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The Treasury
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Compensation Scheme of Last Resort (CSLR): Reform options to support ongoing sustainability

The Super Members Council welcomes the opportunity to respond to this Treasury consultation on how best to ensure ongoing sustainability for the Compensation Scheme of Last Resort.

The CSLR was supposed to be a 'last resort' safety net

As its name underscores, the Compensation Scheme of Last Resort (CSLR) was originally established to be a genuine 'last resort' safety net for consumers who had suffered significant losses but could not be compensated by those responsible – such as when a financial services firm collapses. SMC strongly supports the existence of a genuine last resort compensation scheme.

A key design principle from the outset was that the scheme's funding would be levied on the specific sub-sector of the financial services system from which the harm had originated. That principle is pivotal. It guards against the escalating moral hazard that necessarily arises if a levy is widened to capture consumers in safe, well-run parts of the financial services system which played no role in that consumer harm. The scheme was not designed to operate as an ongoing mechanism to redistribute the costs of recurring misconduct across the financial system, nor to require consumers in one part of the system to subsidise repeated failures in another.

The scheme was already under strain

A key problem is that the scheme was already under strain at its inception. The CSLR was designed for a steady-state environment in which advice failures would occur at a manageable rate and be funded by a modest levy on the financial advice sub-sector. The reality has been the opposite. The collapse of Dixon Advisory alone generated more than 2,700 complaints and an estimated compensation liability bill that has consumed multiple years of the scheme's funding capacity. Other more recent firm collapses – United Global Capital, MWL Financial Services, Next Generation Advice – have added to that load. The advice sub-sector levy cap has already been breached, triggering the special levy mechanism that last year pushed the cost across the rest of the financial services system.

The Shield and First Guardian collapses are now arriving on the CSLR's doorstep. Almost 12,000 Australians lost an estimated $1.2 billion of their life savings due to the chain of misconduct in those terrifying cases, and AFCA's lead determinations are flowing through. The advice firms at the centre of the matter – FSGA, MWL, UGC, Next Generation Advice – are in liquidation. InterPrac, the only solvent licensee implicated, is disputing its liability. The compensation bill that the CSLR will be asked to absorb sits in the hundreds of millions of dollars, on top of a scheme that is already over its funding capacity from the previous wave. The scheme is now being flooded by a tsunami of consumer harm arising from this string of recent financial advice and managed investment scheme failures. This highlights the importance and urgency of the Government's interlocking consumer safety reform proposals to stop consumer harms like these in the first place. Bold reform is essential both to protect millions of Australian consumers from catastrophic harm like these - and to ensure the survival of a true 'last resort' compensation scheme for those who will continue to need it into the future.

A design flaw

These recent pressures do not reflect a temporary imbalance or unusually volatile period. They point to structural weaknesses in the scheme's original design and naivete about how such weaknesses could and would be exploited by bad actors.

Existing settings attribute losses through the legal pathway by which claims are brought, rather than where loss originates or risk is controlled, and allow compensation to extend beyond restoring

consumers to their pre-misconduct position. Together, these design features inflate costs, weaken accountability, and increase pressure to expand the levy base beyond its original scope.

In this context, SMC considers that CSLR sustainability cannot be achieved through levy redesign alone. Adjusting sub-sector caps, refining the special levy, or smoothing the funding curve addresses the symptom, not the cause, of consumer harm and a skyrocketing compensation bill.

The cause is a scheme that has drifted from its design as a last-resort mechanism into a default funding pool for misconduct which the earlier links in the safety and accountability chain should have prevented. Durable reform requires a coherent package that re-anchors this important scheme as a genuine last-resort mechanism (as the scheme's very name affirms), aligns funding with the source of harm, and strengthens recovery and accountability before reliance is placed on levies.

Treatment of sectors outside the current design

A central issue in Treasury's consultation is the treatment of sectors outside the current CSLR subsectors, particularly APRA-regulated superannuation trustees and self-managed superannuation funds (SMSFs). SMC's strong view is that the 12.5 million everyday Australians who choose to keep their super protected with the safeguards, structure and scale of the profit-to-member superannuation system should not be forced to pay a levy to cross-subsidise failings in unrelated financial advice businesses and high-risk super investment vehicles.

