
TREASURY LAWS AMENDMENT (MEASURES FOR CONSULTATION) BILL
2021: COMPENSATION SCHEME OF LAST RESORT

EXPOSURE DRAFT EXPLANATORY MATERIALS

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Glossary

The following abbreviations and acronyms are used throughout this exposure draft explanatory material.

<i>Abbreviation</i>	<i>Definition</i>
AFCA	Australian Financial Complaints Authority
AFCA Fees Bill	Financial Services Compensation Scheme of Last Resort Levy (AFCA Fees) Bill 2021
ASIC	The Australian Securities and Investments Commission
ASIC supervisory cost recovery levy framework	The levy framework established by the <i>ASIC Supervisory Cost Recovery Levy Act 2017</i>
Collection Bill	Financial Services Compensation Scheme of Last Resort Levy (Collection) Bill 2021
Corporations Act	<i>Corporations Act 2001</i>
Financial Services Royal Commission Final Report	The Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry
Levy Bill	Financial Services Compensation Scheme of Last Resort Levy Bill 2021
Ramsay Review	The Final Report of the Review of the financial system external dispute resolution and complaints framework

More information

This exposure draft explanatory material should be read alongside the proposal paper for the compensation scheme of last resort.

The proposal paper provides a detailed overview of the key design features of the scheme, including its governance, coverage, payment arrangements and levy arrangements.

The proposal paper is available at <https://treasury.gov.au/consultation>.

Chapter 1

Compensation scheme of last resort

Outline of chapter

1.1 This Chapter describes how the compensation scheme of last resort (CSLR) will be established and how it will operate.

1.2 All legislative references in this Chapter are to the Corporations Act, unless otherwise stated.

Context of amendments

1.3 The Australian financial system is central to the Australian economy and plays an essential role in promoting economic growth and stability. A well-functioning framework for resolving disputes within the financial system is essential for safeguarding consumer trust and confidence, and to ensure the system continues to meet the needs of its users.

1.4 In April 2016, the Government commissioned the first comprehensive review of the financial system external dispute resolution framework. The review was undertaken by an expert panel chaired by Professor Ian Ramsay and recommended a new financial system dispute resolution framework. In response, the Government announced the establishment of the AFCA scheme, which commenced operations on 1 November 2018.

1.5 AFCA is an independent external dispute resolution scheme that deals with consumer and small business disputes about financial firms. AFCA is a one-stop shop for most complaints concerning insurance, banking, credit provision and superannuation; and is an alternative option to going to court. AFCA is empowered by the law to make binding determinations requiring financial firms to compensate consumers.

1.6 On February 2017, the Government amended the Ramsay Review Terms of Reference to ask the expert panel to make recommendations on the establishment, merits and possible design of a financial services compensation scheme of last resort. A Supplementary Final Report was provided to the Government on 6 September 2017.

1.7 The Supplementary Final Report to the Ramsay Review observed that existing arrangements were not adequate to ensure that users of the financial system were compensated for losses where an external dispute resolution scheme, tribunal or court makes a finding of

misconduct and a subsequent award in favour of the consumer. This issue is compounded in situations of insolvency as consumers who are awarded damages by AFCA or a court are ranked as unsecured creditors.

1.8 As such, the Supplementary Final Report to Ramsay Review recommended that a compensation scheme of last resort be established in Australia. The Financial Services Royal Commission Final Report later recommended that the three principle recommendations made in the Supplementary Final Report should be carried into effect. In its response to the Royal Commission, the Government committed to improving consumer and small business access to redress, including by implementing an industry-funded, forward-looking compensation scheme of last resort that extends beyond personal financial advice failures.

Summary of new law

1.9 The main objective of the proposed CSLR is to provide a pathway for eligible consumers to receive compensation, flowing from an AFCA determination in their favour, where the financial firm has not paid the consumer in accordance with the determination.

1.10 The CSLR operates to create a pool of funds from which eligible claimants who have suffered loss or damage as a result of inappropriate action of a financial firm can access compensation even if, for example, the financial firm has become insolvent.

