1st & 2nd Levy Period Initial Estimates

Compensation Scheme of Last Resort Limited

March 2024

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8 March 2024

The Directors
Compensation Scheme of Last Resort Limited
Level 20, 680 George Street
Sydney NSW 2000

Dear Directors

1st & 2nd Levy Period Initial Estimates

We are pleased to enclose our report that outlines the work carried out, our methodology and results of our estimation of CSLR outgoings for the 1st & 2nd Levy Periods.

We look forward to discussing its contents with you.

Yours sincerely

Stephen Lee	Jon Tindall	Geoff Atkins
Fellow of the Institute of Actuaries of Australia	Fellow of the Institute of Actuaries of Australia	Fellow of the Institute of Actuaries of Australia

Appendices

1 Executive Summary

1.1 Background and scope to this Report

The Financial Services Compensation Scheme of Last Resort ("The Scheme" or "CSLR") was enacted in 2023 and will commence operations on 2 April 2024.

For claims that are within the scope of the legislation, CSLR is required to pay compensation to a complainant with an unpaid Australian Financial Complaints Authority (AFCA) determination, along with unpaid AFCA fees and other associated costs.

Compensation Scheme of Last Resort Limited (CSLR Ltd), The Scheme operator, has engaged Finity Consulting Pty Limited (Finity) as its actuarial services provider. Finity has estimated the 1st & 2nd Levy Period amounts, which are intended to cover the relevant outgoings for CSLR, plus a capital contribution, in the following periods:

- 1st Levy Period: 2 April 2024 to 30 June 2024
- 2nd Levy Period: 1 July 2024 to 30 June 2025.

The relevant outgoings in respect of unpaid claims and unpaid AFCA fees are only for complaints lodged with AFCA on or after 8 September 2022. The other relevant outgoings – CSLR operating expenses and ASIC charges – are those for the period regardless of when a complaint was lodged. Note that all of the outgoings are measured solely on a 'cash basis', i.e. amounts actually paid; no provision is made for future payments on current or past complaints.

The legislation is complex, and relevant aspects are outlined throughout the report as necessary. There are too many details and complexities, however, to attempt to summarise in this section of the report. This summary only includes what we judge as the most important points and should be read in conjunction with the remainder of the report.

1.2 Recommended 1st & 2nd Levy Period amounts

Finity estimates the total required amounts for the 1st and 2nd Levy Periods to be \$4.8m and \$24.1m respectively. The component parts of the levy estimates[1], split by sub-sector, are set out in Table 1.1 and Table 1.2 for the 1st and 2nd Levy Periods respectively.

Table 1.1 – Recommended 1st Levy Period amount

	1st levy period estimate									
Type	No. complaints finalised	No. claims paid	Gross claim Payments (\$000)	AFCA Fees (\$000)	Recoveries & Offsets (\$000)	Capital Contribution (\$000)	CSLR Operating Costs (\$000)	ASIC Costs (\$000)	Investment income (\$000)	Recommended CSLR Estimate (\$000)
Financial Advice - DASS	5	1	92	55	(0)					
Financial Advice - Other	16	4	348	193	(17)					
Financial Advice	20	5	440	248	(18)	417	1,357	-	(18)	2,426
Credit Provision	15	2	4	155	(0)	417	171	-	(7)	740
Credit Intermediation	7	2	98	86	(5)	417	169	-	(7)	758
Securities Dealing	12	2	207	139	(10)	417	178	-	(8)	923
Total	**54**	**11**	**749**	**627**	**(33)**	**1,667**	**1,876**	**-**	**(39)**	**4,846**

[1] The word 'estimate' is used to follow the legislation, which requires CSLR to declare an Estimate, while technically the Levy is determined by ASIC. The amount for the 1st Levy Period is also not technically a Levy, since it is paid by the Government.

Table 1.2 – Recommended 2nd Levy Period amount

	2nd levy period estimate									
Type	No. complaints finalised	No. claims paid	Gross claim Payments ($000)	AFCA Fees ($000)	Recoveries & Offsets ($000)	Capital Contribution ($000)	CSLR Operating Costs ($000)	ASIC Costs ($000)	Investment income ($000)	Recommended CSLR Estimate ($000)
Financial Advice - DASS	116	86	9,431	1,447	(48)					
Financial Advice - Other	43	20	2,109	531	(114)					
Financial Advice	159	107	11,540	1,978	(162)	417	4,717	361	(289)	18,562
Credit Provision	11	6	16	162	(1)	417	571	361	(28)	1,498
Credit Intermediation	10	6	381	126	(22)	417	567	361	(31)	1,800
Securities Dealing	15	10	805	193	(45)	417	593	361	(35)	2,288
Total	**195**	**129**	**12,741**	**2,460**	**(230)**	**1,667**	**6,448**	**1,445**	**(383)**	**24,148**

The amounts for each of the 1st and 2nd levy periods reflect our estimate of the payments made by CSLR in each period. The expected timing of payments is therefore a significant driver of the estimate for each levy period. As an example, for the 1st Levy Period the AFCA fees are almost equivalent to the gross claim payments. This is because we expect that many complaints that are 'pending' or already finalised will create unpaid AFCA fees that can be invoiced to and paid by CSLR as soon as The Scheme commences. Claim payments, on the other hand, do not take place until AFCA has issued a determination involving financial compensation, the complainant lodges a CSLR claim and CSLR processes the claim.

CSLR payments are intended to be accessed after all other avenues for recovery of lost monies have been exhausted (hence the 'last resort'). Offsets and recoveries for clients may derive from PI insurance, legal action by administrators or liquidators, payment by owners of a failed firm or distributions from the liquidation or administration. We have considered the potential for offsets (other compensation paid to the claimant prior to CSLR claim which reduces the claimed amount) and recoveries (subsequent amounts that are recovered by CSLR or through subrogated recovery rights) which will reduce the CSLR claim amount compared to the AFCA determination amount. Offsets will be known at the time of a CSLR claims payment, and therefore our assumed offsets reduce the 1st and 2nd Levy Period estimates as shown in the tables above. Recoveries are likely to take more time, and therefore recoveries related to claims paid by CSLR in the 1st and 2nd Levy Periods will reduce subsequent levy period estimates.

1.3 How the recommended levy estimates were made

The components making up the recommended estimated amounts to meet the relevant costs for the levy period are set out below. The CSLR claims to be paid and the unpaid AFCA fees comprise:

- Dixon Advisory and Superannuation Services (DASS) complaints, which make up around 70% of the total claim payments. This includes complaints lodged with AFCA after 8 September 2022 and future complaints lodged up to April 2024; after which DASS' AFCA membership is expected to expire and complaints can no longer be lodged with AFCA against the firm.
- Complaints against other Financial Firms that are in-scope for CSLR and made against a firm that has failed. This includes both known complaints and future complaints against already failed firms.
- Known and future complaints made against firms that are currently a going concern that would be in-scope for The Scheme coverage, where the firm fails in the future.
- Complaints that will turn out, after full investigation, to be in-scope for CSLR and for which the firm has failed.
- AFCA unpaid fees, combining fees that have been invoiced but remain unpaid and estimated fees following resolution of open and future complaints that are within the scope of the CSLR.

Only AFCA fees and claims relating to complaints lodged to AFCA on or after 8 September 2022 are included in the Levy Period estimates[2].

Allowances are made for offsets and recoveries from other statutory schemes and other sources such as a liquidation. Estimated CSLR operating costs, estimated ASIC fees (2nd Levy Period only) and the capital reserve contribution are apportioned to each sub-sector as described later in the report. Finally, an allowance is made for the investment income expected to be earned between receipt of the levy and the relevant expenditure.

CSLR's Board has approved a policy for levy estimates detailed in this Report, titled "Policy for Determination of Estimates for First and Second Levy Periods". The approach taken in this Report follows this Board Policy.

1.4 Implications of uncertainty

The estimate of the 1st & 2nd Levy Period amounts is uncertain. This is because CSLR is a new arrangement and has not commenced operating, and therefore has no track record of experience. There are no reasonably comparable other arrangements that can be looked to for learnings. The actuarial assumptions are, for these reasons, more weighted to reasoned judgement than to analysis of relevant data.

Even if good experience and data were available, the eventual expenditure from CSLR cannot be estimated with certainty. It depends on future events such as Financial Firm failures that do not occur in a uniform fashion, and essentially give rise to 'randomness' in the outcomes.

At a total level, the key uncertainties affecting the 1st and 2nd Levy Period amounts relate to the Financial Advice sub-sector, and specifically the following assumptions for DASS related claims:

- The total cost of DASS related complaints, which will depend on the number of non-zero determinations to the DASS client and the amount of the determination.
- More DASS related complaints are lodged to AFCA after the date which data was extracted for our assessment in this Report.
- The speed with which DASS related complaints will be determined by AFCA, the delay until the complainant lodges a claim to CSLR, and when these claims will be assessed and paid by CSLR.

In Section 10.3 we describe plausible (but unlikely) scenarios for the 2nd Levy Period that result in outgoings ranging from $11.5m to $39.4m for the Financial Advice sub-sector, compared with the recommended estimate of $18.6m shown in Table 1.2.

For other sub-sectors, less than 50% of the estimates relate to CSLR claim payments. Judgementally, a reasonable range of outcomes for the 2nd Levy Period would be in the order of +/- 25% of the recommended amount if more or fewer claims arise.

The legislation for CSLR sets out a series of adjustment mechanisms to address shortfalls, if these were to occur. Further, desirable public policy principles would include not creating unnecessary financial burdens and, where possible, to provide stability and predictability. Considering the legislation and general principles, our approach where there is uncertainty is to make reasonable estimates of outcomes in a reasonably favourable future environment. In particular no allowance is included for the possibility of higher than normal failure rates or claim costs, even on an average basis. The scheme design is for any unexpectedly large costs to be recovered from future levies once the relevant events are known.

[2] Complaints lodged prior to this are funded by the Pre-CSLR Levy; the estimate of this amount is documented in "Pre-CSLR Complaints Initial Estimate" report, dated 7 December 2023.

Section 10 of the report describes the uncertainty in the levy estimates, and provides a number of scenarios to assist readers in understanding these issues.

Please note the reliance and limitations set out in Section 11 of the report.

2 Background and scope

2.1 Background

CSLR was enacted in 2023 to compensate complainants who have received a determination in their favour from AFCA and the determination amount has not been fully paid by the relevant Financial Firm. This typically occurs because the relevant Financial Firm is insolvent, or is likely to become insolvent.

The Scheme arose from recommendations of the Ramsay Review and the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Hayne Royal Commission).

CSLR Ltd is authorised as the operator of The Scheme (i.e. the "CSLR operator"). CSLR Ltd is a not-for-profit company limited by guarantee and is a subsidiary of AFCA.

The Scheme will provide compensation payments to people (including small businesses and superannuation funds) that have AFCA determinations that are unpaid by the Financial Firm against which the complaint was made (and where the financial service is within the scope of The Scheme). The Scheme will commence operations from 2 April 2024. The set-up work conducted prior to the commencement date has been funded by a budget appropriation.

The Scheme is funded through levies.

Additional details of The Scheme can be found in Section 3.

2.2 Scope of this Report

CSLR Ltd has engaged Finity as its actuarial service provider. This Report considers the estimation of the levies required for the 1st & 2nd Levy Periods:

- 1st Levy[3] Period: 2 April 2024 to 30 June 2024
- 2nd Levy Period: 1 July 2024 to 30 June 2025.

Our recommendations for the levy estimates for both the 1st & 2nd Levy Periods provides funding for claim payments made, unpaid AFCA fees and other associated costs between 2 April 2024 and 30 June 2025.

2.3 Structure of this Report

The remainder of this report is structured as follows:

Section 3 presents a summary of our understanding of the development and intended operation of the CSLR, including the legislative requirements, coverage, claim payments and funding of the scheme.

Section 4 considers complaints against DASS. Claim costs and unpaid AFCA fees to be met by the CSLR during the 1st & 2nd Levy Periods are still expected to be dominated by DASS complaints.

Section 5 details our approach to modelling the 1st & 2nd Levy Period estimates and associated AFCA fees, including the consideration of the various sources of potential claims made against the CSLR.

[3] Technically the amount for the 1st Levy Period is not a 'Levy' because it is paid from a budget appropriation, but it is still called a Levy Period

Sections 6 and 7 summarise the parameterisation of the models and expected claim costs and AFCA fees respectively, for both DASS and Other Financial Firms separately. Section 8 deals with the other components of the estimates for the 1^{st} & 2^{nd} Levy Period amounts.

Section 9 sets out our recommendation for the 1^{st} & 2^{nd} Levy Period estimates, followed by Section 10 that explores the uncertainty in the estimate and provides a number of alternate scenarios.

Our report concludes with a summary of the reliance and limitations of the advice provided in this report in Section 11.

2.4 Board Policy

CSLR Ltd engaged Finity to assist with developing its Board Policy that sets out the principles and procedures that will be followed in determining levy estimates. At the date of preparing this Report, the Board has approved its policy relating to the 1^{st} & 2^{nd} Levy Periods. Development of the Board Policy to include other Levy Periods and other aspects of CSLR's operations is planned for 2024. The Board Policy is discussed in Section 5.11.

2.5 Glossary

Table 2.1 outlines the definition of some of the commonly used terms in this report.

Table 2.1 – Glossary

Term	Definition
'Active' Financial Firms	Financial Firms that are not currently insolvent, in administration or otherwise not trading
AFCA	Australian Financial Complaints Authority
AFCA fees	The fees that AFCA charges to Financial Firms, including complaint fees, annual user charge, and annual registration fees
AFCA extract date	The date of extract of AFCA complaint information used in this report (18^{th} December 2023)
APRA	Australian Prudential Regulatory Authority
ASIC	Australian Securities and Investments Commission
Claim	A claim lodged with the CSLR
Claimant	A person who has lodged a claim with CSLR
Complaint	A complaint made to AFCA by a Complainant (who must be an Eligible Person in accordance with AFCA's Rules) about a Financial Firm that is an AFCA Member at the time that the complaint is submitted to AFCA
Complainant	A person who has submitted a complaint to AFCA
CSLR Ltd	Compensation Scheme of Last Resort Limited, the operator of The Scheme
DASS	Dixon Advisory and Superannuation Services Limited
Determination	A decision made by an AFCA Decision Maker about a complaint in accordance with rule A.14 of the AFCA Rules
'Failed' Financial Firm	A Financial Firm that is currently insolvent, in administration or otherwise not trading

Finalised complaint	A complaint that AFCA has finished dealing with, whether by making a Determination (which in turn could be in favour of the Complainant or the Financial Firm) or in some earlier part of AFCA's processes. Finalisation triggers AFCA's right to invoice for its fees and hence CSLR's obligation to pay
Financial Firm	An AFCA Member, being a person who is a Member of AFCA as defined in AFCA's Constitution
'In-scope' complaints	Complaints that fit the definition in the legislation as being in-scope for the CSLR. This status may change over time as additional information about a complaint emerges
Other Financial Firms	Financial Firms apart from DASS
Post-CSLR complaints	Complaints lodged with AFCA on or after 8 September 2022.
Post-CSLR levies	Refers to the levies related to the post-CSLR complaints, being the 1st & 2nd Levy Period amounts, and all subsequent annual levy amounts. The 1st Levy Period amount is governed under Section 1069M and 1069N of the Corporations Act 2001. The 2nd and subsequent Levy Periods are determined under Section 8 of the Levy Act and calculated in accordance with Section 9 of the Levy Collection Act.
Pre-CSLR complaints	Complaints lodged with AFCA between 1 November 2018 and 7 September 2022.
Pre-CSLR levy	The Levy determined under Section 10 of the Levy Act and calculated in accordance with Section 11 of the Levy Collection Act
Relevant Entity	A Relevant Entity provides financial products or services in the following 4 sub-sectors as defined in the Corporations Act – personal financial advice, credit intermediation, securities dealing, and credit provision
Relevant Service	A financial product or service in one of the four relevant sub-sectors, specifically personal financial advice, credit intermediation, securities dealing or credit provision
Sub-sector	The sub-sector to which a complaint relates. The CSLR covers complaints in the following sub-sectors: personal financial advice, credit intermediation, securities dealing or credit provision
The Scheme	The Financial Services Compensation Scheme of Last Resort
1st Levy Period	Levy period from 2 April 2024 to 30 June 2024
2nd Levy Period	Levy period from 1 July 2024 to 30 June 2025.