The members of APRA-regulated profit-to-member superannuation funds should not be pulled into the CSLR levy framework. Safe, high-performing, tightly-regulated mainstream super funds are not a source of the losses being compensated by the scheme and already operate within a prudential framework designed to prevent fund failures and ensure member remediation where issues arise. Forcing everyday Australians who opt for the safety of mainstream super funds to contribute to CSLR levies in future would be a dangerous departure from the scheme's original design which ensured that its funding would be levied on the specific sub-sector of the financial services system from which the harm had originated. Forcing the members of safe, mainstream super funds to pay the levy would shift this bill onto hardworking low and middle-income Australians – including the nation's minimum wage workers - who are not responsible for the misconduct. This would escalate moral hazard by sending a further signal to bad actors and high-risk entities that the losses they inflict on consumers would be compensated by hard-working everyday Australians forced to pick up the tab for the criminal misconduct of outlaws.

SMC does not support the inclusion of SMSFs as a default response to current levy pressures either. The case for adding new sub-sectors to the levy base should be made on principle, not on funding convenience nor on perceived 'capacity to pay'. That said, if the Government refuses to see sense and forces members of super funds managed by APRA-regulated trustees to pay the levy, fairness and integrity would require that SMSF trustees cannot remain outside it. SMSF trustees are currently eligible to access CSLR compensation where their fund has received bad advice that triggers an AFCA determination — so excluding them from the levy base while preserving their claim eligibility is the textbook structure of adverse selection: a sector that draws on the scheme without contributing to it, yet with their losses funded by millions of Australians on the minimum wage. In such a circumstance, SMSF contribution to the levy should be mandatory and universal. Opt-in or opt-out models would simply compound the current problems of the scheme's ever-escalating compensation bill, creating predictable selection effects, even less funding certainty, and a continuing need for special levies.

The consultation paper proposes a rules-based levy waterfall to manage breaches of sub-sector caps. In SMC's view, the waterfall is form over substance. SMC's modelling shows that, under the proposed architecture, the waterfall makes only a marginal difference to how the cost of major events is distributed. The reason is structural: the sub-sector caps are calibrated on perceived 'capacity to pay' rather than to risk or harm, so the Tier 1 cap is reached quickly in any significant event, and Tiers 2 and 3 are required to make substantial contributions regardless of how the waterfall above them is configured. The waterfall changes the order of the redistribution; it does not change the fact of it.

This matters because the waterfall presents as a graduated, principled response to cap breaches — with the source sub-sector contributing first, adjacent sectors next, and broader sectors only as a backstop — but in practice it locks in cross-subsidisation as a standing feature of the scheme rather than a last-resort mechanism. Mapping the redistribution route in advance also reduces the commercial risk of misconduct for the operators creating the harm, because the contribution thresholds for downstream sectors are effectively guaranteed to be triggered in any significant event.

A more defensible approach is risk-based, loss-proximate funding: levy incidence allocated by reference to the events that trigger CSLR payments, with sub-sector caps weighted toward the business models and conduct types that produce the underlying losses, rather than toward the financial capacity of sectors that happen to be available. This aligns the cost of harm with responsibility for it, removes the standing expectation that unrelated sectors will act as the backstop, and reinforces commercial incentives for better conduct upstream – where the scheme's sustainability is ultimately determined.

Reforming the CSLR must be interlocked with the other reform packages

CSLR reform must be legislated concurrently with the broader proposed consumer protection package. Preventing harm at source – through stronger protections on high-risk superannuation switching, lead generation, product governance, and oversight of platforms and managed investment schemes – will do more to secure the scheme's sustainability than any post-event redistribution of losses. The CSLR sits at the end of a chain; the cost it absorbs is a direct function of how well the earlier consumer protection links hold.

Durable reform requires a coherent package of integrated measures that re-anchors the CSLR as a genuine scheme of last resort, confines compensation to actual losses, aligns funding with where harm originates, and strengthens recovery and accountability. These elements are interdependent: without tighter compensation scope, liabilities remain inflated; without loss-proximate funding, costs continue to be misallocated; without effective recovery, the scheme increasingly relies on levies as a substitute for accountability.

The CSLR is at a critical juncture. Recent funding pressures have highlighted real weaknesses in scheme design, but they also present an opportunity to restore the CSLR to its crucial intended role as a genuine scheme of last resort – one that delivers timely redress to consumers while maintaining fairness, accountability and long-term sustainability. The detailed responses in Appendix A address the specific consultation questions and implementation considerations but should be read as subordinate to the core principles set out in Sections 1–4.

