial-services/buy-now-pay-later-firms-to-cap-late-fees-20200128-p53vh2>

regulation of the unregulated buy-now, pay-later lenders, as well as small business lenders, to legally require them to be AFCA members.

Recommendations 4 - 5

4. The Government should expand the scope of the CSLR to include voluntary AFCA members.
5. If the Government chooses to not include voluntary AFCA members in the CSLR, a special exemption should be made to include the Aboriginal Community Benefit Fund given it became a member of AFCA as a result of regulatory action.

Legislating the scope of the scheme

We strongly recommend that the initial scope of CSLR be included in the legislation, not in regulations. The Government is presented with an opportunity to create a foundation for a well-designed and clearly articulated scheme. This will provide certainty to consumers, financial firms, and the community about the design.

Flexibility can be provided in regulations for additional financial products and services to be included at the discretion of the Minister but any decision to reduce the scope of the scheme should be a matter for the Parliament.

Recommendation 6

The minimum scope of financial products and services captured by the CSLR should be included in the Act.

2. Paying claims

Compensation cap

Consumer groups support the principle that a consumer should be able to recover their full loss as awarded by AFCA or by tribunal or court order. We recommend that the proposed compensation cap of \$150,000 be increased to align with AFCA's compensation caps. This follows the Ramsay Review recommendation that the compensation caps of the CSLR and AFCA should be aligned.¹⁹

We acknowledge that a \$150,000 compensation cap will be sufficient to cover the compensation bill for most clients that our casework organisations assist. However, this cap is too low for some people who have suffered losses from financial advice scandals. Many people who have been victims of financial advice misconduct may have lost their entire life savings or family home. \$150,000 often is not sufficient to cover the damages awarded and will place these people at risk of a retirement in poverty. This will likely be for a small minority of cases and their inclusion will not fundamentally weaken the sustainability of the scheme.

The CSLR compensation cap should be subject to indexation. For example, under AFCA's rules, the compensation limits were adjusted on 1 January 2021 and every three years thereafter, by the higher percentage increase in:

1. "the Consumer Price Index, weighted average of eight capital cities, for the 3 year period ending with the most recent report issued by the Australian Bureau of Statistics in the previous year; and
2. (ii) the Male Total Average Weekly Earnings for the 3 year period ending with the most recent report issued by the Australian Bureau of Statistics in the previous year."²⁰

It is important to include indexation in the compensation cap, as the value of \$150,000 decreases for consumers and small businesses as the cost of goods and services increase. This indexation should be included in *s1065(1)(a) of the Treasury Laws Amendment (Measures for Consultation) Bill 2021: Compensation Scheme of Last Resort* and in the rules of the CSLR operator.

Recommendations 7 - 8

7. The Government should amend s1065 of the *Treasury Laws Amendment (Measures for Consultation) Bill 2021: Compensation Scheme of Last Resort* to align the CSLR compensation cap with AFCA's compensation cap.
8. If the Government chooses a compensation cap lower than AFCA's cap, then the cap should be subject to indexation. This indexation should be included in *s1065(1)(a) of the*

¹⁹Ramsay Review, 2017, 'Review of the financial system external dispute resolution and complaints framework: Supplementary Final Report', pg 14

²⁰ Australian Financial Complaints Authority Rules, 2021, D.4.3

Treasury Laws Amendment (Measures for Consultation) Bill 2021: Compensation Scheme of Last Resort and in the rules of the CSLR operator.

Broad definition of 'unable to pay'

We support a broad definition of a firm being 'unable to pay' an AFCA determination. The definition needs to have sufficient flexibility to account for financial firms ignoring or delaying paying claims to consumers or small businesses. This includes when a financial firm 'ghosts' a claimant and does not pay an individual while continuing to operate as a business.

We strongly support ASIC using their powers to commence legal action or cancel a firm's license if they fail to pay a complainant within a reasonable timeframe.

Consumer groups are aware of a number of financial firms who refuse to comply with AFCA determinations and pay consumers. Between 1 November 2018 and 31 May 2021, 39 financial firms have been reported by AFCA to ASIC for non-compliance with AFCA determinations.²¹

Richard's story

Richard (name changed) lodged a complaint originally with the Credit and Investment Ombudsman against BROKER for a failure to act with due care and skill in their services as a financial services provider. The case was transferred to the Australian Financial Complaints Authority (AFCA) when it opened at the end of 2018. In January 2020, AFCA made a determination against BROKER that they had to pay Richard \$8,750. Richard accepted this determination.