2.6 Note on terminology used in this report

Section 9 of the Financial Services Compensation Scheme of Last Resort Levy (Collection) Act 2023 provides that the CSLR operator may determine an estimate that is the sum of what CSLR reasonably believes (having regard to actuarial principles) will be the total outgoings of the Scheme for each Levy Period. Levy Period refers to the respective time period which the estimate relates to.

The estimated total outgoings for the 1st Levy Period will be paid by the Commonwealth.

Annual levies starting from the 2nd Levy Period will be calculated and imposed on industry by ASIC, in accordance with Section 8 of the Financial Services Compensation Scheme of Last Resort Levy Act 2023. ASIC is to use the estimate determined by the CSLR operator for the Levy Period in calculating the levy, including application of levy thresholds and the scheme caps. This report does not deal with the calculation for each levy payer, as this is the responsibility of ASIC.

3 About the Financial Services Compensation Scheme of Last Resort

3.1 Establishment of The Scheme

The Scheme is established by the Treasury Laws Amendment (Financial Services Compensation Scheme of Last Resort) Act 2023, assented to 3 July 2023, which amends the Corporations Act 2001, Australian Securities and Investments Commission Act 2001, and the National Consumer Credit Protection Act 2009.

The following legislation and regulations are specific to the operation of The Scheme and the CSLR operator:

- Financial Services Compensation Scheme of Last Resort Levy Act 2023 ("Levy Act"), and corresponding Financial Services Compensation Scheme of Last Resort Levy Regulations 2023 ("Levy Regulations")
- Financial Services Compensation Scheme of Last Resort Levy (Collection) Act 2023 ("Levy Collection Act")
- Corporations Amendment (Financial Services Compensation Scheme of Last Resort) Regulations 2023, which amends the Corporations Regulations 2001 ("Corporations Regulations").

This body of legislation and regulations will be referred to as "the legislation" in this report, unless otherwise specified.

3.2 Payments by the Scheme

The Scheme pays compensation in the following circumstances:

- Where an AFCA determination requires an amount to be paid by a Relevant Entity to a complainant, and
- The Relevant Entity has not paid the amount to the complainant, and the complainant has notified AFCA that the determination is unpaid (typically within 12 months), and
- The complainant will not be fully compensated for the amount of the determination by any other statutory compensation scheme or other source such as a distribution in a liquidation, and
- The complainant applies to The Scheme for compensation for the unpaid determination amount.

The complaint against the Relevant Entity must relate to a financial product or service ("Relevant Service") in one of the following 4 sub-sectors – personal financial advice, credit intermediation, credit provision and securities dealing.

The Scheme provides for the following payments:

- Compensation payments for claims lodged for unpaid AFCA determinations against a Relevant Entity. Claims are limited to $150,000 per complainant.
- Unpaid AFCA fees, where AFCA has charged the AFCA Member that is a Relevant Entity (or was an AFCA Member at the time the complaint was lodged) and this amount is unpaid after taking steps to recover the fees (or AFCA is entitled to charge the AFCA Member but decides to not pursue the entity having considered the prospects of payment).
- CSLR operating costs.
- ASIC costs for administering the Scheme Levies.

The Scheme will only make compensation payments if the CSLR operator reasonably believes that the person is unlikely to be paid by the Relevant Entity the full amount of the AFCA determination.

3.3 Levies to be determined

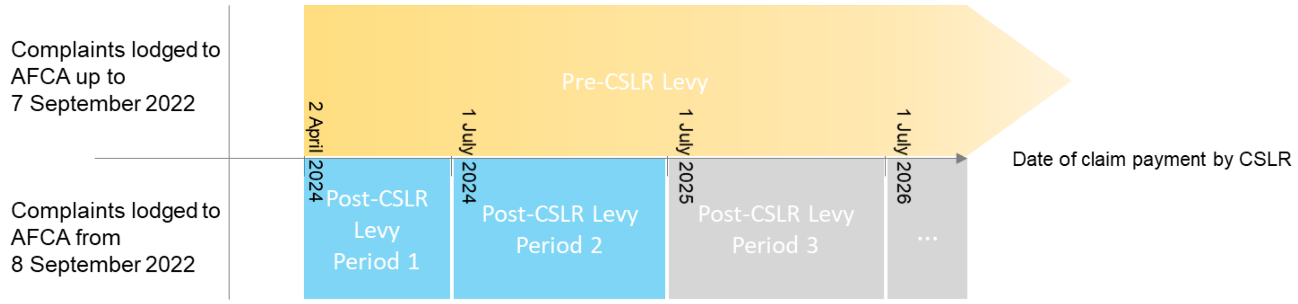
The Scheme is funded by levies.

The legislation differentiates between a levy to fund compensation claims arising from AFCA complaints lodged up to and including 7 September 2022 (referred to as the "pre-CSLR levy") and compensation claims arising from complaints lodged from 8 September 2022 onwards. The one-off levy to cover claims arising from pre-CSLR complaints is intended to fund the total ultimate cost for this cohort of claims and associated AFCA fees. The estimation of this levy was detailed in our report "Pre-CSLR Complaints Initial Estimate", dated 21 December 2023, and a legislative instrument has been tabled specifying a pre-CSLR levy estimate of $241m.

For complaints lodged on or after 8 September 2022, levies are determined annually (noting that the 1st Levy Period runs only from 2 April 2024 to 30 June 2024) to meet The Scheme claim payments and associated costs. These levies will meet the cost of expected CSLR claim payments made to claimants during the levy period.

Figure 3.1 outlines the key dates that relate to the various levy periods.

Figure 3.1 – Levy periods



The subject of this Report, the 1st & 2nd Levy Periods estimates for Post-CSLR complaints, are shown in blue.

The CSLR operator is required by the Levy Collection Act to estimate its expected payments, include operating costs. The following components of the calculation are required for the levy estimate, as set out in Section 9 of the Levy Collection Act:

		(1)		(2)		(3)		(4)		(5)		(6)
Levy	=	Compensation payments to consumers	+	Unpaid fee payments to AFCA	+	ASIC levy administration	+	CSLR operating costs	+	Capital reserve contribution	+	Adjustment for prior year balances.

The Levy Collection Act specifically identifies the components to be included in each levy period, which is summarised in the table below. The 1st & 2nd Levy Periods have been highlighted in blue.

Table 3.1 – Components of each Levy

Levy	Compensation payments (1)	AFCA fees (2)	ASIC levy administration (3)	CSLR operating costs (4)	Capital reserve (5)	Adjustment for prior year balances[1] (6)
Pre-CSLR Levy	For pre-CSLR complaints only	For pre-CSLR complaints only	No	No	No	No
1st Levy Period	Yes	Yes	No	Yes	$1.67m capital contribution	No
2nd Levy Period	Yes	Yes	Yes	Yes	$1.67m capital contribution	Yes (not expected)
3rd Levy Period	Yes	Yes	Yes	Yes	$1.67m capital contribution	Yes
4th Levy Period and thereafter	Yes	Yes	Yes	Yes	Capital recovery, if required	Yes[1]

[1]Including adjustments relating to the pre-CSLR balance

The pre-CSLR Levy will be paid by the ten largest APRA-regulated financial institutions (other than private health insurers and superannuation funds), based on income for 2021/22. ASIC will determine the Levy for each financial institution.

The 1st Levy Period payment will be made by the Commonwealth (i.e. it is not levied on industry).

The payments from the 2nd Levy Period onwards will be determined for each of the 4 sub-sectors, and then paid by Relevant Entities within each sub-sector. ASIC will be responsible for determining the allocation of the Levy to each entity.

The total levy for each levy period is capped at $250m, and, in addition, each sub-sector has a $20m cap unless there is a Ministerial determination for a Special Levy to exceed this amount. In all cases the $250m cap for the levy period will apply.

4 Dixon Advisory and Superannuation Services Limited

4.1 About DASS[4]

DASS held an AFSL and operated a financial advice business focused on providing financial advice, investment advice, portfolio management and superannuation services to retail clients. A substantial amount of the business of DASS was in relation to Self-Managed Superannuation Funds (SMSF).

DASS is a wholly owned subsidiary of E&P Financial Group (formerly Evans Dixon).

DASS has faced legal actions arising from the provision of financial services to clients, in particular people who were advised to invest in the US Masters Residential Property Fund (URF) and URF-related products, which were issued and operated by related companies to DASS. These included a proceeding issued by ASIC in the Federal Court which resulted in orders for DASS to pay a $7.2 million penalty and $1 million towards ASIC's costs. There were two class action proceedings lodged, and there may well be litigation by individual clients.

These legal actions involve similar issues and similar parties to the numerous AFCA complaints, and help inform our assessment of the circumstances of DASS complainants.

On 19 January 2022, DASS was placed into voluntary administration, with the appointment of the Administrators - Stephen Longley and Craig Crosbie from PwC.

DASS operated under an AFSL until 8 April 2022 when it was suspended by ASIC. In May 2022, the Administrators requested that ASIC cancel the AFSL.

On 16 December 2022, a Deed of Company Arrangement (DOCA) was approved by DASS' creditors, which among other things, required E&P Operations to pay an amount of $17.7m to DASS, less a settlement adjustment for expenses incurred by E&P Operations during the administration period.

ASIC cancelled DASS' AFSL, effective 5 April 2023. The terms of the cancellation require DASS to maintain AFCA membership until at least 8 April 2024.

The Administrators' Report to creditors dated 29 November 2022 (the Administrators' Report) provides a detailed background on the company and the circumstances leading up to its administration. We have included details about DASS from the Administrators' Report where this is helpful for assessing CSLR claims costs in this section of our Report.

4.2 Losses on URF Equities for DASS clients

DASS and/or related companies established several investment products that clients invested in, most notably the US Masters Residential Property Fund (URF) that was established in 2011[5], with the URF Equities (ASX:URF)[6] and URF CPUs (ASX:URFPA)[7] being listed on the ASX in July 2012 and December 2017, respectively. The stated purpose of the URF was to provide investors with exposure to a diversified portfolio of US-based residential property assets, with the potential for long-term returns through a combination of capital growth and net rental income.

[4] See ASIC Media Release of 4 August 2023, 'ASIC sues Dixon Advisory & Superannuation Services Pty Limited Director'

[5] US Masters Residential Property Fund includes the URF Equities, URF CPUs and URF Notes. The URF is one of the Related Party Investment Products.

[6] The equity securities in the ASX listed URF entity (ASX:URF) that listed on the ASX on 23 July 2012.

[7] The URF Convertible Step-Up Preference Units (ASX:URFPA) that listed on the ASX in December 2017. The URF CPUs are an equitable interest in the URF, but on which unit holders may receive a priority distribution at a set rate.

The Administrators understood that following the establishment of the URF, DASS advised clients to invest in the fund. At the same time, other related entities were paid significant fees from the URF. This included, for example, amounts paid for managing the URF's assets and for renovating the properties owned by URF. This created a perceived conflict of interest for DASS.

As the value of the URF Equities declined from a peak of $2.33 per share in September 2015 to $0.185 in March 2021, the URF's performance, combined with concerns about the potential conflict of interest issues, resulted in various complaints being made to AFCA against DASS.

4.3 AFCA complaints relating to DASS

The following summarises the history of AFCA complaints, relating predominantly to the URF securities bought by DASS clients[8]:

- The first complaints made to AFCA in relation to the URF occurred in or around June 2018.
- In the period from June 2018 to the Appointment Date of the Administrators, 11 complaints lodged by DASS clients with AFCA were settled and paid by the Company, and a further five complaints were settled in principle, but not paid. In all of these cases, an agreed outcome between DASS and the relevant client was negotiated.
- At the Appointment Date of the Administrators, there were 76 open complaints against DASS. DASS estimated its liability in respect of those 76 complaints to be up to $18.5m (under the AFCA "whole of portfolio loss" methodology) in a board memorandum prepared by DASS director, Mr Ryan, on 18 January 2022 for consideration in advance of placing DASS into administration.
- At a meeting held between the Administrators and AFCA representatives on 25 January 2022, AFCA informed the Administrators that it had paused the processing of complaints against DASS, in line with AFCA's policy of pausing complaints against an insolvent company.
- On 3 August 2022, ASIC issued a media release and correspondence to former clients of DASS recommending they lodge a complaint with AFCA if they believed they had suffered a loss as a result of the misconduct of DASS and/or their former DASS financial adviser in providing financial services.
- By 7 September 2022 (the pre-CSLR date) complaints lodged with AFCA numbered 1,638 and further complaints have been lodged after that date.

4.4 Investor creditors in the DASS administration

The Administrators determined that AFCA complaints were made in respect of four of the Related Party Investment Products, with the vast majority in respect of the US Masters Residential Property Fund (URF), specifically the Australian Securities Exchange (ASX) listed URF equities (the URF Equities). Of the four Related Party Investment Products, only the URF Equities significantly underperformed against relevant benchmarks.

The Administrators therefore consider that only the 4,606 investors in the URF Equities should be treated as creditors of the Company. These investors make up almost all of the creditors in the administration proceedings, by number of creditors (4,606 of 4,620) and the quantum (estimated by the Administrators to be $367.9m out of $368.6m owed) based on estimates[9] shown in the Administrators' Report.

[8] In some instances, this includes other Related Party Investment Products.

[9] But note these estimates are only of the investment loss without interest or the other elements that would be included in an AFCA determination.

4.5 Class actions against DASS and the Deed of Company Arrangement

Class action proceedings were filed in respect of URF claims in the Federal Court against the Company and other defendants on 1 November 2021 by Kosen-Rofu Pty Ltd and on 22 December 2021 by Watson & Co Superannuation Fund Pty Ltd ATF (Class Actions). The legal representatives in the Class Actions are Piper Alderman and Shine Lawyers respectively. The Class Actions include claims against the Company for financial advisor contraventions (such as conflict of interest and advisor conduct), breaches of fiduciary obligations, misleading and deceptive conduct and negligence.

The Federal Court made orders on 15 June 2022 that the proceeding commenced by Shine Lawyers would continue, and that the Piper Alderman action would be stayed until the resolution of the Shine Lawyers proceeding.

In December 2022, DASS creditors approved the Deed of Company Arrangement proposed by E&P Financial Group. The DOCA provided a mechanism to accommodate the settlement of the outstanding class action and included a Sunset Date of 30 June 2023 for a settlement. In addition, in December 2022 the Court ordered that DASS' Administrators grant access to Shine Lawyers to certain insurance policies.

On 20 June 2023, the Sunset Date of the DOCA was extended to 30 November 2023 by mutual consent of all parties to the DOCA to enable additional time to allow for the settlement of the representative proceedings.

4.6 Current status of proceedings

On 14 November 2023 the Administrators announced that a settlement agreement had been made by the parties. We interpret the information in the Administrators' notification to be that the settlement is for $12m, with Shine Lawyers' fees to come from that and the remainder paid to the DASS Administrators.

The settlement also triggered a 'tranche 2' payment of $4m to DASS from the parent company. Thus, the DASS creditors have received $4m and will receive the balance of $12m after Shine Lawyers' fees.

Our understanding is that this outcome was as envisaged by the DOCA and in the Administrators' report. If this understanding is correct then it would confirm the indication from the Administrators that the return to creditors after the DOCA would be about 4 cents in the dollar. This is about $15m out of claims of $369m.

4.7 Implications for the 1st & 2nd Levy Period Estimates

DASS complaints represent more than 80% of the currently open, in-scope, post-CSLR complaints. As such, the estimation of an appropriate 1st & 2nd Levy Period estimate depends substantially on our understanding of the particulars of the situation surrounding DASS. We expect further DASS complaints to be reported, especially as AFCA begins publishing determinations from February 2024.

It appears to us that most, if not all, of the post-CSLR complainants in relation to DASS will be free to have their complaint determined and, if a non-zero determination is made, to then lodge a claim with the CSLR. The decision of the Federal Court in ASIC's action against DASS strongly supports the assumption that these complainants will largely be successful.

5 Methodology

This section outlines our approach to estimating the 1st & 2nd Levy Period amounts, including the structure of the modelling and the approach to parameterisation.

5.1 Data and information sources

We relied on a range of data and information sources in estimating the claim costs relating to the 1st & 2nd Levy Period amounts as well as unpaid AFCA fees. This section outlines these sources.

