



Australian Government  
The Treasury

**TSY/AU**

# Compensation Scheme of Last Resort: Proposal Paper

Financial Services Royal Commission  
Recommendation 7.1

July 2021



© Commonwealth of Australia 2021

This publication is available for your use under a [Creative Commons Attribution 3.0 Australia](http://creativecommons.org/licenses/by/3.0/au/legalcode) licence, with the exception of the Commonwealth Coat of Arms, the Treasury logo, photographs, images, signatures and where otherwise stated. The full licence terms are available from <http://creativecommons.org/licenses/by/3.0/au/legalcode>.



Use of Treasury material under a [Creative Commons Attribution 3.0 Australia](http://creativecommons.org/licenses/by/3.0/au/legalcode) licence requires you to attribute the work (but not in any way that suggests that the Treasury endorses you or your use of the work).

*Treasury material used 'as supplied'.*

Provided you have not modified or transformed Treasury material in any way including, for example, by changing the Treasury text; calculating percentage changes; graphing or charting data; or deriving new statistics from published Treasury statistics — then Treasury prefers the following attribution:

*Source: The Australian Government the Treasury.*

#### **Derivative material**

If you have modified or transformed Treasury material, or derived new material from those of the Treasury in any way, then Treasury prefers the following attribution:

*Based on The Australian Government the Treasury data.*

#### **Use of the Coat of Arms**

The terms under which the Coat of Arms can be used are set out on the Department of the Prime Minister and Cabinet website (see [www.pmc.gov.au/government/commonwealth-coat-arms](http://www.pmc.gov.au/government/commonwealth-coat-arms)).

#### **Other uses**

Enquiries regarding this licence and any other use of this document are welcome at:

Manager  
Media and Speeches Unit  
The Treasury  
Langton Crescent  
Parkes ACT 2600  
Email: [media@treasury.gov.au](mailto:media@treasury.gov.au)

# Contents

- Consultation Process .....4**
- Request for feedback and comments .....4
- 1. Introduction .....5**
- Purpose.....5
- Background.....5
- Consultation objectives .....6
- 2. Scope .....7**
- Financial products or services in-scope.....7
- Defining scope .....7
- Voluntary AFCA members .....7
- Court and tribunal decisions .....8
- Future scalability .....8
- 3. Paying claims.....9**
- Eligibility for CSLR payment.....9
- Claims payment process.....10
- Payment of AFCA fees .....12
- 4. Funding the scheme.....13**
- Levy framework.....13
- Funding streams .....16
- Funding accumulated unpaid determinations .....23
- 5. Governance.....24**
- Roles and responsibilities.....24
- Periodic reviews .....26
- 6. Implementation.....27**
- Timeline .....27
- 7. Other Matters .....28**
- Integrity measures.....28
- Key terms.....29**
- Appendices .....31**
- Appendix A: In-scope financial products and services and leviable financial firms .....31
- Appendix B: Levy calculation methodology .....33
- Appendix C: Levy example.....34
- Appendix D: Potentially leviable financial firms.....35

# Consultation Process

## Request for feedback and comments

Interested parties are invited to comment on the proposals in this paper by 13 August 2021.

The purpose of this proposal paper is to seek comments on the key design features of the compensation scheme of last resort, including the scheme's coverage, payment arrangements, funding arrangements, governance, and mechanisms to maintain the integrity of the scheme.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please submit responses sent via email in a Word or RTF format. An additional PDF version may also be submitted. All information (including name and address details) contained in submissions will be made available to the public on the Treasury website unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails are not sufficient for this purpose. If you would like only part of your submission to remain confidential, please provide this information clearly marked as such in a separate attachment.

Legal requirements, such as those imposed by the Freedom of Information Act 1982, may affect the confidentiality of your submission.

### Closing date for submissions: 13 August 2021

Email	CSLR@treasury.gov.au
Mail	Director Redress Unit Financial System Division The Treasury Langton Crescent PARKES ACT 2600
Enquiries	Enquiries can be initially directed to Director, Redress Unit
Phone	02 6263 2111 (switchboard)

The principles outlined in this paper are not yet law. As a consequence, this paper is merely a guide as to how the principles might operate.

# 1. Introduction

## Purpose

The Government's overarching purpose in establishing a financial services compensation scheme of last resort (CSLR) is to support confidence in the financial system's dispute resolution framework. The CSLR will provide limited compensation where a determination issued by the Australian Financial Complaints Authority (AFCA) remains unpaid and the determination relates to a financial product or service within the scope of the scheme.

## Background

### Supplementary Final Report of the Review of the financial system external dispute resolution framework

The Supplementary Final Report of the *Review of the financial system external dispute resolution framework* (Ramsay Review) made recommendations on the establishment, merits and potential design of a CSLR.<sup>1</sup> The Ramsay Review was finalised and presented to the Government on 6 September 2017. The Ramsay Review noted existing redress arrangements are inadequate to ensure all consumers and small businesses are compensated for losses, especially in the circumstances where an external dispute resolution scheme, tribunal or court has found that there has been misconduct by a financial firm and makes an award in their favour. The Ramsay Review made three principal recommendations on the establishment of a CSLR. In summary, the Ramsay Review recommended:

- establishing a CSLR that targets the areas of the financial sector with the greatest evidence of need;
- a CSLR, if established, be initially restricted to personal financial advice failures but be scalable in the future to include other types of financial service as the evidence of uncompensated losses arise; and
- a CSLR, if established, be established with particular design features, including that the scheme be prospective, *ex-ante* funded and accessible to consumers and small businesses.

### Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Recommendation 7.1 of the Final Report of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Royal Commission) stated that the three principal recommendations within the Ramsay Review to establish a CSLR should be carried into effect.

### Government Response to the Royal Commission

The Government's response to the Royal Commission committed to improve consumer and small business access to redress. Specifically, the Government's response committed to:

---

<sup>1</sup> [Supplementary Final Report](#) of the *Review of the financial system external dispute resolution and complaints framework*, 6 September 2017.

- establishing an industry-funded, forward-looking CSLR for consumer and small business complaints that will be established as part of AFCA; and
- designing the CSLR consistently with the recommendations of the Ramsay Review and extending the scheme beyond personal advice failures.

## Timing

The Government's *Financial Services Royal Commission Implementation Roadmap* committed to establish a CSLR that covers unpaid determinations made under AFCA's rules after 1 November 2018.

The Government consulted on key features of a CSLR through the release of a discussion paper on 20 December 2019. Responses were due on 7 February 2020.

The Government is now consulting on legislation for a CSLR and its proposed operation.

## Consultation objectives

The objective of this proposal paper is to outline the Government's proposals in relation to the CSLR and to seek feedback from stakeholders on the following aspects of the CSLR:

- scope;
- payment arrangements;
- funding arrangements;
- governance; and
- mechanisms to maintain the integrity of the scheme.

Submissions in response to this proposal paper should be provided by close of business 13 August 2021, electronically or by post. While submissions may be lodged electronically or by post, electronic lodgement via email to [CSLR@treasury.gov.au](mailto:CSLR@treasury.gov.au) is preferred.

For accessibility reasons, please submit responses sent via email in a Word or RTF format. An additional PDF version may also be submitted.

## 2. Scope

This chapter outlines the financial products and services that are proposed to be within scope of the CSLR and notes some exclusions from the scheme.

### Financial products or services in-scope

The CSLR will consider claims for unpaid AFCA determinations (that is, where a complaint was made to AFCA from 1 November 2018) and the determination is in relation to a financial product or service within the scheme's scope.

The Government has committed to establishing a CSLR that provides coverage beyond the provision of personal financial advice failures, as recommended by the Ramsay Review. Accordingly, it is proposed that the CSLR will encompass five financial products and services, as follows:

- personal advice on relevant financial products to retail clients;
- credit intermediation;
- securities dealing;
- credit provision; and
- insurance product distribution.

While credit activities undertaken by credit representatives are within the scope of the CSLR, credit representatives will not fund the CSLR as their authorising Australian credit licensees are liable for their activities.

The primary legislation for the CSLR will confer a power to make regulations to prescribe which financial products and services are within scope for the scheme.

### Defining scope

The financial products and services covered by the CSLR are proposed to be defined by reference to the financial product or service that a firm is licenced to provide through an Australian financial service licence (AFSL) or an Australian credit licence (ACL).