SMC recommends that Treasury:

1) Proposal 1: Prevent overcompensation without delaying redress. Adopt clear offset rules, certainty thresholds and hardship safeguards, and avoid routine clawbacks.
2) Proposal 2: Strengthen CSLR recoveries when cost-effective. Expand subrogation to realistic sources (including PI proceeds) with clear cost benefit guardrails so CSLR remains a last-resort scheme.
3) Proposal 3: Implement the technical amendments promptly and scope-neutrally to improve efficiency, reduce delays and protect scheme integrity.
4) Proposal 4: Eliminate the but-for test entirely. CSLR should compensate capital lost due to misconduct, not reconstruct hypothetical investment decisions or foregone market returns.
5) Proposal 5: Do not adopt a rules-based levy waterfall that entrenches cross-subsidisation; allocate costs on a genuinely loss-proximate basis and exclude APRA-regulated super trustees from cross-tier pooling.
6) Proposal 6: If SMSFs remain eligible, require mandatory universal levy participation (no opt-in/opt-out) so the cohorts driving claims contribute and adverse selection is avoided.
7) Proposal 7: Include the MIS sector in special levies on a broad basis; avoid wide 'low-risk' carve-outs and, if tiering is used, make it narrow, objective and ASIC-reviewable.
8) Proposal 8: Introduce a targeted related-entity liability mechanism with clear nexus, proportionality and review rights to deter value shifting and improve recovery of unpaid AFCA determinations.

About the Super Members Council

We are a strong voice advocating for the interests of 12 million Australians with over $1.9 trillion in retirement savings managed by profit-to-member super funds. Our purpose is to protect and advance the interests of those millions of super fund members throughout their lives, advocating on their behalf to ensure super policy is stable, effective, and equitable. We produce rigorous research and analysis and work with Parliamentarians and policy makers across the full breadth of Parliament.

Treasury proposals in detail

1. Funding must reflect where harm is caused

A sustainable CSLR funding framework must begin with a clear principle: the cost of misconduct should fall on the parts of the financial services system that cause or control the risk of loss.

Over time, this crucial alignment has broken down. While CSLR costs are heavily concentrated in the financial advice subsector, this reflects the mechanism through which consumers access the scheme rather than the true origin of losses. Losses arising in MIS, platform-based arrangements and SMSF-related structures are frequently channelled into the CSLR through advice-linked AFCA determinations. As a result, costs appear as “advice costs”, even where advice is not the sole or primary source of failure.

This structural feature has important consequences. It leads to repeated breaches of the advice subsector cap, creates pressure to spread costs beyond the sectors in which losses originate, and obscures where reform effort should be directed. Levy redesign that focuses solely on redistributing these costs cannot resolve this misalignment. A durable solution requires a funding framework that follows loss causation rather than legal pathway.

2. Who should be in, and out, of the funding base

APRA-regulated superannuation

APRA-regulated profit-to-member superannuation trustees are not a loss-proximate source of CSLR claims. These funds operate within a prudential framework designed specifically to prevent firm failure and ensure member remediation where operational issues arise. Trustees are subject to intensive supervision, strict governance standards, and mandatory Operational Risk Financial Requirement (ORFR) reserves, which exist to fund remediation and compensation within the super system. In addition, Part 23 of the *Superannuation Industry (Supervision) Act 1993* provides a further Commonwealth backstop in rare cases of significant loss.

APRA-regulated super funds do not exhibit the failure characteristics that typically give rise to unpaid AFCA determinations and CSLR payments. Requiring these funds – and through them, their members who include millions of low and middle-income working Australians – to contribute to CSLR levies would depart from the scheme's original design. It would require Australians who already pay for strong prudential safeguards, and who typically cannot access CSLR compensation themselves, to fund losses arising in riskier investment structures outside of the safer, mainstream APRA-regulated super system where they choose to place their super. This cost-shifting weakens confidence in compulsory super and undermines the credibility of the CSLR as a targeted last-resort mechanism.

Treatment of SMSFs

Consistent with the principle that Australians in APRA-regulated superannuation funds should not be part of this scheme, SMC's view is that SMSFs should also be excluded – from both the scheme levy and the ability to claim on the scheme. SMSFs should not be afforded an opt-in/opt-out choice if 12.5 million Australians in mainstream super funds are not given that same choice.