We have conducted some reasonableness checks on the data provided.

5.1.1 Complaints

Our primary data reference was an extract supplied by AFCA of all complaints received by AFCA (including its predecessors) since 2013. For the purposes of estimating the 1st & 2nd Levy Period amounts, we received an extract as at 18 December 2023, noting that new complaints which are in-scope for the CSLR and relevant to the 1st and 2nd Levy periods may be reported after the AFCA extract date.

The dataset includes complaints that have been finalised, that are in progress and those that have been paused. Some of the key fields included in this extract are:

- The amount claimed, as entered by the complainant
- The outcome amount where the complaint has been completed (by determination or earlier in the AFCA complaints process)
- The status of the Financial Firm (i.e. insolvent, in administration etc)
- The sales or service channel to which the complaint relates (which indicates the type of financial product or service)
- The current AFCA fees incurred to date, the amounts invoiced to firms and whether fees are unpaid.

An important aspect of the data relating to in-scope complaints relevant to the estimation of 1st & 2nd Levy Period amounts is that, for the vast majority of cases, investigation of the complaint had been paused. This means that we are left to rely largely on information entered by the complainant at the time of lodging the complaint, in particular for the amount claimed and the sales/service channel to which the complaint relates.

5.1.2 Discussions with AFCA and CSLR

With AFCA, and in particular CSLR, being relatively recently developed functions, there remains a significant amount of uncertainty about how these processes will operate as they deal with the backlog of complaints.

We benefited from a number of discussions with AFCA and CSLR who provided us with expectations and insights into their understanding of how operations are likely to progress over the coming two years.

Specifically, these discussions were informative when developing assumptions for the timing of payments for CSLR claims i.e. the expected time complaints may take to navigate both AFCA and CSLR processes, before being paid.

In estimating the timing for AFCA to finalise complaints, we had discussions with AFCA staff on their specific initiatives (to deal with the large number of DASS-related complaints) and business-as-usual complaint handling processes, including expected timeframes of the various work-streams related to processing complaints. We were provided with an overview of the arrangements that AFCA is putting in place to process the 'surge' of complaints related to DASS.

Note that AFCA's initiatives are to address all outstanding claims complaints. Pre-CSLR complaints make up the majority of complaints. Our assumptions in this report consider when Post-CSLR complaints are determined within the context of these initiatives.

We held discussions with CSLR project staff regarding expected timeframes for key tasks undertaken prior to CSLR payment of a claim, such as application & validation, eligibility, offer, acceptance and payment.

5.1.3 Legislation and regulation

We referenced the relevant legislation and regulations governing the establishment and operation of the CSLR in Section 3.1.

5.1.4 Dixon Advisory and Superannuation Services

Information on DASS was obtained mainly from documents provided to creditors by the Administrators and which were provided to us by CSLR. We also referred to the ASIC website, to various media reports and the E&P annual report published in August 2023. Section 4 has more details.

5.1.5 Other information sources

We referenced a number of additional sources of information in our investigation, including:

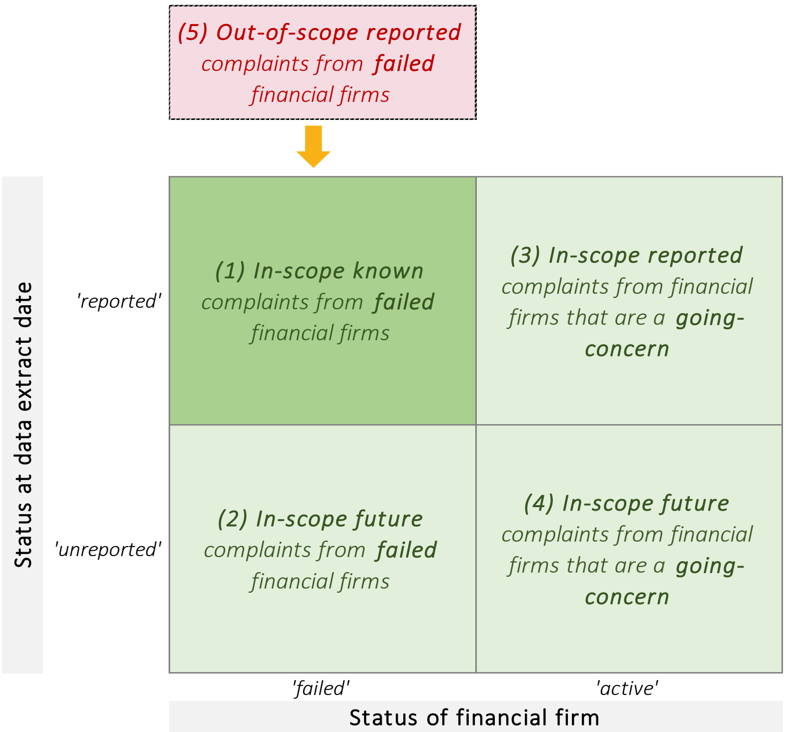
- CSLR operating budgets for FY24 to FY27
- Estimate of ASIC levy administration costs (for administering CSLR levies)
- ASIC levies for 2021/22 by sub-sector
- Searches on ASIC's website on Financial Firms and their trading status
- ASIC documents relating its Industry Funding Model
- Publicly available information relating to Other Financial Firms to assist with understanding their current trading status and additional information as to the nature, or likely result, of complaints made against the Financial Firm.

5.2 General Methodology

5.2.1 Sources of potential claims

There are several cohorts of complaints that could ultimately lead to successful claims against the CSLR. Figure 5.1 outlines the structure by which we have classified and considered the complaints.

Figure 5.1 – Sources of potential CSLR claims



We have considered the following cohorts of in-scope complaints that could ultimately lead to successful claims against the CSLR:

- The cohort of reported complaints which relate to already failed Financial Firms i.e. Group (1) in Figure 5.1. This cohort is expected to make up a significant majority of the successful claims against the CSLR in the 1st & 2nd Levy Periods.
- The potential for complaints relating to already failed Financial Firms to emerge after the date of extract of AFCA complaint information (18 December 2023) and become CSLR claims i.e. Group (2).
- The potential for complaints related to currently active firms to become successful CSLR claims following the failure of the firm after the AFCA extract date. Group (3) is the cohort of complaints that have been reported to AFCA; and Group (4) is the cohort that will emerge after the date which data was extracted (i.e. the "AFCA extract date") for this Report.
- The potential for reported complaints relating to already failed firms, which are currently out-of-scope, however will transition to becoming in-scope during the process of AFCA determination i.e. Group (5).

Table 5.1 summarises the modelling approach for each cohort of potential CSLR claims.

Table 5.1 – Modelling approach

Complaint cohort	Description	Approach
Group (1)	In-scope known complaints from already failed firms	We have relied on individual AFCA complaint information as a starting point of our estimate.

Group (2)	In-scope future complaints from already failed firms	We have considered how complaints emerge relative to the failure date of a firm, based on historical trends observed in AFCA's complaints database. We have made separate allowances by sub-sector for future unreported claims relating to already failed firms.
Group (3)	In-scope known complaints from Financial Firms that are currently a going concern	Groups (3) and (4), which combined form the cohort of in-scope complaints arising from future failures, are modelled together. We have estimated the expected number of firm failures per year as well as the expected number of complaints per firm failure, using the AFCA complaints data. This is separately estimated for each sub-sector.
Group (4)	In-scope future complaints from Financial Firms that are currently a going concern	
Group (5)	Out-of-scope known complaints from already failed firms	We examined each failed Financial Firm that had unresolved out-of-scope complaints. We applied a likelihood of that complaint becoming in-scope, based on publicly available information from ASIC and other external sources.
Other complaints	Out-of-scope complaints relating to future complaints and/or future failures to transition to becoming in-scope complaints	Not further considered.

At a high level, the methodology for estimating the levy period amounts can be characterised as:

$$\mathit{Total\ Cost} = \sum^{\text{in-scope complaints}} [\{\mathbf{Probability}(\mathbf{Successful\ Claim}) \times \mathbf{Outcome\ Amount}\} + \mathbf{AFCA\ fees} - \mathbf{Recoveries}]$$

$$+ \mathbf{Capital\ Contribution}$$

$$+ \mathbf{CSLR\ Operating\ Costs}$$

$$+ \mathbf{ASIC\ Costs}$$

In the following sections we set out the approach to estimating each of the bolded items above. It is worth noting that the AFCA fees are payable on in-scope complaints regardless of whether the complainant is successful in achieving a determination in their favour and making a CSLR claim.

5.3 Group (1): In-scope reported complaints from already failed firms

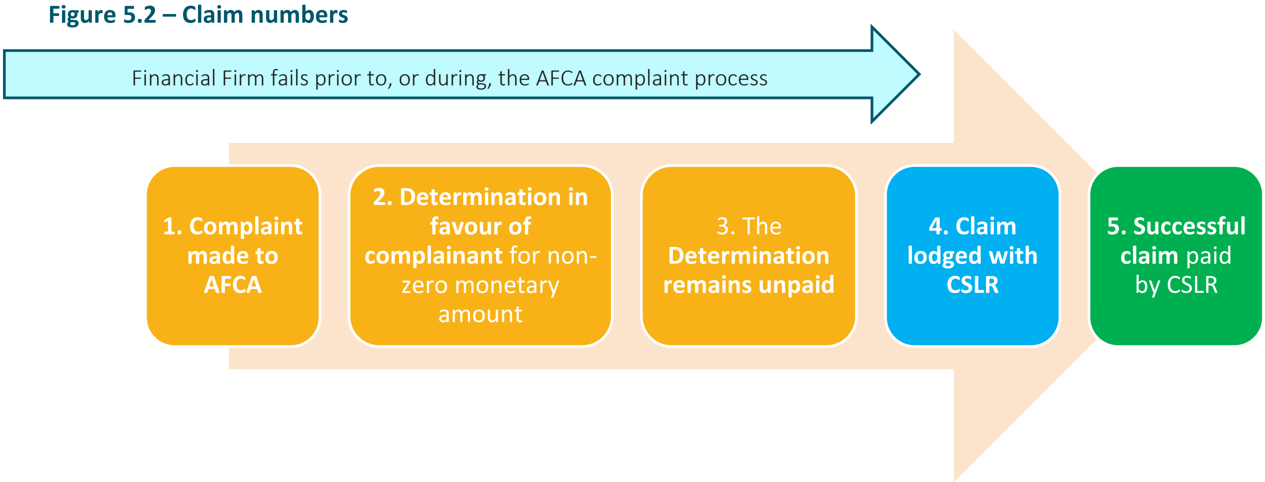
Due to the expected dominance of DASS complaints in the 1st & 2nd Levy Periods, we have approached the parameterisation of the model separately for DASS and Other Financial Firms.

For this cohort, we have relied on the individual AFCA complaint information as a starting point of our estimate.

5.3.1 Probability of a successful CSLR claim

The approach to estimating the probability of a complaint becoming a successful claim against CSLR needs to consider the progress through various stages, as shown in Figure 5.2.

Figure 5.2 – Claim numbers



This cohort of complaints relates to Financial Firms that have already failed, and therefore will not pay the whole determination amount. For these open complaints, we are left to estimate:

- The likelihood of a determination being made by AFCA in favour of the complainant for a non-zero monetary amount
- The likelihood that the complainant lodges a claim with the CSLR
- The likelihood that CSLR accepts the claim.

5.3.2 Estimating the Outcome Amount

In terms of the amount of a determination, our data source contained an 'outcome' amount for only 5 of the 316 known in-scope, post-CSLR complaints that may become successful CSLR claims. For the rest, we are limited to the amount recorded by the complainant as the amount of their loss (the "claimed amount").

Our understanding is that there is no extensive guidance given to complainants about how to estimate this amount and that there would likely be a wide range of understanding amongst complainants about how to approach estimating the size of their loss. In fact, many complainants have not entered a claimed amount, which requires specific analysis in the modelling.

A significant assumption in the modelling of complaints is the relationship between the amount claimed by the complainant, and the amount of any determination made by AFCA in favour of the complainant.

$$Outcome\ Amount\ = Claimed\ Amount\ \times \gamma$$

The legislation limits the amount of any single claim against the CSLR to $150,000.

Our approach to estimating the Outcome Amount was to:

- Where a complaint had been determined, reference the Outcome Amount contained on the data extract received from AFCA
- For 'open' complaints that have a claimed amount we apply a factor representing the relationship between the claimed amount and the outcome amount (the parameter γ above);
  - These parameters were derived from analysis of historical complaints, but with substantial judgemental overlays based on the specifics of the Financial Firm or complaint in question
- Apply a $150,000 cap on each claim made against the CSLR

- For complaints where there is no claimed amount, assume the average size of a CSLR claim by considering the result above, and other relevant factors.

5.4 Group (2): In-scope future complaints from already failed firms

As complaint-level details are not known for these unreported complaints, we have made monthly allowances for unreported complaints to emerge and become CSLR claims. These allowances run from December 2023 through to June 2025, the latest date that a complaint could theoretically be reported and remain relevant for the 1st & 2nd Levy Periods (although in reality, a complaint is extremely unlikely to be able to progress through to a paid CSLR claim within a month).

Usually for a failed Financial Firm, complaints that result in unpaid determinations are reported both before and after the Financial Firm failed[10]. In reality, there are often significant points in time at which general awareness is elevated for specific Financial Firm failures that result in larger volumes of complaints being received. Sometimes this may be related to actions or notifications made by administrators, regulators or the media.

To understand the likely unreported complaints that could emerge from already failed Financial Firms, we referenced the historical complaint distributions from previously failed Financial Firms. We investigated how complaint report dates were distributed around the date of failure of the Financial Firm for the aggregated failure experience of each sub-sector.

For DASS specifically, we have allowed for complaints that will be reported after the AFCA extract date.

The outcome amounts assumed are based on the average size of a CSLR claim from reported in-scope complaints, as detailed in Section 5.3.2. This was separately considered for DASS as well as each of the four industry sub-segments.

5.5 Groups (3) and (4): In-scope complaints from future firm failures

The other potential source of CSLR claims relevant for the 1st & 2nd Levy Period estimates are from complaints related to Financial Firms that fail after the date of AFCA data extraction.

To project expected future Financial Firm failures, by sub-segment and month, we referenced historical AFCA complaints data to understand:

- The number of Financial Firms that have failed over AFCA's 5-year history, and therefore the average number of Financial Firm insolvencies per year, by sub-segment;
- The average number of complaints that are open at failure date[11], and reported after the failure date, by sub-segment; and therefore
- The total number of complaints, by sub-segment and by year, arising from future firm failures, for both reported complaints as well as complaints that emerge after the failure date.

We have relied on historical averages to estimate the costs that may arise from this cohort.

[10] Noting that there is ambiguity in the definition of a 'failure date' and in practice there are multiple points at which a firm could be considered to have failed. For example, ASIC's insolvency statistics publication includes firms that have appointed external administrators or controllers, are undergoing restructuring plans, have voluntarily wound up, are in receivership, etc.

[11] Failure date was sourced from ASIC's insolvency statistics publications for all Financial Firms that failed between 1 November 2018 and 18 December 2023.

5.6 Group (5): Out-of-scope complaints from already failed firms

We have made an allowance for reported complaints on already failed firms which are currently considered out of scope, to transition to in-scope prior to determinations being issued (Group 5 in Figure 5.1). We have considered each failed Financial Firm with complaints identified as out-of-scope. We applied a likelihood of a complaint becoming in-scope, based on the nature of the complaint and our understanding of the activities of the Financial Firm in question.

5.7 Potential for offsets and recoveries

The nature of the CSLR means that it is intended to be accessed after all other avenues for recovery of lost monies have been exhausted (hence the 'last resort'). We have considered the potential for offsets (reductions in claimed amount prior to CSLR payment) and recoveries (subsequent recoveries that are recovered by CSLR or through subrogated recovery rights) which will reduce the CSLR claim amount compared to the AFCA determination amount.

Offsets and recoveries for clients may derive from PI insurance, legal action by administrators or liquidators, payment by owners of a failed firm or distributions from the liquidation or administration. In terms of other statutory compensation arrangements, we are only aware of one such arrangement – the National Guarantee Fund applying to certain stock exchange transactions. The NGF could apply to securities dealing, but it would not cover all situations in that sub-sector.

