

Pre-CSLR Complaints Initial Estimate

Compensation Scheme of Last Resort Limited

December 2023

Strictly confidential

7 December 2023

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

Dear Directors

Pre-CSLR Complaints Initial Estimate

We are pleased to enclose our report that outlines the work carried out, our methodology and results of our initial estimate of the costs relating to Pre-CSLR complaints to the CSLR Scheme.

We look forward to discussing its contents with you.

Yours sincerely



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Pre-CSLR Complaints Initial Estimate

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1 Executive Summary

1.1 Background

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

CSLR Ltd (The Scheme operator) has engaged Finity as its actuarial services provider. The first substantial item of work is to provide an initial estimate of cost to The Scheme relating to Pre-CSLR complaints, i.e. relevant claims arising from complaints received by AFCA between 1 November 2018 and 7 September 2022. For claims that are within the scope of the legislation, CSLR is required to pay compensation to a complainant with an unpaid AFCA Determination, along with unpaid AFCA fees relating to pre-CSLR complaints. References to “levy” or “estimate” in this report relate to these amounts. “Levy” is used for ease of communication because the “estimate” leads directly to the “levy”. The initial estimate of cost documented in this report is a direct input to determining levies imposed on industry, which will be calculated by ASIC.

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 Pre-CSLR levy

Finity’s recommendation for the Pre-CSLR levy is \$241m.

The component parts of the levy estimate are set out in Table 1.1.

Table 1.1 – Recommended Pre-CSLR levy

Sub-segment	Number of successful CSLR claims	Expected claim cost capped (\$m)	Unpaid AFCA fees (incl GST) (\$m)	Recoveries (\$m)	Investment income (\$m)	Recommended pre-CSLR levy (\$m)
DASS personal financial advice ¹	1,556	\$193m	\$20m	-\$1.9m	-\$7.6m	\$203m
Other personal financial advice	284	\$27m	\$4m	-\$0.3m	-\$1.1m	\$30m
Credit intermediation	25	\$3m	\$0m	\$0.0m	-\$0.1m	\$3m
Credit provision	12	\$0m	\$0m	\$0.0m	\$0.0m	\$0m
Securities Dealing	36	\$4m	\$1m	\$0.0m	-\$0.2m	\$4m
Total	1,914	\$227m	\$25m	-\$2.3m	-\$8.9m	\$241m

¹ All DASS complaints relate to personal financial advice

1.3 How the recommended levy was established

The levy is built up from the following components:

- Dixon Advisory and Superannuation Services (DASS) complaints, which make up close to 85% of the total amount
- Complaints against other Financial Firms that have been identified by AFCA as being in-scope for the CSLR and made against a firm that has failed (this and the DASS complaints can be thought of as “known complaints”)
- Complaints lodged before 8 September 2022 which will turn out after full investigation to be in-scope for CSLR and for which the firm has failed (already or in the future), but are not currently individually identified by AFCA (and can be thought of as “unknown complaints”)

- AFCA unpaid fees, combining fees that have been invoiced but remain unpaid and estimated fees following resolution of all the open and future Pre-CSLR complaints that are within the scope of the CSLR.

Further allowances are made for recoveries from other statutory schemes and other sources such as a liquidation, and for investment earnings expected to be achieved from investment of the levy when it is received.

CSLR's Board-adopted Actuarial Policy sets out the principles to be followed in levy setting and other funding decisions. The approach taken in this report is based on the Actuarial Policy.

1.4 Uncertainty

The estimate of the levy is uncertain. The eventual obligation of CSLR for pre-CSLR complaints could turn out with hindsight to be more than \$250m (the legislative cap on the levy) or less than \$200m. This arises 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.

A key assumption for the Pre-CSLR levy is the size of the Determinations for DASS complaints as they are considered by AFCA. We have assumed that almost all the complaints will result in non-zero Determinations to the DASS client, and consequently a higher average size for each of these complaints as they eventually progress to The Scheme. Based on information that we know at this stage around the circumstances leading to DASS client losses (as discussed in Section 4), this appears reasonably likely. However, if a material proportion of complaints end up being favourable for DASS, the CSLR's claim cost for Pre-CSLR claims may turn out below the estimated levy amount.

It is possible for CSLR claim costs to exceed the recommended levy amount. Particularly of note, if there are ultimately more unknown complaints than we have allowed, CSLR's claims cost can be materially higher.

Section 10 of the report describes at some length the sources of uncertainty in various elements of the levy estimate and provides a number of sensitivity tests 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

The Financial Services Compensation Scheme of Last Resort (“The Scheme” or “CSLR”) was enacted in 2023 to compensate complainants who have received a Determination in their favour from the Australian Financial Complaints Authority (AFCA) and the Determination amount has not been 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). Compensation Scheme of Last Resort Limited (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 businesses and superannuation funds) that have AFCA Determinations that are unpaid by the Financial Firm which the complaint was against (and where the financial service is within the scope of The Scheme). The Scheme will commence payment of claims from 2 April 2024.

The Scheme is funded through levies. This report relates to the estimation of claims and unpaid AFCA fees that relate to ‘Pre-CSLR’ complaints. These are unpaid complaints (that usually remain open) and that were lodged with AFCA between 1 November 2018 and 7 September 2022.

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

2.2 Scope of this Report

CSLR Ltd has engaged Finity Consulting Pty Limited (Finity) as its actuarial service provider.

This Report sets out our initial calculation of the levy for Pre-CSLR complaints (as defined in legislation) to provide funding for claims for compensation in relation to complaints made to AFCA between 1 November 2018 and 7 September 2022.

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 background, coverage, claim payments and funding of the scheme.

Section 4 considers complaints against Dixon Advisory and Superannuation Services (DASS). For the Pre-CSLR levy, the majority of the complaints and expected claim costs relate to services provided by DASS.

Section 5 details our approach to modelling the Pre-CSLR claims and associated AFCA fees, including the consideration of the various sources of potential claims made against the CSLR.

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 discusses some of the other actuarial considerations in the estimation of the required Pre-CSLR levy.

Section 9 outlines our recommendation for the Pre-CSLR levy, followed by Section 10 that explores the uncertainty in the estimate and provides a number of sensitivity analyses.

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

2.4 Actuarial Policy

CSLR’s Board has adopted an Actuarial Policy. The current version of the Actuarial Policy sets out the principles and procedures that will be followed in determining the Pre-CSLR levy estimate. Finity provided input to the Board to assist in forming the Actuarial Policy. The development and approval of the remainder of the Actuarial Policy dealing with future levies and other financial decisions is planned for early 2024.