SMSFs are self-directed trust structures, not commercial financial services providers. Their broad inclusion in the CSLR raises fundamental design issues, including a material risk of blurring the boundary between compensating consumers harmed by misconduct and underwriting self-directed investment decisions made by the trustees themselves.

It follows that if the Government forces consumers in APRA-regulated super funds to pay the levy, SMSFs cannot remain outside the levy base and still have eligibility to claim on the scheme. It would be deeply unjust for a minimum-wage worker in a safe, well-run, well-regulated mainstream super fund to be required to bail out failures in unrelated high-risk investment vehicles, while a millionaire with an SMSF is not required to contribute – and yet remains eligible to claim compensation under the scheme.

In those circumstances, CSLR participation should be mandatory and universal. Opt-in or opt-out models create clear adverse-selection risks, reduce funding predictability, and add ongoing operational cost through monitoring of participation, eligibility and entry and exit. The case for opt-in/opt-out flexibility does not outweigh these costs. If the Government does not compel SMSFs into the scheme, it must exempt millions of Australians in mainstream super funds from it too. A scheme that gives SMSF trustees a free pass while charging APRA fund members a flat-rate levy is a regressive tax and inconsistent with the key design principles the scheme was built on.

Advice as a pathway, not the primary source of loss

Access to the CSLR is typically triggered through personal financial advice, because AFCA determinations against advisers are a common legal pathway for establishing consumer loss. This does not mean that advice is the sole or dominant source of the underlying failure. In many cases, advisers recommended products or structures, including MIS and platform-based investments, that subsequently collapsed, were mismanaged, or proved incapable of meeting compensation obligations when harm occurred.

This structural feature of the CSLR means that losses originating outside the advice sector are routinely recorded as advice-attributed costs. Without reform, this misalignment will continue to drive repeated breaches of the advice subsector cap and create pressure to spread costs beyond the sectors where harm arises. Levy redesign that focuses only on redistributing these costs does not resolve the underlying attribution problem.

Bringing loss-causing sectors into the funding base

A durable funding framework must be loss-proximate. This requires bringing into the levy base those sectors that sit in the causal chain of CSLR-relevant losses, including MIS and related platform structures, rather than relying on broad cost-spreading once subsector caps are breached.

Recent failures such as Shield and First Guardian illustrate this point clearly. These events exposed significant weaknesses in MIS governance, product oversight and distribution arrangements, yet their downstream costs were largely absorbed through the CSLR via advice-linked claims. Leaving these sectors outside the CSLR funding framework entrenches a structural gap: entities that design, administer or host high-risk products can externalise the cost of failure, while levy payers in unrelated sectors bear the financial consequences.

Aligning funding with harm origination also supports better regulatory and commercial incentives. Where sectors generating CSLR-relevant risk are required to contribute proportionately to scheme funding, there is a clearer connection between conduct, governance quality and financial consequence. This alignment is critical to addressing CSLR pressures at their source rather than treating downstream symptoms.

3. Levy waterfalls are not a solution

The consultation paper proposes rules-based levy waterfalls to manage breaches of subsector caps. While greater predictability of levy burden is necessary, levy waterfalls address the consequences of

misaligned scheme design rather than the underlying causes. As such, they risk entrenching structural weaknesses in the CSLR rather than resolving them.

The frequency with which special levies are now required is not an anomaly. It is the predictable result of overly broad compensation settings, misattribution of loss to a single access pathway, and the exclusion of key loss-causing sectors from the levy base. Against this backdrop, levy waterfalls function as a mechanism for distributing pressure once caps fail, rather than as a tool for restoring alignment between responsibility for harm and funding outcomes.

Why levy caps are being breached

Breaches of subsector caps, particularly in the financial advice subsector, are not occurring because the caps are set at implausibly low levels. They are occurring because CSLR-funded liabilities reflect losses that originate outside advice but are channelled through advice-linked AFCA determinations. As outlined above, this feature of the CSLR architecture causes losses arising from MIS, platforms and SMSF-related arrangements to be recorded as advice costs, even where advice is not sole source of failure.

