

## **EXPOSURE DRAFT EXPLANATORY STATEMENT**

### *Financial Services Compensation Scheme of Last Resort Levy Act 2022*

### *Financial Services Compensation Scheme of Last Resort Levy Regulations 2022*

Section 19 of the *Financial Services Compensation Scheme of Last Resort Levy Act 2022* (the Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

The Act imposes levies on persons to fund the compensation scheme of last resort (CSLR). The CSLR levy framework contains a primary funding mechanism ('annual levy'), and if needed a secondary funding mechanism ('further levy') if the annual levy collected is insufficient or likely to be insufficient to meet the initial estimate of claims, fees, and costs. The levy framework also contains a special funding mechanism ('special levy') that involves a Ministerial determination where the revised estimate of claims, fees and costs exceed the sub-sector levy cap.

The *Financial Services Compensation Scheme of Last Resort Levy Regulations 2022* (the Regulations) in turn prescribe the sub-sectors that are subject to a levy and applies either a flat rate levy or variable rate levy on such persons. The inputs that inform the method of calculating the amount of levy payable is different for each sub-sector. This approach is appropriate and equitable because of the difference in size and levels of business activity undertaken by each person in each sub-sector.

Leviable persons may fall into multiple sub-sectors for a levy period each financial year depending on the range of their business activities and licence authorisations. As such, leviable persons are required to pay levies for each sub-sector they are a part of.

Details of the Regulations are set out in [Attachment A](#).

The Regulations are a legislative instrument for the purposes of the *Legislation Act 2003*.

The Regulations commence on the day after this instrument is registered on the Federal Register of Legislation or the day the Act commences, whichever is later.

**Details of the *Financial Services Compensation Scheme of Last Resort Levy Regulations 2022***

**Section 1 – Name of the Regulations**

This section provides that the name of the Regulations is the *Financial Services Compensation Scheme of Last Resort Levy Regulations 2022* (the Regulations).

**Section 2 – Commencement**

Schedule 1 to the Regulations commence on the day after the instrument is registered on the Federal Register of Legislation or the day the Act commences, whichever is later.

**Section 3 – Authority**

The Regulations are made under the *Financial Services Compensation Scheme of Last Resort Levy Act 2022* (the Act).

**Section 4 – Definitions**

This section sets out the meaning of some of the key words and terms that are used in the Regulations. Many of the expressions used in this instrument have the same meaning as sections 9 or 761A of the *Corporations Act 2001*.

**Section 5 – Rules about amounts**

This section provides for standard rounding rules, including rounding up amounts of 50 cents to the nearest whole dollar.

**Part 2 – Matters relating to imposition of levy**

**Section 6 – Sub-sectors subject to annual levy**

As outlined above, the CSLR levy framework relies on the annual levy as the primary funding mechanism used to recover the amounts that the CSLR operator estimates will be payable for a sub-sector for a levy period.

This section prescribes four kind of sub-sectors that will be subject to the annual levy. These sub-sectors are defined with reference to the *ASIC Supervisory Cost Recovery Levy Regulations 2017* (ASIC Regulations). The ASIC Regulations group together similar entity types, which are regulated by the Australian Securities and Investments Commission (ASIC), into industry sub-sectors. The four sub-sectors that are in-scope of the annual levy are derived from those industry sub-sectors and include:

- credit intermediaries sub-sector;
- credit providers sub-sector;
- licensees that provide personal advice on relevant financial products to retail clients sub-sector; and

- securities dealers sub-sector.

This means if a person meets the criteria for these sub-sectors (as outlined in the ASIC Regulations) during the qualifying period for a levy period, and meet the general conditions for the annual levy, they will be liable to pay the annual levy.

#### Sections 7 and 8 – General conditions for imposition of annual levy and special levy

These sections prescribe the general conditions for the annual levy and the special levy. The sections provide that the respective levy is only payable by a person if that person is also subject to a levy under the *ASIC Supervisory Cost Recovery Levy Act 2017*. In other words, if a person is exempt from paying a levy under that Act, they would be exempt from paying a CSLR levy too. The sections also provide that a leviable person is required to be a member of the Australian Financial Complaints Authority (AFCA) scheme. Persons who are required to be members of the AFCA scheme are those who hold such an obligation as a result of their AFSL/ACL authorisation.

### **Part 3 – Amount of levy payable**

#### Section 9 – Amount of annual levy

This section provides that the total amount of annual levy payable by a person in a sub-sector for the levy period is the sum of the ***minimum levy component*** and the ***graduated levy component***. The minimum levy component for each sub-sector is \$100. This means that the leviable person in each sub-sector will be subject to a flat minimum levy of \$100 and if applicable a variable graduated levy.