The financial product or service definition used for the CSLR will be consistent with the financial product or service subsectors established for the purposes of the Australian Securities and Investments Commission (ASIC) industry funding model (ASIC IFM). Aligning with these financial product and service subsectors means that those financial firms licenced to provide the same type of financial product or service will, in general, share in meeting the costs of unpaid determinations relating to that product or service. Aligning with these financial product and service subsectors also reduces the cost and time required to establish the CSLR.

Table A1 in Appendix A provides a detailed definition of the five in-scope financial products and services, the financial firms that will be liable in relation to them and the link to the ASIC IFM.

### Voluntary AFCA members

The financial products and services that are in-scope for the CSLR are those that are authorised to be provided by AFSL and ACL holders that are required by legislation to be AFCA members. A financial product or service that is provided by a financial firm that is not required by legislation to be an AFCA member in respect of the provision of that service will not be within scope for the CSLR. This includes

financial products and services provided by voluntary AFCA members, such as small and medium enterprise credit. The inclusion of financial products and services of voluntary AFCA members in the CSLR would create a disincentive for voluntary AFCA membership and would add to CSLR complexity.

## Court and tribunal decisions

Court and tribunal decisions will also be out of scope of the CSLR at the commencement of the scheme. Although the Ramsay Review recommended that eligible court and tribunal decisions should be within scope for the CSLR, there is currently no data on the number and amounts of court and tribunal determinations that remain unpaid. This impedes the ability to estimate the number and quantum of unpaid court and tribunal determinations that could impact the CSLR.

Consideration of the inclusion of court and tribunal decisions in the CSLR, on a forward-looking basis, could occur in the context of the intended periodic reviews of the scheme.

## Future scalability

The CSLR will be scalable over time. Consideration of the inclusion or exclusion of financial products and services in the CSLR is to occur in the context of the intended periodic reviews of the scheme.



## 3. Paying claims

The CSLR operator will provide a clear and consistent CSLR claim process to ensure claimants are informed of the necessary steps to receive compensation. The operator will conduct CSLR claim assessments and pay claims in a transparent, consistent, fair, and timely manner. Consumers and small businesses who are eligible to receive compensation from the scheme will be able to lodge a CSLR claim with the operator by following the process outlined in this chapter.

### Eligibility for CSLR payment

Legislation and regulations will outline the eligibility criteria to claim compensation from the CSLR. For a CSLR claim to be eligible to receive compensation, the AFCA determination must be in scope, AFCA must have been notified within 12 months that the member has not complied with the AFCA determination so AFCA can conduct reasonable steps to secure payment, the member must be unable to pay the compensation owed, and there must not be any other statutory compensation scheme available.

#### AFCA determination is in-scope

A CSLR claim must relate to an unpaid determination that is within the scope of the CSLR. As noted in the previous chapter, a determination is in-scope if it is made following a complaint to AFCA from 1 November 2018 and relates to one of the following financial products and services:

- personal advice on relevant products to retail clients
- credit intermediation
- securities dealing
- credit provision and
- insurance product distribution.

Table A1 in Appendix A provides a detailed definition of each in-scope financial product and service.

#### AFCA notified within 12 months

A CSLR claimant must notify AFCA that their determination remains unpaid, or partially unpaid, within 12 months of the date of acceptance of the determination. This time limit increases certainty for both claimants and financial firms and assists the scheme's forward-planning and payment and levy estimates.

When confirming the eligibility of an AFCA determination for payment, the CSLR operator will have the discretion to waive the 12-month notification requirement in special circumstances. One anticipated special circumstance will be for claimants with unpaid AFCA determinations that arise between 1 November 2018 and before scheme establishment, who will be deemed to have notified AFCA appropriately.

AFCA will be able to confirm to the CSLR operator that it was notified within the 12-month period or that special circumstances applied.

## Reasonable steps

After the claimant has notified AFCA that their determination remains unpaid, AFCA will take reasonable steps to ensure the AFCA member pays the compensation owed.

Based upon current practice, reasonable steps to be taken by AFCA will likely include:

- contacting the AFCA member to seek an explanation of non-compliance;
- explaining to the AFCA member the legal consequences of non-compliance;
- discussing a reasonable payment plan or other arrangement;
- engaging with any insolvency practitioner appointed to an AFCA member that has become a Chapter 5 body corporate to determine whether the AFCA member can meet the requirements of the AFCA determination; and
- taking any other steps considered appropriate and cost-effective by AFCA to try to enforce the AFCA determination or otherwise obtain compliance by the AFCA member.

If steps are taken by parties other than AFCA to obtain compliance with the AFCA determination, for example, by the claimant themselves, that action can be taken into account in the assessment of whether reasonable steps have been taken, provided that action is in accordance with any guidance published by the scheme and is verifiable.

AFCA will be able to confirm to the CSLR operator whether or not a claimant's AFCA determination remains unpaid after reasonable steps have been taken.

## Financial firm unable to pay

Once a CSLR claim has been made, the unpaid AFCA determination is assessed as being in-scope, AFCA has confirmed to the CSLR operator that it was notified within the 12-month period (or that there were special circumstances) that the AFCA determination was unpaid, and that the AFCA determination remains unpaid after the completion of reasonable steps, the CSLR operator will assess whether the relevant financial firm (that is, the AFCA member or former member) is unlikely to pay the compensation owed based on an assessment of the financial position of the firm.

Where the CSLR pays an amount of compensation to the claimant, the CSLR operator must notify ASIC of the relevant financial firm's failure to pay the amount under the AFCA determination. This will allow ASIC to use its power to suspend or cancel the financial firm's licence.

## No other statutory scheme will pay

A defining element of the CSLR is that it would only provide compensation as a last resort where no other schemes are available to do so. The scheme will confirm that no other statutory arrangement, including a relevant state or territory statutory arrangement, is able to pay all or part of the determination. Given the proposed scope of the scheme, the most likely circumstance where another statutory arrangement is able to pay compensation is where the CSLR claim is also payable under the National Guarantee Fund, SFE Fidelity Fund and ASX Supplementary Compensation Fund.

## Claims payment process

The key steps that must be taken for a claimant to receive compensation from the CSLR are lodgement, assessment, and payment of a claim by the scheme. Claimants have no right of review if they are not satisfied with a decision made by the scheme operator.

## Lodgement of CSLR claim

AFCA will provide information to complainants if their AFCA complaint may be eligible for CSLR compensation. Claimants must then lodge a CSLR claim. Each CSLR claim must relate to a single unpaid AFCA determination. The CSLR will not have the ability to reassess the merits of the AFCA determination, including the compensation awarded within it.

Upon lodging a CSLR claim, the scheme operator will verify the claimant's identity and the details of the AFCA determination that is the basis for the CSLR claim, to prevent error or fraud.

## Assessment of CSLR claim

The CSLR operator will assess CSLR claims in line with the scheme eligibility criteria outlined in legislation and reach a conclusion to award or deny compensation. It is expected the operator will develop customer service guidelines with goals for the time within which a CSLR claim should be assessed and paid. As noted above, the CSLR will not have the ability to reassess the merits of the AFCA determination, including the compensation awarded within it.

## Payment of CSLR claim

### Compensation cap

The scheme's legislation sets out the maximum compensation that can be paid through the CSLR. The \$150,000 compensation cap balances the provision of compensation to claimants and scheme sustainability for those financial firms that are not responsible for the misconduct giving rise to the compensation being claimed but are nonetheless being required to pay for it. The maximum compensation for each AFCA determination is proposed to be \$150,000. The maximum compensation amount for the CSLR broadly aligns with the United Kingdom's Financial Services Compensation Scheme's maximum of £85,000.<sup>2</sup>

The compensation cap is proposed to apply to all CSLR claims for compensation from individuals and small businesses (including primary producers) regardless of the financial product or service to which the AFCA determination relates. The CSLR will pay compensation consistent with the terms of the AFCA determination, including for any direct financial loss, indirect financial loss, non-financial loss, interest payments, and any legal or professional costs awarded by AFCA, up to the proposed \$150,000 compensation cap. No interest is proposed to be applied by the CSLR over and above any interest provided for in an AFCA determination because, in the majority of CSLR claims, it is expected that compensation will be payable within a reasonable period from when the AFCA determination is made.

### Payment method

Once the CSLR operator has approved a CSLR claim for compensation, it will make a lump sum payment to the claimant's chosen bank account via an electronic transfer.

### Other payment issues

Where the CSLR operator considers, during a claim year, that expected or actual subsector outlays (that is, CSLR claims, AFCA fees and scheme costs attributable to each of the five financial product or service classes or subsectors), will exceed the subsector cap (that is, the maximum amount that may be levied on the financial firms that are liable for the costs of that financial product or service

---

<sup>2</sup> Using RBA data, the average AUD/GBP exchange rate for the ten-year period of June 2011 to May 2021 is 0.5707. At this exchange rate, AUD 150,000 equates to GBP 85,605.

class), the Minister will be notified by the CSLR operator and will have the power to determine specific actions or take no action.