Introducing increasingly elaborate levy waterfalls to manage this pressure treats the symptom rather than the cause. Without correcting compensation scope and funding attribution, levy waterfalls will become a routine feature of the CSLR, rather than an exceptional backstop for rare, extreme events

The risks of normalising cross-sector pooling

Rules-based levy waterfalls create a material risk that cross-sector pooling becomes normalised by spreading costs beyond the sectors in which caps are breached. They create a clear pathway for APRA-regulated profit-to-member superannuation trustees to be drawn into funding losses that arise elsewhere in the system. Over time, this would weaken the link between conduct and consequence, embed a standing backstop inconsistent with the CSLR's original design, and erode confidence in compulsory super by using members' savings to fund failures they neither caused nor can access compensation from.

"Connection" is not a sufficient basis for allocation

The proposed levy waterfall model relies on broad concepts of "connection" to determine which sectors should bear costs once caps are exceeded. While appealing in principle, this approach is inherently unstable. Connection defined too narrowly will fail to capture loss-causing sectors; defined too broadly, it will capture entities merely adjacent in the value chain, regardless of where control, benefit or failure sits.

Over time, this risks shifting levy allocation from loss causation toward convenience, with classification judgments becoming increasingly contestable and unpredictable. A framework built on these concepts cannot deliver the certainty or fairness the CSLR requires. Sustainable funding cannot be achieved by refining how costs are spread after the fact; it requires correcting how losses enter and are attributed within the scheme in the first place.

Structural alignment must come before levy architecture

Levy waterfalls should not be treated as a primary reform lever. At best, they can provide temporary stability while more fundamental reforms are implemented. Without structural alignment — narrowing compensable loss, correcting attribution and bringing loss-causing sectors into the levy base — waterfall mechanisms will entrench CSLR dependency on repeated special levies and permanent cost-sharing across unrelated sectors.

A sustainable CSLR requires that levy architecture flow from sound design principles, not substitute for them. Restoring alignment between responsibility for harm and funding incidence reduces the need for complex waterfall mechanisms and preserves levy caps as meaningful constraints rather than thresholds that are routinely breached.

Uncertainty arising from discretionary allocation

The proposed model relies on a degree of discretionary allocation between tiers. As noted in consultation discussions, it remains unclear whether subsector caps must be fully exhausted before

costs cascade to other sectors, or how allocation decisions will be calibrated and applied in practice. In the absence of clearly defined thresholds and a consistent methodology, levy outcomes may vary materially from year to year for reasons that are not transparent or directly linked to loss causation.

This reduces predictability for levy payers and weakens confidence that outcomes will be anchored to a stable and coherent policy framework. For a scheme already experiencing sustained levy pressure, this level of uncertainty is inconsistent with the objective of improving funding stability and undermines the credibility of the proposed approach.

Use of regulatory effort in levy settings

Aspects of the proposed levy design rely on regulatory effort in determining levy burden. Use of regulatory effort as a proxy is not aligned with CSLR loss causation. Regulatory effort reflects the cost of supervision, compliance complexity and shifting areas of regulatory focus, rather than the incidence of misconduct that results in unpaid AFCA determinations.

This distinction is critical. A sector may attract higher regulatory attention because it is complex or evolving, not because it is generating CSLR-relevant losses. Conversely, areas of the system that generate significant losses may not be captured accurately by supervisory effort measures, particularly where failures arise in product design, distribution chains or corporate structures that sit outside traditional supervisory intensity.

Reliance on regulatory effort as an allocation proxy therefore risks embedding a structural disconnect between risk creation and funding responsibility. It introduces volatility that is unrelated to actual CSLR exposure and increases the likelihood that costs will be shifted onto sectors that have limited ability to influence or prevent the underlying harm.

A sustainable CSLR funding model must instead rely on loss-proximate measures, grounded in the events that trigger CSLR payments. This ensures that allocation reflects actual risk and preserves the link between conduct and financial consequence.

The waterfall introduces significant structural complexity without addressing the drivers of cost escalation. Consultation feedback has already noted that the model is difficult to interpret and lacks a clear rationale for how allocations are determined. This complexity is unlikely to deliver commensurate policy benefit.

Taken together, these issues confirm that the waterfall model is not a sound foundation for CSLR reform.

4. A risk-based, loss-proximate alternative

A more appropriate and sustainable approach to CSLR funding is to align levy allocation directly with the risk that gives rise to scheme liabilities. This requires a model that is anchored to the events that trigger CSLR payments — namely, unpaid AFCA determinations following firm failure.

