



Insurance Council  
of Australia

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Director, Programs and Redress Unit  
Financial System Division

By email: [CSLR@treasury.gov.au](mailto:CSLR@treasury.gov.au)

Dear Treasury

### **Compensation Scheme of Last Resort: exceeding sub-sector levy caps**

The Insurance Council of Australia (Insurance Council) welcomes the opportunity to respond to the Treasury's Consultation paper, Compensation Scheme of Last Resort: exceeding sub-sector levy caps (the Consultation paper).<sup>1</sup>

The Insurance Council is the representative body of the general insurance industry in Australia and represents approximately 85 per cent of private sector general insurers. As a foundational component of the Australian economy, the general insurance industry employs approximately 60,000 people and on average pays out \$147 million in claims each working day (\$36.5 billion per year).

#### **Overview**

The Insurance Council supports the role of the Compensation Scheme of Last Resort (CSLR) to act as a genuine scheme of last resort which provides victims of financial misconduct an avenue for redress and compensation, when all other avenues, including the Australian Financial Complaints Authority determination process, have been exhausted.

The CSLR has been designed so that it excludes potential claims in relation to AFCA determinations about general insurance complaints, and the general insurance sector is not one of the subsectors contributing to the annual levy. This policy setting recognises that general insurers are subject to robust regulation, including in relation to financial stability and solvency, reducing the need for a last resort compensation scheme for general insurance consumers. Additionally, general insurance policyholders have access to the Australian Government's Financial Claims Scheme.<sup>2</sup>

As the Insurance Council has consistently maintained, including in our submission to the January 2025 Post Implementation Review of the CSLR, we do not support cross-subsidisation. Cross-subsidisation creates many challenges, including raising moral hazard as it essentially requires companies that meet expected ethical and prudential standards to underwrite those who do not. The Insurance Council submits that the general insurance sector should not be called upon to meet funding shortfalls.<sup>3</sup> Given any funding contribution by general insurers will ultimately come from premiums paid by consumers for general insurance products, it is unfair for these consumers to be asked to fund a compensation scheme to which they have no access.

The CSLR's built-in mechanism for cross-subsidisation (the Ministerial special levy) has previously been described as necessary to ensure appropriate compensation for "black swan" events. However, it is inappropriate to describe these events as "black swans". Far from being rare and unpredictable

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<sup>1</sup> Treasury. 2025. *Consultation paper – Compensation Scheme of Last Resort: exceeding sub-sector levy caps*

<sup>2</sup> Australian Prudential Regulation Authority. *Financial Claims Scheme*.

<sup>3</sup> Compensation Scheme of Last Resort. 2024. *Impact Report 2024*.

events, collapses of non-prudentially regulated financial services firms occur on an unfortunately regular basis.

We are concerned the funding shortfall for 2025-26 is indicative of broader scheme sustainability issues and suggest a fulsome review of the scheme's overall settings is required to prevent funding shortfalls within the scheme.

We note the Consultation paper acknowledges the context of the Post Implementation Review of the CSLR, however we believe the issues canvassed cannot be considered in isolation and that a holistic consideration and assessment is essential.

We do not support the options for a special levy beyond the primary subsector. In particular we do not support an approach that would facilitate "repeatability" without a more fundamental review of the scope and operation of the CSLR and its funding model. We therefore reiterate our previous recommendations to ensure that the CSLR is meeting its intended purpose and is sustainable in the long-term:

1. The current scope of the CSLR is not expanded and consideration be given to the scope of the funding model. Currently, there is a Ministerial 'special levy' to be collected from a specified sub-sector (such as general insurers) in circumstances where the estimated costs for one or more in-scope sub-sectors exceeds that sub-sector levy cap. As outlined, we do not support cross-subsidisation which essentially requires companies that meet expected ethical and prudential standards to underwrite those who do not.
2. The funding model be reviewed to consider any risks of inadvertently discouraging subsectors that have created losses to uplift their standards and prevent future consumer harm. We believe that ongoing uplift that prevents future consumer harm is crucial to long-term sustainability and viability.
3. The CSLR is supported by frameworks that help to mitigate against and address underlying issues within in-scope sectors, to help avoid significant stress and anxiety for Australian consumers and potential losses in the first instance. The regulatory framework should be designed to minimise calls on the CSLR - this could include consideration of additional regulatory capital requirements and strengthening the enforcement of requirements to obtain professional indemnity insurance.
4. In reviewing the operation of the 'special levy' element of the funding model, careful consideration is given to potential impacts on the affordability of insurance if a special levy is imposed on the general insurance sector, which would increase further cross-subsidisation of the scheme.
5. AFCA's approach to determining compensation amounts is reviewed against the CSLR's intended purpose.