We understand that the Actuarial Policy will be published on the CSLR website. The Actuarial Policy provides context and is referred to through this report. This report should read together with the Actuarial Policy.

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
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
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 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
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
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
1 st year Levy	Levy period from 2 April 2024 to 30 June 2024
2 nd year Levy	Levy period from 1 July 2024 to 30 June 2025

2.6 Note on terminology used in this report

Section 11 of the Collections Act provides that the CSLR operator may determine for the first levy period an estimate that is the sum of what CSLR reasonably believes (having regard to actuarial principles) will be the total amount of compensation that will be payable under the scheme. References to “levy” or “estimate” used in this report relate to determining this amount.

Levies will be calculated and imposed on industry by ASIC, in accordance with section 10 of the Levy Act. ASIC is to use the estimate determined by the CSLR operator in calculating the levy, whereby the levy is to be set at the lesser of either the estimate determined by the CSLR operator or the scheme levy cap, being \$250m. 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 (i.e. CSLR Ltd):

- Financial Services Compensation Scheme of Last Resort Levy Act 2023 (the “Levy Act”), and corresponding Financial Services Compensation Scheme of Last Resort Levy Regulations 2023 (the “Levy Regulations”)
- Financial Services Compensation Scheme of Last Resort Levy (Collection) Act 2023 (the “Levy Collection Act”)
- Corporations Amendment (Financial Services Compensation Scheme of Last Resort) Regulations 2023, which amends the Corporations Regulations 2001 (the “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 in one of the following 4 sub-sectors – personal financial advice, credit intermediation, securities dealing, and credit provision.

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 (individual or joint).
- 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.

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.

For complaints lodged on or after 8 September 2022, a levy will be determined annually (noting that the first annual levy period runs only from 2 April 2024 to 30 June 2024) to meet The Scheme claim payments and associated costs. The annual levies will meet the cost of expected CSLR claim payments actually made to complainants during the levy period (as opposed to complaints made during the period).

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:

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

The Levy Collection Act specifically identifies the components to be included in each levy period, which is summarised in the table below.

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
1 st year payment	Yes	Yes	No	Yes	\$1.67m capital contribution	No
2 nd year Levy	Yes	Yes	Yes	Yes	\$1.67m capital contribution	Yes (not expected)
3 rd year Levy	Yes	Yes	Yes	Yes	\$1.67m capital contribution	Yes
4 th year Levy and thereafter	Yes	Yes	Yes	Yes	Capital recovery, if required	Yes

¹Including 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 year payment will be paid by the Commonwealth (i.e. it is not a levy on industry).

The 2nd year Levy 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 Levy to each entity.

The total levy for each levy period is capped at \$250m.

The levy for each sub-sector is capped at \$20m, unless there is a Ministerial Determination for a Special Levy to exceed this amount. The \$250m cap for the levy period will still apply.

4 Dixon Advisory and Superannuation Services Limited

4.1 About DASS¹

Dixon Advisory and Superannuation Services (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 have been 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 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 2011², with the URF Equities (ASX:URF)³ and URF CPUs (ASX:URFPA)⁴ 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

¹ See ASIC Media Release of 4 August 2023, 'ASIC sues Dixon Advisory & Superannuation Services Pty Limited Director'

² US Masters Residential Property Fund includes the URF Equities, URF CPUs and URF Notes. The URF is one of the Related Party Investment Products.

³ The equity securities in the ASX listed URF entity (ASX:URF) that listed on the ASX on 23 July 2012.

⁴ 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.

property assets, with the potential for long-term returns through a combination of capital growth and net rental income.

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 sold to DASS' clients⁵:

- 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 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 shown in the Administrators' Report.

⁵ In some instances, this includes other Related Party Investment Products.

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 of 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.

In May 2022, there was a carriage motion hearing before the Federal Court to determine how the representative proceedings would be conducted going forward, given both proceedings largely covered the same matters, and it was inefficient to continue with both proceedings. 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 representative proceedings 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 plus 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 Pre-CSLR Levy

DASS complaints represent more than 80% of the currently open, in-scope, Pre-CSLR complaints. As such, the estimation of an appropriate Pre-CSLR levy depends substantially on our understanding of the particulars of the situation surrounding DASS.

It appears to us that most if not all of the Pre-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 Pre-CSLR Levy, 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 potential Pre-CSLR claim costs and unpaid AFCA fees. This section, along with Appendix A, outlines these sources.

We have conducted some reasonableness checks on the data provided. These checks are discussed in further detail in Appendix A.

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. This 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 Pre-CSLR complaints 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, this is relevant for the amount claimed as well as the sales/service channel to which the complaint relates.

5.1.2 Legislation and regulation

We referenced the relevant legislation and regulations governing the establishment and operation of the CSLR, as set out in section 3.1.

5.1.3 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.

5.1.4 Other information sources

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

- ASIC: Searches 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

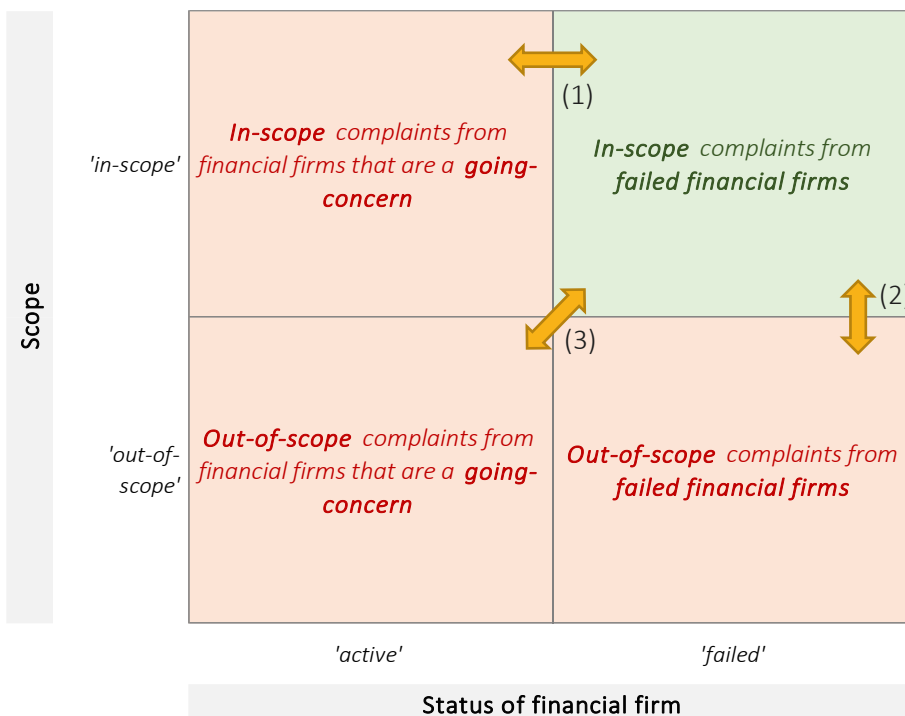
Appendix A contains a list of data provided to Finity for our review.