The BROKER failed to sign a written acceptance of the determination, refused to pay the amount and did not provide any further details as to why. AFCA attempted to persuade BROKER to pay the amount but with no success. In April 2020, Richard lodged a complaint against AFCA. AFCA responded to this complaint in September 2020 informing him that it was not AFCA's role to enforce their determinations. Richard lodged a complaint against AFCA. AFCA responded to this complaint informing him that it was not AFCA's role to enforce their determinations. Instead, it is up to Richard to take further action against BROKER in Court at his own cost. AFCA confirmed they will still try to ask BROKER to pay – As of July 2021, Richard still has not been paid and to his knowledge ASIC has not taken action against BROKER for its failure to pay an AFCA determination. BROKER has not provided any information as to why it will not pay.

Source: Financial Rights Legal Centre (C189205)

²¹ Parliamentary Joint Committee on Corporation and Financial Services, 2021, 'Oversight of ASIC, the Takeovers Panel and the Corporations Legislation No. 1 of the 46th Parliament', AFCA: Answer to question 01 from Mr van Manen MP: Financial institutions reported to ASIC for non-compliance with AFCA determinations - taken on notice from the public hearing on 18 June 2021 (received 9 July 2021)

As an example, we are aware of ASIC commencing civil penalty proceedings against General Commercial Group Pty Ltd for failing to comply with AFCA determinations, including failing to pay a complainant over \$11,000.²² While we strongly support ASIC's action, court proceedings are a lengthy and prolonged process and it may take years for the individual to receive money. In this circumstance, we support the CSLR paying the consumer out first, and then subrogating the consumer's rights to go after the firm if they choose. For many people, \$11,000 can be the difference in keeping a family home or keeping a small business afloat.

Recommendation 9

The CSLR operator should be granted broad discretion to interpret when a firm is "unable to pay" compensation, including when a firm delays or ignores payment to a claimant. ASIC should be empowered to cancel the licence of a firm that delays or ignores payment of compensation to a consumer or small business as determined by AFCA.

Seamless process for claimants

Consumer groups support the process of consumers and small businesses receiving compensation by the CSLR operator as seamlessly as possible.

Consumers want and need to be paid in a timely way. The reality is that anyone needing to claim on a last resort scheme is already at the end of a long journey. At the point of receiving compensation, claimants have already gone through a lengthy dispute resolution process that is stressful, confusing and can be financially straining. The design of the scheme needs to consider the practical realities of this. For example, we recommend that the relevant AFCA case manager is the best point of contact for determining whether an AFCA award has been paid, and following up with the consumer or small business regarding any unpaid awards. If a person from a different organisation contacts the consumer, then they may not respond. This should require AFCA to automatically contact consumers and small businesses after a 1 month period to help them access the CSLR if they haven't received their compensation owed.

Some of the signatories to this submission have experience with the previous Paying Legacy Unpaid EDR Determinations Scheme.²³ There were several problematic barriers to accessing this scheme, including ID requirements, long delays and arranging payment where the consumer's surname had changed. Some consumers entitled to payment thought that links to information sent by the scheme were a scam. This is understandable given the long delays and being contacted by a government department that was different from the EDR scheme that made the award of compensation. This process should be seamless. Claimants should face minimal barriers to receiving compensation. The following case studies demonstrate that the

²² ASIC 2021, 21-194MR ASIC sues General Commercial (Urban Commercial) and Eden Capital (Southside Lending) for failure to cooperate with AFCA

²³ <https://www.grants.gov.au/Ga/Show/142b655f-dffd-e2f8-95fc-f7ff55786058>.

process from misconduct to determination to the CSLR need to be, as far as possible, quick and automated, with a consumer focus, to prevent further harm

Andrea's story

Andrea (name changed) signed up to a rent-to-buy contract for a car in mid-2011. At the time she signed up to the contract she was bankrupt and her sole income was Centrelink. Andrea understood that she would pay \$100 per week and then she would own the car. Andrea paid \$19 000 in payments, repairs and establishment fees and for a car with a market value of just \$4,000. We helped Andrea to obtain a favourable determination from the Financial Ombudsman Service (FOS) in 2014.

