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Australian
**Small Business and
Family Enterprise**
Ombudsman

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Mr Heath Hudson
Director, Compensation Scheme of Last Resort Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

via email: CSLR@treasury.gov.au

Dear Mr Hudson

Compensation Scheme of Last Resort: Reform options to support ongoing sustainability

The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) welcomes the opportunity to make a submission to Treasury's consultation *Compensation Scheme of Last Resort (CSLR): Reform options to support ongoing sustainability*.

It is clear the CSLR's current settings are unsustainable, creating disproportionate and growing cost pressures on small, compliant firms, undermining competition and reducing access to affordable advice. Consistent with our previous submissions, the ASBFEO advocates for reforms that reinforce the function of CSLR as a genuine scheme of last resort, where all other avenues for redress have been exhausted.¹

Pressures on the CSLR are being driven by other financial system factors, including complex corporate structures, financial advice-related misconduct and firm failure, gaps in professional indemnity insurance (PII), and limited firm resilience. Australian Financial Complaints Authority (AFCA) data indicates that financial advice-related complaints remain a key contributor to scheme costs. Recovery is further constrained by gaps in AFCA's reach, particularly where entities are insolvent or liabilities sit across related parties, prompting proposals to expand subrogation and recovery from associated entities. Together, these factors are shifting liabilities into the CSLR, increasing reliance on levies and contributing to cost volatility.²

Without stronger alignment between risk, responsibility and funding, the CSLR risks imposing unsustainable costs on compliant firms, many of which are small businesses, while weakening confidence in regulatory settings. Reforms should reinforce the CSLR as a genuine last-resort mechanism, supported by more effective safeguards within the financial services system, including robust PII, good governance and supervision—to reduce reliance on the scheme.

¹Australian Small Business and Family Enterprise Ombudsman (ASBFEO), "Submission to the Department of the Treasury: Compensation Scheme of Last Resort – enhancing professional indemnity insurance", ASBFEO, 6 February 2026; ASBFEO, "Submission to the Department of the Treasury: Financial Services Compensation Scheme of Last Resort", ASBFEO, 30 July 2021.

² Australian Financial Complaints Authority (AFCA), *Annual Report 2024–25*, AFCA, Melbourne, 2025; Australian Government Treasury, *Compensation Scheme of Last Resort framework*, The Treasury, Canberra, 2023.



In some cases, increased CSLR costs are passed through to consumers; however, there are practical limits to this. Many small firms operate on tight margins and have limited ability to raise fees without losing clients. Where costs, such as levies and compliance obligations, continue to rise, these businesses must either absorb the financial pressure or reassess their viability.

For some firms, particularly smaller or less diversified operators, these pressures can become unsustainable, leading to decisions to scale back services or exit the sector altogether. This has direct implications for market structure. As the number of active providers declines, competitive tension reduces, which in turn can lead to higher prices and fewer service options for consumers.

This dynamic is already evident in the broader financial advice sector. Adviser numbers have fallen significantly—from approximately 26,500 in 2019 to around 15,300 as at July 2025—indicating a sustained contraction. A continued loss of smaller providers risks further reducing access to affordable, tailored financial advice, particularly for small business clients who rely on these services.³

Key issues impacting small business

The CSLR is intended to enhance consumer trust in Australia's financial services system, including the financial advice sub-sector, through supporting victims of financial misconduct by providing compensation when all other avenues have been exhausted.

Small business financial advice firms are significant contributors to the scheme and in our previous submissions we have consistently raised the moral hazard of bad actors causing consumer harm and then exiting the sector, leaving compliant businesses to pay higher levies. This scenario is playing out with small firms expressing concern about the rising cost of CSLR levies to meet increasing losses due to financial misconduct.

The current CSLR settings are placing growing pressure on the financial advice sub-sector, with the impact keenly felt by small, compliant firms. Special levies—commonly reported in the range of \$2,000–\$4,000 per adviser—have been applied following high profile financial firm failures. Under the existing funding model, these costs are shared across the sub-sector, resulting in compliant firms contributing to losses arising from the failure of unrelated entities.

The CSLR levy framework relies on past sub-sector outcomes to set future costs, rather than reflecting current firm-level risk. As a result, well-governed firms contribute to cover losses caused by firms that have already failed or exited, weakening the link between risk and responsibility. This highlights a key limitation of the current design: while levies are forward-looking in forecast, they are based on past events, with limited ability to identify or respond to higher-risk behaviour earlier.