5.2 General Methodology

5.2.1 Sources of potential claims

There are a several cohorts of Pre-CSLR 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 Pre-CSLR claims



A significant majority of successful claims made against the CSLR, in relation to Pre-CSLR complaints, are expected to come from the cohort of currently in-scope complaints relating to already failed Financial Firms (the segment coloured green in Figure 5.1).

However, there is the potential for complaints to transition from the red segments to the green segment in Figure 5.1, through either:

- A currently active financial firm with an open Pre-CSLR complaint fails – group (1)
- 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 – group (2)
- Other situations including a combination of the above, where neither the possible failure of the Financial Firm nor the nature of the financial service and the misconduct can be reasonably regarded as 'in-scope' for CSLR based on currently known information – group (3).

In estimating the expected claim costs and unpaid AFCA fees, we have separately considered these potential transitions.

For (1), we have applied, to the known cohort of in-scope Pre-CSLR complaints from active Financial Firms, a likelihood of that Financial Firm failing. We differentiate the likelihood of failing based on the size or scale of the firm where possible with the information available.

For (2) and (3), we make an aggregate, ‘net’ allowance to cover the potential for complaints that are currently out-of-scope (for either active or failed Financial Firms), to become in-scope as additional details of the complaint are obtained and assessed by AFCA⁶.

These are ‘net’ allowances to the extent that it is possible for currently ‘in-scope’ complaints to subsequently be determined to be out-of-scope. We don’t expect these to represent a significant proportion of the gross transitions between in-scope and out-of-scope complaints.

5.2.2 Estimating the total cost of claims

At a high level, the methodology for estimating the costs and fees relating to Pre-CSLR complaints can be characterised as:

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

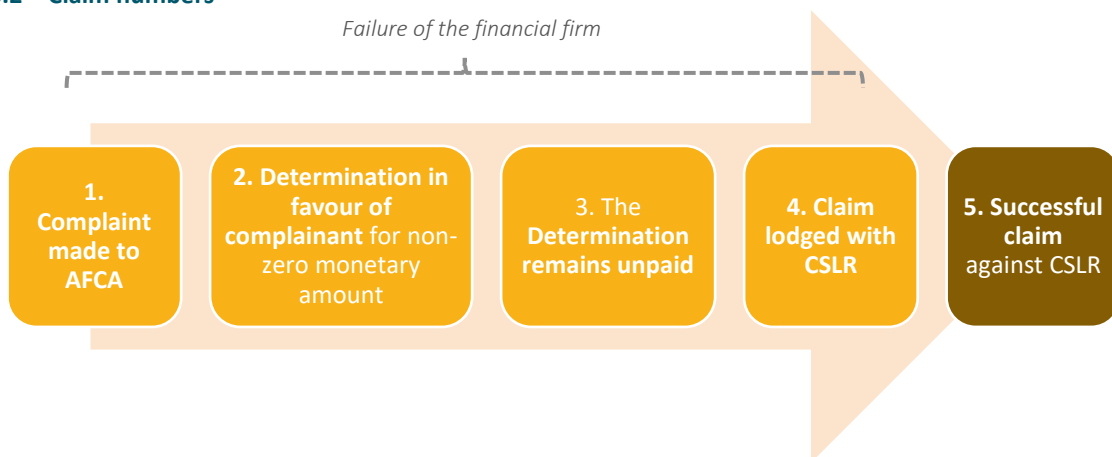
In this section we set out the approach to estimating each of the bolded items above. It is worth noting that the AFCA fees are payable on in-scope complaints regardless of whether the complainant is successful in achieving a Determination in their favour and making a CSLR claim.

Due to the dominance of complaints in the Pre-CSLR period from DASS we have approached the parameterisation of the model separately for DASS and Other Financial Firms.

5.2.3 Probability of a successful CSLR claim

The approach to estimating the probability of a Pre-CSLR 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



⁶ An example is a complaint recorded by the complainant as relating to a Managed Investment Scheme, which is out-of-scope. Investigation by AFCA may determine that the misconduct was actually in the provision of personal financial advice, thereby bringing the complaint in-scope.

All of the relevant complaints have been made to AFCA. For the majority of 'Pre-CSLR' in-scope complaints, we already know the relevant Financial Firm has 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.

For the potential transitions outlined in Figure 5.1 that can occur when an Active Financial Firm fails, we apply an additional probability of failure.

5.2.4 Estimating the Outcome Amount

In terms of the amount of a Determination, our data source contained an 'outcome' amount for only 62 of the 1,849 known in-scope, Pre-CSLR complaints. 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 Pre-CSLR 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.

$$\text{Outcome Amount} = \text{Claimed Amount} \times \gamma$$

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, make an assumption about the parameter γ above; the relationship between the claimed amount and the outcome amount
 - > 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, make an assumption for the average size of a CSLR claim by considering the result above and other relevant factors.

5.2.5 Potential for 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').

For the estimation of the Pre-CSLR levy, the potential recoveries that are possible for either DASS or non-DASS complaints are an important consideration.

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. This fund 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 recovery from these various sources so that assumptions are largely judgemental. For DASS there is some relevant information in the Administrators' Report (see section 4.6), which estimates recoveries of 4 cents in the dollar based on their assessment of investor losses. There is uncertainty around the recoverability of this amount by CSLR, which will depend on the treatment at AFCA determination, and the operation of any future overpayment recoveries.

Informed by the Actuarial Policy, we have adopted an assumption of 1% recovery across the whole of the pre-CSLR claims estimate, but not the AFCA fees. In modelling the impact of recoveries, we have applied a single percentage of the claim amount to each individual complaint. In reality, recoveries will not be even across all complainants, and this is a simplified approach.

5.3 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 2022⁷.

There are three types of fees charged to Financial Firms:

1. An annual membership/registration fee
2. A case fee associated with each complaint, varying by the stage at which the complaint is completed
3. A 'user charge' fee⁸ based on the number of closed complaints against a financial firm in the previous year, weighted by the stage at which the complaint is completed.

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.

We have assumed that, for the purposes of estimating the Pre-CSLR complaint levy, 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 Pre-CSLR complaints.