The specific actions the Minister may determine are that:

- a special levy be issued to the financial firms liable for that subsector to make up the shortfall;
- a special levy be issued to financial firms liable in relation to other subsectors to make up the shortfall;
- a lower compensation cap should apply to a class of CSLR claims; and/or
- that a class of CSLR claims should be paid over more than one financial year.

These mechanisms will assist the Minister to balance the interests of claimants and scheme sustainability for those financial firms that are not responsible for the misconduct giving rise to the CSLR claims but are nonetheless being required to fund it.

The scheme will also have the ability to recover compensation paid in circumstances where the claimant was not entitled to the compensation, such as in the case of fraud.

### No right of review

A decision made by the CSLR operator will not be reviewable by the Administrative Appeals Tribunal or under the *Administrative Decisions (Judicial Review) Act 1977*, which is consistent with the treatment of AFCA decisions.

Given the scheme operator will not reconsider the merits of an AFCA complaint or make any substantive judgments or assessments other than against a relatively strict CSLR eligibility criteria, a right of review is not required.

## Payment of AFCA fees

AFCA is Australia's 'one stop shop' external dispute resolution scheme for consumer and small business complaints in relation to financial products and services. AFCA is not-for-profit and its services are provided free of charge to complainants and are funded by complaint fees charged to AFCA members upon resolution of a complaint. All AFCA members pay an annual membership levy and some members also pay a user charge, with transitional arrangements applying for superannuation.

Noting that AFCA will incur costs in assessing and making decisions in relation to the resolution of complaints against insolvent financial firms, AFCA will need a mechanism to recover the costs in relation to making these determinations. The CSLR will pay AFCA's complaint handling fees in such cases.

AFCA costs incurred before the commencement of the scheme will be recovered through a one-off levy on ten of Australia's largest financial firms or related corporate groups

## 4. Funding the scheme

This chapter outlines the CSLR's proposed levy framework and the proposed policy settings to be embedded within the framework.

This levy framework is based on the Government commitment that the CSLR would be funded by industry. The framework also reflects feedback received in response to the 2019 Discussion Paper which included, for example, concerns about the level of levies that could be imposed on industry and the extent to which there would be cross-subsidisation without Ministerial oversight. The levy framework will operate across primary legislation, regulations and, if necessary, Ministerial directions.

Under this framework, the CSLR operator will estimate the funds required to meet expected subsector outlays, that is, the CSLR claims, AFCA fees, capital reserve contribution and administrative costs attributable to each in-scope financial product and service. The levies will be collected by ASIC from leviable financial firms as a tax. The Minister will have power to make decisions in relation to the scheme in limited circumstances. The scheme will not operate on a fee-for-service or cost-recovery basis.

This chapter outlines the scheme's two funding streams: a primary funding mechanism (an annual levy); and secondary funding mechanisms that will be used if the primary funding mechanism is insufficient to meet actual or estimated outlays. The secondary funding mechanisms are those facilitating the draw-down of unutilised funding from a single pool, the capital reserve and/or a special levy.

The chapter also describes how unpaid AFCA determinations and AFCA fees which have accumulated ahead of the start of the scheme will be funded through a one-off levy against ten of Australia's largest financial firms or related corporate groups.

The levy framework used for the CSLR will align with the ASIC IFM. The financial firms that are leviable for outlays associated with each in-scope financial product or service are the same firms that would be leviable for the same financial product or service under the ASIC IFM. To be leviable for the CSLR the firm must also be an AFCA member.

The CSLR levy framework will not form part of the ASIC industry funding model framework itself, but rather will adopt the same subsector definitions and use data collected by it. This will reduce the cost and time required to establish the CSLR.

Table A1 in Appendix A provides a detailed definition of the five in-scope financial products and services, the financial firms that will be leviable in relation to them and the link to the ASIC industry funding model.

### Levy framework

#### Primary legislation

##### Power to issue levy notices and collect levies

The primary legislation will establish the power for ASIC to issue levy notices and collect levies from relevant financial firms for the purpose of funding the scheme. A power will be conferred onto the CSLR operator to make at least an annual determination of an amount to be levied to fund the scheme, including the amount to be collected from relevant subsectors.

The CSLR operator will continually monitor existing and anticipated demand under the scheme. This would include working with AFCA to monitor the progression of existing AFCA complaint and maintaining an awareness of developments within the broader financial services market.

The primary legislation for the CSLR will confer a power to make regulations to prescribe which financial firms are liable in relation to each financial product or service that is within scope for the scheme and the levy calculation methodology that is to be used to determine what each liable firm will pay. ASIC will be responsible for collecting the amount determined by the operator in accordance with the criteria and formulas prescribed in the regulations. Levied funds collected by ASIC will be paid into the consolidated revenue fund.

### Subsector cap – \$10 million annual subsector cap

The primary legislation will prescribe an annual subsector cap of \$10 million for each financial product or service prescribed as in-scope of the scheme. The subsector cap is the maximum amount that may be levied from liable financial firms in relation to an in-scope financial product or service in any one year, without involvement of the Minister. Levy amounts collected through the first annual levy to fund the establishment of the scheme, including the CSLR operator's establishment of the CSLR payment function and ASIC's establishment of the CSLR levy function, will not contribute to the subsector cap.

The subsector cap is intended to provide liable financial firms with guidance as to the maximum amount that is expected to be levied against them in relation to each in-scope financial product or service in a claim year. A \$10 million subsector cap balances the provision of compensation to claimants and scheme sustainability for those financial firms that are not responsible for the misconduct giving rise to the compensation being claimed but are nonetheless being required to pay for it.

Where the CSLR operator considers, during a claim year, that expected or actual subsector outlays will exceed the subsector cap, the Minister will be notified by the CSLR operator and will have the power to determine specific actions or take no action. This is discussed further below as part of the section on 'Subsector cap expected to be exceeded – Ministerial determination' at page 24.

A subsector cap will be applied in relation to each financial product or service which is prescribed by the regulations to be in-scope of the scheme. No subsector cap will be applied to subsectors which are out-of-scope as levies will not be collected from financial firms in relation to out-of-scope financial products and services. The subsector cap which may be applied in relation to any financial product or service included in the CSLR in the future will be considered on a case-by-case basis.

The subsector caps will be amendable via regulations and any reconsideration of the subsector cap level is to occur in the context of the intended periodic reviews of the scheme.

### Scheme cap – \$250 million annual scheme cap

The primary legislation will prescribe a scheme cap of \$250 million. The scheme cap prescribes the absolute maximum amount which may be levied from liable financial firms under the scheme in any one year, including following Ministerial involvement.

A \$250 million scheme cap balances the provision of compensation to claimants and scheme sustainability for those financial firms that are not responsible for the misconduct giving rise to the compensation being claimed but are nonetheless being required to pay for it. The amount is considered high enough to fund claims for compensation in circumstances where there has been a large or 'black swan' event relating to a financial firm providing an in-scope financial product or service. Additionally, the amount is also considered low enough to support the sustainability of the scheme by limiting its potential yearly impact on liable financial firms throughout the life of the scheme.

The scheme cap will be amendable via regulations and any reconsideration of the scheme cap level is to occur in the context of the intended periodic reviews of the scheme.

## Standing appropriation

The primary legislation will contain a standing appropriation to enable levies collected by ASIC to be appropriated from the consolidated revenue fund to the CSLR scheme operator.

## Regulations

While the primary legislation establishes the scheme’s operating framework and confers relevant powers onto the Minister, scheme operator, and ASIC, the regulations would facilitate the operationalisation of the scheme.

The regulations would contain the criteria for determining which firms are to be levied and the formulas for calculating the levies each firm will pay. The key components which would feature in the regulations to facilitate the grouping of relevant firms and how much each would pay are outlined below.

### Leviable financial firms

The regulations will prescribe the leviable financial firms in relation to each financial product and service that is prescribed as in-scope. This will be a subset of the financial firms that are leviable in relation to the same financial product or service in the ASIC industry funding model. However, to be subject to the CSLR levy, a financial must be an AFCA member.

Table A1 in Appendix A provides a detailed definition of the five in-scope financial products and services, the financial firms that will be leviable in relation to them and the link to the ASIC industry funding model.