The legislation is complex, and there are major interdependencies with insolvency laws and practices that have not yet been explored. Further, there may be differences based on whether the CSLR claim is paid before or after any other compensation. These details will not be resolved in the near future (and potentially not for a few years until interpretations are actually tested).

There is nothing known about the experience of offsets or recovery from these various sources so those assumptions are largely judgemental. For DASS there is some relevant information in the Administrators' Report (see section 4.6), which estimates offset/recovery of 4 cents in the dollar based on their assessment of investor losses. There is uncertainty about the recoverability of this amount by CSLR, which will depend on the treatment at AFCA determination, and the operation of any future subrogation recoveries.

We have adopted an assumption of 1% (of claim costs, excluding unpaid AFCA fees) recovery for all DASS complaints (including unreported DASS complaints), because there are limited offsets and recoveries expected that may reduce CSLR's potential claims cost.

For Other Financial Firms we have assumed offsets of 5% and recoveries of 5% to the gross claim cost (i.e. overall a gross cost reduction of 10%). In modelling the impact of offsets/recoveries, we have applied the assumed offset/recovery to each complaint. In reality, offsets/recoveries will not be even across all complainants and this is a simplified approach.

5.8 Estimating AFCA's Unpaid Fees

AFCA charges fees for its services in relation to its administration of the authority and the determination of complaints. These fees provide the core funding for AFCA under its new funding model that came into effect from 1 July 2022[12].

There are three types of fees charged to Financial Firms:

1. An annual membership/registration fee

[12] https://www.afca.org.au/members/news/new-funding-model-comes-effect-on-1-july-2022

2. A case fee associated with each complaint, varying by the stage at which the complaint is completed
3. A 'user charge' fee[13] based on the number of closed complaints against a Financial Firm in the previous year, weighted by the stage at which the complaint is finalised.

AFCA fees for any eligible complaint are recoverable from CSLR, irrespective of the outcome or whether the complainant makes a CSLR claim. This means that the AFCA fees will arise from a larger number of complaints than the CSLR claims.

We have assumed that, for the purposes of estimating the 1st year and 2nd year Levies, only (2) and (3) would remain unpaid. Membership fees are relatively small and the amount would not be material.

Section 7 outlines our estimate of unpaid AFCA fees relating to the 1st and 2nd year Levies.

5.9 Timing of payments

The 1st & 2nd Levy Periods, and subsequent annual levy periods, cover claim payments made in the relevant period, rather than complaints lodged within the period. Therefore, in the estimation of 1st & 2nd Levy Period amounts, the timing of AFCA determination, CSLR claim lodgement and ultimate payment of the claim are important in the consideration of:

- What payments will be made in the respective levy periods,
- Investment income earned from the receipt of levy monies to the payment of claims and AFCA fee reimbursements, and
- Indexing of AFCA fees.

We have relied on conversations with AFCA and CSLR to understand the likely operational plan to execute on claim payments. AFCA have provided us with details of their current workforce solution, including the expected timings of projects to progress paused complaints for DASS and other firms in a phased approach. The CSLR has also provided details on the expected time between receiving a CSLR lodgement, to payment of the claim.

5.9.1 Investment income

We have assumed that the 1st & 2nd Levy Period monies will be invested conservatively (which must be the case by law) during the delay from receipt of the levy to the payment of claims and other amounts. We further discuss our estimate of investment income in Section 8.1.

5.10 Other Levy components

The legislation prescribes a number of additional components to be included in levy estimates, which were outlined in Table 3.1. These additional components, including our approach to estimating and allocating by sub-sector, are outlined in Table 5.2.

Table 5.2 – Additional levy components

Component	Description	Approach
Capital Contribution	The legislation prescribes for a capital contribution of $5,000,000 to be made evenly across the first three post-CSLR Levy Periods.	For the 1st & 2nd Levy Periods, this amounts to $1,666,667 each. We apportion this capital contribution equally across the four sub-sectors.

[13] As detailed at https://www.afca.org.au/members/funding-model/user-charge

CSLR Operating Costs	The CSLR operating costs incurred in each levy period are included in the post-CSLR levy estimate. For the 1st & 2nd Levy Periods, a material portion of these costs will relate to time spent on pre-CSLR claims.	We were provided with expected CSLR operating costs for the 4 years to 2026/27. We have allocated the operating costs for 2023/24 and 2024/25 to the 1st & 2nd Levy Periods respectively. Our first step was to identify the 'surge' costs[14] related to the processing of DASS claims and allocated them entirely to Financial Advice. We then allocated the remaining operating expenses by referencing a 'fixed' and 'variable' proportion. The fixed component of the operating expenses was equally split across the four sub-sectors. The variable component of the expenses was allocated to each sub-sector based on the number of CSLR claims (including pre-CSLR claims) expected to be processed during each levy period.
ASIC Costs	ASIC's costs in levying Financial Firms on behalf of CSLR is to be included in the 2nd Levy Period and subsequent annual levies.	We were provided with the expected ASIC costs in managing levies. As per legislation, ASIC costs will not apply in the administration of the 1st Levy Period as this is a Commonwealth payment. We apportioned the ASIC costs equally across the four sub-sectors.

The legislation requires that the apportionment of these levy components to sub-sectors to have regard to actuarial principles. Actuarial principles include considering financial soundness, sustainability, fairness, simplicity, and materiality of alternate apportionment approaches; though it does not lead to one 'optimal' solution. Finity, with CSLR's management and Board, have considered appropriate approaches to apportionment of the other levy components. The approach adopted reflects the outcomes of these considerations.

5.11 Board Policy

The estimation of the 1st & 2nd Levy Period amounts in this Report has been determined in accordance with Board Policy, specifically the "Policy for Determination of Estimates for First and Second Levy Periods".

The Board Policy sets out the Board's principles in determining the 1st & 2nd Levy Period amounts consistent with the obligations and objectives of the legislation. Specifically, we note the following statements from the Board Policy:

- *Make separate estimates for complaints finalised and claims arising from the failure of identified known large Financial Firms and other claims;*
- *Separately estimate the number of AFCA 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:*

[14] CSLR plans to engage an external provider for a period to help process a surge in DASS claims resolution

- > *are not on the database because they have not been notified;*
- > *have an incorrect notification date;*
- > *are recorded as another type of financial service, but will be ultimately determined as covered by the Scheme; and*
- > *are against Financial Firms that are not known to have failed but will fail prior to the end of the Levy Period;*

- *Include a reasonable allowance for investment income that is expected to be earned on the balance of amounts received by the CSLR, from receipt until expenditure; and*
- *Utilise the quantitative and qualitative information that is available, and then make reasoned actuarial judgements about the parameters for the estimates.*

The legislation sets out a series of adjustment mechanisms to address shortfalls, if these were to occur. Further, it would be reasonable to conclude that desirable public policy principles include not creating unnecessary financial burden and, where possible, to provide stable and predictable levies to industry.

Considering the Board Policy, our approach where there is uncertainty is to make reasonable estimates of outcomes in a reasonably favourable future environment. In particular no allowance is included for the possibility of higher than normal failure rates or claim costs, even on an average basis. The scheme design is for any unexpectedly large costs to be recovered from future levies once the relevant events are known.

Uncertainty and sensitivities in respect of the 1st & 2nd Levy Period amounts is discussed further in Section 10 of this report.

6 Estimate of Claim Costs

In this section, we document the estimate of the claim costs paid by the CSLR, arising from post-CSLR complaints, for each of the 1st & 2nd Levy Periods. We separately consider the expected costs associated with DASS complaints from the complaints relating to other Financial Firms.

6.1 In-scope reported complaints already identified

Table 6.1 shows the number of in-scope, post-CSLR complaints relating to DASS and other Financial Firms, along with the total complaint amounts reported as 'lost' by the complainants[15].

These 316 complaints have been identified in the AFCA complaints data through their service channel. They are the complaints in Group (1) of Table 5.1.

Table 6.1 – Reported in-scope complaints and complaint amounts

	Number of in-scope complaints			In-scope complaint amount ($000)		
	Open	Closed[2]	Total	Open	Closed[2]	Total
DASS personal financial advice[1]	265	-	265	44,532	-	44,532
Other personal financial advice	25	2	27	4,828	48	4,876
Credit provision	18	1	19	36	-	36
Credit intermediation	-	-	-	-	-	-
Securities dealing	5	-	5	114	-	114
Total	313	3	316	49,509	48	49,557

[1] All DASS complaints relate to personal financial advice

[2] Closed complaints that haven't been paid by the financial firm, but excluding complaints with nil outcome amounts

DASS dominates the cohort of open complaints, both in terms of the number of complaints and the total amount claimed by complainants in-scope for the CSLR.

In the remainder of this section we detail the estimation of the cost to CSLR of these in-scope reported complaints. We also work through the more challenging task of estimating the number and cost of CSLR claims arising from complaints not currently identified in this way, but that could ultimately lead to successful claims against the CSLR if and when:

- A complaint against an already failed in-scope Financial Firm arises after the data extraction date
- A currently active Financial Firm in an in-scope sub-sector fails
- A complaint against a known failed firm is subsequently determined to be in-scope for CSLR, generally because the nature of the financial service and cause of the loss are not yet accurately identified.

6.2 Groups (1) and (2): DASS Complaints

A more detailed analysis was undertaken, and substantial effort was spent, in understanding the particulars of the complaints against DASS and the nature of the DASS administration process; as set out in Section 4.

[15] Note that a proportion of complaints do not have a loss amount nominated by the complainant

6.2.1 DASS: Claim probabilities – number of CSLR claims paid

This section estimates how many CSLR claims will eventually be paid from the 265 open post-CSLR DASS complaints, and the number of CSLR claims that will arise from DASS complaints that have not yet been reported.

There have been no post-CSLR DASS complaints that have closed.

Probability of a non-zero determination in favour of the complainant

In the AFCA complaint database there are 24 DASS complaints (reported prior to announcement of the CSLR) that record an outcome, of which 20 are closed and 4 open. We assessed these complaints even though they are mainly now quite old and probably not representative of the currently open complaints.

Of these 24 complaints, 4 were withdrawn, 1 had no compensation awarded and 1 was out-of-scope. This left 18 with a non-zero monetary outcome in favour of the complainant, representing 75% of the 24 complaints.

We consider this to be a lower-bound for the probability of a non-zero Outcome for a DASS complaint as the majority of these complaints were resolved prior to the failure of DASS and were generally the subject of negotiation between parties. All remaining open complaints will proceed to determination by AFCA.

From our understanding of the nature of the losses incurred by clients of DASS, as set out in Section 4, it is reasonable to assume that the vast majority (particularly URF investors) will be successful in achieving a non-zero monetary determination in their favour.

We have assumed that all the open DASS complainants will be awarded a non-zero determination in their favour (i.e. a 100% chance).

Propensity to claim

As the CSLR has not yet become operational, we have no direct experience of the actions of complainants who have received a non-zero determination that remains unpaid. Hence, we were not able to reference relevant experience and judgement was relied on to establish a basis.

While it is unrealistic to assume that every single complainant able to lodge a CSLR claim will do so, we believe that in the specific case of DASS a very high proportion will do so. This is based on consideration of:

- The scale of the losses from the URF that implies the losses incurred by complainants would generally be significant in the context of their original investment
- CSLR's stated objective of making the process of submitting a claim as simple as possible
- The recent development in the class action matter
- The publicity surrounding DASS, its administration and legal actions being taken against it
- Indications that the Administrators are in contact with each creditor and are including information about CSLR in their communication
- That ASIC directly communicated with clients of DASS in August 2022 to increase the awareness of the situation surrounding DASS and encouraged them to submit a complaint if they hadn't already.

For the purpose of our modelling of post-CSLR complaints relating to DASS, we have assumed that 95% of complainants who receive a non-zero determination in their favour will go on to lodge a claim with CSLR. This is the same assumption adopted in the estimation of the pre-CSLR Levy.

Claim acceptance

Considering the very similar nature of all the outstanding post-CSLR complaints against DASS, as well as reflecting on discussions with AFCA and CSLR, we selected a 100% probability that CSLR will accept and pay a DASS claim following an application.

Table 6.2 summarises the assumptions for claim probabilities relating to post-CSLR DASS complaints that have the potential to be covered by the 1st & 2nd Levy Periods.

Table 6.2 – DASS claim probability selections

Financial Firm	Probability > $0 determination	Propensity to claim	Claim acceptance	Probability of successful claims
DASS	100%	95%	100%	**95%**

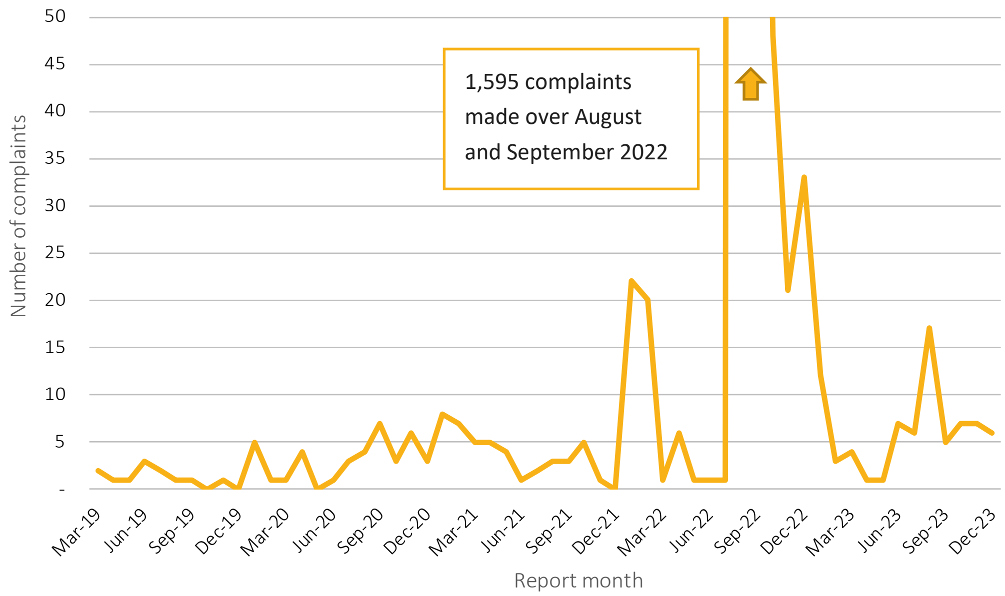
Hence, overall, we assume that 95% of the post-CSLR DASS complainants will have a successful claim against CSLR.

Future complaints

We expect that there will continue to be complaints made against DASS in the months after the AFCA extract date, with reasonable probability of payment over the 1st & 2nd Levy Periods.

The number of DASS complaints made by report month is shown in Figure 6.1. There has been a notable decrease in the number of DASS complaints made in the year following the ASIC notice in August 2022. A small number of complaints continue being received each month.

Figure 6.1 – DASS complaints by report month



We have assumed an additional 25 complaints will be reported, which reflects reducing levels of complaints lodged with AFCA in the periods leading up to the data extraction date. For these additional 25 complaints we assume that 95% will result in a successful claim against the CSLR, consistent with the assumption for the known post-CSLR DASS complaint cohort.

The number of future reported claimants is uncertain; it is dependent on factors outside of AFCA and CSLR's control. Section 10.3 shows a plausible outcome where the number of future reported claims is higher. As discussed in Section 5.11, we have not assumed higher than normal rates in our assumptions because (a) adjustment mechanisms are available if experience turns out to be materially higher than assumed, and (b) complaints reported towards the end of 2024 are unlikely to progress to CSLR during the 2nd Levy Period.

Table 6.3 – DASS: AFCA complaints and successful CSLR claims

	Number of complaints	Probability of successful claim	Number of successful CSLR claims
Reported DASS complaints	265	95%	252
Future DASS complaints	25	95%	24
Total DASS complaints	290	95%	276

We estimate there will be 276 successful CSLR claims for DASS in the post-CSLR period.

6.2.2 DASS: Average cost of claims, including Outcome Amount and Recoveries

Outcome Amount

As outlined in Section 5.3.2, we apply a factor, γ, to the average amounts entered by complainants as their loss when lodging their complaint with AFCA.

Directly referencing the 18 closed DASS complaints with non-zero outcome amounts gives a γ estimate of 104%. We believe it underestimates the likely value of γ for open DASS complaints because:

- These complaints pre-date the administration process and at a time when DASS was able to engage with AFCA in the complaint resolution process
- The nature of the losses incurred by URF, as well as the method of loss estimation by AFCA, mean that it is expected that γ increases over time between the investment and determination of the complaint.