⁷ <https://www.afca.org.au/members/news/new-funding-model-comes-effect-on-1-july-2022>

⁸ As detailed at <https://www.afca.org.au/members/funding-model/user-charge>

5.4 Other actuarial matters

There are a number of other important considerations in the estimation of the Pre-CSLR levy. These are detailed further in Section 8 of this report.

5.4.1 Payment pattern

We have selected payment patterns to account for the expected time that will elapse from the receipt of Pre-CSLR levy monies and the payment of claims. For the Pre-CSLR levy, we have a set cohort of already lodged complaints and hence the delay to payment is relevant for the consideration of investment income earned on levy monies received by the CSLR.

5.4.2 Investment income

We have assumed that Pre-CSLR levy 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.

6 Estimate of Claim Costs

In this section, we document the estimate of the claim costs for the CSLR arising from Pre-CSLR complaints. We separately consider the expected costs associated with DASS complaints from the complaints relating to other Financial Firms.

6.1 In-scope complaints currently identified

Table 6.1 shows the number of 'in-scope', Pre-CSLR complaints relating to DASS and other Financial Firms, along with the totals of the amounts reported as lost by the complainants⁹.

These 1,849 complaints are individually identified by AFCA and flagged in the data files provided to us. They are the complaints in the 'green box' of Figure 5.1.

Table 6.1 – Complaints and complaint amounts

Financial Firm	Number of complaints	Complaint amount (\$m)
DASS	1,638	\$322m
Other	211	\$37m
Total	1,849	\$359m

DASS dominates the cohort of Pre-CSLR complaints, both in terms of the number of complaints and the total amount claimed by complainants in-scope for the CSLR. This is the reason for dealing with DASS claims separately in this report.

In the balance of this section we work through the estimation of the cost to CSLR of these 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 will transition to in-scope status as per the diagram in Section 5.2.1 including if and when:

- A currently active financial firm with an open Pre-CSLR complaint 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
- Other situations including a combination of the above, where neither the possible failure of the Financial Firm nor the nature of the financial service and the misconduct can be reasonably regarded as 'in-scope' for CSLR based on currently known information.

6.2 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.

6.2.1 DASS: Claim probabilities – number of CSLR claims paid

This section estimates how many CSLR claims will eventually be paid from the 1,638 open DASS complaints.

⁹ But note that a proportion of complaints do not have a loss amount nominated by the complainant

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

In the complaint database there are 23 DASS complaints that record an outcome, of which 20 are closed and 3 open. We assessed these complaints even though they are now quite old and probably not representative of the currently open complaints.

Of these 23 complaints, 4 were withdrawn, 1 had no compensation awarded and 1 was out-of-scope. This left 17 with a non-zero monetary outcome in favour of the complainant, representing approximately 75% of the 23 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. Taking into account the Actuarial Policy, 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 required 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 Pre-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.

Claim acceptance

Considering the very similar nature of all the outstanding Pre-CSLR complaints against DASS, as well as reflecting on discussions with AFCA and CSLR personnel, 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 Pre-CSLR DASS complaints.

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 Pre-CSLR, in-scope complainants will have a successful claim against CSLR. The consequence is that the estimate of the Pre-CSLR levy includes 1,556 claims from DASS.

Table 6.3 – DASS AFCA complaints and successful CSLR claims

Financial Firm	Number of AFCA complaints	Number of successful CSLR claims
DASS	1,638	1,556

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

Outcome Amount

As outlined in Section 5.2.4, we apply a factor, γ , to the average amounts entered by complainants as their loss when lodging their complaints with AFCA.

Directly referencing the 17 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 made 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 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 140% 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.

For those complaints with a loss amount recorded, the CSLR claim is estimated by taking 140% 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 \$135,000.

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 \$135,000. However, after looking at the distribution of loss amounts in the Administrators' Report and thinking about the likely behaviour of complainants, we concluded that the average claim size arising from the complaints without a loss amount (about 20% by number) would be lower. We applied a capped average claim amount of \$100,000, informed by the results of several other size distributions for cohorts of claims.

The overall average claim size for DASS is \$124,000, combining those with and without a recorded loss amount.

Recoveries

As noted earlier, we have applied a recovery rate of 1% of the claim costs for Pre-CSLR complaints related to DASS.

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 Pre-CSLR complaints against DASS, as shown in Table 6.4.

Table 6.4 – DASS: summary of expected net claim costs

Financial firm	Number of AFCA complaints	Complaint amount (\$m)	Number of successful CSLR claims	Average capped claim amount (\$k)	Expected claim cost capped (\$m)	Recoveries (\$m)	Net claim cost (\$m)
DASS	1,638	\$322m	1,556	\$124k	\$193m	-\$2m	\$191m

We estimate that, after taking account of potential recoveries, the net CSLR claim costs relating to Pre-CSLR complaints against DASS is likely to be approximately \$191m.

6.3 Complaints from other Financial Firms

For Financial Firms other than DASS, the approach follows a similar structure, but it is necessary to deal with an estimate of the complaints that will transition to in-scope as well as the 211 complaints currently identified.

6.3.1 Other Financial Firms: Claim probabilities

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

Directly referencing closed Pre-CSLR complaints relating to other Financial Firms yields an estimate of the probability of receiving a non-zero Determination of approximately 40%.

For similar reasons as outlined for DASS complaints, we believe this will understate the likely 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.

We have therefore assumed a 65% chance that an in-scope complainant will be awarded a non-zero Determination in their favour.

Propensity to claim

As for DASS complaints, as the CSLR has not yet become operational, we had no direct experience of complainants who had received a non-zero Determination in their favour and then lodged a claim with CSLR.

A similar rationale as for DASS complaints was applied to the consideration of the propensity to claim for other Financial Firms. For the purposes of modelling Pre-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

As with DASS, 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.

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

Table 6.5 – Claim probabilities: other financial firms

Financial Firm	Probability > \$0 determination	Propensity to claim	Claim acceptance	Probability of successful claims
Other	65%	95%	100%	62%

Overall, we are assuming that 62% of the Pre-CSLR, in-scope complaints will result in a claim being paid by CSLR.

6.3.2 Other Financial Firms: Number of CSLR claims

As noted above, some claims in respect of other Financial Firms will arise from complaints already identified as in-scope and an unknown number will arise from other complaints that have been lodged with AFCA but are not currently identified as in-scope. The estimate of the number of successful CSLR claims is 358, made up of four components as set out in Table 6.6

Table 6.6 – AFCA complaints and successful CSLR claims: other financial firms

Segment	Number of AFCA complaints	Number of successful CSLR claims
In-scope complaints from failed financial firms	211	139
Potentially in-scope complaints from failed financial firms (missing sub-segment information)	59	17
In-scope complaints from active financial firms	53	2
Possible scope-change transitions		200
Total Non-DASS Financial Firms		358

The first component, coming from the identified in-scope complaints, gives an estimate of 139 successful CSLR claims, applying the probabilities in Table 6.5 to the 211 known complaints.