#### Section 10 – Levy component for persons who are deregistered or who cease to be a member of a sub-sector

If a person is deregistered (or ASIC publishes a notice regarding the proposed deregistration of a person) before the person is required to return information for the purposes of a CSLR levy, and the person's registration is not reinstated before that day, the person will not be required to pay annual levy. Similarly, if a person ceases to be a member of sub-sector before the person is required to return information for the purposes of a CSLR levy, and the person does not resume their membership before this date, they will not be required to pay annual levy. In such cases, the amount of annual levy that would otherwise have been payable will not be recovered as the relevant person no longer exists.

#### Section 11 – Graduated levy component

This section prescribes the formula for calculating the graduated levy component of the annual levy. The formula provides for all persons in prescribed sub-sectors to pay a minimum levy amount and an additional variable component based on each person's proportionate size within the sub-sector.

The purpose of the annual levy is to recover the initial claims, fees and costs estimate for the levy period and a sub-sector. This is the ***sub-sector costs*** component of the formula. The CSLR operator will determine the initial claims, fees and costs estimate

for the levy period and a sub-sector in a legislative instrument within 12 months before the start of a levy period.

Of the total sub-sector costs for the levy period and the sub-sector, the minimum levy component of the formula will recover an amount equal to the minimum levy for each sub-sector (that is, \$100) multiplied by the *sub-sector population*, that is the number of persons that form part of that sub-sector for the purposes of the CSLR.

The graduated component of the annual levy formula will recover the remainder of the sub-sector costs for the levy period and the sub-sector. This is calculated by first reducing the total costs of the sub-sector by the amount that will be recovered under the minimum levy component of the formula. Following this step, costs are apportioned to each leviable person by dividing the *graduated entity metric* (that is, a metric measuring the size of the person within the sub-sector as outlined in section 12) by the *sub-sector metric* (that is, the total size of the sub-sector as measured by the metric). The purpose of this approach is to apportion levies payable in proportion to a leviable person's size.

Unlike the ASIC Regulations, for levy calculation in the CSLR, only those required to be members of the AFCA scheme are included. In other words, the sub-sector metric is simply the sum of the amounts of graduated entity metric for the levy period and the sub-sector for all persons who are required to be members of the AFCA scheme. In practice, this number is arrived at by first determining the relevant sub-sector population for the purposes of the ASIC Regulations and then reducing it by removing those persons who are not required to be members of the AFCA scheme.

### Section 12 – Entity metric

This section prescribes the graduated entity metric for each sub-sector, which is used to apportion the costs of the whole sub-sector for the purposes of the graduated levy component of the annual levy. In each case, the graduated entity metrics corresponds to the entity metric of that sub-sector as outlined in the ASIC Regulations.

#### *Credit intermediaries*

The entity metric for the credit intermediaries sub-sector is the number of credit representatives the credit intermediary has at the end of the qualifying period of the levy period. In practice this means that in addition to the minimum levy of \$100, each credit intermediary will pay a variable amount depending on the number of credit representatives it has as a proportion of the total number of credit representatives in the sub-sector.

The credit intermediary entity metric is also subject to a pro-rata adjustment, so that each credit intermediary only pays the levy in proportion to the number of days in the qualifying period it holds an Australian credit license that authorises those credit representatives.

### ***Credit providers***

The entity metric for the credit providers sub-sector is the gross amount of credit provided by the person in the qualifying period for the levy period under credit contracts (not including small or medium amount credit contracts).

The graduated entity metric for this sub-sector, for the purposes of section 11 of the Regulations, is the difference between the gross amount of credit provided by the person in the qualifying period for the levy period under credit contracts (not including small or medium amount of credit contracts) and \$100 million. In practice this means that in addition to the minimum levy of \$100, each credit provider will pay a variable amount depending on its share of the total value of credit contracts above the \$100 million threshold provided by each person in the sub-sector for a levy period. The graduated component of the levy will be calculated on the actual amount of credit provided to consumers during the financial year (rather than approvals).

### ***Licensed personal advice***

The entity metric for the licensed personal advice sub-sector is the number of relevant license holders at the end of the qualifying period for the levy period that are authorised to provide personal advice to retail clients on behalf of the provider. In practice this means that in addition to the minimum levy of \$100, all licensees pay a variable amount depending on each person's share of the total number of registered financial planners authorised to provide advice on a credit provider's behalf in the sub-sector.

However, the licensed personal advice sub-sector will not include persons that only provide advice on financial products that are admitted to quotation, provide advice on financial products that are traders on a prescribed foreign financial market, or provide advice on basic banking products.