Under the current framework, allocations are shaped by structural features of the scheme rather than by the source of risk. Losses are attributed through the pathway by which they enter the CSLR, particularly via advice-linked AFCA determinations, rather than by reference to where misconduct originates or where risk is controlled. As a result, funding incidence is disconnected from the underlying drivers of harm. A risk-based model corrects this by re-anchoring levy allocation to observable and repeatable indicators of CSLR exposure.

In practice, this would involve allocating the annual funding requirement across sectors using a transparent methodology based on exposure to CSLR-relevant trigger events. These events are already well defined within the scheme: a retail client suffers financial loss, an AFCA determination is made, the firm fails or becomes insolvent, and the determination remains unpaid. Anchoring allocation to these conditions provides a consistent and objective basis for assessing relative sector risk.

A risk-based approach would not require a fundamentally new architecture. It could build on existing CSLR data and use sector weightings calibrated to the observed and expected incidence of trigger events — that is, the events that generate unpaid AFCA determinations and claims on the scheme. Publishing the methodology, assumptions and data inputs would support transparency and allow levy payers to understand and anticipate their exposure on principled grounds, rather than negotiate it through opaque allocation rules.

This approach avoids reliance on the secondary proxies the current framework uses to allocate cost — most importantly, "regulatory effort." Regulatory effort is not a measure of risk. It is a measure of how much supervisory and enforcement time a regulator has spent on a sector in a given period, which reflects a wide range of factors that have little or no relationship to the conduct that triggers CSLR payments. These factors include the size and complexity of the regulated population, the maturity of the regulatory regime, the policy priorities of the regulator in the relevant year, the volume of routine licensing and reporting activity, the availability of supervisory resources, and the visibility of misconduct (which is itself a function of regulator focus, not of underlying risk). A sector that is heavily supervised because it is large, complex, or well-organised will register high regulatory effort regardless of whether it produces CSLR-relevant losses. A sector that is lightly supervised because it sits at the edge of the regulatory perimeter — precisely where the Shield and First Guardian conduct emerged — will register low regulatory effort even where it is the source of the harm. Using regulatory effort as a proxy for risk inverts the relationship the scheme is supposed to reflect.

The same critique applies to broader "connection" concepts, which allocate cost on the basis of perceived adjacency to the harmful conduct rather than actual contribution to it. Adjacency is not a substitute for loss causation. A scheme that allocates cost on the basis of where regulators have spent time, or on the basis of which sectors are nominally adjacent to the harm, will systematically misallocate cost away from the actors who generated the events and toward the actors who happen to be visible to regulators or commercially proximate to the conduct.

A loss-proximate model corrects this by allocating funding up front, based on where the events that trigger the scheme demonstrably sit. The result is more stable and predictable funding for compliant operators, a clearer link between conduct, governance quality and financial consequence, and a scheme that operates on principled grounds rather than on whichever sector is closest to hand when costs need to be redistributed.

Where necessary, allocation can be refined within sectors to avoid blunt cost-spreading. If APRA-regulated superannuation were to be included, for example, a more granular approach could distinguish between areas of higher and lower exposure to CSLR-relevant risk — platform-like arrangements compared to traditional diversified superannuation products. This ensures mainstream superannuation members are not required to subsidise risks that arise at the edge of the system.

A risk-based model also reinforces the principle that eligibility and contribution should align. If SMSFs remain eligible for CSLR compensation, they must be included in the funding base on a mandatory and universal basis. This captures the cohorts contributing to scheme costs and avoids the structural inequities of partial participation.

Taken together, a risk-based, loss-proximate approach provides a more defensible and sustainable foundation for CSLR funding. It aligns levy incidence with the source of harm, reduces reliance on discretionary or proxy-based allocation, and strengthens incentives across the system for better conduct and risk management.

5. Re-anchoring the CSLR as a last-resort scheme

The CSLR was deliberately designed to operate as a safety net of last resort — a backstop that steps in only when misconduct has caused loss and all other avenues for redress have failed. Its legitimacy and sustainability depend on maintaining a clear and disciplined boundary around what the scheme is intended to compensate.