For the second component, we were able to identify failed Financial Firms with open complaints that, while not flagged as in-scope, could be in-scope following investigation. These were typically related to investments, and could possibly be related to investment advice. We included an assumed 17 claims, being 30% of the complaints that were identified as meeting these criteria.

The third component also derives from a limited amount of data analysis able to be completed of the available dataset. These are open complaints against active firms, that otherwise would meet the criteria for being in-scope. We applied a judgemental probability of failure for each firm, varying with its size, ownership and number of complaints. The outcome was an estimate that of the 53 identified complaints in this group, the expectation is that only 1 or 2 would result in a successful CSLR claim.

The fourth component is the most difficult in the estimation process. It is an allowance for any complaints from Pre-CSLR dates that will become in-scope at some time in the future but at present have no indication of being likely. After much discussion we made an allowance for 200 CSLR claims arising from these unknown sources, noting that the eventual number could be much higher or much lower. We return to the uncertainty of this component in Section 10.

6.3.3 Other Financial Firms: Average cost of claims

Outcome and Claim Amount

As outlined in section 5.2.4, 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 Financial Firms in the four relevant sub-sectors. Table 6.7 summarises the results for this history, while noting that the sample sizes are small and these closed complaints are not necessarily representative of open ones that will become CSLR claims.

Table 6.7 – 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	96	2,270	1,475	65%
Securities Dealing	1	171,500	48,500	28%
Total	153	66,327	47,502	72%

What we can glean from this analysis is:

- That the outcome amounts were, on average, somewhat below the reported loss amounts (72% overall)
- That the financial advice 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 \$1,500.

In the absence of better evidence, we have assumed that the average capped CSLR claim for the successful claims (other than DASS) will be \$95,000. The implicit assumption is that the average claim amount would be equal to the average reported loss where it is available (i.e. $\gamma = 100\%$), and that the average for those that did not have a reported loss amount would be the same as for those that did.

Recoveries

We have used a recovery rate of 1% of the gross claim costs for Pre-CSLR complaints related to other Financial Firms. There is no relevant information available to consider this assumption and, noting this is relatively minor in terms of the Pre-CSLR levy, we used the same assumption as for DASS. We were unable to identify any practical way that we could obtain any relevant evidence.

6.3.4 Other Financial Firms: Expected Claim Costs

Table 6.8 summarises the modelled claim costs for Financial Firms other than DASS.

Table 6.8 – Other Financial Firms: summary of expected net claim costs

Financial firm	Number of successful CSLR claims	Average capped claim amount (\$k)	Expected claim cost capped (\$m)	Recoveries (\$m)	Net claim cost (\$m)
Other	358	\$95k	\$34m	\$0m	\$34m

We estimate that, after potential recoveries, the net CSLR claim costs relating to Pre-CSLR complaints against other financial firms to be approximately \$34m.

These results are combined with the other components of the levy estimate (AFCA fees and investment income) in Section 9.

7 Estimate of Unpaid AFCA Fees

7.1 AFCA's normal fee structure

AFCA bases its case fees 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.

7.2 Estimate of Unpaid AFCA fees for Pre-CSLR complaints

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 Pre-CSLR levy we have included \$11,000 per relevant open complaint. This figure excludes GST. We have included \$12,100 including GST per relevant open complaint. 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.

For closed complaints we have used the fee amount recorded on the AFCA data for each complaint. For completeness, we note that there is a small number of closed but unpaid complaints from the very early period of AFCA operation that were charged under the fee structure at the time, and for these the fee can be up to about \$30,000 for complaints going to an Ombudsman or Panel.

The same assumption has been applied for DASS and Other complaints, apart from the closed complaints where the amount actually invoiced has been used.

The result is an estimate of AFCA unpaid fees in respect of Pre-CSLR complaints of \$25m.

8 Other actuarial matters

8.1 Timing of cash flows

The expected pattern of claim payments will be an important consideration for annual CSLR levies in future as levies are intended to cover claim payments made in a year. For the Pre-CSLR levy, the situation is slightly simplified in that it is intended to cover all claim payments from Pre-CSLR complaints, regardless of when they are paid.

The expected pattern of payments is still relevant for estimating the investment income derived from receipt of the pre-CSLR levy to the payment of the claims.

8.1.1 Receipt of levies

We have assumed that the average date of receipt of the Pre-CSLR levy is 31 July 2024. This is based on the following reasoning:

- The Pre-CSLR levy must be charged in two equal instalments in the 1st and 2nd levy years
- ASIC will issue the invoices and must allow at least 28 days before payment is due
- The invoice for the first instalment can be issued at any time during 2023/24, but the timing of the legislative instrument means that earliest practical date would be in April 2023.
- While the second instalment must be due for payment after 1 July 2024, the invoice can be issued before that date
- We have assumed that CSLR will request ASIC to issue invoices relatively early, and that ASIC will do so in a measured manner (meaning weeks, not days or months)
- Institutions are generally aware of the levy requirements and are likely to pay on or before the due date of the instalments
- The assumption of an average date of 31 July 2024 would be satisfied if the two instalments were 31 May 2023 and 30 September 2023, or alternatively 30 June 2023 and 31 July 2023.