*FOS found that the contract was a consumer lease regulated under the National Consumer Credit Protection Act and that the RV Investments (AUST) Pty Ltd (**RV Investments**) breached the responsible lending provisions because it should have been aware Andrea could not afford the payments. FOS awarded Andrea compensation of approximately \$11 000, however, it was never paid by the trader, RV Investments. FOS sued RV Investments in September 2015 for the unpaid determination and obtained default judgement. We took the claim to the Motor Car Traders Guarantee Fund but the application was rejected. RV Investments became insolvent.*

We assisted Andrea to apply for payment under the unpaid EDR determination scheme established 1 July 2019 in response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. Andrea received payment of approximately \$11, 500 for the unpaid FOS determination. Andrea has told us that it was a big surprise to see the money finally in her account after so long. She has been able to use this money to buy a new washing machine, phone and sofa and has saved the rest.

Maya's story

In late September/early October 2012, Maya (name changed) approached a 'rent-to-buy' caryard to trade in her old car and purchase a larger car. At that time, her sole source of income was Centrelink and she had no assets. She was also living in emergency accommodation and supporting three children. Due to misrepresentations by staff members, Maya believed that she was buying a car under finance. She traded-in her old vehicle as part of the deal. However, the trader claimed that the agreement was for short-term rental only. At the end of 2012, the trader repossessed the new car. The car dealer sold both her new car and her old car. We lodged a dispute with FOS. In 2014, FOS made a determination in favour of Maya, finding that the trader had engaged in misleading or deceptive conduct, irresponsible lending and inappropriate debt collection. FOS determined that Maya should be paid approximately \$13 000 by the trader. FOS sued the trader in September 2015 for the unpaid determination and obtained default

judgement. We took the claim to the Motor Car Traders Guarantee Fund but it was rejected. The trader became insolvent.

We assisted Maya to apply for payment from the Legacy Unpaid EDR Determinations Scheme established 1 July 2019 in response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

Maya has now been paid approximately \$13 000 for the unpaid determination. Maya told us that she never thought that she would get any of the money from the FOS determination, and she has put aside the money to buy a new car – the first new car in her life.

Source: Consumer Action Law Centre

In another case, a consumer entitled to payment under the scheme could not be contacted by their representative or AFCA, despite repeated efforts. To our knowledge, the consumer remains uncompensated. This underscores the importance of a seamless, fast and accessible process for consumers.

We welcome the CSLR operator having the discretion to waive the 12-month notification requirements in special circumstances.²⁴ Our experience is that some clients disengage with the process due to complaint fatigue and other logistical challenges. This is especially a challenge for clients in regional Australia and communities experiencing vulnerability. The initial low take-up of consumers accessing AFCA's legacy complaint process is indicative of this challenge. The CSLR operator and AFCA must have a responsibility in being proactive in reaching out to people who are due compensation.

Recommendations 10 - 12

10. The CSLR operator and AFCA must have a duty to be proactive in contacting people who are owed compensation.
11. The CSLR operator should establish clear processes that mean claimants face minimal barriers to receiving compensation.
12. The CSLR operator should have the discretion to waive the 12-month notification requirements in special circumstances, especially when people have experienced or are experiencing vulnerability.

²⁴Compensation Scheme of Last Resort: Proposal Paper, p.7

Ensuring people receive fair compensation

We also note in the Treasury's Discussion Paper that compensation from the CSLR will not be provided to claimants if a statutory compensation arrangement is able to "pay all or part of the determination".²⁵ It would be an unfair outcome if a claimant received only part of their AFCA determination through an existing statutory arrangement and were not eligible for the remaining compensation through the CSLR. People should be eligible for compensation through CSLR only if there is no other statutory scheme that is able to pay *all* of the determination. Any shortfall from existing statutory arrangements should be covered by the CSLR up until the compensation caps.

Recommendation 13

The Government should amend the regulations to state that people should be eligible for compensation through the CSLR only if there is no other statutory scheme that is able to pay all of the determination

²⁵Compensation Scheme of Last Resort: Proposal Paper, p.10

3. Funding the scheme

Consumer groups strongly support the proposal to have the CSLR model funded by industry in advance of potential claims. We have a number of recommendations that will strengthen the operation of the scheme.

Funding shortfalls should not unfairly impact consumers

We support the CSLR operator having a range of options available in the event of a funding shortfall. The scheme should have adequate flexibility to ensure that the scheme both manages financial risk and that consumers receive the compensation they rightly deserve. However, funding shortfalls should not unfairly impact claimants and limit the amount of money they are entitled to receive.