The licensed personal advice entity metric is also subject to a pro-rata adjustment, so that each licensee only pays the levy in proportion to the number of days in the qualifying period it holds an Australian financial services license that authorises the registered financial planners to provide financial product advice on relevant financial products to retail clients.

### ***Securities dealers***

The entity metric for the securities dealers sub-sector is the total value of transactions in securities that are executed or reported to a large securities exchange, reported by the operator of the large securities exchange to ASIC's Market Surveillance System, and are recognised by ASIC's Market Surveillance System as executed transactions.

In practice this means that in addition to the minimum levy of \$100, each security dealer will pay a variable amount depending on each its share of the total value of executed transactions in securities within the sub-sector.

### **Section 13 – Amount of further levy where levy does not exceed the sub-sector cap**

If at any time during a levy period, the annual levy collected for a sub-sector is insufficient or is likely to be insufficient to meet the actual or estimated claims

payable for the sub-sector, the CSLR operator may recalculate the amounts included in the initial estimate of claims, fees and costs and determine a revised estimate of claims, fees and costs for the levy period and a sub-sector.

Where a revised estimate of claims, fees and costs would not exceed the sub-sector levy cap of \$20 million for a particular sub-sector for the relevant levy period, the CSLR operator may determine that a further levy needs to be imposed on the sub-sector. This section prescribes the method for calculating that further levy.

The total amount of further levy imposed on the sub-sector is equal to the difference between the revised estimate and the total amount of levy already paid for that levy period. As the method for calculating the further levy is the same as the annual levy, this means that the amount of further levy imposed on each person in the sub-sector will be the person's share of the costs (that is, the graduated levy component) under the revised estimate of sub-sector costs.

#### Section 14 – Amount of special levy on one sub-sector where levy exceeds the sub-sector cap

In addition to the primary funding mechanisms available to the CSLR operator, the scheme is built to respond to significant events that may cause a surge in the number of complaints received. Examples include a large firm becoming insolvent or other 'black swan' events in the financial services industry. Such events may be addressed via a Ministerially determined imposition of a special levy that exceeds the sub-sector levy cap of \$20 million.

This section contemplates a situation where a special levy is imposed only on one sub-sector. If the necessary pre-requisites of the CSLR operator making a revised estimate and the Minister subsequently determining that a special levy needs to be imposed have occurred, then an amount equal to the difference between the revised estimate and the total amount of levy already paid, is imposed as special levy. As the method for calculating this special levy is no different to the method used for the annual levy, in practice, this amount will be the new graduated levy component calculated with the revised estimate of sub-sector costs.

#### Section 15 – Special levy on several sub-sectors where levy exceeds the sub-sector cap

This section contemplates a situation where a special levy is imposed on several sub-sectors, regardless of whether they are subject to an annual levy. If the necessary pre-requisites of the CSLR operator making a revised estimate and the Minister subsequently determining that a special levy needs to be imposed on several sub-sectors have occurred, then an amount worked in accordance with either section 16 or section 17 is imposed as special levy.

#### Sections 16 & 17 – Amount of special levy

These sections prescribe the formulas for calculating the amount of special levy that is payable by entities. The formula apportions the amount of special levy that the CSLR operator determines for the sub-sector in a revised estimate to each person based on the person's size within the sub-sector.

ASIC Regulations apportion costs using a basic levy component or a graduated levy component. The Regulations follow the same approach. This means that when calculating the amount of special levy payable, the formula will use the entity metrics that correspond to the sub-sector in the ASIC Regulations. If a basic levy component applies, the special levy is apportioned equally between leviable persons in a sub-sector for the levy period. If a basic levy component does not apply, that is, a graduated levy component applies in the context of the ASIC Regulations, then the formula apportions special levy based on each leviable person's size within the sub-sector.

In each case, the total size of the sub-sector for a financial year will be the difference between the figure prescribed in the relevant annual legislative instrument ASIC makes under the ASIC Regulations; and the sum of the graduated entity metric for all persons in the sub-sector who are not required to be members of the AFCA scheme.

#### Section 18 – Amount of levy to fund scheme costs before the accumulation recovery day

This section prescribes the formula for calculating the amount of levy payable by the top ten banking and insurance groups in Australia. The levy thus collected will fund unpaid claims and associated unpaid AFCA fees flowing from complaints that were given to AFCA before the date the *Financial Sector Reform Bill 2022* was introduced into the Parliament. The formula apportions the amount of levy that the CSLR operator determines in an initial estimate made for this purpose, to each of the persons representing the top ten banking and insurance groups in proportion to each person's total income (that is, revenue) for the 2019-20 income year.