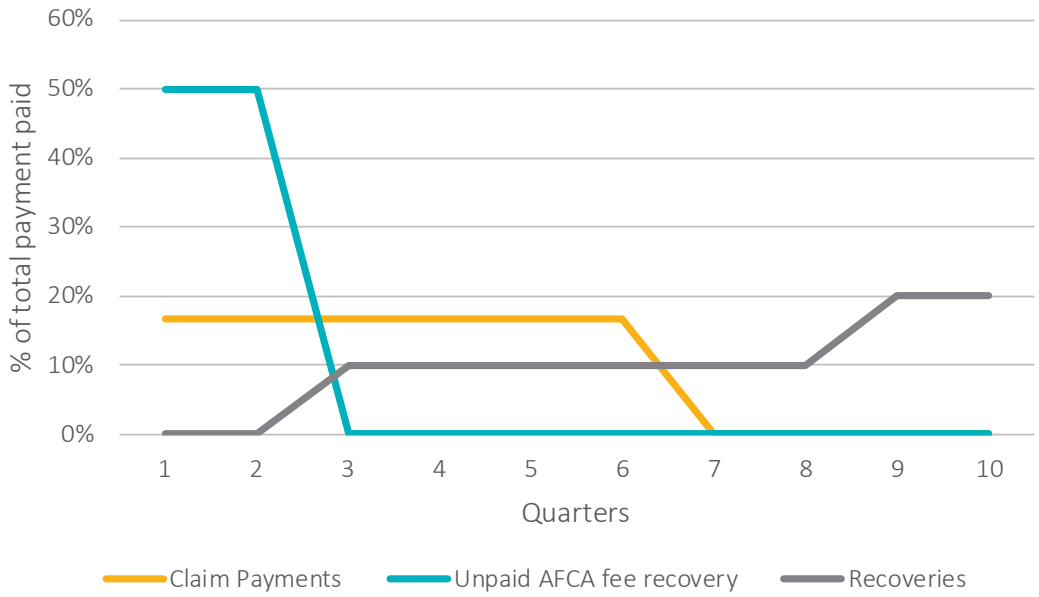
8.1.2 Payment of claims

For the levy estimate we have assumed that the Pre-CSLR claim payments will be made relatively quickly, in order to avoid overstating the investment income.

Figure 8.1 outlines the expected pattern of payments and recoveries from 1 July 2024.

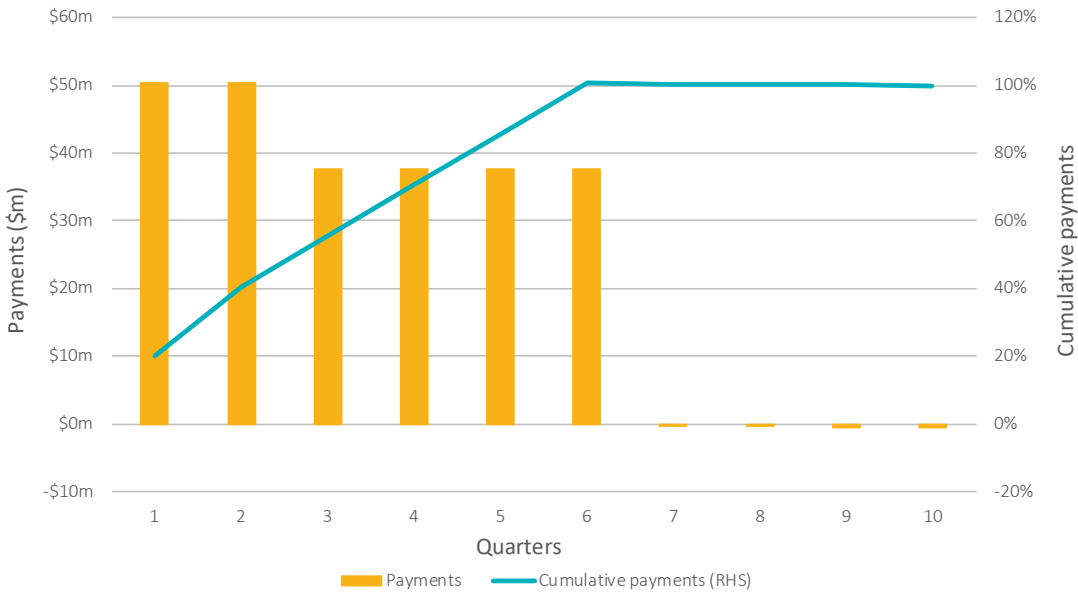
The claim payments (the largest component) are spread evenly over 18 months for this purpose. AFCA fees, which are invoiced when a complaint is closed (which will well before a CSLR claim is paid) are spread over six months. The small amount of recoveries is spread over a later and longer period.

Figure 8.1 – Payment pattern (quarters from 1 July 2024)



Combining these assumptions gives the pattern of payments by quarter shown in Figure 8.2.

Figure 8.2 – Expected payment timing



It is worth reiterating that for the Pre-CSLR levy these payment assumptions are relevant only to the amount of investment income that would be assumed, and the impact of changing the assumption is not material.

In future years the payment patterns will be much more important because they will directly impact on the levy amount. Experience of dealing with the Pre-CSLR complaints will help inform assumptions about the timing of claim payments in future.

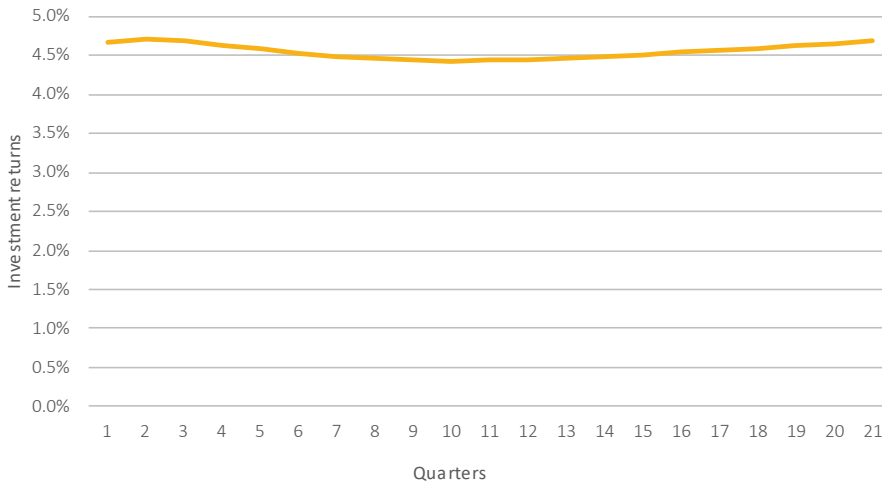
8.2 Investment income

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 8.3 details our assumption for investment returns generated by the investment levy monies.

Figure 8.3 – Investment return (quarters from 1 July 2024)



As can be seen, the current risk-free yield curve is relatively flat at about 4.5% p.a. over our period of interest. Given the relatively short payment patterns assumed, the impact of investment income is limited. Overall, the projected amount of investment earnings is about \$9m, reducing the Pre-CSLR levy by 3.6%.

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.

None of the other transactions are assumed to attract GST.

9 Recommendation for Pre-CSLR levy

In summary, we have been requested by CSLR to estimate the costs associated with Pre-CSLR complaints in order to recommend an appropriate Pre-CSLR levy. This section discusses the results.

9.1 Estimate of Pre-CSLR levy costs

We have combined the estimates of claim costs, unpaid AFCA fees, recoveries and investment income to arrive at an estimate of the required Pre-CSLR levy.