1.11 The CSLR will be administered by the operator, which is a company that meets the operator requirements and is authorised by the Minister. Under the scheme, a complainant who has been provided a determination by Australian Financial Complaints Authority will be able to seek the determined compensation, up to \$150,000, from the operator.

Key features of new law

Establishment of the CSLR operator

Minister may authorise the CSLR operator

1.12 Amendments to the Corporations Act, provide that the Minister may authorise a person, which will be a company, to operate the CSLR. Once authorised, the operator of the CSLR will be known as the CSLR operator.

1.13 The Minister may make the authorisation by notifiable instrument. The Minister may choose to revoke or vary the authorisation by notifiable instrument. Only one authorisation of the CSLR operator

may be in force at any one time. *[Amendments to the Corporations Act, item 4, section 1059 and subsections 1060(1) to (3)]*

1.14 Regardless of whether the Minister authorises a new operator, or revokes or varies an existing authorisation, they are required to specify both the date on which the decision takes effect, as well as any conditions that pertain to that decision. *[Amendments to the Corporations Act, item 4, subsection 1060(4)]*

Mandatory requirements for the CSLR operator

1.15 Before authorising a company to operate the CSLR, the Minister must be satisfied that it meets certain requirements. Once authorised, the operator is required to ensure they continue to meet these requirements, which may be regulated by ASIC. *[Amendments to the Corporations Act, item 4, subsection 1061(1) and sections 1069E to 1069F]*

1.16 The mandatory requirements are broadly grouped into four categories: organisational, operator-related, operational, and compliance-related.

1.17 The organisational requirement is that the CSLR operator must not charge a fee to any applicant seeking compensation. Neither can the CSLR operator require an applicant to pay a fee to another entity if it is in relation to their application. *[Amendments to the Corporations Act, item 4, subsection 1061(2)]*

1.18 The operator requirements include that the CSLR operator must be a not for profit company limited by guarantee. It is also required to have particular arrangements in place for its Board of directors, as set out in section 1061. These arrangements are aimed at providing suitable senior leadership with the relevant experience required to steer the CSLR. *[Amendments to the Corporations Act, item 4, subsection 1061(3)]*

1.19 The operational requirements include that the CSLR operator conducts its business in accordance with its constitution and any regulations made under this scheme. The operator is also required to have the appropriate expertise to carry out its central functions of assessing claims for compensation and estimating scheme costs. *[Amendments to the Corporations Act, item 4, subsection 1061(4)]*

1.20 The compliance requirements are that any conditions specified by the Minister in the authorisation, as well as any other requirements provided for in relevant regulations, are complied with by the CSLR operator. *[Amendments to the Corporations Act, item 4, subsection 1061(5)]*

Payments made by the CSLR operator

1.21 Once authorised, the CSLR operator is empowered to administer payments, independent of the Government. These include reimbursing operating costs, as well as making payments to eligible applicants.

Compensation payments

Applying for a compensation payment

1.22 In practice, an applicant can make an application for compensation to the CSLR operator after they have received a **relevant AFCA determination** (see below).

1.23 Applications for compensation under the CSLR must be made in the form to be approved by the CSLR operator. Where relevant, the applicant must declare any amounts they received in relation to their claim – for example, as an unsecured creditor in an insolvency process. *[Amendments to the Corporations Act, item 4, section 1064]*

Eligibility for a compensation payment

1.24 An applicant who has made, and not withdrawn, an eligible application will be entitled to a compensation payment if they have a relevant AFCA determination in their favour, and meet any other requirements prescribed by the regulations. These requirements may include an assessment of the likelihood of the applicant getting their payment from the financial firm, and a requirement prohibiting the applicant from recovering compensation under any other statutory scheme for matters that pertain to their AFCA determination. *[Amendments to the Corporations Act, item 4, section 1063]*

1.25 A determination is a **relevant AFCA determination** if when it was made, it required an AFCA member (that is, a financial firm), to make a payment to a person (that is, an applicant), in order to compensate the person for losses and subsequently no payment or only a partial payment was made. AFCA must make such determinations in accordance with the requirements set out in the regulations and is also required to have taken reasonable steps to enforce the determination. *[Amendments to the Corporations Act, item 4, subsection 1063(2)]*

1.26 The CSLR will fund unpaid determinations made by AFCA that have accumulated since the beginning of the AFCA scheme, that is, 1 November 2018. Therefore, a relevant AFCA determination may relate to unpaid determinations that are either made after the commencement of the CSLR or those that have accumulated since the beginning of the AFCA scheme.