We also have particular concerns with options that seek to consider applying the levy to 'large' entities (or those with the 'greatest capacity to pay'). The top ten financial institutions by income, including insurers, paid an upfront levy to the CSLR of approximately \$241 million to fund the costs of addressing the backlog of in-scope complaints that accumulated with the Australian Financial Complaints Authority (AFCA) between 1 November 2018 and 2 September 2022.<sup>4</sup> It is not appropriate for these institutions to be continually called upon to meet funding shortfalls. There is no link to the risk

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<sup>4</sup> Compensation Scheme of Last Resort. 2024. *Impact Report 2024*.

posed by the activities of these entities and, as previously indicated, prudentially regulated insurers are not the subject of any unpaid AFCA determinations. Levying large entities to pay valid claims against other subsectors subverts principles of accountability, regulatory certainty, transparency, fiscal responsibility, sectoral risk differentiation, sustainability and equity. We suggest these principles should underpin the CSLR.

Finally, in considering issuing a 'special levy' on general insurers, careful consideration should be given to potential impacts on the affordability of insurance. Further inequity arises if prudentially regulated entities are required to underwrite those that are non-prudentially regulated. Regulated capital has an associated cost. Consumers and shareholders of prudentially regulated firms should not be required to underwrite non-prudentially regulated entities which do not have the associated capital costs. Increasing the cross-subsidisation of the scheme by imposing a special levy on the insurance sector is likely to have the effect of increasing cost pressures across general insurance businesses, thereby putting further upward pressure on premiums. In the current economic environment where significant effort is being put into reducing cost pressures on general insurance premiums, it would be counterproductive to add additional costs into the system.

However, should the Minister determine to levy sub-sectors beyond the at-fault sectors, it should be across all ASIC IFM sub-sectors to minimise the cost burden on a smaller group of organisations in order to minimise the distortionary and financial impact.

### *Responses to discussion questions*

The Insurance Council provides the following responses to the discussion questions provided in the consultation paper. We would welcome the opportunity to discuss these further with the Treasury.

No.	Question	Insurance Council response
1.	What principles should the Minister have in mind when considering high-level options for dealing with an excess estimate?	<p>Principles for dealing with an excess estimate should be guided by long-term stewardship of the CSLR. It is evident that no guiding principles exist for the CSLR. Given the CSLR's important role in delivering compensation to victims of financial misconduct, this should be rectified before a decision is made on dealing with this excess estimate. These guiding principles could then support future decisions, embedding consistency in decision making. We suggest the Government consider "genuine last resort", "fairness", "equity" and "scheme sustainability" among suggestions for guiding principles and would be open to further consultation.</p> <p>Careful consideration should be given to the downstream economic consequences of levying sub-sectors unrelated to the underlying conduct. Transferring the cost of misconduct onto unrelated sectors will have perverse outcomes for consumers in the broader economy. The insurance industry, which is highly regulated, already faces myriad external cost and affordability pressures, and any additional levy would be borne by insurance customers.</p> <p>Any determination should be made with respect to the longer-term challenges faced by the scheme. Without consideration of the regulatory framework around those sectors who contribute the CSLR costs and reform, current settings are likely to produce repeated excess scenarios. The Minister should consider</p>

introducing threshold changes to the Scheme to get it on a sustainable footing ahead of any determination to cover the excess costs forecast for 2025-26.

Levying sectors responsible for misconduct can have a positive behavioural effect leading to a more sustainable Scheme. Faced with the prospect of high levy fees, primary sectors are more likely to look to industry-led solutions that reduce the prevalence of misconduct. Conversely, levying unrelated sub-sectors can signal to the primary sector that others will bear the financial responsibility of misconduct and deter a broader sector uplift.