Recent experience demonstrates that the CSLR is drifting away from that original role. Current compensation settings allow the scheme to fund loss that go beyond restoring consumers to their pre-misconduct position, including compensation for hypothetical or counterfactual investment returns, duplicative payments for a single underlying loss, and amounts attributable to conduct or products that fall outside the intended scope of the CSLR. These design features materially inflate scheme liabilities and weaken clarity about the purpose of CSLR-funded compensation.

Compensation should be limited to actual loss

As a scheme of last resort, CSLR-funded compensation should be confined to actual, realised loss suffered as a result of misconduct — namely capital loss and reasonable transaction costs. This approach restores a clear distinction between compensation for wrongdoing and results driven by market performance.

Under current arrangements, a significant proportion of CSLR-funded payouts reflect counterfactual or "but-for" returns — amounts intended to represent what a consumer might have earned had they remained in an alternative investment pathway. While such approaches may be appropriate in AFCA's broader fairness jurisdiction, they are not appropriate in a last-resort, industry-funded scheme designed to provide minimum essential redress where payment has otherwise failed. Compensating foregone or hypothetical investment returns shifts the CSLR away from redressing misconduct and towards underwriting investment decisions, significantly expanding the scheme's financial footprint.

Narrowing compensable loss to actual loss does not diminish consumer protection. Rather, it ensures the CSLR remains targeted and sustainable, while preserving AFCA's ability to determine fair decisions outside the CSLR context where appropriate.

Eliminating over-compensation and duplication

The CSLR should not provide multiple payments for the same underlying harm. Current settings permit duplicative compensation in certain structures — particularly in cases involving multi-trustee arrangements — where more than one claimant may receive a full payout in respect of a single loss. This approach is inconsistent with the purpose of a last-resort scheme and artificially inflates total liabilities without improving consumer experiences.

Restricting CSLR compensation to one payout per underlying loss ensures the scheme focuses on restoring consumers to a baseline position, rather than generating windfalls that divert limited funds away from other eligible claimants.

Restoring scheme integrity

Taken together, narrowing compensable loss and eliminating duplicative payouts are critical to re-anchoring the CSLR as a genuine scheme of last resort. These changes do not reduce access to redress for consumers who have suffered real harm — they restore discipline to the scheme, improve predictability, and ensure limited CSLR resources are directed to their intended purpose.

Re-anchoring the scheme in this way is also a necessary precondition for any sustainable funding framework. Without clearer boundaries around what the scheme compensates, pressure will continue to build for broader levy bases, repeated special levies, and cost-spreading across sectors with no proximate connection to the underlying losses.

Before expanding reliance on levies, the CSLR framework should be strengthened to ensure that those responsible for misconduct bear the cost wherever possible. The scheme is intended to operate as a backstop of last resort, not as a substitute for effective recovery. Where realistic avenues exist to recover funds from responsible parties or associated entities, these should be pursued as a first priority.

Current settings do not consistently achieve this outcome. Gaps in recovery pathways mean that losses which could, in principle, be borne within the originating corporate or product structure are instead externalised to levy payers. This weakens accountability, reduces incentives for prudent behaviour, and increases pressure on the levy framework to absorb costs that should not fall on it.

Strengthening subrogation arrangements is a critical component of reform. The CSLR operator should have clear and effective access to recovery from available sources, including professional indemnity insurance proceeds where cover exists and recovery is cost-effective. These mechanisms should be supported by cost-benefit guardrails to ensure recovery activity is proportionate and does not delay compensation to consumers.

There is also a need to address gaps that allow value to be shifted within corporate groups, leaving insufficient assets available to meet compensation liabilities. A targeted related-entity liability mechanism would help ensure that entities which have controlled, benefited from, or extracted value connected to the underlying business cannot avoid responsibility by structuring activities across multiple entities. The mechanism should be calibrated with clear nexus tests, proportionality limits, and safeguards for legitimate commercial arrangements.

These reforms reinforce the CSLR's role as a true scheme of last resort by ensuring that financial responsibility rests, to the greatest extent possible, with those who caused or benefited from the conduct giving rise to loss. This reduces pressure on levy payers and improves confidence in the fairness and sustainability of the scheme.

Appendix A - Responses to Treasury consultation questions

This appendix provides concise responses to Treasury's consultation questions. It should be read with the main submission, which sets out SMC's overarching policy position and rationale.