Some of these costs are being passed onto consumers by way of higher fees for advice. Industry estimates suggest CSLR-related costs have contributed to increases in the cost of advice of approximately 10–15 per cent for small firms, reducing the affordability of advice for consumers with modest resources.⁴

³ Australian Securities and Investments Commission (ASIC), "Financial Adviser Register", ASIC Connect, 2026, accessed 15 May 2026; Australian Government Treasury, *Compensation Scheme of Last Resort framework*, The Treasury, Canberra, 2023.

⁴ Financial Advice Association Australia (FAAA), *CSLR Impact Analysis and Member Survey 2026*, FAAA, Sydney, 2026, accessed 15 May 2026.



The combined impact of these pressures is contributing to the exit of financial advisers and a shrinking of the financial advice sub-sector. ASIC data shows a reduction of more than 40 per cent in the number of financial advisers between 2019 and 2025. Industry surveys indicate CSLR costs are a contributing factor in exit decisions, with around 1 in 10 advisers signalling intent to leave the industry. This has direct implications for competition, consumer choice and advice accessibility.⁵

ASBFEO's response to proposals set out in the Options Paper.

Proposal 1 – Enabling CSLR to deduct payments from compensation

ASBFEO supports this proposal, which strengthens scheme integrity by allowing the CSLR operator (via AFCA determinations and scheme administration) to deduct relevant amounts already received by claimants through other compensation pathways. This can reduce duplication, lower overall scheme costs, and help minimise excess pressure on sub-sector levies.

Proposal 2 – Expanding CSLR subrogation rights

ASBFEO supports Option 2 to extend subrogation to additional recovery mechanisms. This proposal would strengthen the CSLR's role as a genuine scheme of last resort and place downward pressure on the levies applied to compliant firms. Approaches such as the UK model, which enables recovery from related or associated entities, may improve outcomes by addressing circumstances where assets have been transferred or dispersed across corporate structures prior to failure.

Evidence indicates that recovery under current arrangements is often constrained where liable entities are insolvent, asset-light, or part of complex corporate groups. AFCA data shows that a significant proportion of unpaid determinations occur because firms do not have enough assets to pay compensation. This means there is often no way for AFCA to recover the money. Allowing recovery from related or associated entities would give AFCA more options to recover funds, improve recovery rates and reduce the need for claims to flow to the CSLR. This enables better alignment of redress with those responsible for, or closest to, the underlying harm.⁶

To strengthen this measure, reform should ensure subrogation arrangements are clear and enforceable, with practical pathways for recovery. As the CSLR operator bears the cost of pursuing recovery, arrangements should support efficient and targeted action, considering the costs and likelihood of recovery.

This proposal should be complemented by reforms that address the contribution to losses of product issuers, directors, marketers and corporate groups to curb or reduce the volume of claims drawing on the CSLR. ASBFEO notes this is partially addressed through ASIC's regulatory focus on financial influencers, reflecting the need for clearer accountability and oversight in the marketing of financial products and information.

Proposal 3 – Technical improvements

⁵ ASIC, "Financial Adviser Register", ASIC Connect, 2026, accessed 15 May 2026; FAAA, *Industry Survey 2026*, FAAA, Sydney, 2026, accessed 15 May 2026.

⁶ Australian Financial Complaints Authority (AFCA), *Annual Report 2024–25*, AFCA, Melbourne, 2025, accessed 15 May 2026; HM Treasury (UK), *Financial Services Compensation Scheme (FSCS) framework and recovery arrangements*, HM Treasury, London, 2026, accessed 21 May 2026.



ASBFEO supports technical improvements where they improve scheme clarity, consistency and regulatory certainty.

One example is the proposal to enable compensation payments to be split across multiple parties or accounts, for example, where a claim involves a joint application (such as a husband and wife) or different beneficiaries of a Self-Managed Super Fund (SMSF), ensuring compensation is distributed appropriately to each eligible party.

ASBFEO does not have views regarding the other proposals but in progressing technical improvements, we caution against creating further complexity within the scheme and not adding to levy pressures on small, compliant firms.

Proposal 4 – Revising the treatment of counterfactual loss for CSLR-eligible financial advice complaints

ASBFEO supports Option 1 to clarify the treatment of counterfactual loss by limiting compensation to capital losses only. This proposal aligns with the CSLR's role as a scheme of last resort and would improve predictability, fairness and sustainability for levy payers.⁷

ASBFEO considers that counterfactual losses increase claim size, and limiting compensation to capital loss provides a balanced approach between supporting outcomes for victims and those who fund the scheme. AFCA data continues to show that financial advice complaints are a significant contributor to compensation claims, reinforcing the need for tightly defined and consistent methodologies.