AFCA's approach to measuring investment losses is particularly important for DASS complaints. The Administrators have been clear that they have estimated only the direct investment loss (buy price minus dividends and sell price) as the amount of debt.

AFCA, on the other hand, estimates an opportunity cost, being the difference between the actual position of the complainant and what it would likely have been if the misconduct had not occurred. The loss estimation therefore includes two extra components to the direct investment loss:

- The investment earnings that would otherwise have been earned during the period that the misconduct continued to apply (i.e. until disposal of the investment)
- Interest awarded from the disposal date to the determination date, calculated at a rate equal to the change in CPI.

To estimate the lost investment earnings AFCA sometimes uses a counter-factual of the complainant investing in the Vanguard Balanced Fund. We have assumed that this approach would be applied to DASS clients.

While we do not have any information about individual investments, the Administrators' Report shows the peak time for investments into URF was in 2015 (when the price was at its maximum) and the peak time for sale of URF investments was 2022 (when the price was at its minimum). By applying the AFCA counter-factual and interest to an investor in this scenario gives an estimate of the likely AFCA determination amount in the order of 140% of the direct investment loss.

With this significant contribution to potential CSLR claim amounts, we have estimated DASS claims as 120% of the claim amount provided by the complainant. This assumes that many claimants would have recorded their loss as the amount advised to them by the Administrators for the purpose of voting at the creditors meeting. This compares to 140% adopted in the estimation of the pre-CSLR levy amount; the lower assumption adopted in this Report reflects our application of the Board Policy applying to the annual levies.

For those complaints with a loss amount recorded, the CSLR claim is estimated by taking 120% of the loss recorded by the complainant and then applying the $150,000 cap per claim. The result is an estimated average CSLR claim amount of $121,000.

As noted above there are complaints where the claimed amount on the dataset is blank, noting the complainant is not required to enter a value. For these complaints we considered whether to use the same average claim amount of $121,000, but considered that complainants with larger losses were more likely to have included a complaint amount. Based on this, and after referencing the distribution of loss amounts in the Administrators' Report, we assessed that the average claim size arising from the complaints without a loss amount (about 20% by number) would likely be lower than the average of DASS complaints where a value is entered. We have selected a capped average claim amount of $85,000, having also looked at the results of a number of other size distributions.

Consistent with this reasoning, we have also assumed that investors with larger losses are more motivated to lodge their complaints, and therefore the complaints that remain unreported at the time of preparing this report (but that will emerge by April 2024) would have further reduced size. We have applied a $42,500 average claim size for the future reported claims, being half of the $85,000 assumed for reported complaints.

The overall average claim size for DASS is $107,000, combining those with and without a recorded loss amount, and those that will be reported in the future.

Offsets and recoveries

As noted in Section 5.7, we have assumed that the CSLR payment will be reduced by 1% of the claim costs, from offsets and recoveries against DASS claims.

6.2.3 DASS: Expected Claim Costs

Our assumptions for claim probabilities, outcome amounts, capped claim amounts and recoveries combine to estimate the net claim cost arising from post-CSLR complaints against DASS, as shown in Table 6.4. This includes known and future reported complaints.

Table 6.4 – DASS: summary of expected net claim costs

Financial firm	Number of AFCA complaints	Number of successful CSLR claims	Average capped claim amount ($000)	Expected claim cost capped ($000)	Recoveries ($000)	Net claim cost ($000)
DASS	290	276	107	29,509	(295)	29,214

We estimate that, after taking account of potential recoveries, the net CSLR claim costs relating to post-CSLR complaints against DASS is likely to be approximately $29.2m.

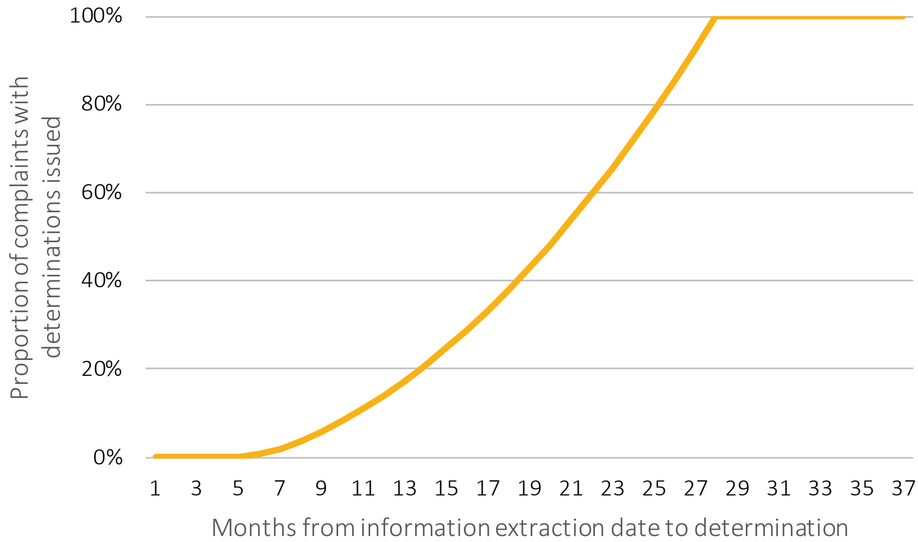
6.2.4 DASS: Expected Determinations Timing

In order to estimate the 1st & 2nd Year levies, we need to allow for the expected timing of both the complaint resolution process and the claim payment process to estimate how much of the ultimate costs are likely to be paid in the relevant levy periods.

This section discusses the expected timing of DASS determinations. The additional time between AFCA issuing a determination and the CSLR payment is discussed in Section 6.6.

Figure 6.2 shows the assumed time from the data extract date to determination for reported DASS complaints.

Figure 6.2 – DASS: Timing of determinations



As outlined in Section 5.1.2, our considerations of the time to determination has been informed by discussions with key AFCA personnel. For reported DASS complaints, we have assumed a pattern based on planned AFCA workforce solutions, with the CSLR looking to employ an external vendor to help with the surge in expected DASS claims.

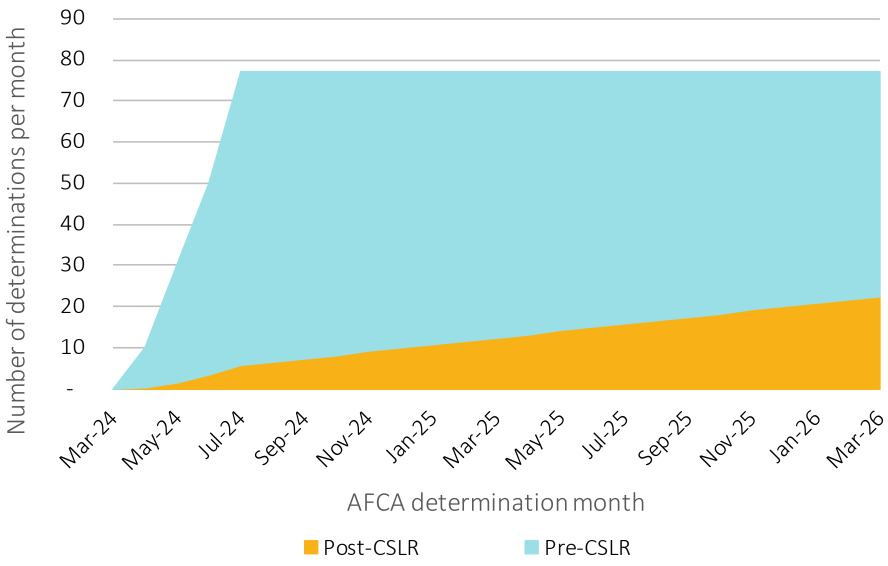
We have applied a judgemental overlay to the timing indications provided by AFCA, reflecting our understanding of the 'start-up' nature of these operations.

We assume that the operating approach for DASS complaints will be tested on a small number of claims over April and May 2024, which are the first two months of the CSLR. Once the process is established, DASS determinations will progress at a steady rate over FY25 and FY26. Note that the workforce solution is planned to cover the processing of all DASS complaints lodged after the ASIC media release in August 2022, which includes 1,512 complaints in the pre-CSLR cohort, 265 complaints reported to date in the post-CSLR cohort and any future complaints.

AFCA has indicated that for DASS complaints, they are likely to be able to identify cohorts of complaints with similarities that may be considered together. This means that DASS complaints will not all be processed in the order that they were lodged, and that some post-CSLR DASS complaints may be processed together with pre-CSLR DASS complaints.

We have allowed for known post-CSLR DASS complaints to be processed concurrently with pre-CSLR DASS complaints, with the proportion of post-CSLR DASS complaints increasing over time. This is shown in Figure 6.3, which outlines the assumed pattern of processing for both pre-CSLR and post-CSLR DASS complaints that were lodged on or after 7 September 2022.

Figure 6.3 – Assumed DASS complaint processing



We assume that by July 2024 AFCA has established operating processes and will make determinations on 77 DASS complaints per month until all known complaints are processed by March 2026. We allow for the proportion of post-CSLR DASS complaints processed per month to increase over time, from 6 processed in July 2024 up to 22 processed in March 2026. These assumptions imply that, of the 265 post-CSLR DASS complaints reported so far, 43% will be determined by FY25 and 57% in FY26.

We assume that unreported DASS complaints will be processed, on average, after the existing backlog (with the majority of payments made after the 1st and 2nd Levy Periods).

6.3 Groups (1) and (2): In-scope known and unreported complaints for Other Financial Firms that have already failed

We consider the 51 complaints currently identified, and estimate the number of CSLR claims that will arise from unreported complaints for other Financial Firms that have already failed.

6.3.1 Other Financial Firms: Claim probabilities

Probability of a non-zero determination in favour of the complainant

Directly referencing closed complaints relating to other Financial Firms yields an estimate of the probability of receiving a non-zero determination of approximately 40%[16].

For similar reasons as outlined for DASS complaints, we believe this will likely understate the probability of a non-zero determination for the open complaints as the Financial Firm is unable to play an active part in the resolution and negotiation of complaint outcomes through AFCA's complaint process. The open complaints are also likely to be later in time and more likely to be related to the difficulties that led to failure of the Financial Firm.

[16] Based on analysis of AFCA's complaint history data, for closed complaints relating to in-scope failed Financial Firms other than DASS.

We have assumed a 50% chance that an open in-scope complainant against a failed firm will be awarded a non-zero determination in their favour. The corresponding assumption in the pre-CSLR levy estimate was 65%, the difference arising from applying the Board Policy.

For closed complaints, we have relied on the complaint outcome; that is, for complaints with a positive determination we have adopted a 100% probability, and for complaints with a nil determination we have adopted a 0% probability.

Propensity to claim

As the CSLR has not yet become operational, there is no direct experience of complainants who had received a non-zero determination in their favour and then lodged a claim with CSLR.

For the modelling of post-CSLR complaints for these firms, we have assumed that 95% of complainants who receive a non-zero determination in their favour will lodge a claim with CSLR.

Claim acceptance

We expect that a complainant with a non-zero determination who then goes on to lodge a claim with CSLR has a very high chance that the claim will be accepted by CSLR. We have assumed 100% for the modelling, consistent with the corresponding assumption used for DASS.

Table 6.5 summarises the assumptions for claim probabilities relating to open post-CSLR complaints against other Financial Firms.

Table 6.5 – Claim probabilities: Other Financial Firms

Type	Probability > $0 determination	Propensity to claim	Claim acceptance	Probability of successful claims
Open	50%	95%	100%	**48%**
Closed	100%	95%	100%	**95%**

Overall, we assume that 48% of the open in-scope complaints and 95% of the closed in-scope complaints with a positive determination will result in a claim being paid by CSLR.

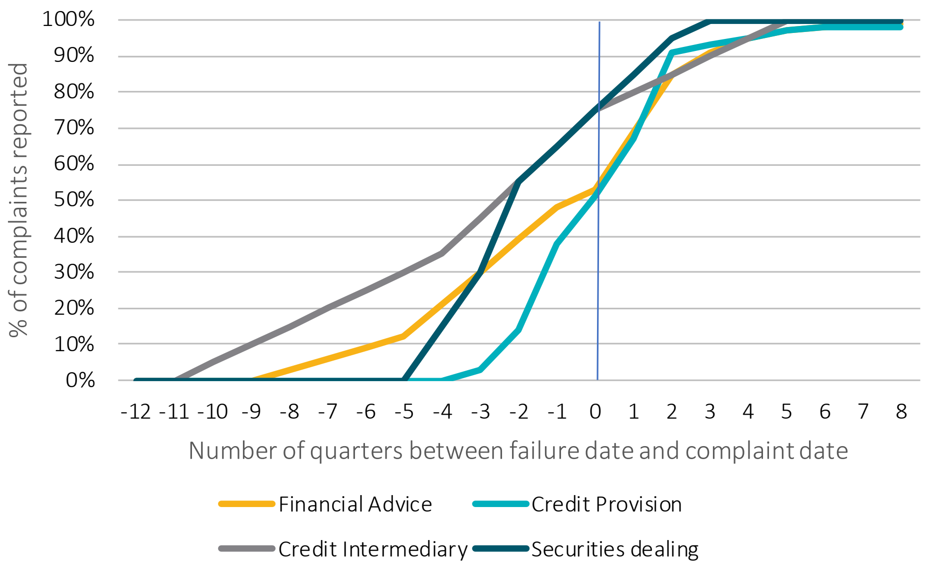
Future complaints

Generally speaking, complaints that ultimately remain unpaid and become subject to a potential CSLR claim often build up prior to the failure of the Financial Firm, and then continue to be lodged after the firm's failure. Hence for recently failed firms, there is the potential for complaints to be lodged in the near future that could become the subject of a CSLR claim.

To understand the likely unreported complaints that could emerge from already failed Financial Firms, we referenced the historical complaint distributions from previously failed Financial Firms. Figure 6.4 shows how complaint report dates were distributed around the date of failure[17] of the Financial Firm for the aggregated failure experience of each sub-sector. Note that we have only considered complaints that were open at the point of failure, or were reported after failure; complaints finalised before the failure date have been excluded.

[17] Failure date was sourced from ASIC's insolvency statistics publications for all Financial Firms that failed between 1 November 2018 and 18 December 2023.

Figure 6.4 – Time between firm failure date and complaint date for complaints open or reported after failure date



We observe that many of the relevant complaints are reported well before the failure date of the firm. In the Financial Advice and Credit Intermediary sub-sectors, at the point of failure, some of the complaints had been open for up to 2 or 3 years respectively.

We also observe that at the time of firm failure, around 50% of the relevant complaints had been reported for the Financial Advice (excluding DASS) and Credit Provision sub-sectors. For Securities Dealing and Credit Intermediary, this was higher, at 75%. Complaints that emerge after the failure date are typically reported within a year.

In estimating the number of unreported claims that may arise from already failed Financial Firms, we have applied this distribution of complaints timing. For each failed firm, we consider how much time had elapsed between the failure date and the data extraction date, and therefore how many unreported claims are expected to emerge after the data extraction date. Table 6.6 shows our estimate of the unreported complaints.

Table 6.6 – Number of future complaints, by sub-sector

	Financial Advice			Credit Provision			Credit Intermediation			Securities Dealing		
Year of firm failure	No. complaints open at or reported after failure	Reported to date %	Unreported complaints	No. complaints open at or reported after failure	Reported to date %	Unreported complaints	No. complaints open at or reported after failure	Reported to date %	Unreported complaints	No. complaints open at or reported after failure	Reported to date %	Unreported complaints
Prior	206	100%	-	4	98% -	0.4	8	100%	-	15	100%	-
2022	6	97%	0.2	3	98%	0.1	1	100%	-	0	100%	-
2023	20	58%	14.3	18	92%	1.5	1	92%	0.1	2	91%	0.2
Total	232		14.4	25		1.1	10		0.1	17		0.2

Overall, we assume there are 16 unreported complaints from other Financial Firms that have already failed.

We have assumed the same claim propensities as shown in Table 6.5 apply to this claim cohort; i.e. that 48% of future complaints relating to already failed Financial Firms will result in a successful claim against the CSLR.

Table 6.7 shows the expected number of post-CSLR claims that will arise from known and future in-scope complaints related to other Financial Firms that have already failed.