Proposal 1: Enabling CSLR to deduct payments from compensation

SMC supports avoiding overcompensation, but the scheme should default to prompt payment based on known amounts. Deductions should only apply where other recoveries are sufficiently certain. Any reconciliation mechanism should be simple, proportionate and designed to minimise the need to recover money from consumers.

If Treasury proceeds, SMC recommends:

- clear timeframes so offset checks do not delay payment;
- clear rules on what counts as "received" and how later recoveries are treated;
- clawbacks only in limited cases, with thresholds and hardship safeguards; and
- transparent communications and a simple review pathway.

Proposal 2: Expanding CSLR subrogation rights

SMC supports stronger recovery rights where recoveries are realistic and cost-effective. Treasury should prioritise reforms broadly consistent with Option 2, particularly recovery from additional sources such as PI insurance proceeds and non-Chapter 5 AFCA members. Recoveries should reduce future levy pressure, but must not delay compensation to consumers.

If Option 1 is pursued, it should only proceed with safeguards to preserve consumers' rights above the CSLR cap and avoid delaying payment. Recovery reform should be treated as one part of a broader sustainability package, not a stand-alone solution.

Proposal 3: Technical improvements

SMC supports the technical improvement package and recommends it be implemented as early as feasible for the 2026-27 levy period, provided it remains scope-neutral and does not shift new costs onto unrelated sectors. Priority should be given to changes that protect scheme integrity and reduce delays.

SMC's priority items are:

- preventing payments for unauthorised and out-of-scope conduct;
- reducing the levy instrument disallowance period to 5 sitting days; and
- aligning special levy liability with the qualifying period.

The remaining technical amendments should also proceed, but can be handled more briefly given their technical and largely non-contentious nature.

Proposal 4: Revising the treatment of counterfactual losses for CSLR-eligible financial advice complaints

SMC does not support either Option 1 or Option 2. The preferable reform is to eliminate the but-for test entirely. The CSLR should compensate actual capital loss caused by misconduct or non-payment of an AFCA determination, not hypothetical foregone returns.

Retaining any benchmarked or modified but-for approach would continue to import a counterfactual exercise into a last-resort scheme, inflate liabilities and blur the boundary between redress for misconduct and protection against investment performance risk.

Proposal 5: Embedding greater certainty in the special levy framework

SMC does not support the proposed rules-based three-tier special levy waterfall. A rules-based

waterfall risks entrenching cross-subsidisation by spreading costs to sectors with little or no genuine connection to the losses.

If Treasury proceeds with a more rules-based framework, levy allocation should be based on a genuinely loss-proximate test rather than broad concepts of "connection". Any model should include clear evidence thresholds, independent assurance and a credible government backstop for extreme tail events. APRA-regulated super trustees should be explicitly excluded from cross-tier pooling.

Proposal 6: Considering responses to the role of SMSF losses in pressure on the CSLR

SMC supports SMSFs contributing to CSLR funding if they remain eligible to access CSLR compensation. SMSF-related advice and investment arrangements generate a material share of current scheme costs, so levy settings should reflect that.

SMC does not support either an opt-in or opt-out model. If SMSFs remain eligible, participation should be mandatory and universal across the SMSF cohort to avoid adverse selection and preserve funding predictability.

If Treasury includes SMSFs in the levy framework, it should:

- define the cohort using objective criteria and clear commencement rules;
- align levy participation and eligibility;
- set a proportionate annual cap; and
- avoid elective participation models.

Proposal 7: Facilitating levying of Managed Investment Scheme (MIS)- related losses

SMC does not support a broad exemption for a lower-risk segment of the MIS sector. Bringing the MIS sector into special levies is the most direct way to better align scheme costs with where losses originate.

If Treasury nonetheless adopts a risk-informed approach, any carve-out should be narrow, objective and administratively simple. It should rely on existing data where possible and include ASIC review and anti-avoidance safeguards. Broad carve-outs would risk renewed cross-subsidisation, boundary disputes and levy volatility.

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

SMC supports a targeted related-entity liability mechanism to improve recovery of unpaid AFCA determinations within corporate groups. The objective should be to prevent value being shifted away from the liable firm and to ensure costs are borne by those who benefited from the business, rather than unrelated levy payers.

Any mechanism should be proportionate, evidence-based and confined to circumstances where a related entity has controlled, benefited from, or extracted value connected to the unpaid liability. It should include clear safe harbours for ordinary arm's-length dealings and preserve core corporate principles.