1.27 The regulation making powers in relation to eligibility for compensation under the scheme provide for further eligibility requirements to underpin the scheme. Allowing the regulations to prescribe these matters will provide the Government with the necessary flexibility to make timely responses to changes in the financial system. If any regulations in relation to eligibility are made, they will be subject to disallowance and parliamentary scrutiny.

Amount of compensation

1.28 The amount of compensation an applicant is offered by the CSLR operator is generally the amount that AFCA decides in their determination, up to a maximum of \$150,000. However, the amount may vary if there is a Ministerial determination, or if the amount needs to be adjusted to account for payments the applicant may have already received. *[Amendments to the Corporations Act, item 4, section 1065]*

1.29 The compensation cap of \$150,000 may be affected by a Ministerial determination (discussed below). A determination may have the effect of reducing the compensation cap for a particular group of claims, and therefore have an impact on the amount of compensation an applicant is offered. *[Amendments to the Corporations Act, item 4, paragraph 1065(1)(b)]*

1.30 Compensation payments will also be adjusted to reflect any payments made to an applicant through an insolvency process. The identification requirements for payments made through an insolvency process will be set out in the regulations. It is appropriate to deal with this matter in delegated legislation because it will require a level of technical detail most appropriately included in regulations. *[Amendments to the Corporations Act, item 4, subsection 1065(2)]*

Making a compensation payment and subsequent reporting to ASIC

1.31 If an applicant is eligible for compensation, the CSLR operator must make an offer to the applicant in writing. If the applicant wishes to accept the compensation amount, they too are required to agree to the terms of the offer in writing. *[Amendments to the Corporations Act, item 4, subsections 1062(1), 1066(1) and section 1067]*

1.32 Once the amount is agreed, the CSLR operator may pay compensation as a single lump sum (unless otherwise determined through a Ministerial determination – see below). *[Amendments to the Corporations Act, item 4, subsection 1062(2)]*

1.33 If a compensation payment is made, the operator is required to notify ASIC of the details of the financial firm that was the subject of the relevant AFCA determination and the circumstances surrounding its failure to pay the amount determined by AFCA. This allows ASIC to consider taking action, including suspending or cancelling relevant licences. *[Amendments to the Corporations Act, items 4 and 10, subsection 1069C(1), paragraph 915B(1)(g); Amendment to the National Consumer Credit Protection Act 2009, item 15, paragraph 54(1)(e)]*

1.34 The CSLR operator's payment of compensation does not involve discretion and is not subject to merits review under *Administrative Appeals Tribunal Act 1975*. Consistent with AFCA's making of determinations, the payment or non-payment of compensation is not subject to judicial review under the *Administrative Decisions (Judicial*

Review) Act 1977. [Amendment to the Administrative Decisions (Judicial Review) Act 1977, item 5, paragraph (hbb) of Schedule 1]

Subrogation of rights

1.35 The amendments provide the CSLR operator with a right of subrogation. That is, when an applicant obtains compensation under the scheme, their rights and remedies against the financial firm are assigned to the CSLR operator to pursue against the firm (where the firm becomes a Chapter 5 body corporate). The subrogation is limited to the amount of compensation paid by the operator. *[Amendments to the Corporations Act, item 4, subsection 1066(2) and section 1068]*

1.36 The effect of subrogating an applicant's right to the operator is that the operator can take the place of the applicant in relation to any legal rights and remedies the applicant may have had in relation to the AFCA determination. This is intended to avoid a circumstance where a consumer receives payment via the CSLR as well as another remedy.