### Sizing metrics

The levies payable by individual financial firms within each subsector will be scaled based on a prescribed metric. The CSLR will adopt the sizing metrics applied by the ASIC industry funding model framework to size firms and their provision of an in-scope financial product or service in relation to a particular subsector. The outcome is that the levy a financial firm pays will reflect its relative size and/or the relative size of its provision of an in-scope financial product or service as measured by the relevant subsector metric.

Table 1 lists the metrics to be applied to size firms and/or firm provision of in-scope financial products and services.

**Table 1: Sizing metrics**

Subsector activity	Firm sizing metric
Credit providers (including small and medium amount credit providers)	Credit provided in the financial year (contracts other than small and medium amount credit contracts)
Credit intermediaries	Credit representatives and number of days authorised
Licensees that provide personal advice on relevant financial products to retail clients	Adjusted number of advisers on the financial advisers register and number of days authorised
Securities dealers	Annual transaction turnover value
Insurance product distributors	Annual gross premium that the insurance product distributor facilitates being paid to insurance product providers*

\* The ASIC IFM does not apply a sizing metric to the insurance product distributors subsector activity. The metric applied in Table 1 may be applied to size firms captured within the insurance product distributors subsector. Treasury is interested in working with financial firms and industry associations to settle an appropriate sizing metric for the insurance product distributors subsector for use in the scheme.

## \$1,000 minimum levy threshold

Only leviable firms whose levy in relation to each in-scope financial product or service is above a minimum levy threshold will be required to fund the scheme. The minimum levy threshold is to be prescribed in regulations and is proposed to be \$1,000. The levies that would have been paid by the leviable firms whose levy is below the \$1,000 minimum levy threshold will be re-allocated to firms whose levies are above the threshold.

The purpose of the minimum levy threshold is to limit the administrative costs of the CSLR and its impact on leviable financial firms by only charging a levy where its level is material, that is, in excess of the minimum levy threshold of \$1,000. This will prevent the imposition of small levy amounts on the smallest leviable firms within a subsector.

While the \$1000 minimum levy threshold seeks to ensure that smaller firms would not receive a levy to fund the scheme, the scheme's proposed funding model is dynamic in nature and which firms would receive a levy is subject to the total amount to be collected against a particular subsector activity. As the total amount to be collected rises, the total value of levies to be collected would grow resulting in a greater number of smaller firms' levies rising above the minimum levy threshold. However, the scheme is designed such that the smallest leviable firms would never be required to pay a levy.

The minimum levy threshold will be prescribed in regulations and any reconsideration of its level is to occur in the context of the intended periodic reviews of the scheme.

## Ministerial direction

The CSLR legislative framework enables the Minister to issue directions in limited circumstances. Where the CSLR operator considers, during a claim year, that expected or actual subsector outlays will exceed the subsector cap, the Minister will be notified by the CSLR operator and will have the power to determine specific actions or take no action. This is discussed further below as part of the section on 'Subsector cap expected to be exceeded – Ministerial determination' at page 24.

## Funding streams

The CSLR's funding model will operate on an *ex ante* basis. The scheme operator will estimate subsector outlays for the upcoming or remaining period of the claim year, that is, the sum of CSLR claims, AFCA fees, capital reserve contribution and administrative cost attributable to an in-scope financial product or service for a claim year.

The scheme contains two funding mechanisms: a primary funding mechanism; and secondary funding mechanisms that can be used if the primary funding mechanism is not sufficient. Each of these mechanisms are discussed in detail below.

### Primary funding mechanism: annual levy

The annual levy will be the primary funding mechanism within the scheme's levy framework. ASIC will issue annual levy notices to leviable financial firms ahead of the claim year to fund estimated subsector outlays in relation to each in-scope financial product or service during the upcoming claim year.

In years where funds collected through the annual levy are sufficient to fund the actual subsector outlays, leviable firms will only receive an annual levy notice. Where newly estimated or actual subsector outlays exceed the funds collected through the annual levy, the secondary funding mechanism can be used to fund any shortfall.



## Cost drivers

The CSLR operator will estimate the funds required to meet expected subsector outlays in the next claim year, that is, the CSLR claims, AFCA fees, capital reserve contribution and administrative costs attributable to each in-scope financial product and service. These four cost drivers contributing to the total amount that will be collected through annual levies are discussed below.

### CSLR claims

The scheme operator will estimate the total amount of compensation that will be claimed against the scheme in the upcoming claim year. The estimation will be informed by actuarial analysis and modelling with reference to relevant data, including existing in-scope AFCA determinations which remain unpaid. Estimations will also be informed by working closely with AFCA to assess AFCA complaints anticipated to progress through the AFCA complaints process and be eligible for compensation under the CSLR in a particular claim period.

### AFCA fees

AFCA will notify the CSLR operator of the total AFCA claims handling costs it has or will incur as part of assessing AFCA complaints against insolvent firms which relate to an in-scope financial product or service. The costs that AFCA incurs in resolving these AFCA complaints, including where the complaint is resolved in favour of the AFCA member, will form part of a fee notification. The fee amounts that AFCA will charge for progressing AFCA complaints which could potentially be eligible for compensation under the scheme will be agreed between the CSLR operator and AFCA.

The CSLR operator will work closely with AFCA on an ongoing basis throughout this process, particularly in sharing relevant information and data to inform the operator's analysis and modelling.

### Capital reserve

The operator will have a responsibility to establish and maintain a capital reserve of \$5 million as part of the scheme. The purpose of the capital reserve is to cater for circumstances where expected or actual subsector outlays exceed the amount collected through the annual levy.

The capital reserve will be built up over the first three claim years from commencement. During the first three claim years, the operator may only collect a maximum total of \$1.67 million (one-third) each year to establish the capital reserve. From the fourth year of the scheme's operation, the operator would have the discretion to collect an amount of levies in each claim period as appropriate to replenish the capital reserve to its prescribed \$5 million level.

The capital reserve of \$5 million will be prescribed in primary legislation and be amendable through regulations to enable revisions to be made as appropriate.

### Administration costs

#### *Ongoing administration costs*

Annual administrative costs will include the annual costs for the CSLR operator and the annual costs for ASIC to administer the CSLR levy. An indicative estimate of these costs is \$3.7 million.

The scheme operator's annual administrative costs will include, but are not limited to, ensuring potential claimants are aware of the scheme, managing a claims payment process, information gathering to support eligibility assessment, reporting to other parties as required, estimation of future claims, fees and costs, entity governance and corporate functions. The operator will estimate these costs ahead of the claim year and they will form part of the total annual levy.

ASIC's annual administrative costs will include, but are not limited to, maintaining and assuring levy data, raising invoices, debt management activity, licensee account management and licensing action for non-payment of levies. ASIC will estimate these costs ahead of the claim year and they will form part of the total annual levy.

### *Establishment costs*

Establishment costs will include the establishment costs for the scheme operator and ASIC's costs to establish the CSLR levy. An indicative estimate of these costs is \$6.3 million.

The scheme operator's establishment costs will include, but are not limited to, establishing the company, employing the inaugural workforce, fitting-out the operator's office space, procuring IT and other capital equipment, developing the application for operator authorisation and developing standard operational arrangements.

ASIC's establishment costs will include, but are not limited to, developing business processes for the CSLR levy, the CSLR levy system build, modifying its debt management arrangements, modifying its licensing review arrangements and managing interactions with ASIC's industry funding model.

Establishment costs are a one-off cost and will only be recovered through the first annual levy. Establishment costs will not count towards any of the subsector caps.

### Levy calculation methodology

The levy calculation methodology levy is outlined at Appendix B and an example is provided at Appendix C.

### Illustrative annual levy for first claim year

Analysis and modelling has been undertaken to illustrate the value of the levies which may be issued in relation to the initial claim years. The modelling is underpinned by a number of datasets, including: AFCA membership data; ASIC industry funding model firm level data; existing AFCA complaints against insolvent financial firms which are in-scope and that remain subject to AFCA decision; and determinations relating to credit provision activities made by the FOS and CIO predecessor schemes.

ASIC industry funding model data does not distinguish between financial firms that are AFCA members and those that are not. Treasury's modelling matched AFCA membership data with ASIC industry funding model firm level data. This resulted in an overall match in 85 per cent of cases, with the percentage of matches varying between subsectors. This was considered adequate for illustrative results. Actual results will vary.