CSLR funds should be primarily used for compensating victims, however the CSLR is set to incur roughly \$8.6 million in unpaid AFCA fees and \$1.5 million in ASIC administrative costs. This adds to the existing cost burden and the Minister should determine CSLR funds are reserved for compensation.

3. Is 'repeatability' an important consideration?

We strongly oppose the repeatability of this levy arrangement as a consideration in this decision. Important policy decisions such as this should be guided by principles of good public policy, not their 'repeatability'.

We note that the 'Ramsay Review' recommended that "the funding mechanism should be designed to minimise the volatility in funding requirements, that is, it should be designed to minimise the need for a CSLR to raise additional ad-hoc funding to meet its obligations."<sup>5</sup> Embedding 'repeatability' of what is essentially an ad-hoc funding solution runs counter to principles of good public policy and the Ramsay Review.

Without broader scheme reform, any determination made in regard to 2025-26 excesses raises repeatability concerns and set a precedent for future excesses.

Factoring in future unrealised costs incurred by insurers as a result of additional special levying will be difficult to predict and ultimately lead to higher costs on consumers.

'Repeatability' without broader system changes will bring significant uncertainty for ASIC IFM sub-sectors who may be consistently called upon to fund shortfalls under existing legislation.

Moreover, sub-sectors outside the responsible primary sectors were already captured by the initial upfront levy, with 10 entities, including some insurers, contributing a combined \$241 million to cover compensation between 1 November 2018 and 7 September 2022.

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<sup>5</sup> Professor Ian Ramsay, Julie Abramson and Alan Kirkland. 2017. *Supplementary final Report: Review of the financial system external dispute resolution and complaints framework*. 15.

4. Which one or more of the high-level options would be most appropriate for dealing with the excess in the 2025-26 financial year?
 

Any determination on how to fund excess claims should be paused until the government has finalised its review of the CSLR and made amendments to the scheme design to make it fairer and more sustainable.

Cost pressures on the CSLR would be significantly reduced by a ministerial direction to the CSLR operator to exclude 'but for' claims from being eligible for compensation. Currently, these claims account for 80 per cent of all CSLR claims. This is despite these types of claims having only a hypothetical loss, not a capital loss, and should not qualify under a 'last resort' scenario.

Amendments to the Corporations Act should be considered as part of a broader review of the scheme, including capital guarantee requirements for AFSL holders beyond banks and insurance companies to minimise the likelihood of liquidation and therefore reliance on the scheme.

The government should further consider thresholds on eligibility and compensation to control the scheme from continuing to balloon. This may include a reduction in the cap and establishing a means-based test for eligibility.

Should the government proceed with a special levy ahead of a formal review of the CSLR, it should be spread as broadly and thinly as possible to only capture sub-sectors connected to the underlying conduct, including Managed Investment Schemes (MIS).
5. Who bears the burdens – financial and non-financial – of your preferred option, and what is their capacity to bear it? Would your preferred option impact the viability of a sub-sector?
 

The financial costs of the CSLR should be borne by the primary sectors creating the need for compensation to avoid penalising unrelated businesses.

The ICA's preferred approach to review the current scheme and make appropriate amendments to financial loss scope that is appropriate to be recovered under the scheme. This will secure scheme sustainability and reduce the financial and non-financial burden on all sectors.

While these amendments may impact the value or circumstances in which compensation can be accessed, it balances the costs borne by everyday consumers with a sustainable mechanism of last resort compensation.
6. Is your preferred option repeatable if necessary in the future?
 

The preferred option is to secure long-term sustainability so that the Minister will not need to consider repeatability, which again, has no grounding in principles of good public policy.

The insurance industry does not support the option of repeatability under any scenarios provided by this consultation.
7. If your preferred option is a combination of a special levy

with a determination to spread compensation over time (or taking no action), how much of the excess should be left unrecovered by the special levy? Why?

8. Should a Minister consider imposing a special levy on a sub-sector because of its connection to the losses that have driven an excess? If so, what are the factors that should be taken into account in the Minister's consideration?

The insurance industry supports financial responsibility falling with the sub-sectors connected to the losses. Under current arrangements, the levy does not capture all responsible sectors or entities. For example, managed investment schemes and parent companies with financial advice subsidiaries.