1.37 Subrogating rights to the CSLR operator is especially relevant in an insolvency setting. An applicant who has been compensated through the CSLR may also seek payment of the relevant AFCA determination through a liquidation process. The subrogation in this context prevents the applicant being paid more than what they are owed. *[Amendments to the Corporations Act, item 4, section 1068 and subsection 1069C(2)]*

1.38 The right of subrogation allows the CSLR operator to pursue payment from a financial firm without delaying the payment of compensation to an applicant.

Reimbursement of unpaid AFCA Fees

1.39 AFCA incurs costs in assessing and making determinations on complaints. Generally, these are paid for by the financial firm against which a complaint has been made. However, there are instances, for example where a firm becomes insolvent, where the firm does not or is unable to pay this fee.

1.40 These fees are central to the ongoing operation of AFCA. The CSLR is designed to reimburse AFCA's fees where reasonable steps have been taken to recover the fees but they remain unpaid. Other operational details, including how unpaid fees are dealt with in the CSLR levy framework model is explained in Chapter 2 and the proposal paper.

1.41 The terms *AFCA unpaid fee* and an *AFCA accumulated unpaid fee* are defined in the amendments to the Corporations Act. Generally, an *AFCA unpaid fee* is the monthly sum of all fees that was charged to—but never paid by—firms that were subject to a claim that AFCA resolved. An *AFCA accumulated unpaid fee* is generally the sum of all unpaid fees that AFCA has accumulated since the beginning of the

AFCA scheme and up to when the CSLR comes into force. *[Amendments to the Corporations Act, item 3, subsections 1058A(2) and 1058A(4)]*

1.42 In both instances, AFCA is expected to have taken reasonable steps to recover their fees. The regulations may prescribe reasonable steps for this purpose. Upon notification from AFCA, the CSLR operator is required to make payments of fees to AFCA as soon as reasonably practicable, and in accordance with the date requirements specified in regulations. *[Amendments to the Corporations Act, items 3 and 4, sections 1058A and 1069A]*

1.43 Regardless of the type of unpaid fees, when making a notification to the CSLR operator, AFCA must do so in writing and meet any time requirements specified in the amendments. *[Amendments to the Corporations Act, items 3 and 4, subsections 1058A(1) and 1058A(3)]*

Ministerial determination

1.44 The CSLR is funded by an industry levy framework - described in Chapter 2. The scheme is primarily funded through an annual levy and, in some circumstances, supplemented by a secondary funding mechanism which may include the imposition of a further levy. The Minister's power to utilise the further levy is triggered where the CSLR operator determines that the value of claims made against the scheme are set to exceed a particular subsector cap. The further levy is imposed by the Minister by a Ministerial determination which is a legislative instrument.

1.45 The purpose of these mechanisms is to ensure that the scheme is able to respond to unexpected events that cause the value of claims made, or expected to be made against the scheme, to exceed the funds levied. These mechanisms enable compensation payments to continue to be made, and made quickly, and not delayed until further amounts can be levied through the annual levy process.

1.46 One feature of the Ministerial determination is that the Minister is empowered to determine that the maximum amount of compensation payable for a class of applicants should be reduced. Such a determination may reduce the compensation cap for a particular class of claims, and therefore reduce the amount of compensation an applicant may receive under the CSLR. *[Amendments to the Corporations Act, item 4, subsection 1069D(2)]*

1.47 Another feature of the Ministerial determination is to require that particular compensation payments be paid over a number of periods, rather than in a lump sum. *[Amendments to the Corporations Act, item 4, subsection 1069D(3)]*

1.48 Other features of the Ministerial determination relate to imposing a further levy and are discussed in Chapter 2.

1.49 In practice, when the CSLR operator estimates that further levy is required, it will notify the Minister (explained further in Chapter 2).

Once notification is received, and only then can the Minister intervene by making a determination. *[Amendments to the Corporations Act, item 4, subsections 1069C(3), 1069C(4) and 1069D(1)]*

1.50 Guided by the principles outlined in the Supplementary Final Report to the Ramsay Review, the scheme is designed to limit reliance on ad-hoc funding through a carefully calibrated levy calculation methodology, and by clearly specifying circumstances where a Ministerial determination is warranted. The power to make such an instrument is justified because it builds necessary flexibility into a scheme that operates within an evolving and dynamic financial system.