Table 6.7 – Other Financial Firms: AFCA complaints and successful CSLR claims

	Number of complaints	Probability of successful claim	Number of successful CSLR claims
Open in-scope reported complaints from other Financial Firms	48	48%	23
Closed in-scope reported complaints from other Financial Firms with positive outcome amounts	3	95%	3
In-scope future complaints from other Financial Firms	15	48%	7
Total in-scope complaints from other Financial Firms	66	50%	33

We estimate that, in total, there will be 33 successful CSLR claims in the post-CSLR period for other Financial Firms that have already failed.

6.3.2 Other Financial Firms: Average cost of claims

Outcome and Claim Amount

As outlined in section 5.3.2, our preferred approach is to apply a factor, γ, to the average amounts entered by complainants as their loss when lodging their complaints with AFCA. This is only possible if a suitable representative group of complaints can be identified to estimate the reported loss amounts.

One observation we could make is of closed complaints for failed Financial Firms in the four relevant sub-sectors. Table 6.8 summarises the results for this history, while noting that the sample sizes are small.

Table 6.8 – Other Financial Firms: summary of Outcome to Complaint ratio (gamma)

Sub-segment	Number of complaints	Average complaint amount	Average outcome amount	Gamma (γ)
Personal financial advice	52	168,326	124,936	74%
Credit intermediation	4	251,406	145,279	58%
Credit provision	57	3,294	2,184	66%
Securities Dealing	1	171,500	48,500	28%
Total	114	88,753	63,603	72%

Our observations from this analysis are:

- That the outcome amounts were, on average, somewhat below the reported loss amounts (72% overall)
- That the financial advice and credit intermediation cases have a high average outcome amount, well in excess of $100,000
- That the complaints regarding credit provision resulted in a small average outcome of around $2,200.

Based on the above analysis of historical outcome amounts, we have assumed that the average claim amount would be 75% of the average reported loss where it is available (i.e. γ = 75%), and that the average for those that did not have a reported loss amount would be the same as for those that did. This compares to a γ of 100% assumed in the pre-CSLR Levy estimate; the lower assumption adopted reflects the application of the Board Policy (see Section 5.11).

The average complaint amount and the average capped CSLR claim size, for currently open in-scope complaints relating to Financial Firms excluding DASS, is shown in Table 6.9.

Table 6.9 – Other Financial Firms: average capped claim size

Sub-segment	Average complaint amount ($000)	Average capped amount ($000)
Personal financial advice	345	112
Credit intermediation	-	-
Credit provision	3	2
Securities Dealing	23	17
Total	166	56

For this cohort, the average reported complaint amount is $166,000, with high average complaint amounts for financial advice of $345,000, and much lower complaint amounts averaging less than $25,000 for credit provision and securities dealing. There are no reported complaints for credit intermediation. After applying the γ assumption of 75% and the $150,000 per-claim cap (which applies to the majority of the reported financial advice complaints), the average capped CSLR claim amount is around $56,000.

For future in-scope complaints relating to Other Financial Firms that have already failed, we have assumed an average claim size of $100,000 for all sub-sectors other than credit provision, for which we have assumed $3,000. This is broadly consistent with the historical outcome amounts shown in Table 6.8, after considering the impact of the $150,000 claim cap.

Offsets and recoveries

We have assumed that offsets and recoveries will reduce the gross claims costs by 10%, for complaints related to Other Financial Firms. There is no specific information available to consider this assumption. Offsets reduce the amount paid by CSLR, while any recoveries are assumed to be received at least a year after the CSLR commences operations. We were unable to identify any practical way that we could obtain any relevant evidence.

6.3.3 Other Financial Firms: Expected Claim Costs

Table 6.10 summarises the modelled claim costs for already failed Financial Firms, excluding DASS. This includes known[18] and future reported complaints.

Table 6.10 – Other Financial Firms: summary of expected net claim costs

Sub-sector	Number of AFCA complaints	Number of successful CSLR claims	Average capped claim amount ($000)	Expected claim cost capped ($000)	Recoveries ($000)	Net claim cost ($000)
Financial Advice (non-DASS)	41	21	101	2,112	(211)	1,901
Credit Provision	20	10	2	20	(2)	18
Credit Intermediary	0	0	100	4	(0)	4
Securities Dealer	5	2	20	49	(5)	44
Total	66	33	65	2,185	(219)	1,967

We estimate that, after potential recoveries, the net CSLR claim costs relating to in-scope complaints against Other Financial Firms that have already failed would be approximately $2.0m.

[18] Known complaints include open complaints and closed complaints that haven't been paid by the financial firm. Closed complaints exclude complaints with nil outcome amounts.

6.3.4 Other Financial Firms: Expected Determinations Timing

As outlined in Section 5.1.2, we referenced discussions with key AFCA personnel when considering the likely timing to determination. AFCA will resume determinations from January 2024 for reported complaints on already failed firms other than DASS that were previously paused, with complaints processed in accordance with 'business-as-usual' AFCA practices. For this known cohort of complaints, we have assumed that 7% of determinations will occur each month starting in January 2024. We assume that all complaints in this cohort will have determinations issued by March 2025.

For unreported complaints on already failed firms, we have considered the timing between complaint lodgement and determination, and assumed the same determinations pattern that applies to the known complaints with a 2 month delay. That is, we assume that processing on other Financial Firms were, on average, progressed by 2 months at the time that AFCA paused determinations.

6.4 Groups (3) and (4): Future firm failures

Another source of potential unreported, in-scope complaints is from Financial Firms that fail after the data extraction date. This section estimates complaints that were reported but remained unpaid at the point of failure, as well as complaints that arise after failure.

6.4.1 Future firm failures: Expected Claim Costs

Table 6.11 shows the total number of firms that have failed over AFCA'S 5-year history, and the number of complaints that were open or reported after the failure date. For the purposes of considering the longer-term experience we have excluded DASS complaints from the below analysis.

Table 6.11 – Number of complaints from known historical insolvencies per year and sub-sector

Sub-sector	Total insolvencies[1]	Average insolvencies per year[1]	Total complaints [2] [3]	Average number of complaints per insolvent firm[3]	Average future firm failure complaints per year[3]
Financial Advice	21	4.2	232	11.6	48.7
Credit provider	6	1.2	25	4.2	5.0
Credit intermediary	3	0.6	10	3.3	2.0
Securities dealer	4	0.8	17	4.3	3.4
Total	34	6.8	284	8.7	59.1

[1] Including DASS insolvency
[2] Complaints open at or reported after failure date
[3] Excluding DASS complaints (as volume of complaints would skew the average)

There have been 34 insolvencies within in-scope sub-sectors, or an average of around 7 per year. Financial Advice makes up over half of these insolvencies.

Financial Advice also has the highest number of complaints per firm that are unpaid or unreported at failure date. For this sub-sector, we have assumed that 4.2 firms will fail on average every year with an average of 11.6 complaints per firm, consistent with the historical experience. This means we expect 48.7 in-scope complaints to arise from Financial Advice firms that will fail each year.

For the other sub-sectors, we expect around 1 firm to fail each year, with around 4 complaints per failed firm.

In total, we assume that around 59 in-scope complaints will arise each year from future firm failures, for both reported complaints as well as complaints that emerge after the failure date.

Consistent with the future complaints arising from other Financial Firms that have already failed, we have assumed that:

- 48% of complaints arising from future firm failures will lead to a CSLR claim (see Section 6.2.1)
- Average claim sizes of $100,000 for all sub-sectors other than credit provision, which has an average claim size of $3,000 (see Section 6.3.2).

For the purposes of determining the 1st & 2nd Levy Period estimates, we have projected the expected complaints relating to future firm failures through to June 2025 (as complaints raised after this point will, if successful, have CSLR payments that fall in subsequent annual levy periods). Table 6.12 summarises the modelled claim costs for future firm failures to June 2025. This includes known and future reported complaints. Note that figures in this table have been rounded.

Table 6.12 – Future firm failures: summary of expected net claims costs

Sub-sector	Number of AFCA complaints	Number of successful CSLR claims	Average capped claim amount ($000)	Expected claim cost capped ($000)	Recoveries ($000)	Net claim cost ($000)
Financial Advice (non-DASS)	75	36	100	3,558	(356)	3,202
Credit Provision	8	4	3	11	(1)	10
Credit Intermediary	3	1	100	137	(14)	123
Securities Dealer	5	3	100	256	(26)	230
Total	91	43	92	3,961	(396)	3,565

We estimate that, after potential offsets/recoveries and excluding unpaid AFCA fees, the net CSLR claim costs relating to future firm failures between December 2023 and June 2025 to be approximately $3.6m.

6.4.2 Future firm failures: Timing of determinations

For complaints on firms that have not yet failed, we consider the timing from failure date of the firm to determination. This applies to both reported complaints at the time of failure (as complaints, even if known, do not become eligible for the CSLR until the firm fails) as well as unreported complaints that emerge after the failure date.

Noting that around 50% of complaints that are determined after failure of a firm are reported by the time of failure (see Section 6.3.1), we have assumed the same delay as between complaint lodgement date and determination date for already failed Other Financial Firms, with 4 months delay to allow for reasonable steps to be taken for offsets/recovery and other insolvency proceedings. That is, we assume that no determinations occur for the first 7 months after a firm fails, after which 7% of complaints are processed each month over the following 14 months.

6.5 Group (5): Out-of-scope complaints relating to already failed firms

We were able to identify failed Financial Firms with open complaints that, while not flagged as in-scope, could be in-scope following investigation. About 30% of these complaints were for Youpla Group funeral funds, which we considered to be out of scope.

The remaining complaints were typically related to investments, and could possibly be related to financial advice. We have assumed that 25% of reported out-of-scope complaints relating to already failed firms (other than Youpla complaints) would subsequently be found to be in scope, of which 50% would have a positive AFCA determination and lodge a successful CSLR claim. This is an allowance of 18 claims.

Table 6.13 summarises the modelled claim costs for out-of-scope known complaints. Note that figures in this table have been rounded.

Table 6.13 – Out-of-scope known complaints: summary of expected net claims costs

Sub-sector	Number of AFCA complaints	Number of successful CSLR claims	Average capped claim amount ($000)	Expected claim cost capped ($000)	Recoveries ($000)	Net claim cost ($000)
Financial Advice (non-DASS)	4	0	66	31	(3)	28
Credit Provision	-	-	-	-	-	-
Credit Intermediary	81	8	58	457	(46)	412
Securities Dealer	78	9	100	925	(93)	833
Youpla - out of scope	64					
Total	227	18	80	1,414	(141)	1,272

We estimate that, after potential offsets/recoveries and excluding AFCA fees, the net CSLR claim costs relating to out-of-scope reported complaints on already failed firms to be approximately $1.3m.

6.6 Timing of CSLR claim payments

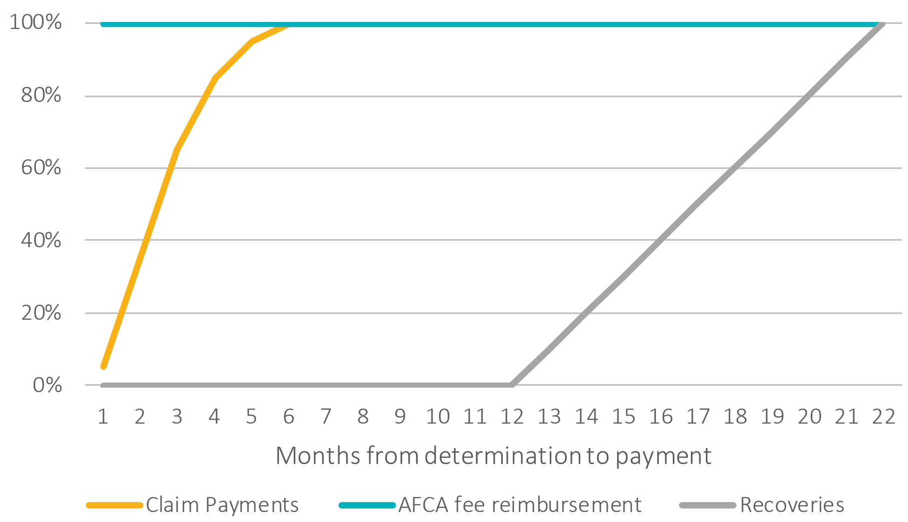
So far in this section we have estimated the ultimate cost that emerges from the cohort of post-CSLR complaints that have the potential to be covered by the 1st & 2nd Year Levies, and discussed the assumed timing of AFCA determinations (which drives the payment of AFCA fees).

In order to estimate the 1st & 2nd Year levies, we then need to apply expected delays from the AFCA determination to CSLR claim payment, to determine which claim payments are likely to be made in the relevant levy periods, i.e.:

- For the 1st Year Levy: payments made from 2 April 2024 to 30 June 2024
- For the 2nd Year Levy: payments made from 1 July 2024 to 30 June 2025.

The following chart shows the assumed time from AFCA determination to CSLR payment.

Figure 6.5 – Cumulative payment pattern – time from determination to payment



As detailed in Section 5.1.2, the timing of the various claim processing activities has been informed by discussions with key AFCA/CSLR personnel. We have selected the following patterns from AFCA determination date to CSLR claim payment date:

- CSLR claim payments: This is based on CSLR's expected process timings, and indications we've received from AFCA and CSLR on the likely delays while a claimant decides to accept the AFCA determination outcome and proceed with a CSLR claim.

  We have assumed the same pattern across all claim cohorts.
- AFCA fees: We assume AFCA fees are paid in the same month that a complaint is finalised (further discussed in Section 7).
- Recoveries: We assume that recoveries will not start being received until at least 6 months after payment, based on our understanding of the general complexities surrounding recovery processes.

A summary of the pattern of payments by quarter is shown in Section 9.1.

6.7 Expected Claim costs for 1st & 2nd Levy Periods

Table 6.14 and Table 6.15 show the total claims cost discussed in Sections 6.2 to 6.6 by claim cohort and by sub-sector respectively, net of offsets and recoveries. Note that the tables only show the expected net claims costs relating to firms that fail by 30 June 2025. The -$0.1m expected from Group (5) claims is due to recoveries received after the 2nd Levy Period.

Table 6.14 – Total expected net claims cost for 1st & 2nd Levy Periods by claim cohort ($000)

Claim cohort	1st levy period	2nd levy period	Contribution to subsequent levy periods	Total
Group (1) & (2): DASS	91	9,383	19,739	29,214
Group (1) & (2): Other FF	337	1,480	149	1,967
Groups (3) & (4): Future firm failure[1]	-	605	2,960	3,565
Group (5): Reported out-of-scope, failed firm	288	1,043	(58)	1,272
Total	**716**	**12,512**	**22,790**	**36,018**

[1]Firms that fail by 30 June 2025

Table 6.15 – Total expected net claims cost for 1st & 2nd Levy Periods by sub-sector ($000)

Sub-sector	1st levy period	2nd levy period	Contribution to subsequent levy periods	Total
Financial Advice - DASS	91	9,383	19,739	29,214
Financial Advice - non-DASS	331	1,995	2,805	5,131
Credit Provision	4	15	9	28
Credit Intermediary	93	360	85	538
Securities Dealer	197	759	151	1,107
Total	**716**	**12,512**	**22,790**	**36,018**

DASS complaints continue to account for a significant portion of the Levy Period estimates, comprising 70% of the combined 1st and 2nd Levy Period estimated claim payments.

These results are combined with the other components of the levy estimate in Section 9.

7 Estimate of Unpaid AFCA Fees

7.1 AFCA's normal fee structure

AFCA derives its revenue from membership fees, case fees and user charge fees. The case fees are based on the stage to which the complaint proceeded through the complaint process. Table 7.1 outlines the case fees for the 2024 financial year.

Table 7.1 – AFCA fee structure (1 July 2023 to 30 June 2024)

Fee schedule	Fees (ex.GST)
Closed before Referral	$0.00
Rules assessment	$0.00
Registration and Referral	$80.16
Fast Track – Case Management	$951.23
Case Management	$1,865.06
Fast Track – Decision	$2,746.82
Decision	$8,090.82

The user charge fee is determined for each Financial Firm early in the financial year based on the number of complaints closed in the previous year and the stage at which those complaints were closed. There is no standard formula or dollar amount available at this time, and it has not yet been determined how user charge fees will be set for failed firms.

