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Dear Chris

Compensation Scheme of Last Resort

The Property Council welcomes the opportunity to comment on Treasury's consultation on the Compensation Scheme of Last Resort (CSLR). We note the Government's approach follows the three principal recommendations to establish a CSLR made by the *Supplementary Final Report of the Review of the financial system external dispute resolution and complaints framework* (Ramsay Review). However, we are concerned about the proposed structure of the scheme, and the very real potential for unintended consequences based on the current drafting.

The Property Council believes a robust and competitive financial services industry is one that balances integrity and healthy competition with regulatory costs and red tape, and our submission is written in support of this equilibrium. The Property Council submits that the CSLR should be designed consistently with the recommendations of the Ramsay Review, recommendations that were supported by ASIC in its submission to the Ramsay Review and supported by Commissioner Hayne in his Final Report of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*.

We understand Government's intention for the CSLR is to follow the Ramsay Review recommendations and have a narrow focus, however the wording of the legislation has the potential to include all Australian financial services and credit license holders. This goes beyond the recommendations of the Ramsay Review.

We therefore take this opportunity to reiterate the concerns made in our submission to the Discussion Paper on a CSLR in February 2020 that the introduction of such a scheme may lead to perverse behavioural outcomes as 'good' corporate citizens are obligated to subsidise the losses of non-compliant participants. It is critical therefore that the design and operation of the CSLR ensures it is genuinely a last resort mechanism and is narrow in its scope. **We maintain our position that managed investment schemes (MIS) and responsible entities should not be included in the CSLR**, as recommended in the Ramsay Review.

Our submission recommends the following specific changes to the CSLR:

- Restriction of a CSLR to 'primary' activities of AFSL holders to ensure the scheme is appropriately targeted or, alternatively, that Government utilise an alternative mechanism to identify sectors that are within scope of the scheme
- Removal of the proposed Ministerial discretion to tax financial sectors that are not prescribed as being in-scope of the CSLR, set out under 1069D
- Reconsideration of governance arrangements to ensure efficiencies in the new scheme.

The property sector plays a vital role in the Australian economy

The Property Council of Australia is the leading advocate for Australia's biggest industry and biggest employer; our industry represents 13% of Australia's GDP and employs 1.4 million Australians. Our members invest in, design, build and manage homes, retirement villages, shopping centres, office buildings, industrial areas, education, research and health precincts, tourism and hospitality venues and more.

Property is an essential part of the Australian economy, and there are over 16 million Australians with a stake in property through their superannuation and various investment channels. This investment underpins Australia's commercial property market, including world class office buildings, industrial precincts and shopping centres.

Looking ahead, Australia's need for investment will continue to grow strongly, especially in light of the economic recovery post-COVID. Australia has experienced significant growth, particularly in our cities, and continuing this growth will require investment in real estate and infrastructure. Investors, both domestic and global, are savvy and will factor in risk to their investment decisions. This includes surveying the regulatory and compensatory landscape in Australia.

The current drafting of the CSLR has the potential to upset the existing equilibrium of property funds management, particularly as the scheme could cause property fund managers who are practicing good corporate governance – and are not the intended target of the CSLR – to compensate for non-compliant financial sector participants. It is also concerning that the funding for the CSLR is characterised as being a new 'tax' on business in Australia.

We identify specific elements of the scheme below that require amendment.

The CSLR should be targeted and a genuine 'last resort' mechanism

We note the CSLR is intended to be 'last resort' and we support the process of resolving complaints through other means. We also note the proposed role for AFCA and CSLR Co is to ensure other avenues are first exhausted, including payment from the financial provider or through a statutory scheme. It is important that the integrity of the CSLR is maintained and genuinely used as a 'last resort'. We are concerned that the existence of such a scheme may encourage less risk averse behaviour, leading to a reliance on the scheme for compensation in the event of business failures.