Table 2 provides an estimate of the annual levies that are estimated to be collected from leviable firms in relation to in-scope financial products and services based on: data for open and closed AFCA complaints relating to credit intermediation, financial advice, securities dealing and insurance product distribution (lodged between 1 November 2018 and 10 March 2021) against insolvent firms; data for unpaid FOS and CIO determinations relating to credit provision; data on associated AFCA fees; and estimated annual administration costs. Table 2 excludes establishment costs and contributions to the capital reserve to illustrate the costs of the scheme in an ordinary year following its establishment and the building of the capital reserve. Also included in Table 2 is an estimation of levies that would be collected from leviable firms in circumstances where a subsector cap is reached for each in-scope financial product or service.

Table 3 provides further estimates of levies that would be collected with the inclusion of establishment costs and capital reserve contribution and capital reserve contribution alone.

**Table 2: Estimated ongoing levies, without establishment costs and capital reserve contribution**

Financial product or service	Features	Ongoing levy (mature scheme)	If subsector cap of \$10 million fully utilised
Credit Providers	Minimum threshold (value of provided credit p.a.)	\$1,806,993,091	\$57,680,427
	Per cent of firms that pay levy	5%	21%
	Cost per \$1B in provided credit	\$556	\$17,348
	Median levy	\$3,302	\$5,002
	Total levy on subsector	<b>\$297,141</b>	<b>\$10,000,000</b>
Credit Intermediaries	Minimum threshold (number of representatives)	37	4
	Per cent of firms that pay levy	5%	32%
	Cost per representative	\$28	\$283
	Median levy	\$3,661	\$2,260
	Total levy on subsector	<b>\$887,563</b>	<b>\$10,000,000</b>
Financial Advice	Minimum threshold (number of financial advisors)	4	3
	Per cent of firms that pay levy	34%	45%
	Cost per financial adviser	\$291	\$458
	Median levy	\$2,039	\$2,290
	Total levy on subsector	<b>\$6,170,774</b>	<b>\$10,000,000</b>
Securities Dealers	Minimum threshold (value of annual transactions)	\$93,414,681	\$7,314,083
	Per cent of firms that pay levy	12%	51%
	Cost per \$100M of annual transactions	\$1,075	\$13,703
	Median levy	\$2,150	\$4,311
	Total levy on subsector	<b>\$680,592</b>	<b>\$10,000,000</b>
Insurance Prod. Dist.	No sizing data (2,374 firms)*	\$9	\$4,212
	Total levy on subsector	<b>\$21,418</b>	<b>\$10,000,000</b>
<b>TOTAL LEVY ACROSS ALL SUBSECTORS</b>		<b>\$8,057,489</b>	<b>\$50,000,000</b>

*\*Table 2 (above) outlines a proposed sizing metric to apply to the Insurance Product Distributors subsector activity under the scheme. Treasury is interested in working with industry to settle an appropriate sizing metric for the insurance product distributors subsector activity under the scheme.*

**Table 3: Estimated levies in other circumstances**

Subsectors	Features	With capital reserve cont. and estab. costs (year 1)	With capital reserve cont. (years 2–3)	Ongoing levy (years 4+)
Credit Providers	Minimum threshold (value of provided credit p.a.)	\$968,425,000	\$1,554,757,000	\$1,806,993,091
	Per cent of firms that pay levy	7%	5%	5%
	Cost per \$1B in provided credit	\$1,066	\$664	\$556
	Median levy	\$3,100	\$3,198	\$3,302
	Total levy on subsector	<b>\$590,933</b>	<b>\$358,604</b>	<b>\$297,141</b>
Credit Intermediaries	Minimum threshold (number of representatives)	19	31	37
	Per cent of firms that pay levy	8%	6%	5%
	Cost per representative	\$54	\$33	\$28
	Median levy	\$2,683	\$3,422	\$3,661
	Total levy on subsector	<b>\$1,765,122</b>	<b>\$1,071,153</b>	<b>\$887,563</b>
Financial Advice	Minimum threshold (number of financial advisors)	2	3	4
	Per cent of firms that pay levy	62%	45%	34%
	Cost per financial adviser	\$544	\$341	\$291
	Median levy	\$2,177	\$1,705	\$2,039
	Total levy on subsector	<b>\$12,271,993</b>	<b>\$7,447,180</b>	<b>\$6,170,774</b>
Securities Dealers	Minimum threshold (value of annual transactions)	\$49,756,048	\$79,142,385	\$93,414,681
	Per cent of firms that pay levy	18%	14%	12%
	Cost per \$100M of annual transactions	\$2,017	\$1,269	\$1,075
	Median levy	\$2,444	\$2,202	\$2,150
	Total levy on subsector	<b>\$1,353,512</b>	<b>\$821,370</b>	<b>\$680,592</b>
Insurance Prod. Dist.	No sizing data (2,374 firms)*	\$18	\$11	\$9
	Total levy on subsector	<b>\$42,595</b>	<b>\$25,849</b>	<b>\$21,418</b>
<b>TOTAL LEVY ACROSS ALL SUBSECTORS</b>		<b>\$16,024,155</b>	<b>\$9,724,155</b>	<b>\$8,057,489</b>

### Annual levy process

The process through which the annual levy will be estimated, issued and collected is outlined below.

**July-September:** Metric data is collected or verified by firms as part of the annual ASIC industry funding model reporting process.

**October:** The scheme operator, in collaboration with AFCA, undertakes actuarial analysis and modelling work to quantify the estimated costs for the next claim year.

**November-December:** The scheme operator makes the determination for the next claim year.

**January:** ASIC issues invoices to relevant firms.

**March:** Levies are payable by relevant firms.

**April:** Penalties for late payment apply.

**June:** Funds are appropriated to the scheme operator for the next claim year.

**July:** The scheme operator makes compensation payments for eligible claims.

### Secondary funding mechanisms

In addition to the primary funding mechanism (annual levies), secondary funding mechanisms have been built into the scheme. The purpose of the secondary funding mechanisms is to ensure the scheme has access to additional funding in circumstances where estimated or actual subsector

outlays exceed the subsector funds available as a result of the annual levy. These mechanisms would enable the payment of eligible CSLR claimants as quickly as possible, rather than requiring claimants to wait for further funding through the next annual levy process.

The secondary funding mechanisms will be of particular use in circumstances where a larger firm, whose activities falls within scope of the scheme, becomes insolvent. In these circumstances, the claims which may be expected to be made against the scheme in a normal claim year may be significantly exceeded. Depending on the size of the failure, a special levy may be issued to fund the compensation payments for those claims resulting from the failure.

The three secondary funding mechanisms – levy pool, capital reserve and special levies – are discussed in detail below.

## Levy pool

Levies collected by the scheme operator will be placed into a single pool to fund all CSLR claims against in-scope financial products and services. The funds within the pool would be available to be drawn upon to fund all compensation payments made under the scheme, including where annual levies provided for a particular subsector are insufficient to meet subsector outlays for that subsector during the claim year. In these circumstances, other subsectors whose levied funds have not been drawn upon to the extent expected could be used to fund the subsector whose levies are insufficient to meet newly estimated or actual claims.

Where this occurs, it is intended that in the following claim year leviable firms within subsectors who experienced a shortfall would likely be subject to a larger levy given that the estimate for the previous claim year proved to be insufficient.

## Capital reserve

The capital reserve will be available to fund any shortfall where annual levies provided for a particular subsector are insufficient to meet subsector outlays for that subsector during the claim year. The capital reserve is intended to be actively used to manage scheme funding requirements, not simply maintained as a minimum capital obligation.

## Special levies

The special levy is similar in nature to the annual levy. Its purpose is to fund a substantial shortfall where annual levies provided for a particular subsector are insufficient to meet subsector outlays during the claim year and other secondary mechanisms are not available (for example, the capital reserve has been substantially depleted) or are not appropriate (for example, outlays in other subsectors are also expected to exceed levies provided).

However, the special levy differs from the annual levy in two key respects. Firstly, a special levy cannot be used to collect funds to replenish the capital reserve. Secondly, only the Minister can determine that a special levy may be used to collect additional funds that would result in a subsector cap being exceeded.

It is intended that seeking additional funding through the collection of special levies should only occur in circumstances where there is a clear need for additional funding. It is also intended that the number of instances special levies are collected within a claim year should be limited to the extent possible to minimise disruption to industry activities and planning.

The special levy will be a key funding mechanism to fund the payment of a large body of eligible claims made against the scheme following a large failure or 'black swan' event. In circumstances where a large firm has failed and AFCA complaints lodged against the failed firm would be eligible for

compensation under the scheme, the special levy would facilitate the collection of additional funds to meet any subsequent CSLR claims.