While the normal fee structure is described above, at this early stage of the CSLR, there has been no agreement put in place as to specific measurement and processes for the AFCA fees that will be reimbursed by CSLR. AFCA has indicated that the broad intention is that AFCA would be reimbursed for approximately the cost it incurs (mostly staff costs) in respect of CSLR matters.

We are not aware of AFCA's intentions regarding the potential indexing of fees in future financial years. We have indexed these fees at 3% per annum for financial years beyond FY23-24.

7.2 Estimate of Unpaid AFCA fees for 1st & 2nd Levy Periods

Noting the early stage of development of systems and procedures between AFCA and CSLR, AFCA has provided to us an indication of the fees they anticipate. Note this is a preliminary estimate from AFCA staff, and has not been settled or discussed with the AFCA or CSLR Boards.

The indication from AFCA management is that fees in respect of CSLR complaints, which covers both case and user charge fees, are expected to be in the order of $10,000 to $12,000 per finalised complaint. For the estimate of the 1st Levy Period amount we have included $11,000 (excluding GST, or $12,100 including GST) per complaint finalised. For the estimate for the 2nd Levy Period amount we have indexed the fee by 3%.

AFCA fees for any eligible complaint are recoverable from the CSLR, irrespective of the outcome or whether the complainant makes a CSLR claim. This means that the AFCA fees will arise from a larger number of complaints than the CSLR claims.

The same assumption has been applied for DASS and Other complaints.

This results in an estimate of AFCA unpaid fees in respect of the 1st Levy period of $0.6m and $2.5m for the 2nd Levy period. Table 7.2 shows these estimates across each of the sub-sectors.

Table 7.2 – Unpaid AFCA fees

Type	1st levy period		2nd levy period	
	Number of complaints	AFCA fees ($000)	Number of complaints	AFCA fees ($000)
DASS personal financial advice[1]	4.5	55	116.1	1,447
Other personal financial advice	15.9	193	42.6	531
Credit provision	15.1	155	10.7	162
Credit intermediation	7.1	86	10.1	126
Securities dealing	11.5	139	15.5	193
Total	54.1	627	195.1	2,460

[1] All DASS complaints relate to personal financial advice

8 Other Considerations

8.1 Investment income

8.1.1 Timing of cash flows

The expected pattern of claim payments is an important consideration for post-CSLR levies as levies are intended to cover claim payments made in a year.

For the 1st & 2nd Levy Periods, the timing of claim payments is important in determining whether individual CSLR claims will be covered by each levy period. In Section 6.6 we considered how payment timing influenced the estimation of what complaints would be paid in each levy period. Here we additionally consider the impact of claim payment timing on the investment income generated by the levies.

8.1.2 Receipt of levies

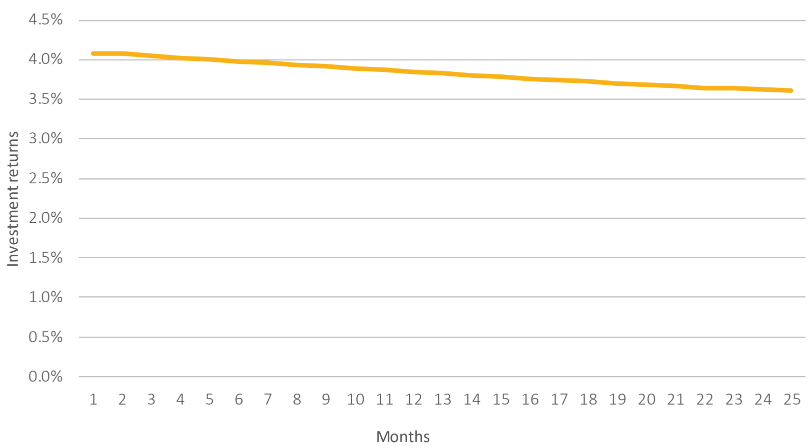
We have made a number of assumptions about the receipt and expenditure of levy monies for the 1st and 2nd Levy periods, specifically:

- The 1st year levy is received by the end of March 2024
- The 2nd year levy is received by the end of September 2024, and all invoiced amounts are received in full
- CSLR and ASIC costs are uniform over their respective levy periods
- Capital contributions remain in the fund over the respective levy periods.

CSLR is able to earn an investment return on the levy monies it receives prior to paying successful claims. We have assumed that levy monies are invested conservatively (as is required under the Corporations Act) and we have applied a low-risk rate of return based on observations of Australian Government Securities at various durations.

Figure 8.1 shows the assumption for investment returns generated by the investment levy monies.

Figure 8.1 – Investment return (months from 1 Jan 2024)



As can be seen, the current risk-free yield curve is sloping downward from between 4.1% to 3.5% p.a. over a two year period. Given the relatively short payment patterns assumed, the impact of investment income is limited. Investment income was estimated as:

- $0.04m for the 1st Levy period

- $0.38m for the 2nd Levy period

These amounts have been allowed for in estimating the net costs to be covered by the 1st and 2nd Period levies.

8.2 Other levy components

The legislation prescribes a number of additional components to be provided for by individual levies. We outlined these in Table 3.1 and discussed the approach to allocation, by year and sub-sector, in Section 5.10.

Table 8.1 shows these additional levy components for each of the 1st & 2nd Levy Periods, by sub-sector.

Table 8.1 – Summary of additional levy components

	1st levy period ($000)				2nd levy period ($000)			
Type	Capital contribution	CSLR operating costs	ASIC costs	Sum of other levy components	Capital contribution	CSLR operating costs	ASIC costs	Sum of other levy components
Personal financial advice	417	1,357	-	1,774	417	4,717	361	5,495
Credit provision	417	171	-	588	417	571	361	1,349
Credit intermediation	417	169	-	586	417	567	361	1,344
Securities dealing	417	178	-	594	417	593	361	1,371
Total	**1,667**	**1,876**	**-**	**3,542**	**1,667**	**6,448**	**1,445**	**9,559**

While the focus of this report is the 1st & 2nd Levy Periods, CSLR will be processing both pre-CSLR and post-CSLR claims at the same time. As discussed in Section 5.10, all CSLR operating costs incurred in each levy period are to be included in the relevant levy estimate for that period.

This means that, for the 1st & 2nd Levy Periods, a material portion of the CSLR operating costs will relate to time spent on pre-CSLR claims.

8.3 GST

The services rendered by AFCA in considering complaints against Financial Firms attract GST. For the estimates of unpaid AFCA fees in this report we have added GST, unless explicitly stated otherwise.

For the estimates of ASIC costs in this report we have added GST.

None of the other transactions are assumed to attract GST.

9 Recommendation for 1st & 2nd Levy Period estimates

In summary, we have been requested by CSLR to estimate the costs associated with post-CSLR complaints in order to recommend appropriate 1st & 2nd Levy Period amounts. This section discusses the results.

9.1 Estimate of levy costs

We have combined the estimates of gross claim payments, AFCA fees, recoveries, and investment income with the Capital contribution, CSLR operating costs and ASIC costs to arrive at estimates of the 1st & 2nd Levy Period amounts.

Table 9.1 and Table 9.2 show these estimates, summarised by sub-sector.

Table 9.1 – 1st Levy Period estimates

	1st levy period estimate									
Type	No. complaints finalised	No. claims paid	Gross claim Payments ($000)	AFCA Fees ($000)	Recoveries & Offsets ($000)	Capital Contribution ($000)	CSLR Operating Costs ($000)	ASIC Costs ($000)	Investment income ($000)	Recommended CSLR Estimate ($000)
Financial Advice - DASS	5	1	92	55	(0)					
Financial Advice - Other	16	4	348	193	(17)					
Financial Advice	20	5	440	248	(18)	417	1,357	-	(18)	2,426
Credit Provision	15	2	4	155	(0)	417	171	-	(7)	740
Credit Intermediation	7	2	98	86	(5)	417	169	-	(7)	758
Securities Dealing	12	2	207	139	(10)	417	178	-	(8)	923
Total	**54**	**11**	**749**	**627**	**(33)**	**1,667**	**1,876**	**-**	**(39)**	**4,846**

Table 9.2 – 2nd Levy Period estimates

	2nd levy period estimate									
Type	No. complaints finalised	No. claims paid	Gross claim Payments ($000)	AFCA Fees ($000)	Recoveries & Offsets ($000)	Capital Contribution ($000)	CSLR Operating Costs ($000)	ASIC Costs ($000)	Investment income ($000)	Recommended CSLR Estimate ($000)
Financial Advice - DASS	116	86	9,431	1,447	(48)					
Financial Advice - Other	43	20	2,109	531	(114)					
Financial Advice	159	107	11,540	1,978	(162)	417	4,717	361	(289)	18,562
Credit Provision	11	6	16	162	(1)	417	571	361	(28)	1,498
Credit Intermediation	10	6	381	126	(22)	417	567	361	(31)	1,800
Securities Dealing	15	10	805	193	(45)	417	593	361	(35)	2,288
Total	**195**	**129**	**12,741**	**2,460**	**(230)**	**1,667**	**6,448**	**1,445**	**(383)**	**24,148**

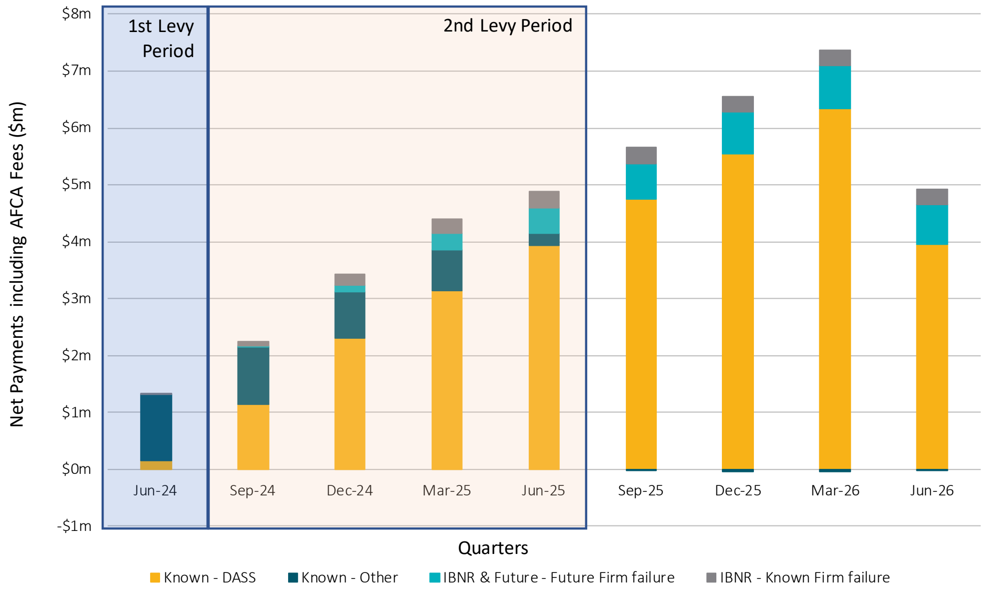
The result of our estimation is that the recommended 1st Levy Period amount is $4.8m, in order to fund an estimated 11 claims, AFCA fees on 54 complaints, a capital contribution amount and CSLR operating costs.

The recommended 2nd Levy Period amount is $24.1m, in order to fund an estimated 129 claims, AFCA fees on 195 complaints, a capital contribution amount, CSLR operating costs, and ASIC fees.

The lion's share of the estimated levy amounts relates to the Financial Advice sub-sector. This is heavily influenced by DASS, but even leaving aside DASS, the Financial Advice sub-sector would still pay the largest part of the levies.

Figure 9.1 shows the expected timing of payments, by the source of CSLR claim.

Figure 9.1 – Expected timing for claim payments, net of offsets and recoveries[19]



9.2 Uncertainty of estimates

There are many sources of uncertainty in the estimates of the required levies. In the next section we include specific discussion of the main uncertainties and show a number of sensitivity tests.

[19] Figure 9.1 shows future firm failures up to June 2025 only.

10 Implications of uncertainty

This section of the report explains key elements of the uncertainty in estimating the 1st & 2nd Levy Period amounts and discusses the implications of uncertainty on the recommended result.

10.1 Context

CSLR is a new arrangement and has not commenced operating. There are no reasonably comparable alternative arrangements that could be investigated for significant, relevant learnings.

AFCA has a specific role which is largely unrelated to CSLR. The structure, approach and data held by AFCA are not aligned with CSLR needs, although progress in this direction can be anticipated for the future.

The actuarial assumptions are, for these reasons, more weighted to reasoned judgement than to analysis of relevant data.

We are also conscious that the legislation is complex and untested. We have attempted to analyse it for various interpretations, and have discussed the interpretations with AFCA and CSLR. There is a risk, however, that these interpretations may turn out to be incorrect and the costs are materially different.

10.2 Reasonable estimate

In this report we have presented our assessment of a reasonable estimate for the 1st & 2nd Levy Period cost outcomes. However, throughout our assessment we could have made alternate assumptions that would result in a different estimate which an actuary would consider to also be a reasonable estimate. This means that there is a range of what could be considered reasonable estimates.

As noted above, estimating the 1st & 2nd Levy Period cost outcomes requires a significant degree of reasoned judgement. One key aspect is that CSLR is new, and there is no direct past experience to analyse to inform the assumption setting process. As CSLR experience emerges, setting future assumptions will rely more on historical data, and consequently the range of reasonable estimates will likely narrow.

At the time of writing this report, the range of reasonable estimates is unavoidable; any extra information available in the coming months prior to when the 1st & 2nd Levy Periods commence is unlikely to narrow the reasonable range materially.

A distinction needs to be made between a range of reasonable estimates and plausible scenarios where outcomes would be higher or lower than our estimate. Take for example flipping an unbiased coin 10 times – a reasonable estimate would be 5 heads, while a plausible outcome includes 10 heads. However, unlike in this analogy, the uncertainty in setting the estimates in this report arises because the distribution of future outcomes is unknown (i.e. we know the coin is not 50/50, but do not have past data to estimate the probability of heads or tails at this stage). The levy estimates in this Report do not include an explicit margin to cover random variability of outcomes.

10.3 Range of outcomes

Informed by our consideration of the Board Policy for the 1st & 2nd Levy Periods (see Section 5.11), our assessment of a reasonable estimate is based on expected amounts in a reasonably favourable environment, with no allowance for the chance of a poor outcome, even on an average basis. In this section we consider some alternative plausible scenarios that may result in outcomes that are more or less than the estimate we have adopted. Given that the 1st Levy Period amount covers only the first 3 months of CSLR operations, we focus on alternative scenarios in the 2nd Levy Period below.

10.3.1 Financial Advice

The 2nd Levy Period estimate for Financial Advice is $18.6m. DASS related claims dominate this estimate, and therefore the uncertainty in this sub-sector largely arises because of uncertainty in the ultimate claim outcomes arising from DASS. The key areas of uncertainty for DASS affecting the 2nd Levy Period estimate where we could have selected different reasonable assumptions are:

- The total cost of DASS related complaints, which will depend on the proportion of non-zero determinations to the DASS client and the amount of the determination
- The number of DASS related complaints lodged to AFCA after the data extraction date
- The timing for AFCA to determine DASS related complaints, complainant to be lodged to CSLR, and when these claims ultimately be paid by the CSLR.

For reasons set out below, we would consider plausible outgoing scenarios for the 2nd Levy Period to range from $11.5m to $39.4m for the Financial Advice sub-sector.

The table below shows the range of plausible estimates if we varied assumptions for the above components.

Table 10.1 – Scenarios for Financial Advice sub-sector (estimate for 2nd Levy Period)

Scenario	Base scenario (assumption)	Low scenario (assumption)	High scenario (assumption)
Number of DASS related claims that receive non-zero determinations receiving CSLR payment	$18.6m (95%)	$16.4m (75%)	$19.1m (100%)
Average claim size for DASS related claims	$18.6m ($110,000)	$17.2m ($90,000)	$20.7m ($130,000)
Number of additional DASS related complaints lodged to AFCA	$18.6m (25 claims)	$18.4m (10 claims)	$24.2m (300 claims)
Timing which AFCA determines complaints and claims are ultimately paid by CSLR	$18.6m (DASS claims finalised by the 3rd Levy Period)	$11.5m (DASS claims finalised towards the end of the 3rd Levy Period)	$39.4m (all DASS claims finalised by the 2nd Levy Period)

An outcome of the 2nd Levy Period amount exceeding $18.6m could, for example, plausibly result from:

- All DASS complainants who receive a non-zero determination go on to lodge a successful claim with CSLR. This could increase the 2nd Levy Period amount to $19.1m, compared to our levy estimate which assumes 95% of DASS complainants lodge a successful CSLR claim.
- A higher average claim size for DASS claims than anticipated. Should the claim amount ultimately turn out to be $130,000[20] rather than $110,000 assumed, this could increase the 2nd Levy Period amount to $20.7m.