Powers of the CSLR operator

Information and document gathering power

1.51 The CSLR operator has the power to obtain information that is relevant to the operation of the scheme. This power to gather information extends to giving information and producing documents. It also applies to any person whom the operator believes is connected to a claim, except ASIC. *[Amendments to the Corporations Act, item 4, subsections 1069B(1) and 1069B(8)]*

1.52 The amendments specify the manner in which information is to be produced, including detail on notice requirements and deadlines. The amendments also outline how information gathered in this way may be used by the operator. *[Amendments to the Corporations Act, item 4, subsections 1069B(2) and (3)]*

1.53 Except for when there is a reasonable excuse, it is an offence for someone to not comply with a notice to provide information given by the operator. The maximum penalty for failing to provide information is 30 penalty units. If a financial firm does not comply, the operator must notify ASIC and AFCA. This notification requirement enables these organisations to take action as appropriate. *[Amendments to the Corporations Act, item 4, subsections 1069B(4) to (7)]*

Regulating the CSLR operator

1.54 The CSLR operator is to be regulated by ASIC.

1.55 ASIC may issue a written notice to the CSLR operator if the operator does not comply with the mandatory requirements that apply to the operator (see above), conditions set by the Minister at the time of authorisation, or other regulatory requirements set by ASIC. *[Amendments to the Corporations Act, item 4, subsection 1069G(1)]*

1.56 This first notice - a notice of intention to issue a direction - gives the operator a chance to resolve issues before a more formal direction is issued. The notice gives the operator notice of into the specific measures

that ASIC may require it to take if ASIC subsequently decides to issue a direction. [*Amendments to the Corporations Act, item 4, subsection 1069G(2)*]

1.57 If after a notice of intention to issue a direction, ASIC makes an assessment that the operator has still not complied with the requirements, ASIC can progress by issuing a direction in writing. Such a direction will specify a time or a period of time by which the operator needs to take action. ASIC may subsequently choose to vary or revoke a direction in writing. [*Amendments to the Corporations Act, item 4, subsections 1069G(3) and (4); and 1069G(8) to (10)*]

1.58 An ASIC direction to the operator is not a legislative instrument. This is consistent with regulations made for the *Legislation Act 2003* which provide that a direction of this kind is not legislative instrument. [*Amendments to the Corporations Act, item 4, subsection 1069G(5)*]

1.59 It is an offence for the CSLR operator to not comply with an ASIC direction given to them. The maximum penalty for not complying with an ASIC direction is 100 penalty units for an individual and 1,000 penalty units for a company, with penalties applying for each day or part of a day that the offence is committed. Failure to comply may also result in ASIC seeking a court order to compel the operator to comply. [*Amendments to the Corporations Act, item 4, subsections 1069G(6) and (7); see also item 14 inserting required changes to schedule 3 of the Corporations Act*]

Other features of new law

Appropriation and authority to spend

1.60 The amendments to the Corporations Act provide an appropriation for amounts collected under the levy framework (described in Chapter 2) to be appropriated and paid by ASIC, as the collector of the levy and on behalf of the Commonwealth, to the CSLR operator. The amount appropriated is to be equal to the amount levied. [*Amendments to the Corporations Act, item 4, section 1069H*]

1.61 A standing appropriation is justified because the timely administration of payments is central to the operation of any compensation scheme, including the CSLR. To ensure accountability, the appropriation is constrained to a fund that consists of levies collected solely for the purposes of the levy framework explained Chapter 2. Other safeguards include a requirement for the operator to use the funds only for the types of payment described in the amendments. [*Amendments to the Corporations Act, item 4, sections 1069H and 1069J*]

Chapter 2

Financial services compensation scheme of last resort levy

Outline of chapter

- 2.1 This chapter provides an overview of the levy framework created for the compensation scheme of last resort.
- 2.2 Throughout this chapter, the Levy Bill refers to the Financial Services Compensation Scheme of Last Resort Levy Bill 2021, the Collection Bill refers to Financial Services Compensation Scheme of Last Resort Levy (Collection) Bill 2021 and the AFCA Fees Bill refers to Financial Services Compensation Scheme of Last Resort Levy (AFCA Fees) Bill 2021. Collectively, these bills form the levy framework described in this Chapter.