The total value of levies collected for a claim year through annual and special levies cannot exceed the prescribed annual scheme cap of \$250 million.

### Cost drivers

The cost drivers that contribute to the cost of special levies are:

- CSLR claims payments – the total amount of compensation that is estimated or will be claimed against the subsector during the remainder of the claim year or the next claim year;
- AFCA fees – the total amount of costs AFCA has or will incur in assessing AFCA complaints against insolvent AFCA members that relate to in-scope financial products or services, including AFCA complaints where a decision is made in favour of the insolvent firm; and
- Administration costs – the total administrative costs which the scheme operator and ASIC are estimated to incur in issuing a special levy and processing the additional CSLR claims to be made against the scheme.

The two circumstances in which a special levy may be issued – where a subsector cap would or would not be exceeded – are discussed below.

### Subsector cap not expected to be exceeded – operator determination

Where the CSLR operator considers, during a claim year, that expected or actual subsector outlays will exceed the levies collected for a subsector but not exceed the subsector cap, the operator will have discretion to determine how to fund the shortfall. If other secondary mechanisms are not available or are not appropriate, the CSLR operator may determine that a special levy be collected from leviable firms relating to that subsector, up to the subsector cap.

Consistent with the approach applied under the annual levy process, ASIC will be responsible for collecting from leviable firms the amount determined by the CSLR operator in accordance with the levy calculation methodology prescribed in the regulations.

### Subsector cap expected to be exceeded – Ministerial determination

Where the CSLR operator considers, during a claim year, that expected or actual subsector outlays will exceed the subsector cap, the operator will be required to notify the Minister as soon as practicable. The notification would include the total amount that the operator considers would need to be collected with respect to the subsector in order to meet actual or expected CSLR claims, AFCA fees and administrative costs attributable to the subsector. The notification will be a notifiable instrument.

Once the Minister has received the notification from the operator, the Minister may determine that one or more of the actions outlined below should be taken with respect to the notified subsector. The Minister's action would be through the issuing a Ministerial direction. As the Minister is not required to take any action, resolution of the situation could be left to the CSLR operator.

The Minister cannot direct the collection of special levies that would result in the value of total levies collected for the claim year, including through the annual levies, exceeding \$250 million.

### Levy more funds only from the subsector whose claims will exceed the subsector cap

The Minister may decide to issue a special levy to leviable firms relating to the subsector subject to the notification. The Minister may alternatively decide to levy additional funds only from a class of these leviable firms, such as larger firms, within the relevant subsector to fund the shortfall.

### Levy more funds from other subsectors

The Minister may decide to levy additional funds from other subsectors to fund the shortfall, including subsector relating to financial products and services that are not prescribed as being in-scope of the CSLR. The leviable firms in these other subsectors would be required to provide financial products or services to retail clients and thus be AFCA members. (Twenty-two such subsectors have been identified and are listed in Table D1 in Appendix D.)

For example, if the claims relating to the in-scope credit intermediaries subsector are estimated to exceed the subsector cap, the Minister may decide that firms within other financial product and service subsectors, such as the credit provider subsector (an in-scope activity) and the insurance provider subsector (an out of scope activity), should receive a special levy notice to fund the shortfall.

### Compensation to be paid over multiple claim years

The Minister may decide that compensation for CSLR claims, or a class of CSLR claims, against the relevant subsector should be paid over multiple claim years.

For example, where the Minister is notified that expected outlays for personal advice on relevant products to retail clients are estimated to exceed the subsector cap as a result of the insolvency of a firm whose advisers engaged in systemic misconduct, the Minister may decide that compensation applying to claims relating to that firm should be paid over two consecutive claim years. This would spread the cost for leviable firms across at least two years.

### Reduce the value of compensation to be paid for particular claims

The Minister may decide that the compensation cap is to be reduced with regard to a particular class of CSLR claims.

For example, where the Minister is notified that expected outlays for security dealing are estimated to exceed the subsector cap as a result of the failure of a large firm, the Minister may decide that the compensation cap applying to CSLR claims relating to that large firm should be reduced from the prescribed compensation cap of \$150,000.

## Funding accumulated unpaid determinations

The CSLR will fund the payment of eligible CSLR claims for unpaid AFCA determinations and AFCA fees (accumulated between 1 November 2018 and a prescribed day in advance of the start of the CSLR) that relate to in-scope financial products and services. The compensation will be funded through a one-off 'accumulated unpaid determinations' levy to be collected as part of the annual levy process for the first claim year.

The one-off 'accumulated unpaid determinations' levy will be issued to the ten largest financial firms or their holding companies as measured by the total income reported in the Australian Taxation Office *Report of Entity Tax Information*. Only firms that are prudentially regulated, or holding companies that have a prudentially regulated firm within their corporate group, will pay the one-off levy. Private health insurers will be excluded from receiving a notice for the one-off levy because a proportion of private health insurance premiums are subsidised and thus the subsidy would be contributing to scheme costs that are intended to be funded by industry.

## 5. Governance

### Roles and responsibilities

The CSLR will operate within a framework established by Parliament with primary legislation outlining core requirements and regulations providing eligibility and levy details. These legislative requirements will support Ministerial authorisation of a public company (CSLR Co) to operate the scheme. The Board of CSLR Co will be accountable for the operator's administration of the scheme and will be subject regulatory oversight by ASIC. Unlike the AFCA framework, the rules relating to eligibility, paying CSLR claims and levying financial firms will be established in primary legislation and/or regulations rather than in scheme rules set by the scheme operator. In addition to the scheme operator and AFCA, a number of government authorities will be allocated responsibility to oversee, advise, or otherwise assist the efficient achievement of the scheme's goals.

#### Minister

The Minister will recommend to the Federal Executive Council that regulations be made for the CSLR relating to the detail of scheme eligibility and levy arrangements.

The Minister will appoint the initial independent Chair of the public company (CSLR Co) that is to become the scheme operator.

The Minister will then authorise CSLR Co as scheme operator, after satisfaction that the proposed organisational, operator, operational, and compliance requirements meet the mandatory standards as provided for in legislation.

Where the CSLR operator considers, during a claim year, that expected or actual subsector outlays will exceed the subsector cap, the Minister will be notified by the CSLR operator. The Minister will then be empowered to determine the appropriate actions to be taken. The specific actions the Minister may determine are that:

- a special levy be issued to the financial firms leviable for that subsector to make up the shortfall;
- a special levy be issued to financial firms leviable in relation to other subsectors to make up the shortfall;
- a lower compensation cap should apply to a class of CSLR claims; and/or
- that a class of CSLR claims should be paid over more than one financial year.

These mechanisms will assist the Minister to balance the interests of claimants and scheme sustainability for those financial firms that are not responsible for the misconduct giving rise to the CSLR claims but are nonetheless being required to fund it.

The intention is that there will be periodic reviews of the scheme and the Minister will determine the scope of each review.

#### AFCA

AFCA will play an important role by determining AFCA complaints against insolvent firms, or firms that are unlikely to pay, where the AFCA complaint relates to a financial product or services that is in-scope for the CSLR. Where an AFCA determination is made in the complainant's favour and is notified as unpaid, AFCA will be required to take reasonable steps to enforce the determination. Where the determination remains unpaid, it may be an eligible CSLR claim.



AFCA may assist the scheme operator (CSLR Co) with administrative matters and services where it is efficient to do so.

## Scheme operator / CSLR Co

CSLR Co is proposed to be a subsidiary of AFCA Limited and must be a company limited by guarantee and operate on a not-for-profit basis. CSLR Co must administer the scheme in accordance with primary legislation and regulations. To comply with the mandatory standards contained in legislation, CSLR Co's Constitution will require the CSLR operator to maintain levied funds for the purposes of the scheme.

CSLR Co will be overseen by a Board with an independent Chair (initially appointed by the Minister) and four other members. The other Board member must include one of AFCA's industry directors, one of AFCA's consumer directors, a person who holds actuarial qualifications or expertise, and a person with expertise in claims handling. The appointment of AFCA directors will ensure consistency, communication, and shared knowledge between AFCA and CSLR Co.

CSLR Co will establish scheme rules and policies relating to internal governance.

CSLR Co will estimate levy requirements based on the yearly complaints and actuarial advice, and then request ASIC to levy a set amount from each in-scope financial services class or subsector. Upon receiving these funds from the consolidated revenue fund, CSLR Co will pay eligible claimants compensation payable under the scheme. These funds will also be used to pay unpaid AFCA fees, the operational costs of CSLR Co and ASIC's administrative costs under the CSLR.