Further detail provided in response to question 10.

9. What evidence should a Minister require, or what process should be undertaken, before determining that there exists a subjective responsibility that should be reflected in a special levy?

10. Should a Minister consider imposing a special levy on a sub-sector because of its capacity to pay? Is this approach supported by the legislation (is it 'most effective')? How would the Minister assess a sub-sector's capacity to pay?

Treasury should consider options to levy parent companies with holdings over financial advice subsidiaries who are generally exempted from the industry levy because of their structure under the Corporations Act. Not only are these parent companies generally not required to pay, the structure also means liability for wrongdoing cannot be borne by the parent company even if the holding company has become illiquid and unable to fulfill its financial obligations. Addressing this loophole would create a far more equitable funding system that would not punish unrelated sectors, while also elevating pressure on smaller financial advice firms.

The general insurance industry would be particularly disadvantaged by a generalised capacity to pay metric. This is because general insurers experience cyclical profit cycles where the industry can experience several years of losses before recovering for a period with improved profit margins. This is particularly problematic when factoring in repeatability if a determination was made in a profitable year that could then have extreme impacts in a downward cycle of diminished underwriting profits. For example, over the four years to 2023, insurers paid out \$104 in claims for every \$100 paid by customers for home insurance, according to APRA data. The subsequent improvement in profitability is largely driven by a recovery in investment returns, improvements in some commercial lines, and low extreme weather costs. Ongoing cost pressures will continue to put pressure on affordability and any uncertainty brought about by a CSLR levy would worsen affordability pressures.

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| <p>11. Is any of the ASIC IFM sub-sectors a good proxy for financial sector entities with the greatest capacity to pay?</p>   | <p>Taking only the ASIC IFM as a proxy for capacity to pay does not account for the cyclical nature of insurer profits and is not supported by the general insurance industry.</p> <p>It also fails to consider the original intent of the CSLR as a last resort mechanism because it would deliver perverse outcomes for the broader consumer base, while continuing to provide compensation for hypothetical losses.</p>  |
| <p>12. Should the Minister consider specifying more than one sub-sector with 'large' entities? If so, how should the special levy amount be apportioned between them?</p>   | <p>The general insurance industry does not support any special levying before structural reforms are made to the CSLR.</p>  |
| <p>13. Should a Minister consider imposing a special levy on all retail-facing sub-sectors? Is this approach supported by the legislation (is it 'most effective')?</p>   | <p>We do not support the Minister imposing a special levy on all retail-facing sub-sectors.</p>   |
| <p>14. If so, what is the best method for apportioning the special levy among retail-facing sub-sectors? To what extent is capacity to pay relevant, and what is the best means of assessing this? What data are available to inform this assessment?</p> |   |
| <p>15. Are the data and methodologies used by Treasury in calculating illustrative estimates of these options reliable and appropriate? What alternative approaches exist?</p>  |   |
| <p>16. Are there options outside the current legislative framework that may be a more effective way of dealing with excess cost estimates in future?</p>  | <p>The ICA recommends the government consider several reforms to deliver a sustainable scheme:</p> <ol style="list-style-type: none"> <li>1. <b>Exclude 'but for' CSLR claims:</b> Direct AFCA to exclude 'but for' claims that don't have an actual capital loss, either through a Ministerial Direction or regulation that provides implementation guidance.</li> <li>2. <b>Consider Corporations Act amendments:</b> Including capital guarantee requirements for financial advice firms, as well as enhanced regulatory oversight to prevent misconduct before it occurs</li> <li>3. <b>Better targeted scheme:</b> consider refining the eligibility criteria and lower the compensation cap to ensure compensation is targeted to the needs of lower income consumers who disproportionately experience hardship as a result of losses</li> </ol> |



### *Conclusion*

The Insurance Council appreciates the challenges faced in ensuring the CSLR remains sustainable and continues to provide consumers an avenue for redress and compensation, when all other avenues have been exhausted. If you have any questions in relation to our submission, please contact myself or Leisha Watson, Director Regulatory and Consumer Policy, at [lwatson@insurancecouncil.com.au](mailto:lwatson@insurancecouncil.com.au).

Yours sincerely,



**Andrew Hall**

Executive Director and CEO