[20] An average claim amount, after capping, would result if the determination outcome was 180% of the amount lodged by the complainant (compared to 120% assumed in the levy estimate) and the average determination where the complainant has not provided an amount is $160,000 (compared to $85,000 assumed).

- An additional surge of complaints if more investors lodge complaints to AFCA. An additional 300 complaints reported early in 2024 (assuming they are settled concurrently with the reported DASS complaints) could increase the 2nd Levy Period amount to $24.2m. Complaints reported later are likely to be paid by CSLR after the 2nd Levy Period, noting the time needed for the complaint to be determined by AFCA and subsequently handled by CSLR.
- AFCA processes complaints faster than anticipated in our determination patterns. We have assumed that around 43% of the post-CSLR DASS complaints will have determinations issued by June 2025. However, if AFCA is able to determine all DASS complaints by March 2025, then the 2nd Levy Period amount could end up around $39.4m.

  The assumed AFCA determination and CSLR payment patterns for DASS is a significant assumption in determining the levy estimates. If AFCA determined 15% more DASS complaints than expected by 30 June 2025, the 2nd Levy Period amount for the Financial Advice sub-sector would exceed $20m.

An outcome of the 2nd Levy Period amount being lower than $18.6m could also plausibly result from:

- Fewer DASS complaints proceeding to a CSLR claim payment. If the propensity of successful DASS complaints reduces to 75% rather than 95%, this would reduce the 2nd Levy Period amount to $16.4m.
- A lower average claim size for DASS complaints than anticipated. If the complaint amount entered by the complainant turns out to ultimately be correct, then the average claim size will reduce to $90,000. The 2nd Period Levy amount could reduce to $17.2m.
- Fewer DASS complaints reported after the data extract date, as the majority of motivated claimants will have already lodged a complaint with AFCA. Reducing the number of future reported DASS complaints to 10 (from 25) could result in a 2nd Levy Period amount of $18.4m.
- AFCA processes complaints slower than anticipated in our determination patterns. Should determinations take an extra 6 months to complete, a material portion of DASS complaints will be finalised in the 3rd Levy Period. This could result in a 2nd Levy Period amount of $11.5m.

10.3.2 Other sub-sectors

The 2nd Levy Period amounts estimated for the Credit Provision, Credit Intermediation and Securities Dealing sub-sectors are around $2m each. Less than 50% of the estimates relate to CSLR claim payments; the majority of the levy for each sub-sector is from the allocation of the capital contribution and CSLR operating costs.

The major driver of uncertainty for these sub-sectors is actually the allocation of the non-claim costs; this is discussed in Section 5.10.

Given that claim payments comprise a minor component of the 2nd Levy Period amount, we observe that the risk of over-collection (through the cost of claims being less) is low.

The risk of under-collection would mostly arise if there are more complaints lodged, determined and paid than we have assumed for the 2nd Levy period (because more firms fail, the number of complaints per firm is higher or the average size of a claim is higher).

Table 10.2 shows possible outgoing outcomes for each sub-sector if there are twice as many claims as we have assumed.

Table 10.2 – Scenarios for Other sub-sector (estimate for 2nd Levy Period)

Subsector	Base scenario (assumed number of claims paid)	High scenario (assumption)
Credit provision	$1.5m (6)	$1.7m (13)
Credit intermediation	$1.8m (6)	$2.3m (13)
Securities dealing	$2.3m (10)	$3.2m (20)

10.4 Implications of uncertainty on levied amounts

The legislation for CSLR sets out a series of adjustment mechanisms ranging from collecting any underfunding in subsequent levies to applying special levies during the levy period in the case that a revised estimate of the levy implies an increase is needed.

The simple example in Table 10.3 highlights the implications of uncertainty and how the adjustment mechanisms apply to our estimates of DASS related claims. We have ignored investment income and the allocation of other costs as they do not materially impact this illustrative example.

Table 10.3 – Scenarios for DASS related claims ($m)

DASS claim outcomes relative to levy estimate	1st & 2nd Levy Period estimate scenario	1st & 2nd levy periods			Subsequent levy periods			Total		
		Levy amount	Outcome	Deficit/ (Surplus)	Levy amount	Outcome	Deficit/ (Surplus)	Levy amount	Outcome	Deficit/ (Surplus)
Base scenario turns out to be correct	Base	11.0	11.0	-	22.0	22.0	-	32.9	32.9	-
Scenario 1: Faster determination and claim payment	Base	11.0	32.9	22.0	22.0	-	(22.0)	32.9	32.9	-
Scenario 2a: Fewer CSLR claims, average size 10% lower	Base	11.0	7.8	(3.2)	12.4	15.6	3.2	23.4	23.4	-
Scenario 2b: Fewer CSLR claims, average size 10% lower	Faster settlement	32.9	7.8	(25.1)	-	15.6	15.6	32.9	23.4	(9.5)
Scenario 3a: Faster payments, average size 10% higher	Base	11.0	36.2	25.3	25.3	-	(25.3)	36.2	36.2	-
Scenario 3b: Faster payments, average size 10% higher	Faster settlement	32.9	36.2	3.3	3.3	-	(3.3)	36.2	36.2	-

The total amount of our estimate of DASS-related claims is $32.9m. CSLR would fund $11.0m in the 1st and 2nd Levy Periods, and $22.0m in subsequent annual levy periods. Should the DASS outcomes turn out as we have modelled, then there is no deficit or surplus in any levy period.

In Scenario 1, the speed of determining complaints and payment of claims is faster than assumed in this Report. The 1st & 2nd Levy Periods would be under-funded by $22.0m, but the total amount levied after the 2nd Levy Period would still be $22.0m, because the total amount paid by CSLR is the same. The levies do not change, but there is a temporary deficit in the fund.

In Scenario 2a, fewer AFCA complaints become CSLR claims and the average claim size is 10% lower than assumed. The estimate (and consequently the levy to industry) from the 3rd Levy Period onwards can be adjusted downward to reflect the emerging experience and the surplus from the 1st and 2nd Levy Periods. Under this scenario, the levy amount collected is equal to the total CSLR payments made.

In Scenario 2b, CSLR claims costs are the same as under Scenario 2a, but the levied amounts for the 1st & 2nd levy periods assumed all DASS related claims are paid by 30 June 2025. In this scenario CSLR will collect $32.9m but ultimately turn out to need $23.4m, an overcollection of $9.5m.

In Scenario 3a, actual CSLR payments turn out to be faster than anticipated and CSLR claims are higher than expected. If the levied amounts in the 1st & 2nd Levy Periods are consistent with the base scenario (i.e. assumes slower claim payments at lower costs), then will be a deficit for the 1st & 2nd Levy Periods. However, the adjustment to levy amounts in subsequent annual periods will allow for collection of this shortfall, and will reflect the recognition of the higher average claim sizes. Under this scenario, the total levy amount collected overall is equal to the total CSLR payments made.

In Scenario 3b, the CSLR claims costs and payment speeds are the same as under Scenario 3a, but the levied amounts for the 1st & 2nd levy periods assumed all DASS related claims are paid by 30 June 2025. In this case, the amount collected for the 3rd Levy Period onwards is only the extra costs as the higher claim sizes are recognised. Under this scenario, the total levy amount collected overall is equal to the total CSLR payments made.

We make the following observations of CSLR implications from these examples:

- Differences due to timing of actual CSLR payments being different to our model estimates do not affect the total amount that will be levied to industry.
- Adopting a higher estimate for the 1st and 2nd Levy Period would lead to a large levy for the 1st and 2nd Levy Periods, which will be offset by much lower levies for the 3rd and subsequent Levy Period. This means that levies to industry may be more volatile year to year. Further, if it turns out that CSLR outgoings are less than modelled, CSLR will have collected more funds than needed. The legislation does not make any provision for the return of extra funds to Financial Firms, and the surplus can only be used to offset future levy periods.
- Setting a lower end estimate for the 1st and 2nd Levy Periods gives CSLR flexibility to respond to better or worse emerging experience, while managing the risk of over collection of levies compared to actual outgoings. Further, the year to year volatility in estimates is reduced, even if CSLR is required to respond to adverse emerging experience.

10.5 Severe events

The occurrence of severe events, such as the failure of a major Financial Firm or a severe economic downturn, could increase CSLR payments beyond our estimates in this Report. No allowance is made for future severe events (see Section 5.11), noting the high level of uncertainty around the occurrence of these events in any one Levy Period, and the scheme being designed to post-fund severe events.

11 Reliance and limitations

11.1 Use of this Report

We have prepared this report for CSLR Ltd for the purposes outlined in Section 2.2 of this report. It is not necessarily suitable for any other purpose. We understand that CSLR Ltd may wish to provide this report to third parties. The report may be shared with AFCA, ASIC and other Australian Government entities for the purposes of operating The Scheme. The report should be shared in full. If excerpts from this report are required then the authors should be contacted to ensure that the elements of this report are portrayed in the correct context.

We understand that our involvement and report findings may be referenced by CSLR or Australian Government entities, and this report may become publicly available. There may be commercial sensitivities that will need to be addressed in any public release of this report.

Third parties, whether authorised or not to receive this report, should recognise that the furnishing of this report is not a substitute for their own due diligence and should place no reliance on this report or the data contained herein which would result in the creation of any duty or liability by Finity to the third party.

We remain available to answer any questions which may arise regarding our Report and conclusions. We assume that users of this report will seek such explanation and/or amplification of any portion of the Report that is not clear.

11.2 Reliance and limitations

We have relied on the information provided to us as detailed in Section 5.1 and Appendix A of this report. We have checked this information for reasonableness only and consider it to be appropriate for the scope of this review.

There are many limitations on the quality, completeness and relevance of the underlying data sources. The results, however, should be reasonable in order to inform decisions.

11.3 Uncertainties

We have formed our views based on the current environment and what we know today. If future circumstances change it is possible that our findings may not prove to be correct.

It is not possible to predict the financial impacts on the CSLR with certainty, particularly prior to the commencement of the scheme and with limited relevant historical data with which to calibrate the modelling framework. We have adopted assumptions that we believe are reasonable considering the scope and nature of the assignment.

It would be reasonable to expect that the eventual outcome, after a few years have elapsed and the outcome of the complaints become known, to be materially higher or lower than our estimate. This level of uncertainty is unavoidable for any estimate at this early point in time as required by the legislation.

Appendices

A Data provided for our review

We received the following information to assist with our review:

- A database of all complaints received by AFCA (and its predecessors) since 2013
- A file listing about 20,000 determinations made by AFCA since its commencement
- Discussions and various documents explaining current AFCA processes and evolving plans for processing the post-CSLR complaints and set-up of CSLR procedures
- CSLR operating budgets for FY24 to FY27
- Estimated ASIC costs to manage industry levies for the 2nd Levy Period
- Responses to several legal questions about interpretation of CSLR legislation
- Regular discussions with CSLR management
- DASS information sourced from the Administrators' website
- ASIC levies for 2021/22 by sub-sector
- Searches on ASIC's website on Financial Firms and their trading status
- Publicly available information relating to Other Financial Firms to assist with understanding their current trading status and additional information as to the nature, or likely result, of complaints made against the Financial Firm.

A.1 Validation of data

There are no independent sources to validate or reconcile the complaints data. The data maintained and reporting prepared by AFCA is designed to meet AFCA's role and needs in resolving disputes. There are many respects in which the CSLR data requirements will be different, and we understand that development of systems is in the planning stages.

AFCA's database contains only the current version of the relevant information on the complaint. AFCA was unable to provide us with a dataset showing the past changes in details of each complaint. AFCA's validation of coding of individual fields is fit-for-purpose but does not require specific validation of some of the fields relevant to CSLR, such as nature of financial service, outcome amount or claimed loss. Several items (especially for paused complaints) are limited to what has been self-reported by the complainant when the complaint was made with AFCA.

A.2 Reasonableness checks

Where possible we applied reasonableness checks to various summaries and data items, based on consistency of different sources, general knowledge of the firms and their businesses, and web searches.

Possible discrepancies were discussed with CSLR management and AFCA. In most cases the data appears to be valid, while in a few cases an error in the data extraction was identified and a correct extract provided to us.

The reasonableness checks focussed on:

- Counts of complaints and Financial Firms meeting different criteria of complaint status, cause of complaint and financial status of the firm (as known to AFCA).

- The average amount of loss reported by the complainant.
- The average financial outcome amount by sector and advice type, including comparison with the loss reported by the complainant.

B Estimate of 1st and 2nd Levy Period costs by sub-sector

The estimates in this report are the result of actuarial projections using the methodology discussed throughout the report. We have not rounded the outcomes of our analysis. Amounts shown in the body of the report have been shown as rounded figures for simplicity.

Table B.1 and Table B.2 outline the component parts of the levy estimates for the 1st and 2nd Levy Periods respectively, split by sub-sector and to the nearest cent. The amounts below are shown split according to parliamentary instrument specifications.

Table B.1 – Recommended 1st Levy Period amount

Act references	Description	Sub-sectors				Total
		Credit intermediaries	Credit providers	Licensed personal advice	Securities dealers	
Paragraph 1069M(1)(a)	Gross claim Payments	$98,070.81	$3,841.21	$440,179.38	$207,267.70	$749,359.10
	Recoveries & Offsets	-$4,903.54	-$236.32	-$17,872.33	-$10,363.39	-$33,375.58
	Compensation claims	$93,167.27	$3,604.89	$422,307.05	$196,904.31	$715,983.52
Paragraph 1069M(1)(b)(i)	AFCA unpaid fees	$85,658.57	$154,517.41	$247,747.42	$139,432.86	$627,356.26
Paragraph 1069M(1)(b)(iii)	CSLR's administrative costs	$169,413.76	$171,472.78	$1,357,179.87	$177,704.59	$1,875,771.00
	Investment income	-$7,012.61	-$6,544.38	-$17,591.58	-$8,144.66	-$39,293.23
	CSLR's administrative costs	$162,401.15	$164,928.40	$1,339,588.29	$169,559.93	$1,836,477.77
n/a	ASIC's administrative costs	$0.00	$0.00	$0.00	$0.00	$0.00
Paragraph 1069M(1)(b)(ii)	Capital reserve establishment	$416,666.67	$416,666.67	$416,666.67	$416,666.67	$1,666,666.68
Total		$757,893.66	$739,717.37	$2,426,309.43	$922,563.77	$4,846,484.23

Table B.2 – Recommended 2nd Levy Period amount

Act references	Description	Sub-sectors				Total
		Credit intermediaries	Credit providers	Licensed personal advice	Securities dealers	
Paragraph 9(1)(a)	Gross claim Payments	$381,235.88	$15,675.76	$11,539,539.27	$804,872.61	$12,741,323.52
	Recoveries & Offsets	-$21,514.34	-$923.56	-$161,681.38	-$45,427.33	-$229,546.61
	Compensation claims	$359,721.54	$14,752.20	$11,377,857.89	$759,445.28	$12,511,776.91
Paragraph 9(1)(b)(i)	AFCA unpaid fees	$126,498.55	$162,323.36	$1,978,098.65	$193,006.55	$2,459,927.11
Paragraph 9(1)(b)(ii)	CSLR's administrative costs	$566,632.55	$571,030.57	$4,717,242.05	$592,739.84	$6,447,645.01
	Investment income	-$30,680.04	-$28,150.59	-$288,953.19	-$35,118.11	-$382,901.93
	CSLR's administrative costs	$535,952.51	$542,879.98	$4,428,288.86	$557,621.73	$6,064,743.08
Paragraph 9(1)(b)(iii)	ASIC's administrative costs	$361,146.50	$361,146.50	$361,146.50	$361,146.50	$1,444,586.00
Paragraph 9(1)(b)(iv)	Capital reserve establishment	$416,666.67	$416,666.67	$416,666.67	$416,666.67	$1,666,666.68
Total		$1,799,985.77	$1,497,768.71	$18,562,058.57	$2,287,886.73	$24,147,699.78

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