The Ramsay Review recommended a range of approaches in the event of a funding shortfall including:

- *additional levies could be collected;*
- *levies could be set higher each each year than is required to ensure there is a buffer for future events;*
- *payout caps could be introduced so that consumers receive their compensation over a period of years;*
- *a credit facility could be established to allow compensation to be paid when required, while recovering the necessary levies over a longer period of time.*²⁶

Importantly, the Ramsay Review did not recommend that people have compensation reduced as a result of a funding shortfall. We do not support the proposal for the Minister to have the powers to reduce compensation caps to cover a funding shortfall. In most circumstances, funding shortfalls should be covered by increased levies on industry. The costs should be borne by the industry that caused the misconduct. Only as a last resort should the Minister determine that claims should be paid over more than one financial year. If a class of claims are required to be paid over more than financial year, then:

- the maximum time period should be three years; and
- payments should be prioritised to people in hardship.

This will help to mitigate further impacts from financial hardship. There is precedent for prioritising remediation to people in financial hardship. After the collapse of Timbercorp, liquidators KordaMentha appointed an Independent Hardship Advocate (IHA) to identify people in hardship and prioritise financial assistance.²⁷

²⁶ Ramsay Review, 2017, 'Review of the financial system external dispute resolution and complaints framework: Supplementary Final Report', pg 94

²⁷ Catriona Lowe submission to the Senate Economics Committee Inquiry into Forestry Managed Investments Schemes

Recommendation 14

In the event of a funding shortfall, the Minister should only have the power to increase levies or determine that a class of claims be spread over more than one financial year. If a class of claims are required to be paid over more than one financial year, then:

- the maximum time period should be three years; and
- payments should be prioritised to people in hardship.

Ministerial flexibility to increase the scheme cap

Consumer groups strongly support the Minister having the powers to increase the annual scheme cap above \$250 million. This will provide the scheme with enough flexibility and adaptability to cater for unlikely 'black swan' events.

The proposal paper states that the total scheme cap, "will be amenable via regulations".²⁸ However, s17 of the *Financial Services Compensation Scheme of Last Resort Levy Bill 2021* states that, "the total amount of levy may be imposed for any levy period on all persons across all sub-sectors must not exceed \$250 million." It states that \$250 million is the "maximum amount of levy that may be imposed for a levy period".

We strongly support the Minister having the discretion to increase the scheme cap. While this is unlikely to occur, the scheme will be hamstrung in the event of 'black swan' events.

The scheme cap should also be indexed to reflect the time value of money for diminishing into the future.

Recommendation 15

The Minister should have the power by regulations to increase the annual scheme cap above \$250 million.

²⁸Compensation Scheme of Last Resort: Proposal Paper, p.7

4. Governance

Consumer groups support a balanced governance structure of the CSLR operator, with an independent chair and an equal number of members with consumer and industry experience. This is the existing governance model of AFCA, and its predecessor schemes Financial Ombudsman Service and the Credit and Investments Ombudsman.

The Ramsay Review found that this governance model has been critical to the success of the existing industry ombudsman schemes and recommended that the new scheme 'be governed by a board with an independent chair and equal numbers of directors with industry and consumer backgrounds' (Recommendation 2).²⁹

We acknowledge the importance of the CSLR operator having the right balance of skill-set and experience, including having directors with actuarial and claims handling experience. We expect the two director positions that satisfy these requirements to likely come from industry. As a result, industry positions should be balanced with an additional equal number of directors with consumer experience.

We support the Government mirroring the legal requirements of the CSLR operator that requires AFCA to have a constitution that requires,

“that the number of directors of the operator who have experience in carrying on the kinds of businesses operated by members of the scheme must equal the number of directors who have experience in representing consumers.”³⁰

We recommend that the Government amend s1061(3)(f) of the draft legislation to align the CSLR with AFCA's governance model and legislate a board with an independent chair with an equal balance of consumer and industry board directors.

Recommendation 16

The Government should amend s1061(3)(f) of the draft legislation to state that the board of the CSLR operator must have an independent chair, with an equal number of consumer and industry directors.

²⁹ Ramsay Review, 2017, 'Review of the financial system external dispute resolution and complaints framework: Supplementary Final Report',

³⁰ s1051(3)(d) *Corporations Act 2001*