Limiting compensation to capital loss would reduce reliance on assumptions about alternative investment outcomes, improve consistency in determinations, and reduce the value of claims.

Proposal 5 – Embedding greater certainty in the special levy framework

ASBFEO supports the proposal to improve clarity and predictability around how special levies are imposed. Based on current estimates, there is a risk that 'special levies' become a more regular feature of the framework, with one currently applied and a further special levy expected in 2026-27 and beyond. This raises questions about their intended purpose as an exceptional measure.

With regard to the proposed 'waterfall' framework, ASBFEO notes that it could add additional levy pressures on small, compliant firms in the primary sub-sector. We therefore note that the proposal carries potential risks and should only be considered as part of a broader package of complementary measures that put downward pressure on levies, ensuring balanced and sustainable outcomes across the framework. We also suggest that any changes to the levy framework prioritise certainty, transparency and predictability in design, as levy volatility can impair business certainty and planning.

Proposal 6 – SMSF losses and CSLR funding

ASBFEO does not support Option 1 to extend the special levy to SMSFs. Applying levies to SMSF trustees would impose costs on entities who are not responsible for the underlying conduct driving claims.

⁷ Australian Government Treasury 2026, *Compensation Scheme of Last Resort – Reform options to support ongoing sustainability*, Consultation Paper, The Treasury, Canberra, April 2026.



ASBFEO also does not support the proposed opt-in mechanism whereby only SMSFs contributing to the scheme would be eligible for compensation. Consistent with their treatment under AFCA's guidelines, SMSFs should be recognised as clients for the purposes of complaints and compensation, not levy-paying entities.

More broadly, CSLR reforms should maintain clear alignment between levy responsibility and the source of misconduct causing consumer harm. Expanding levies to include SMSFs risks introducing cross-subsidisation and undermining fairness and confidence in the framework, particularly where participants have limited capacity to absorb additional costs.

ASBFEO notes that the Government is separately considering a range of options to clarify the treatment of SMSFs in the context of CSLR.

Proposal 7 – Facilitating levying of Managed Investment Scheme-related losses

The CSLR has compensated consumers who have suffered losses linked to managed investment schemes (MIS). Often, this has arisen from the conduct of scheme operators and advice practices associated with the scheme, including decisions around product design, distribution, and concentration of client investments. In some cases, advisers have directed clients to in-house or closely connected schemes without appropriate diversification.

As these MIS losses are closely connected to the actions and incentives of those operating or promoting the schemes, there should be clear accountability for MIS operators and associated entities, including appropriate contribution to the costs of compensation where their activities have led to consumer harm.

ASBFEO supports applying a levy to MIS participants to expand the CSLR funding base and considers Option 1, a broad-based levy, to be more achievable, simpler to administer and less likely to distort investor behaviour. While a risk-informed approach would more closely align risk and responsibility, we acknowledge the practical challenges with achieving this and caution against adding further uncertainty and complexity to the scheme.

While this proposal would be a welcome reform, ASBFEO considers it should not detract from other efforts to enhance MIS oversight and governance.

Proposal 8 – Improving recovery of unpaid AFCA determinations within corporate groups

ASBFEO supports strengthening recovery mechanisms at the corporate group level, as this can improve accountability and reduce reliance on the CSLR where losses arise within complex organisational structures. Effective recovery arrangements should ensure that entities within a corporate group, particularly those with control, capital, or risk management responsibility, can be held accountable for unpaid determinations.

ASBFEO supports both Option 1 and Option 2 that together provide a targeted response to known gaps in recovery arrangements, including situations where assets or clients may be transferred within a corporate group prior to firm failure. The proposed 'benefits test' for related entities directly addresses this issue, as highlighted in cases such as Dixon Advisory, where victims with no redress as the entity had been essentially stripped of its assets and revenue generation.

This proposal would strengthen AFCA's ability to pursue recovery from related entities where there is a clear connection to the underlying misconduct. This has the potential to improve recovery outcomes, reduce reliance on the CSLR, and limit the build-up of claims that ultimately drive special levies on the financial advice sub-sector.



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The ASBFEO is broadly supportive of the proposals in the Options Paper that address both the source of losses and the effectiveness of recovery of money for claims made to the CSLR. Taken together, they should support the long-term sustainability of the CSLR and enhance consumer trust in Australia's financial services system.

If you require any further information, please do not hesitate to contact the Policy and Advocacy team via email at advocacy@asbfeo.gov.au.

Yours sincerely

Lynda McAlary-Smith

Australian Small Business and Family Enterprise Ombudsman