We maintain our argument that MIS and responsible entities should be excluded from a CSLR. Operators of MIS count for minimal value of unpaid determinations.¹ Product categories within MIS vary significantly and include agriculture, property, and equities (to name a few). Given the diversity within the MIS category, we welcome the Government's approach of only expanding the scope of the CSLR as need arises, a process which would require extensive consultation. It is important that a CSLR is appropriately and narrowly targeted.

¹ Australian Financial Complaints Authority, AFCA Datacube, <https://data.afca.org.au/>.

Recommendation: Any decision to expand the CSLR should only occur after there has been evidence of significant problems of uncompensated losses and rigorous examination and consultation as to the best approach to provide remedies.

Distinction between ‘primary’ and ‘incidental’ activities of AFSL holders

We have concerns with how the CSLR may view ‘primary’ vs ‘incidental’ activities under authorisations of AFSLs. The CSLR scheme includes ‘securities dealing’ as one of the five financial products and services for inclusion. AFSLs for responsible entities often have broad authorisations including allowance for securities dealings, but this is not their ‘primary’ reason for obtaining an AFSL.

Similarly, it is common for responsible entities to have AFSL authorisations to provide financial product advice to retail clients (for example, a responsible entity may provide investment reports or newsletters to investors) and to deal in insurance products (so that the responsible entity is authorised to procure insurance in relation to the property assets of a fund). By adopting the subsectors used in the *ASIC Supervisory Cost Recovery Levy Regulations 2017*, many (if not most) of the ‘out of scope’ subsectors (as set out in Appendix D of the proposal paper) would inadvertently be brought within the scope of the CSLR scheme simply because the relevant AFSL holders have ‘incidental’ AFSL authorisations that include those specified in Appendix A of the proposal paper as being ‘in-scope’.

It is important to have a distinction between ‘primary’ and ‘incidental’ activities under the CSLR. The integrity of the scheme should be targeted at the primary activities of a license holder. We believe the CSLR does not mean to capture everyone who has incidental use for one of the five in-scope financial products or services. On that basis we query whether adoption of the ASIC industry funding subsectors is the most appropriate mechanism to identify sectors that are within the scope of the CSLR scheme.

Recommendation: Restrict the CSLR to primary activities undertaken by AFSL holders OR utilise an alternative mechanism to identify sectors that are within scope of the CSLR scheme.

Industry participants should not be forced to ‘cross-subsidise’ losses of other sub-sectors

Whilst the design of the CSLR generally takes a ‘sub-sector’ approach in determining maximum levies and treating each ‘in-scope’ financial product or service separately, there is significant discretion on how special levies can be determined which could result in ‘out of scope’ financial firms facing CSLR levies at the discretion of the Minister.

In particular, we draw attention to the proposed Ministerial direction on a further levy for other sub-sectors (1069D(5)). We understand that in addition to imposing a further levy on the relevant sub-sector with an expected shortfall, the Minister may determine to levy further amounts from another sub-sector, including one that is not within the scope of the CSLR. Twenty-two such subsectors have been identified and include responsible entities, custodians and trustee companies.

This discretionary power effectively shifts the risk of non-compliant participants to all market participants and may lead to perverse behavioural outcomes as ‘good’ corporate citizens are obligated to subsidise the losses of non-compliant participants.

The Ramsay Review recognised that cross-subsidisation between sectors could arise if the CSLR is scalable and acknowledged that this would be a potential issue in the future, particularly around levy volatility.² The Panel indicated that the United Kingdom’s (UK) Financial Conduct Authority’s (FCA)

² Supplementary Final Report, September 2017, Review of the financial system external dispute resolution and complaints framework, <https://treasury.gov.au/sites/default/files/2019-03/Supplementary-Final-Report-2.pdf>, p.96.

review of their Financial Services Compensation Scheme (FSCS) should be considered when it was complete.³ The FSCS review found volatility to indeed be a potential issue and opted to only merge two funding classes, retaining separation of other funding classes to ensure integrity and fairness in the FSCS.⁴

To avoid this perverse outcome where other sectors of the financial services industry are effectively subsidising those five sectors in which the issue of uncompensated losses is most acute, we recommend this Ministerial Determination be removed. This will ensure those financial firms that are overwhelmingly responsible for uncompensated loss will be responsible for contributing to the CSLR, rather than creating uncertainty and potentially higher operating costs for other sub-sectors that are not at fault.