Table 9.1 outlines these estimates (with DASS shown separately).

Table 9.1 – Cost estimate by Financial Firm

Financial firm	Number of successful CSLR claims	Expected claim cost capped (\$m)	Unpaid AFCA fees (incl GST) (\$m)	Recoveries (\$m)	Investment income (\$m)	Recommended pre-CSLR levy (\$m)
DASS	1,556	\$193m	\$20m	-\$2m	-\$8m	\$203m
Other	358	\$34m	\$5m	\$0m	-\$1m	\$38m
Total	1,914	\$227m	\$25m	-\$2m	-\$9m	\$241m

The result of our estimation is that the appropriate Pre-CSLR levy is \$241m, in order to fund an estimated 1,914 CSLR claims plus AFCA fees.

The cost arising from DASS is expected to account for around 85% of the required Pre-CSLR levy.

Table 9.2 outlines the estimated total costs, summarised by the sub-sector to which the Pre-CSLR complaint relates. Values to the nearest cent can be found in Appendix B. For this estimate we have apportioned the amount for which the sub-sector is unknown pro-rata to where it is known but excluding DASS.

Table 9.2 – Cost estimate by Sub-sector

Sub-segment	Number of successful CSLR claims	Expected claim cost capped (\$m)	Unpaid AFCA fees (incl GST) (\$m)	Recoveries (\$m)	Investment income (\$m)	Recommended pre-CSLR levy (\$m)
DASS personal financial advice ¹	1,556	\$193m	\$20m	-\$1.9m	-\$7.6m	\$203m
Other personal financial advice	284	\$27m	\$4m	-\$0.3m	-\$1.1m	\$30m
Credit intermediation	25	\$3m	\$0m	\$0.0m	-\$0.1m	\$3m
Credit provision	12	\$0m	\$0m	\$0.0m	\$0.0m	\$0m
Securities Dealing	36	\$4m	\$1m	\$0.0m	-\$0.2m	\$4m
Total	1,914	\$227m	\$25m	-\$2.3m	-\$8.9m	\$241m

¹ All DASS complaints relate to personal financial advice

Approximately 97% of the total net cost estimate of \$241m is expected to arise from personal financial advice. If we leave DASS out, the proportion of the remainder would still be about 80% arising from personal financial advice.

9.2 Uncertainty of estimates

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

9.3 Recommended Pre-CSLR levy

Based on our estimation of likely costs, combined with the application of the Actuarial Policy, we **recommend a Pre-CSLR levy of \$241m.**

10 Uncertainty and sensitivity testing

This section of the report explains key elements of the uncertainty with estimating the required Pre-CSLR levy and gives some quantification of the impact of relevant assumptions on the result.

10.1 Context

CSLR is a new arrangement and has not commenced operating. There are no reasonably comparable other arrangements that can be looked to for 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. There is a risk, however, that these interpretations may turn out to be incorrect and the cost of Pre-CSLR claims are materially different.

10.2 Reasonable estimate

In this report we have presented our assessment of a reasonable estimate for the Pre-CSLR 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.

While the concepts are subtle, a distinction needs to be made between a range of reasonable estimates at commencement, and a range of plausible outcomes after the event. The range of plausible outcomes is considerably wider, but does not inform the reasonable estimate other than through the Actuarial Policy. Take for example flipping an unbiased coin 10 times – a reasonable estimate before flipping would be 5 heads, while a plausible outcome includes anything from zero to 10 heads.

The Pre-CSLR levy estimate in this report does not include an explicit margin to cover random variability of outcomes or any concept of ‘the cost of risk’.

10.3 Relevant assumptions

Table 10.1 shows the assumptions underlying the estimate, with the exception of some minor ones, with a cross-reference to the section of the report where they are derived.

Table 10.1 – Pre-CSLR Levy assumptions

Segment	Assumption	Section	Parameter Value
DASS	Number of AFCA complaints	6.1	1,638
	% of complaints becoming successful CSLR claims	6.2.1	95%
	Average capped cost of CSLR claim	6.2.2	\$124k

Other financial firms: known ¹⁰	No of AFCA complaints	6.1	211
	Number of successful CSLR claims	6.3.1	139
	Average capped cost of CSLR claim	6.3.4	\$95k
Other financial firms: unknown ¹¹	Number of successful CSLR claims	6.3.1	219
	Average capped cost of CSLR claim	6.3.4	\$95k
Recoveries	Recovery rate: proportion of claim costs covered by other compensation or subrogation by CSLR	6.2.2 and 6.3.3	1%
AFCA fees	AFCA Fees per complaint outcome	7	\$12,100
Investment income	Investment income rate of return per annum	8.2	4.5%

10.4 Sensitivity to Major Assumptions

For the more important assumptions we have varied the relevant assumption from that adopted, and recalculated what the amount of the recommended Pre-CSLR levy would be. The degree of the variation used depends in a qualitative way on the uncertainty in the parameter estimate.

The sensitivities shown are plausible outcomes that are more or less than the assumptions we adopted. Some of the assumptions, such as assuming all DASS complainants receive a non-nil Determination and a subsequent CSLR claim, represent an upper bound of what could happen and not necessarily appropriate to assume for a reasonable estimate. Furthermore, the reasonableness of the estimate should be assessed in aggregate. It would not be appropriate to adopt the upper end for each assumption, because the end result would be too high to be considered a reasonable overall estimate.

The results of this sensitivity analysis are conveyed in Table 10.2. Discussion of the main results follows the table.

¹⁰ In-scope complaints from failed financial firms

¹¹ Includes: potentially in-scope complaints from failed financial firms (missing sub-segment information), in-scope complaints from active financial firms, and possible scope-change transitions

