

CSLR  
Compensation Scheme  
of Last Resort

Policy for Determination of Estimates  
for First and Second Levy Periods

## Table of Contents

<b>1. Introduction</b> .....	3
<b>2. Board's Guiding Principles</b> .....	6
<b>3. Conceptual framework</b> .....	6
3.1 High-level framework.....	6
3.2 Code of Conduct and standards .....	7
3.3 Apportionment of Fixed Components to the Sub-Sectors.....	7
3.4 Revised Claims, Fees and Costs Estimates.....	7
<b>4. Principle 1 - Strengthening Trust and Confidence</b> .....	8
<b>5. Principle 2 - Compliance with all Legislative and Regulatory Requirements</b> ...	8
5.1 Regard to be had to 'actuarial principles' .....	8
5.2 Efficient, Effective and Economical .....	9
<b>6. Principles 3 – Recognising impact of CSLR Scheme on Sub-Sectors</b> .....	10
<b>7. Principle 4 - Professional Assistance from Suitably Qualified Experts</b> .....	10
<b>8. Principle 5 – Board's Diligent Enquires &amp; Reasonable Belief</b> .....	11

# 1. Introduction

## 1.1. Legislative context

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

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

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

## 1.2. Purpose of the policy

This policy provides agreed principles and a framework for the CSLR Scheme Operator, Compensation Scheme of Last Resort Limited (“**CSLR**”) in relation to its responsibility to determine estimates as provided for under the Legislation, including:

- the ‘**First Levy**’ that is to be paid by the Commonwealth Government to the CSLR operator;
- the ‘**Second Levy**’ that is to be paid by industry participants in the relevant sub-sectors as defined by the Legislation (**the Sub-Sectors**); and
- a ‘**Further Levy**’, as governed by the Legislation and if deemed necessary by the Board considering revised claims, fees and costs estimate having been made for the Second Levy Period.

This policy is set and approved by the CSLR Board and was prepared with input from suitably qualified actuarial experts.

## 1.3. Scope and design

This policy is currently focused on the principles the CSLR Board will consider when determining the estimates for the First Levy Period and Second Levy Period in accordance with the Legislation.

The Board has previously adopted an actuarial policy specific to the pre-CSLR Complaints Estimate. This Policy is supplementary to that policy and applies to determinations of the estimates for the First and Second Levy Periods.

The policy is expected to be further refined, as appropriate, beyond the First Levy Period and Second Levy Period as the more complex issues of revised estimates, excesses and shortfalls, and additional levies become relevant.

**1.4. Roles and responsibilities**

CSLR Operator	<p>In September 2023, the responsible Minister <a href="#">authorised</a> Compensation Scheme of Last Resort Limited (<b>CSLR</b>) to be the operator of the CSLR scheme under section 1060 of the <i>Corporations Act</i>.</p>
CSLR Board	<p>The Board is the decision-making body of CSLR and is tasked under this Policy and the Legislation to determine an estimate for the levy amount for both the First Levy Period and Second Levy Period.</p> <p><b>First Levy Period</b></p> <p>The Board’s role is to determine the First Levy Period estimate and an estimate for each of the relevant Sub-Sectors, which it <b>reasonably believes</b>, having <b>regard to actuarial principles</b>, is the sum of the following:</p> <ol style="list-style-type: none"> <li>1. the total amount of compensation payable under the Legislation during the First Levy Period for each of the relevant Sub-Sectors; and,</li> <li>2. the portion of the sum of the following that is attributable to each of the relevant Sub-Sectors:             <ol style="list-style-type: none"> <li>a. the sum of AFCA's unpaid fees payable by CSLR for complaints lodged after 7 September 2022;</li> <li>b. the capital reserve establishment contribution; and,</li> <li>c. the CSLR operator's expected administrative costs for the First Levy Period.</li> </ol> </li> </ol> <p><b>Second Levy Period</b></p> <p>The Board is also responsible for determining estimates for the Second Levy Period as governed by the Legislation. The requirement is the same as for the First Levy Period except that the amount includes the expected charge from ASIC to CSLR.</p> <p>Once a determination has been made by the Board, the Board is responsible for tabling a legislative instrument before Parliament.</p>