We also recommend that if a sub-sector is identified for inclusion in the CSLR, then that sub-sector alone should pay for their respective CSLR costs.

We are not clear on the impact of a special levy related to claims from a 'Black Swan' event and how the CSLR could fairly be utilised to compensate in such a situation. This would impose significantly high costs on industry and likely result in heavy cross-subsidisation, especially if the Ministerial Determination under 1069D(5) is not removed from the scheme.

Recommendation: Remove the Ministerial discretion under 1069D(5) to impose the CSLR tax on out-of-scope financial participants and ensure that sub-sectors identified for inclusion in the CSLR are responsible for paying their respective CSLR costs.

Streamlining governance and minimising costs and red tape for business

The proposed governance arrangements for administration of the CSLR involves two existing bodies (AFCA and ASIC) and establishes a new CSLR Co, a public company, as a subsidiary of AFCA. There are considerable costs involved in establishing and operating CSLR Co and additionally for ASIC to establish and administer the CSLR levy and for AFCA to support the CSLR.

Industry is already bearing significant year-on-year costs as part of the ASIC industry funding model, and will be expected to additionally contribute to the one-off costs of establishing the new CSLR and the ongoing operational costs of AFCA, ASIC and CSLR Co. As we have raised previously, there are aspects of the ASIC industry funding model that result in disproportionate or 'duplicate' costs being borne by parts of the sector, and we would be very concerned about these costs being exacerbated further as this will lead to prohibitive costs for new entrants and smaller-scale funds, and therefore lessen competition in the market.

We urge Government to consider other governance options for the administration of CSLR. At present, the rationale for establishing CSLR Co as a public company is not clear. Industry is already providing considerable funding for ASIC and AFCA, and the establishment of yet another regulatory body requires clear explanation and justification. There should also be clear accountability and responsibilities allocated between ASIC, AFCA and the CSLR Co (as applicable) to ensure there are not overlapping duties or a lack of clarity on who is responsible for various aspects of the CSLR.

In addition, we would like to understand what happens to the single pool and the capital reserve if these prove to be more than sufficient to fund claims. Whilst we understand it is out of scope for this

³ The FSCS Review was not yet finalised at the time of the Ramsay Review publication.

⁴ Financial Conduct Authority, October 2017, Reviewing the funding of the Financial Services Compensation Scheme (FSCS): feedback from CP16/42, final rules, and new proposals for consultation, <https://www.fca.org.uk/publication/consultation/cp17-36.pdf>.

consultation, we believe there should be consideration into post-funding the scheme, or for refundable levies.

Recommendation: *Government reconsider the proposed CSLR governance arrangements to ensure efficiencies in the new scheme.*

Conclusion

The Property Council supports efforts to maintain the integrity of the financial services industry and is keen to work with Government to develop a CSLR that is targeted and genuinely a scheme of last resort. We reiterate the findings from the Ramsay Review that the CSLR should take a 'narrow-coverage approach', with MIS and responsible entities not identified as target sectors for inclusion in the scheme.

We believe the CSLR should only apply to the five sectors identified in the proposal paper, and this application should be restricted to the 'primary' activities of an AFSL holder to ensure the narrow focus recommended in the Ramsay Review is achieved. Creating a Ministerial Discretion to impose a tax on other well performing and compliant sub-sectors has the potential to punish those who are doing the right thing. The FSCS review demonstrated that volatility in levies is not a desirable outcome and was ultimately not supported by the UK FCA.

Our other focus in this submission has been on the seeming duplication of responsibilities to establish and administer the CSLR. We have welcomed the Government's broader deregulation agenda and believe an efficient CSLR can be established which does not require onerous industry funding or administrative complexity to operate.

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Yours sincerely



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