CSLR Co will undertake regular reporting and stakeholder engagement activities to ensure all significant aspects of the scheme, and any ongoing changes, are properly communicated and consulted upon.

## ASIC

ASIC will play a role in regulating the CSLR operator's administration of the scheme and levying financial firms to provide funds to the scheme to compensate claimants.

After receiving advice from the CSLR operator, ASIC will collect an annual levy from financial firms in advance of the claim year and pay the funds into the consolidated revenue fund before they are appropriated to the CSLR for payment to claimants. ASIC would also collect any one-off or special levies associated with the scheme.

ASIC will have a power to suspend or cancel a licensee's licence if the CSLR pays compensation that the licensee was otherwise obliged to pay or the licensee does not pay required CSLR levies after 12 months. ASIC will be specifically notified by the scheme operator of payments on behalf of financial firms where the firm is not a Chapter 5 body corporate (for example, a firm under external administration). ASIC will have the power to deregister a company if the company does not pay the levies required under the CSLR, in conjunction with any associated costs, 12 months after the initial due date.

ASIC will have the power to share confidential or protected information with the CSLR operator where ASIC considers the disclosure of that information would enable or assist the operator.

ASIC will have powers to give general directions if the scheme operator does not do all things reasonably practicable to ensure compliance with the mandatory requirements. Failure of the CSLR to comply with a written direction made by ASIC would be an offence and ASIC would have the ability to apply for a court order if the CSLR fails to comply with its direction.

## Periodic reviews

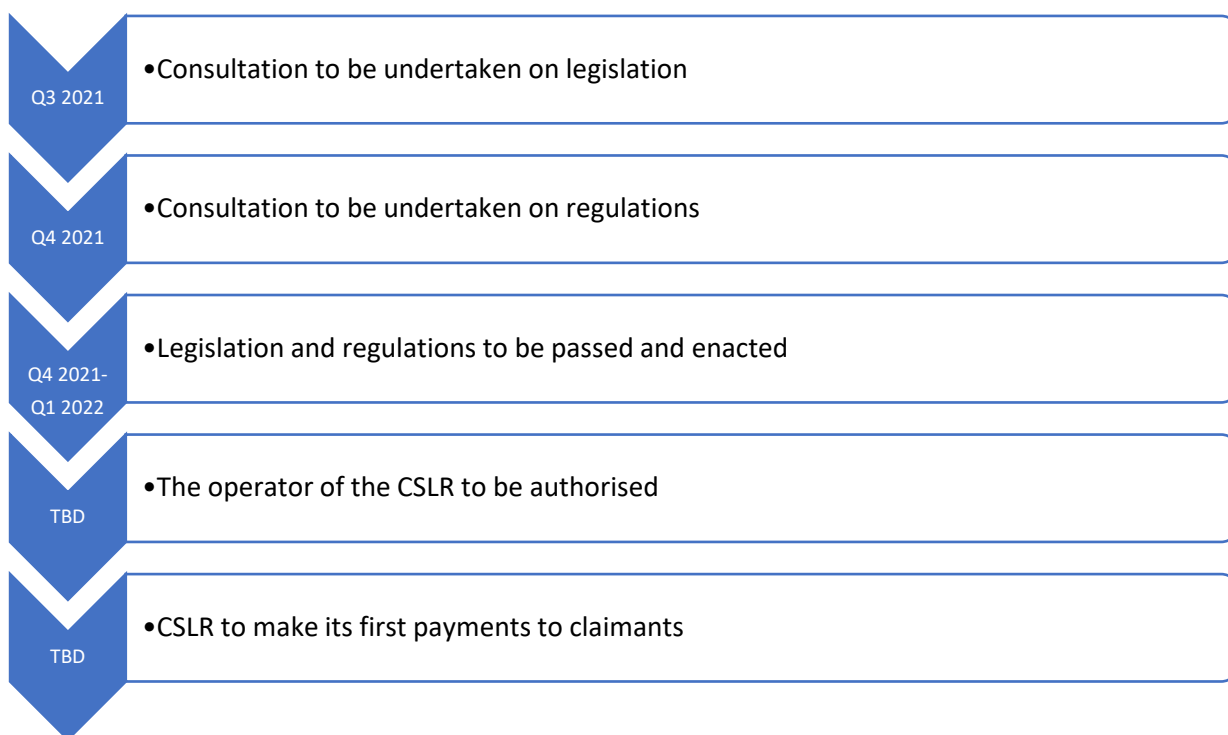
The intention is that the CSLR will be reviewed every five years to evaluate the effectiveness and efficiency of the scheme. The responsible Minister will set the scope of the review, which could include examination of claimant feedback, the appropriateness of caps, the scope of the scheme, eligibility criteria, levy arrangements and whether court and tribunal decisions should be included.

## 6. Implementation

Legislation establishing the CSLR will be introduced during the 2021 Spring sittings with further consultations to be undertaken in relation to regulations and other aspects of the scheme design.

### Timeline

The following timeline displays the approximate dates for major CSLR implementation milestones.



## 7. Other Matters

### Integrity measures

#### Preventing ‘double dipping’

The CSLR will provide limited compensation to consumers and small businesses who have suffered losses relating to an in-scope financial product or service due to misconduct by a financial firm. They may seek compensation through several channels including, but not limited to, being a creditor of a solvent firm, being an unsecured creditor of an insolvent firm and as a claimant from the CSLR.

#### Subrogation of rights

Where a claimant receives compensation under the CSLR for an unpaid AFCA determination, the claimant’s rights and interests against the financial firm are subrogated to the scheme operator, commensurate with the value of the compensation paid by the CSLR. Thus, a claimant retains their right to pursue compensation through other avenues for any compensation owed that is not met by the CSLR.

Where a subrogation of rights and interests occurs, and the scheme operator is aware that a financial firm has become a Chapter 5 body corporate (for example, because the firm is under external administration), the CSLR operator will be required to notify the relevant officer within the Chapter 5 body corporate that compensation has been paid to the claimant by the CSLR. The CSLR operator then retains the rights of the claimant exercisable against the firm, up to the value of the compensation paid by the CSLR. The CSLR operator may use those rights to recover funds from the Chapter 5 body corporate, where it is cost effective to do so.

#### Reduction of CSLR compensation where already paid

Where the scheme operator is aware that a financial firm has become a Chapter 5 body corporate (for example, because the firm is being wound up), and the Chapter 5 body corporate makes a payment to creditors (including creditors who have eligible unpaid AFCA determinations), the scheme operator may require information from the relevant officer of the Chapter 5 body corporate so that it is in a position to prevent CSLR claimants from receiving amounts that have already been paid.

#### Cancellation of firm licence

If the CSLR compensates a claimant in relation to an eligible unpaid AFCA determination, ASIC will be given the power to suspend or cancel the financial firm’s Australian financial service licence (AFSL) and/or Australian credit licence. This will ensure that licensees meet their obligations in relation to AFCA determinations and do not consider the CSLR as an opportunity to avoid meeting those obligations.

Further, ASIC will also be able to suspend or cancel a financial firm’s licence if they do not pay in full any required CSLR levy and any associated costs after 12 months of the payment due date.

#### Deregistration of a company

Where a company is required to pay levies to the CSLR and the company has not paid the required amount 12 months after the due date for payment, ASIC has the power to deregister a company. This will ensure firms that are liable to pay levies understand a lack of payment will impact their ability to operate as a company.

## Key terms

Term	Meaning in this document
AFCA	Australian Financial Complaints Authority: the current authorised EDR provider for consumer and small business complaints relating to financial products and services provided by financial firms. AFCA replaced FOS, CIO and the Superannuation Complaints Tribunal.
AFCA complaint	An application made to FOS, CIO or AFCA regarding the conduct of a financial firm.
AFCA determination	A determination made under AFCA's rules that is binding on a member financial firm.
AFCA member	A financial firm that is a member or former member of AFCA.
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
Chapter 5 body corporate	As defined in the Corporations Act 2001, a Chapter 5 body corporate is a company that is being wound up, to which a receiver has been appointed, that is under administration, that has executed a deed of company arrangement (that has not terminated) or entered into a compromise or arrangement the administration of which has not been concluded.
CIO	Credit and Investments Ombudsman; an ASIC approved but now superseded EDR provider for consumer and small business complaints relating to financial products and services that operated from 19 November 2014. CIO itself superseded a number of predecessors EDR schemes.
claimant	A person who makes a claim to the CSLR.
compensation cap	The maximum compensation payable in relation to a CSLR claim. The compensation cap will be set at \$150,000 in primary legislation. The compensation cap may be reduced by the Minister in limited circumstances.
complainant	A person who makes a complaint to FOS, CIO or AFCA.
CSLR claim	An application made to the CSLR for compensation. A claim must relate to an unpaid AFCA determination that is within scheme scope.
CSLR Co	A public company limited by guarantee and not-for-profit that is proposed to be the CSLR operator.
CSLR operator	CSLR Co will be authorised by the Minister to be the scheme operator.
EDR	External dispute resolution
FOS	Financial Ombudsman Scheme: an ASIC approved but now superseded EDR provider for consumer and small business complaints relating to financial products and services provided by financial firms that operated from 1 July 2008. FOS itself superseded a number of predecessor EDR schemes.
insolvency practitioner	An administrator, receiver or liquidator.