	<p><b>Further Levy</b></p> <p>The Legislation also provides that the Board may make a revised claims, fees and costs estimate before the end of the Second Levy Period. The Board may then determine an estimate for a further levy to be imposed for the Second Levy Period and the relevant Sub-Sector(s), provided the Sub-Sector Cap would not be exceeded.</p> <p>The Board is responsible for notifying the Minister as soon as is practicable if a revised estimate of costs would exceed the relevant Sub-Sector(s) levy cap.</p>
Principal actuary	<p>The Principal Actuary is the primary, independent and reputable actuarial firm engaged by the Board, which has taken the lead and reports to the Board on actuarial analysis and modelling in relation to determination of the estimates, as well as providing input into the development of this Policy.</p>
Reviewing actuary	<p>The Reviewing Actuary is a second independent, reputable actuarial consultancy engaged by the Board to provide a quality assurance mechanism and which has reviewed the Principal Actuary's actuarial approach, modelling and calculations in relation to the Estimates.</p>
ASIC	<p>Once the legislative instrument for the Second Levy Period is in force, ASIC is responsible for imposing the Second Levy on firms in the relevant Sub-Sectors including ascertaining how that levy will be distributed within the relevant Sub-Sectors.</p> <p>ASIC is also responsible for providing CSLR with an estimate of its own costs associated with imposing the Second Levy.</p>
AFCA	<p>AFCA provides complaint and other information to inform actuarial modelling, including its expected fees to be paid by CSLR.</p>
Minister	<p>Where the estimated fees and costs in respect of one or more Sub-Sectors exceed the Sub-Sector Levy Cap, and following notification by the Board, the Minister may, by legislative instrument, decide either:</p> <ol style="list-style-type: none"> <li>1. to impose a special levy for the relevant Sub-Sector(s) exceeding the cap; or</li> <li>2. to impose a special levy across sub-sectors.</li> </ol>
Commonwealth of Australia	<p>The Commonwealth will pay the CSLR Operator the sum of the determined estimates made by the Board in relation to the First Levy Period.</p>

## 2. Board's Guiding Principles

In accordance with the Legislation, it is the CSLR Board's responsibility to determine the estimates for each levy period as an amount which it *reasonably believes* to be the cost of operating the CSLR Scheme for the relevant period, *having regard to actuarial principles*.

This policy is the Board's policy on how it will properly discharge its responsibilities under the Legislation in relation to the First Levy Period and Second Levy Period.

The Board has agreed to adopt the following five guiding principles which are as follows:

1. CSLR is committed to strengthening the trust and confidence in the dispute resolution framework for financial services by providing a fair and reasonable compensation service for eligible consumers.
2. CSLR is committed to complying with all legislative and regulatory requirements in determining the estimates for each levy period.
3. CSLR recognises the impact of the CSLR Scheme on the relevant Sub-Sectors and seeks to operate a cost-effective, efficient and economical service and to ensure the funds levied on the financial service industry are used appropriately and transparently to promote trust in the Scheme.
4. CSLR will seek professional assistance from suitably qualified experts to determine the estimates, including the engagement of the Principal Actuary and the Reviewing Actuary to assist with its determination and independent review of estimates, having regard to actuarial principles.
5. CSLR will make all diligent enquiries necessary and consider any appropriate factors which the Board deems relevant to ensure that it is the Board's reasonable belief that the estimates reflect the expected cost of operating the Scheme during the relevant period.

## 3. Conceptual framework

### 3.1 High-level framework

The CSLR scheme is likely to be volatile and uncertain from year to year, based on the incidence, scale and consumer impacts of failures of Financial Firms. The Board remains aware that the amount of each estimate is subject to considerable uncertainty, and that the eventual outcomes from each year can be much different than the previous estimates.

The Principal Actuary has been engaged to assist the Board in determining the estimate for each levy period in accordance with the Legislation which requires the estimates to be determined by the Board having regard to actuarial principles.

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

It is expected that the Principal Actuary and the Reviewing Actuary will make realistic assumptions and adopt methodology that is based on actuarial principles, including the impact on third parties and the continuing sustainability of the scheme. The Board accepts that there will inevitably be a range of estimates that could be considered reasonable given the uncertainties and potential limitations with data, and that the eventual outcomes are unlikely to match the estimates.

The Board, and particularly the Actuary Director, will engage with the Principal and Reviewing Actuary during the determination process and scrutinise the methodology used, and assumptions made.

### **3.2 Code of Conduct and standards**

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

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

### **3.3 Apportionment of Fixed Components to the Sub-Sectors**

There are costs involved relating to the running of the Scheme that are not derived directly from the relevant Sub-Sectors, including the CSLR operating expenses, ASIC charges for levy collection and capital contribution to the Scheme.

