

CSLR Compensation Scheme of Last Resort

Actuarial Policy for Determination of Estimate for Pre-CSLR Complaints Levy

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1. Introduction

1.1. Legislative context

In June 2023, the Australian Parliament passed legislation establishing a Compensation Scheme of Last Resort (“**the CSLR Scheme**”). The following legislation outlines the operation of the CSLR Scheme:

- [Treasury Laws Amendment \(Financial Services Compensation Scheme of Last Resort\) Act 2023](#), which amends the Corporations Act 2001, ASIC Act 2001 and the National Consumer Protection Credit Protection Act 2009.
- [Financial Services Compensation Scheme of Last Resort Levy Act 2023](#) (the ‘**Levy Act**’)
- [Financial Services Compensation Scheme of Last Resort Levy \(Collection\) Act 2023](#) (the ‘**Levy Collection Act**’).

This body of legislation and regulations will be referred to as ‘**the Legislation**’ in this policy, unless otherwise specified.

1.2. Purpose of the policy

This policy provides the principles and a framework for the CSLR Scheme operator, Compensation Scheme of Last Resort Limited (“**CSLR**”) in relation to its responsibility to determine estimates for the purposes of quantifying levies imposed under the scheme to industry. This policy is set and approved by the CSLR Board and was designed with input from suitably qualified actuarial experts.

1.3. Scope and design

CSLR has engaged actuaries to assist in calculating estimate for the first levy to be imposed under the CSLR Scheme (“**Pre-CSLR Complaints Levy**”) in accordance with the legislation and to assist the CSLR Board in development of an actuarial policy.

This policy is currently focused on the principles the CSLR Board will consider when determining the estimates for the Pre-CSLR Complaints Levy in accordance with the Levy Collection Act.

The policy will be further refined, as appropriate, when determining the levies for subsequent levy periods.

1.4. Roles and responsibilities

CSLR Operator	In September 2023, the responsible Minister authorised Compensation Scheme of Last Resort Limited (CSLR) to be the operator of the CSLR scheme under section 1060 of the <i>Corporations Act</i> .
CSLR Board	<p>The Board is the decision making body of CSLR and has engaged suitably qualified actuarial experts with principal and reviewing actuary to</p> <ul style="list-style-type: none"> • access appropriate expertise as per under section 1062(4)(e) of the <i>Corporations Act</i>; and • be able to have regard to actuarial principles. <p>In relation to section 11 of the <i>Levy Collection Act</i>, the Board’s task is to determine its estimate of the sum of the three items provided for in subsections (a) to (c) (“the Estimate”). Once the Estimate has been determined and approved by the Board and a legislative instrument lodged in Parliament, it is up to ASIC to determine and impose the Pre-CSLR Complaints Levy. The Board does not set the Pre-CSLR Complaints Levy and does not have regard to the scheme levy cap imposed under the Legislation when making its assessment of the estimate.</p>
Principal actuary	The Principal Actuary is the primary, independent and reputable actuarial firm engaged by the Board, which has taken the lead and reports to the Board on actuarial analysis and modelling in relation to determination of the Estimate, as well as providing input into the development of this policy.
Reviewing actuary	The Reviewing Actuary is a second independent, reputable actuarial consultancy engaged by the Board to provide a quality assurance mechanism which has reviewed the Principal Actuary’s actuarial approach, modelling and calculations in relation to the Estimate.
ASIC	Once the disallowance period for the section 11 legislative instrument has elapsed, ASIC will determine and impose the Pre-CSLR Complaints Levy under section 10 of the Levy Act. ASIC is responsible to pro-rata the Estimate across the relevant institutions and apply the \$250m scheme cap (if applicable). Its methodology is outlined in both legislation and regulations.
AFCA	AFCA has provided complaint and other information to inform actuarial modelling, including its expected fees.

2. Board's Guiding Principles

In line with the Legislation, it is the CSLR Board's responsibility to determine the Estimate, which it *reasonably believes* to be the cost of operating the CSLR Scheme, *having regard to actuarial principles*.

This policy is the Board's policy on how it will properly discharge its responsibilities under the Legislation and in particular, the Levy Collection Act in relation to the Pre-CSLR Complaints Levy.

The Board has agreed to adopt four guiding principles which are as follows:

1. CSLR is committed to comply with all legislative and regulatory requirements in determining the Estimate for the subsequent determination and imposition of the Pre-CSLR Complaints Levy upon industry by ASIC to appropriately fund the CSLR Scheme.
2. CSLR will seek professional assistance from suitably qualified experts to determine the Estimate including the engagement of the Principal Actuary to assist with its determination of the Estimate in line with actuarial principles.
3. CSLR will further seek professional assistance from suitably qualified experts to review the Estimate once determined, including the engagement of the Reviewing Actuary to review the determination of the Estimate by the Principal Actuary to ensure alignment with actuarial principles.
4. CSLR will undertake to make diligent enquires and appropriate examinations of both the Principal Actuary's estimate, the Reviewing Actuary's quality assurance and all other enquiries or consideration of appropriate factors which the Board deems relevant to ensure that it is the Board's reasonable belief that the Estimate accurately reflects the expected cost of operating the scheme within the relevant period.

3. Conceptual framework

3.1 High-level framework

The Board understands that the amount of Estimate is subject to considerable uncertainty.

Against that uncertainty, the Principal Actuary has been engaged to assist the Board in determining the Estimate in accordance with the Legislation and in particular, section 11 of the Levy Collection Act, which requires the Estimate to be determined by the Board having regard to actuarial principles.

The Board has also engaged the Reviewing Actuary to provide a quality assurance mechanism to ensure increased transparency and further strengthening confidence in the determination of the Estimate.