Context of amendments

- 2.3 The Levy Bill and Collection Bill implements the levy framework through which levies will be collected to fund the CSLR and associated AFCA fees.

Summary of new law

- 2.4 The levy framework creates a tax to be levied against relevant industry entities to fund the CSLR.
- 2.5 An annual levy will be payable by persons who are members of a sub-sector prescribed in the regulations. The annual levy will cover amounts that the CSLR operator believes will be payable to applicants under the compensation scheme and to AFCA as unpaid complaints handling fees, as well as amounts to build a capital reserve, to cover the CSLR operator's expected establishment and administrative costs and ASIC's administrative costs. Other levy components will collect amounts to cover relevant unpaid claims and AFCA fee amounts accumulated since 1 November 2018.
- 2.6 The total amount of annual levy payable will be determined by the CSLR operator in a legislative instrument. Amounts payable by individual firms will be worked out in accordance with a method to be prescribed in the regulations – drawing on concepts in place for the similar calculations for ASIC's industry funding model. The relevant

sub-sectors for the purposes of the levy framework will also draw from the structures in place for the ASIC industry funding model.

2.7 Amounts to be paid under the levy framework will be subject to caps. The overall scheme cap is \$250 million – this is the total amount that can be levied in a levy period on all persons across all sub-sectors. A sub-sector cap of \$10 million will also apply – this is the amount of levy that may be imposed for any levy period on all persons in a particular sub-sector. The sub-sector-cap may be increased in the regulations and may also be exceeded where a relevant Ministerial determination is made.

2.8 In some circumstances, the flow of expected compensation claims may cause the CSLR operator to revise its estimate of the amounts needed in a levy period. Where a revised estimate exceeds a sub-sector cap, the Minister may determine to levy amounts against a sub-sector in excess of a sub-sector cap or levy amounts against a sub-sector not liable for the annual levy. The Minister is not required to exercise either of these options (or the options described in Chapter 1 regarding reducing the amount of compensation payable or paying compensation in instalments).

Key features of the new law

2.9 The CSLR’s levy framework contains a primary funding mechanism (‘annual levies’, including the capacity to revise estimates of annual levy) and, if needed, a secondary funding mechanism involving a Ministerial determination (‘further levies’).

2.10 ASIC, on behalf of the Commonwealth, is responsible for issuing levy notices and collecting all levies imposed under the scheme. [*Collection Bill, sections 13 and 16*]

Annual levy

2.11 The annual levy is payable by a person if the person is a member of a **sub-sector** and, if conditions are prescribed in the regulations, the conditions are met in relation to the person, and the person is not in a class of persons prescribed in the regulations. Levy will be imposed on a person if the person meets these criteria at any time in the 12 months preceding the levy period. What constitutes a **sub-sector** for the purposes of the annual levy will be prescribed in the regulations and will draw on concepts used in the ASIC supervisory cost recovery levy framework (see the *ASIC Supervisory Cost Recovery Levy Act 2017*). [*Levy Bill, the definition of ‘sub-sector’ in section 7 and subsection 8(1)*]

2.12 If a person is a member of more than one sub-sector for the same levy period (and meets the other conditions prescribed, if any), they would be subject to the annual levy in relation to each of those sub-sectors for the levy period.

2.13 For the purposes of the levy framework, a **levy period** is a financial year starting on or after the day the Levy Bill commences or, otherwise, a period prescribed by the regulations. [*Levy Bill, definition of 'levy period' in section 7*]

2.14 The amount of annual levy imposed on a person and a sub-sector for a levy period will be worked out in accordance with a method to be prescribed in the regulations. The Minister must be satisfied that the proposed regulations would be consistent with the objectives that the total amount of levy imposed all persons for a levy period and a sub-sector:

- does not exceed the initial claims and costs estimate;
- does not cause the sub-sector levy cap to be exceeded; and
- does not cause the scheme levy cap to be exceeded.