In apportioning those costs, the Board will consider the interests of all impacted third parties under the Scheme to ensure that the apportionment of those costs is reasonable, given all the relevant circumstances and information available to the Board.

### **3.4 Revised Claims, Fees and Costs Estimates**

During the Second Levy Period, the Board has discretion under the Legislation to re-estimate the costs to be incurred for running the Scheme within that period for any given Sub-Sector.

When considering a re-estimation, the Board will continue to apply the guiding principles under this Policy and will ensure that it reasonably believes the revised

estimate to be accurate, considering all information available to the Board at the time of the re-estimation and having regard to actuarial principles.

## 4. Principle 1 - Strengthening Trust and Confidence

The Board seeks to provide an efficient claims handling process for eligible consumers, recognising the vulnerability of many consumers eligible for compensation payments under the Scheme.

It's ability to provide an efficient process and effective customer service for eligible consumers is a key consideration for its determination of the levy estimates for the 1<sup>st</sup> and 2<sup>nd</sup> Levy Periods.

## 5. Principle 2 - Compliance with all Legislative and Regulatory Requirements

### 5.1 Regard to be had to 'actuarial principles'

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

The relevant sections of the Legislation do not define actuarial principles.

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

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

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

In considering the nature of the CSLR Scheme, the funding sources for the First Levy Period and Second Levy Period and the legislative requirements for the CSLR operator, the following principles and aspects of actuarial practice (although not exhaustive) are deemed relevant by the CSLR Board for the determination of the estimates:

- 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:
  - 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 Principal Actuary and the Reviewing Actuary will ensure that these considerations are referred to when preparing the actuarial advice and reviewing the advice respectively.

## 5.2 Efficient, Effective and Economical

The legislation provides that the CSLR operator must manage money in a manner that is **efficient, effective** and **economical**. The Board recognises that the operating model of the Scheme must operate efficiently, effectively and economically, which are factors that will be considered when coming to a reasonable belief that the estimates accurately reflect the expected cost of operating the Scheme during the relevant period.

The Board is committed to ensuring the Scheme:

- Achieves productivity and appropriate value with minimal wasted effort, time or expense;
- Utilises appropriate expertise in reaching its determination of the Estimates and in its operation of the Scheme, to achieve intended outcomes in line with legislative requirements and key stakeholder expectations; and
- Minimises the cost of resources without compromising quality, efficiency and/or ability to achieve intended outcomes.

## 6. Principles 3 – Recognising impact of CSLR Scheme on Sub-Sectors

The Board recognises the financial services industry commitment to funding the CSLR Scheme in the 1<sup>st</sup> and 2<sup>nd</sup> Levy Period and beyond.

The CSLR Scheme seeks to operate under a model that is designed to be transparent for all key stakeholders, including the relevant Sub-Sectors upon which the period levies are imposed.

The Board is committed to providing key stakeholders, including those Sub-Sectors, good visibility over its determination of the relevant levy estimates and its operation of the CSLR Scheme, to promote trust and confidence in the Scheme.

## 7. Principle 4 - Professional Assistance from Suitably Qualified Experts

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

It is noted that both the Principal Actuary and Reviewing Actuary should satisfy the following criteria to ensure expert actuarial analysis and modelling is undertaken to determine the Estimate:

- Have significant expertise and experience in the financial services industry;
- Have significant experience in dealing with uncertainty;
- Be experts in scenario planning and have experience in evaluating the likelihood of future events;
- To be able to analyse data to develop reasonable assumptions;
- Able to competently test methodologies to estimate liabilities, including the implications of uncertainty in the estimation process;
- Be professional and reflect the mandatory standards of compliance, competence, care, and objectivity as provided for under the *Actuaries Institute Code of Conduct* (refer section 3.2 above); and
- Competently apply the discipline of the actuarial control cycle to define a problem, design and implement a solution, monitor the effectiveness of the solution and revise if necessary; and
- Be independent from CSLR, AFCA and any key stakeholders impacted by the levy to be determined and undertake to declare any conflicts to the Board that may fetter such independence, be those actual, potential or perceived conflicts.

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

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

## 8. Principle 5 – Board’s Diligent Enquires & Reasonable Belief

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

Whilst the Board must have regard to actuarial principles when determining the Estimates, above all it must ensure that it has a reasonable belief that the Estimates accurately reflect the expected costs of running the CSLR Scheme in accordance with the Legislation.

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

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