Term	Meaning in this document
minimum levy threshold	Only leviable firms whose levy in relation to each in-scope financial product or service is above a minimum levy threshold will be required to fund the scheme. The minimum levy threshold is to be prescribed in regulations and is to be \$1000.
moral hazard	Moral hazard exists when people take risks because they know that someone else is protecting them against a financial lost.
primary funding mechanism	Annual levies.
Ramsay Review	Supplementary Final Report of the <i>Review of the financial system external dispute resolution framework</i>
secondary funding mechanisms	Second funding mechanism are used if the primary funding mechanism (annual levies) is insufficient to meet actual outlays. The secondary funding mechanism are to draw unutilised funding from the single pool, draw on the capital reserve and/or issue a special levy.
scheme cap	The primary legislation will prescribe a scheme cap of \$250 million. The scheme cap prescribes the absolute maximum amount which may be levied from leviable financial firms under the scheme in any one year, including following Ministerial involvement. A scheme cap of \$250 million will specified in primary legislation and may be varied by regulation
subsector cap	The maximum amount that may be levied from leviable financial firms in relation to an in-scope financial product or service in respect of a claim year, without involvement of the Minister. A subsector cap of \$10 million will be specified in primary legislation and may be varied by regulation.
subsector outlays	The sum of CSLR claims, AFCA fees, capital reserve contribution and administrative cost attributable to an in-scope financial product or service for a claim year

## Appendices

### Appendix A: In-scope financial products and services and leviable financial firms

Table A1 describes the financial services covered by the CSLR and reference the relevant regulation in the ASIC Supervisory Cost Recovery Levy Regulations 2017.

**Table A1: In-scope financial product or services, leviable financial firms and ASIC IFM references**

Financial product or service	Leviable licensee	ASIC IFM reference
<b>Personal advice on relevant financial products to retail clients</b>		
Provide financial product advice to retail client on relevant financial products Note: A relevant financial product is a financial product other than: (a) basic banking products; or (b) general insurance product; or (c) consumer credit insurance; or (d) a combination of any of those products.	An Australian financial service licensee that is, at any time in the financial year, authorised to provide financial product advice (including a class of product advice) on relevant financial products to retail clients	Reg 43
<b>Credit intermediation</b>		
Credit activities other than as a credit provider	An Australian credit licensee that is, at any time in the financial year, authorised to engage in credit activities other than as a credit provider	Reg 25
<b>Securities dealing</b>		
Deal in a financial product to retail clients by: 1. applying for, acquiring, varying or disposing of, or 2. applying for, acquiring, varying or disposing of, on behalf of another person; or 3. arranging for another person to issue, apply for, acquire, vary or dispose of; or 4. arranging for another person to apply for, acquire, vary or dispose of; securities	An Australian financial service licensee that is, at any time in the financial year: 1. authorised to deal in securities in relation to retail clients; and 2. not a participant in a clearing and settlement facility, a large futures exchange or a large securities exchange; and 3. an entity for which more than \$250,000 in transactions are executed on, or reported to, a large securities exchange in the financial year	Reg 67
<b>Credit provision</b>		
Credit activities as a credit provider	An Australian credit licensee that is, at any time in the financial year,	Reg 26

Financial product or service	Leviable licensee	ASIC IFM reference
	authorised to engage in credit activities as a credit provider	
<b>Insurance product distribution</b>		
<p>Deal in a financial product to retail clients by:</p> <ol style="list-style-type: none"> <li>1. issuing, applying for, acquiring, varying or disposing of, or</li> <li>2. applying for, acquiring, varying or disposing of, on behalf of another person; or</li> <li>3. arranging for another person to issue, apply for, acquire, vary or dispose of; or</li> <li>4. arranging for another person to apply for, acquire, vary or dispose of; general insurance products, life risk insurance products or investment life insurance products</li> </ol>	<p>An Australian financial service licensee that is, at any time in the financial year:</p> <ol style="list-style-type: none"> <li>1. authorised to deal in general insurance products, life risk insurance products or investment life insurance products in relation to retail clients; and</li> <li>2. the entity does not form part of the insurance product providers sub-sector</li> </ol>	<p>Reg 70</p>



## Appendix B: Levy calculation methodology

The proposed levy calculation methodology is proposed to be as follows:

- The scheme operator arranges for actuarial analysis and modelling to estimate the value of claims to be made against the scheme in the upcoming claim year.
- The scheme operator makes a determination specifying the levy to be raised from each financial service subsector for the upcoming claim year.
- The scheme operator's levy determination will be equal to the sum of:
  - The estimated value of claims to be made against the CSLR in relation to each in-scope financial service class or subsector
  - The estimated value of AFCA fees resulting from AFCA's assessment of complaints against insolvent firms in relation to each in-scope financial service class or subsector
  - The estimated value of the following cost components, a share of which would be allocated to each in-scope financial service class or subsector proportionate to its share of the total value of claims against the scheme and AFCA fees:
    - : Annual administrative costs
    - : In the first three annual levies from commencement, a one-third contribution to the scheme's \$5 million capital reserve
    - : In the first annual levy from commencement, establishment costs
- ASIC calculates the levies to be collected from firms within each financial services class or subsector in accordance with regulations. The calculation detailed in regulations would follow these steps:
  - Step 1: The amount to be levied from a financial services class or subsector is allocated across all firms in the subsector proportionate to each firm's sizing metric.
  - Step 2: If all firms are calculated to have a levy over \$1,000, the process ends. However, if any firms are calculated to have a levy under \$1,000, the smallest of those firms is excluded.
  - Step 3: The amount to be levied from the financial services class or subsector is reallocated across the remaining firms in the subsector proportionate to each remaining firm's sizing metric.
  - Step 4: Steps 2 and 3 are repeated.
  - Special levies that may arise throughout the year will be calculated using the same steps applied to the total amount to be levied in the year, with any amount paid from earlier levies credited to the firm.
- ASIC issues and collects the levy from leviable firms.

## Appendix C: Levy example

For the purposes of this worked example, there are assumed to be 36,929 representatives working for 1,398 credit intermediary licensees with compulsory AFCA membership in the credit intermediary subsector.

XYZ Mortgage Broking Limited is a credit intermediary licensee with compulsory AFCA membership and 321 representatives.

From Table 2, the total cost for the credit intermediary subsector is estimated to be \$887,563, which is the sum of \$479,994 in expected CSLR claim and AFCA fee costs and \$407,569 in attributable administrative costs (that is, 11 per cent of \$3.7 million, reflecting the proportion of total CSLR claims and AFCA-fees attributable to the subsector). No establishment costs or capital reserve contributions are required in this example claim year.

The levy calculation methodology in Appendix B is followed and it produces a result that every leviable credit intermediary licensee with 37 or more representatives would be calculated to incur a levy of at least \$1,000. (Note: The result was 37 representatives and not 36 representatives as there is no licensee in the dataset with 36 representatives.) Thus, a credit intermediary licensee with 37 credit representatives will incur a levy of

$$\boxed{\$27.84 \times 37 = \$1,030.08}$$

XYZ Mortgage Broking Limited, a credit intermediary licensee with 321 representatives, will thus incur a levy of

$$\boxed{\$27.84 \times 321 = \$8,936.64}$$

## Appendix D: Potentially leviable financial firms

**Table D1: Potentially leviable financial firms**

Subsector	Subsector	Subsector
margin lenders	IDPS operators	securities exchange participants
credit intermediaries	responsible entities	OTC traders
credit providers	superannuation trustees	securities dealers
deposit product providers	general advice	insurance product providers
payment product providers	personal advice to retail clients on non-relevant products	insurance product distributors
Custodians	personal advice on relevant products to retail clients	risk management product providers
MDA operators	retail OTC derivatives issuers	
traditional trustee companies	futures exchange participants	