[*Levy Bill, section 12*]

2.15 The total amount of annual levy for a sub-sector, for a levy period, cannot exceed the annual sub-sector cap of \$10 million (or an amount otherwise prescribed for the sub-sector in the regulations). The sub-sector cap is intended to provide assurance to relevant industries about the maximum amount expected to be levied against each sub-sector in a levy period. [*Levy Bill, section 17*]

Initial estimate of claims and costs

2.16 Under the levy framework, the CSLR operator will determine, in a legislative instrument, the **initial estimate of the claims and costs** for an upcoming levy period and a sub-sector. The initial estimate must be made within 4 months before the start of a levy period. [*Collection Bill section 9(1)*]

2.17 The **initial estimate of claims and costs** includes the following:

- **claims payable** – the amount that is expected to be payable as compensation in relation to relevant AFCA determinations for a sub-sector in the upcoming levy period. The estimate will be informed by collaborations with AFCA and an understanding of the compensation pipeline – that is, matters that are expected to flow from complaints made to AFCA, through to AFCA determinations and applications made to the CSLR.
- **administration costs** – the CSLR operator's expected operational costs for the upcoming levy period – for example, staff and IT costs.
- **capital reserve contributions** – the annual levy for the first three levy periods will include an amount to establish the capital reserve. For the first three levy periods, approximately one third of the capital reserve amount will be included in the

annual levy. After the first three levy periods, the CSLR operator can continue to include capital reserve contributions in the annual levy to maintain the capital reserve. Unless specified otherwise in the regulations, the capital reserve is \$5 million.

- *establishment costs* – the costs expected to be incurred by the CSLR operator in its establishment. As this cost is tied to establishing the CSLR operator, it will only be included in the annual levy for the first levy period.
- *ASIC’s administrative costs* – the costs ASIC incurs or expects to incur for a levy period in performing its responsibilities and functions under the CSLR and the levy framework. For the first levy period, ASIC’s administrative costs may also include any costs ASIC incurs to establish systems that will enable them to perform its functions under the CSLR and the levy framework.
- *reconciliation for earlier levy periods* – this allows amounts to be added to or removed from the initial estimate of costs and claims for a levy period where the CSLR operator identifies an excess or shortfall from an earlier period.

[Collection Bill, subsections 9(1) and (4)]

Revised estimate of annual levy

2.18 If at any time during a levy period, the annual levy collected for a sub-sector is insufficient or is likely to be insufficient to meet the actual or estimated claims payable for the sub-sector, the CSLR operator may recalculate the amounts included in the ***initial estimate of claims and costs*** and determine a ***revised estimate of claims and costs*** for the levy period and sub-sector. *[Collection Bill, subsection 10(1)]*

2.19 Where a revised estimate of claims and costs would not exceed the sub-sector cap for a particular sub-sector for the relevant levy period, the CSLR operator may, by legislative instrument, determine a revised estimate of claims and costs. A further levy is imposed on the sub-sector where such a determination is made. *[Levy Bill, subsection 8(2) and Collection Bill, subsection 10(3)]*

2.20 The total amount of further levy imposed on the sub-sector will be equal to the difference between the revised and the initial estimate claims and costs for that levy period. As with the annual levy imposed by the initial estimate, the amount of further levy payable by each individual firm in the sub-sector will be calculated in accordance with a method prescribed in the regulations. *[Levy Bill, section 13]*

2.21 As the revised estimate of claims and costs does not exceed the prescribed annual sub-sector cap for that sub-sector for the levy period, the CSLR operator is not required to notify the Minister before making a determination that a further levy needs to be imposed on a sub-sector.

2.22 The availability of a further levy in a levy period is aimed at ensuring that the funds needed to pay compensation under the CSLR are available within a levy period. The availability of further levy (up to the sub-sector cap) reduces the need for a further levy under a Ministerial determination or the need to wait for expected claims costs to be incorporated in the initial estimate in a later levy period.