Table 10.2 – Sensitivity of assumptions

Segment	Assumption	Value Used	Alternative Value	Pre-CSLR levy (\$m)	Change (\$m)	Change (%)
Base				\$241m		
DASS	% of complaints becoming successful CSLR claims	95%	100%	\$251m	\$10m	4%
DASS	% of complaints becoming successful CSLR claims	95%	75%	\$202m	-\$39m	-16%
DASS	Average capped cost of CSLR claim	\$124k	\$140k	\$265m	\$24m	10%
DASS	Average capped cost of CSLR claim	\$124k	\$110k	\$220m	-\$21m	-9%
Other FFs (known) ¹	Number of successful CSLR claims	139	200	\$246m	\$5m	2%
Other FFs (known)	Number of successful CSLR claims	139	100	\$237m	-\$3m	-1%
Other FFs (known)	Average capped cost of CSLR claim	\$95k	\$104k	\$244m	\$3m	1%
Other FFs (known)	Average capped cost of CSLR claim	\$95k	\$86k	\$238m	-\$3m	-1%
Other FFs (unknown) ²	Number of successful CSLR claims	219	600	\$282m	\$41m	17%
Other FFs (unknown)	Number of successful CSLR claims	219	100	\$228m	-\$13m	-5%
Other FFs (unknown)	Average capped cost of CSLR claim	\$95k	\$110k	\$246m	\$5m	2%
Other FFs (unknown)	Average capped cost of CSLR claim	\$95k	\$80k	\$236m	-\$5m	-2%
All	Recovery rate	1%	0%	\$243m	\$2m	1%
All	AFCA Fees per complaint outcome	\$12k	\$16k	\$249m	\$8m	3%
All	AFCA Fees per complaint outcome	\$12k	\$9k	\$235m	-\$6m	-3%
All	Investment income rate of return	4.5%	1.0%	\$248m	\$7m	3%

¹ Other FFs (known): in-scope complaints from failed financial firms

² Other FFs (unknown): includes potentially in-scope complaints from failed financial firms (missing sub-segment information), in-scope complaints from active financial firms, and possible scope-change transitions

One can immediately see that, given the scale of DASS, the contribution of DASS to the uncertainty is high. Qualitatively:

- The number of Pre-CSLR complaints should be pretty accurate (we used AFCA data directly)
- The number of successful CSLR claims arising from DASS complaints is judgemental, and we have assumed a high proportion for reasons explained earlier in the report
- The average cost of a CSLR claim is informed by the losses self-reported by complainants and indirectly from the Administrators’ Report. We have assumed a significant uplift arising from the AFCA ‘loss of profits’ approach, which means that the average cost cannot mathematically get very much higher because of the \$150,000 cap.

For the other Financial Firms where complaints are currently identified as in-scope, reasonable variations in the assumptions would move the overall result by \$3m to \$5m up or down.

For other Financial Firms that cannot be currently identified as risky, on the other hand, the uncertainty is large. The adverse scenario (of 600 CSLR claims) would contribute a large extra cost, but it would require the failure of one or more large firms (not necessarily the scale of DASS) that are currently not known to be at risk. While this is unlikely, it is one of the contingencies that would make a very large difference to the cost of Pre-CSLR claims.

On the other hand an assumption of 100 claims would also be reasonable.

Recoveries are very difficult to assess as discussed earlier in the report. However, the assumption we have made is small at 1% and if there were to be no recoveries, the impact on Pre-CSLR costs would be immaterial.

AFCA fees are relatively straightforward to estimate based on the input from AFCA. The basis for CSLR paying AFCA fees is, however, still under consideration and not settled. Should a different basis be determined by the time operations commence this component of the levy could be wrong. Even so, it is not a big contributor to the overall uncertainty, with quite large variations impacting the result by less than \$10m.

The investment income is even less important in the uncertainty. If a return of only 1% p.a. was achieved, the impact on the outcome would only be \$7m.

These sensitivity tests do not encompass the full range of possible outcomes. It is also possible that more than one variation would occur at the same time, resulting in an even larger impact.

We would typically expect some of our assumptions will ultimately prove to be high and that this will be offset against other assumptions where the opposite is true.

10.5 Range of reasonable estimates

Taking the above discussion and sensitivity into account, it is our view that a reasonable range of estimates for the pre-CSLR levy is as low as \$200m and as high as \$260m (noting the legislative cap is \$250m).

The draft Actuarial Policy states that where there is uncertainty, an estimate towards the higher end of a reasonable range should be preferred. It is our opinion that the recommended Pre-CSLR levy meets the requirements set out in the Actuarial Policy, being towards the higher end of the reasonable range.

As noted previously, our suggested range should not be considered high and low scenarios of what might eventuate after pre-CSLR complaints have all be processed and claims paid.

10.6 Responding to the uncertainty

As discussed in the draft Actuarial Policy there is little that CSLR can do to manage the uncertainty:

- The legislation specifies that the Pre-CSLR levy is a 'one-off' amount with no way of collecting more or returning some to the payers of this levy
- The CSLR does not yet operate, for most assumptions there is no relevant historical data to work from, and there is no prospect of making a more reliable estimate at the present time.

What CSLR will need to do is adequately monitor the progress of Pre-CSLR complaints and then carefully plan and communicate how and when any surplus or shortfall is best included in annual levies. We would expect any flowthrough of surplus or shortfall to be spread over more than one year if the amount is significant.

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 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 are 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 Reliances and limitations

We have relied on the information provided to us as detailed in Section 5.1 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 largely 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 since 2013
- A list of AFCA complaints that have been identified by AFCA as within the relevant sub-sectors and against a failed financial firm
- Several other extracts of complaints files responding to requests for different selection criteria
- 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 pre-CSLR complaints and set-up of CSLR procedures
- Responses to several legal questions about interpretation of CSLR legislation
- Regular discussions with CSLR management
- DASS information sourced from the Administrators' website

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:

- A comparison of the in-scope CSLR complaints as identified by AFCA, against the full AFCA complaints database.
- 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 Pre-CSLR levy costs by sub-sector

Table B.1 outlines the estimated total costs, summarised by the sub-sector to which the Pre-CSLR complaint relates, to the nearest cent. For this estimate we have apportioned the amount for which the sub-sector is unknown pro-rata to where it is known but excluding DASS.

Table B.1 – Cost estimate by sub-sector (to the nearest cent)

Sub-segment	Number of successful CSLR claims	Expected claim cost capped	Unpaid AFCA fees (incl GST)	Recoveries	Investment income	Recommended pre-CSLR levy
DASS personal financial advice ¹	1,556	\$192,955,871.15	\$19,819,800.00	-\$1,929,558.71	-\$7,558,889.46	\$203,287,222.98
Other personal financial advice	284	\$27,443,637.32	\$4,239,232.87	-\$274,436.37	-\$1,099,265.34	\$30,309,168.48
Credit intermediation	25	\$2,559,653.16	\$384,556.28	-\$25,596.53	-\$102,343.40	\$2,816,269.50
Credit provision	12	\$199,715.45	\$102,309.74	-\$1,997.15	-\$9,216.40	\$290,811.64
Securities Dealing	36	\$3,782,754.54	\$560,514.77	-\$37,827.55	-\$151,114.28	\$4,154,327.48
Total	1,914	\$226,941,631.62	\$25,106,413.66	-\$2,269,416.32	-\$8,920,828.88	\$240,857,800.07

¹ All DASS complaints relate to personal financial advice