It is understood that the Principal Actuary and the Reviewing Actuary will make prudent and realistic assumptions and adopt methodology that relies on actuarial principles. Despite this, the Board accepts that there will inevitably be a range of estimates that could be considered reasonable given the uncertainties and the fact that there is no historical data.

In consideration of this uncertainty, it is the Board's policy to adopt a conservative approach when determining the Estimate.

3.2 Code of Conduct and standards

The CSLR Board and this policy acknowledges that the Principal Actuary and Reviewing Actuary are expected to adhere to the Actuaries Institute's [Code of Professional Conduct](#) and any relevant practice standards.

This policy is not intended to override the Actuaries Institute's [Professional Standards](#).

4. Principle 1 - Compliance with all Legislative and Regulatory Requirements

4.1. Regard to be had to 'actuarial principles'

The Legislation provides that the Estimate must be determined by CSLR, as the Scheme Operator, *having regard to actuarial principles*.

The Levy Collection Act does not define actuarial principles.

However, the mandatory requirements for the CSLR operator are set out in section 1062 of the Corporations Act 2001 ("**Corporations Act**"). These requirements provide important guidance for the sound and prudent operation of the CSLR Scheme.

Notably, section 1062(4) of the Corporations Act provides for the operational requirements, including that:

- the operator manages money of the operator in a manner that is efficient, effective and economical, and
- the operator has appropriate expertise available to undertake actuarial analysis and modelling to estimate the value of claims to be made against the scheme.

In considering the nature of the CSLR Scheme, the funding source for the Pre-CSLR Complaints Levy, the significant monetary value of the Pre-CSLR Complaints Levy,

and the legislative requirements for the CSLR operator, the following principles and aspects of actuarial practice (although not exhaustive) are deemed relevant by the CSLR Board for the determination of the Estimate (“**the Actuarial Considerations**”):

- Make separate estimates for complaints under the CSLR Scheme arising from the significant failure of a particular financial firm and other complaints;
- Separately estimate the number of complaints expected to result in successful claims under the CSLR Scheme and the average compensation amount for those claims;
- Use the AFCA database to determine the date the complaint was notified to AFCA and the type of financial service to which it relates;
- Consider the need for an additional allowance for complaints that are not on the database, have an incorrect notification date or are recorded as another type of financial service, but will finish up as complaints relevant for the Estimate and Pre-CSLR Complaints Levy;
- Consider whether it is appropriate to allow for investment income that is expected to be earned on the Pre-CSLR Complaints Levy balance from its receipt until its expenditure; and
- Utilise the quantitative and qualitative information that is available, and then make reasoned actuarial judgements about the parameters for the Estimate.

The Principal Actuary and the Review Actuary will ensure that the Actuarial Considerations are referred to when assisting with the determination and review of the determination of the Estimate.

5. Principle 2 & 3 - Professional Assistance from Suitably Qualified Experts

To ensure compliance with the Legislation, due regard is given to actuarial principles and to ensure that expert actuarial analysis and modelling is undertaken to determine the Estimate, the Principal Actuary and Reviewing Actuary have been engaged by the Board to assist with its determination.

Both the Principal Actuary and Reviewing Actuary should fulfil the following criteria to ensure expert actuarial analysis and modelling is undertaken to determine the Estimate:

- Have significant expertise and experience in the financial services industry;
- Have significant experience in dealing with uncertainty;
- Be experts in scenario planning and have experience in evaluating the likelihood of future events;
- Be able to analyse data to develop reasonable assumptions;
- Able to competently test methodologies to estimate liabilities, including appropriate margins for uncertainty;

- Be able to utilise prudent and rigorous valuation methods using discount rates and risk-free rates of return;
- Be professional and reflect the mandatory standards of compliance, competence, care, and objectivity as provided for under the *Actuaries Institute's Code of Conduct* (refer section 3.2 above); and
- Competently apply the discipline of the actuarial control cycle to define a problem, design and implement a solution, monitor the effectiveness of the solution and revise if necessary.

The Board will continue to benchmark the Principal Actuary and Reviewing Actuary to ensure that they both continue to meet the above criteria.

6. Principle 4 – Board's Diligent enquires & Reasonable Belief

The Board will make diligent enquiries to rigorously review the work undertaken by the Principal Actuary and Reviewing Actuary to ensure that the Actuarial Considerations have been applied.

The Principal Actuary and Reviewing Actuary both undertake to provide the Board with a substantive, formal written report outlining the work undertaken and how the Actuarial Considerations have been applied (and any other relevant actuarial principles) in determining the Estimate and any review of the determination of the Estimate.

Whilst the Board must have regard to actuarial principles when determining the Estimate, above all it must ensure that it has a reasonable belief that the Estimate accurately reflects the expected cost of running the CSLR Scheme.

Therefore, it is noted that the Board may reach a value for the Estimate which departs from actuarial principles where the Board reasonably believes it appropriate to do so based on objective facts available to it at the time of making the determination. However, given the weight to be afforded to the actuarial principles under the Legislation and the Board's obligations under section 1062(4) of the Corporations Act, any departure should not be excessive.

Notwithstanding the above, it is noted that it would be appropriate under actuarial principles for the Board to consider the impact on interested third parties under the CSLR Scheme, including (but not limited to):

- Complainants who may be entitled to make a claim for compensation from CSLR Scheme;
- Levy payers for the Pre-CSLR Complaints Levy (the ten largest financial institutions); and

- Financial firms in the four sub-sectors that will be required to pay levies in future years.

Accordingly, the Board undertakes to consider the interests of any impacted third parties under the Scheme when making its determination of the Estimate and formulating its reasonable belief that the Estimate is appropriate to cover the costs of the Scheme within the relevant period.