AFCA's unpaid fees

2.23 AFCA operates as a not for profit entity and provides its services free of charge to its complainants. As such, AFCA is funded by the complaint handling fees charged to AFCA members (that is, financial firms) upon a resolution of a complaint. Where the financial firm is unable or otherwise unwilling to pay these complaint handling fees, the fees remain unpaid; or if the firm is insolvent, may be in part recoverable by AFCA in an administration process.

2.24 So that AFCA can recover its complaint handling fees, the levy framework collects levy for the payment of unpaid AFCA fees ('AFCA unpaid fees levy'). The levy for AFCA's unpaid fees follows a similar process to the annual levy process outlined above.

2.25 The AFCA unpaid fee levy is payable by a person if the person is a member of a **sub-sector** and, if conditions are prescribed in the regulations, the conditions are met in relation to the person, and the person is not in a class of persons prescribed in the regulation. Levy will be imposed on a person if the person meets these criteria at any time in the 12 months preceding the levy period. What constitutes a **sub-sector** for the purposes of the annual levy will be prescribed in the regulations. [AFCA Fees Bill, subsection 9(1)]

2.26 The amount of AFCA unpaid fee levy payable by a person and a sub-sector for a levy period will be worked out in accordance with a method outlined in the regulations. Before these regulations can be made, the Minister must be satisfied that the total amount of levy imposed on all persons for a levy period and a sub-sector:

- in the case of an initial estimate - does not exceed the initial estimate of AFCA's unpaid fees;
- in the case of a revised estimate – does not exceed the difference between the revised estimate and the amount imposed earlier following an initial estimate;
- does not cause the sub-sector cap to be exceeded; and

- does not cause the scheme levy cap to be exceeded

[AFCA Fees Bill, section 12]

Initial estimate of AFCA's unpaid fees

2.27 The CSLR operator will determine, in a legislative instrument, what portion of the total amount of the AFCA unpaid fees for each month in the upcoming levy period is reasonably attributable to a sub-sector, and any shortfall amounts arising from an earlier levy period. Accounting for a shortfall in an earlier period allows amounts to be added or subtracted from the estimate of levies for the next levy period where the CSLR operator identifies an excess or shortfall from an earlier period. The initial estimate must be made within 4 months before the start of a levy period.

[Collection Bill, subsections 12(2) and (3)]

2.28 AFCA must notify the CSLR operator of its unpaid fees for a particular month on or after a fee recovery day as soon as practicable after the end of that month. The fee recovery day will be prescribed by the regulations. *[Amendments to the Corporations Act, item 4, subsection 1058A(1)]*

Revised estimate of AFCA's unpaid fees

2.29 If at any time during a levy period, the AFCA unpaid fees levy collected for a sub-sector is insufficient or is likely to be insufficient to meet the actual or estimated fees payable for that sub-sector, the CSLR operator may recalculate the amounts included in the initial estimate and determine a revised estimate of AFCA's unpaid fees for that levy period and sub-sector. *[Collection Bill, subsection 12(5)]*

2.30 A further levy is imposed on the sub-sector when, by legislative instrument, the CSLR operator determines the revised estimate of AFCA's unpaid fees. *[AFCA Fees Levy Bill, subsection 12(6) and Collection Bill, subsection 12(5)]*

2.31 The total amount of further levy imposed on the sub-sector will be equal to the difference between the revised and the initial estimate of AFCA unpaid fees for the levy period. As with the levy imposed by the initial estimate, the amount of further levy payable by each individual firm in the sub-sector will be calculated in accordance with a method prescribed in the regulations. *[AFCA Fees Bill, section 12]*

Ministerial determination

2.32 The amount of annual levy payable in an upcoming levy period depends largely on the CSLR operator's estimate of the compensation claims and costs for the period. While the CSLR operator will engage with AFCA to inform this estimation, the forward-looking nature of the levy framework limits its ability to model for events that cannot be forecasted or accurately estimated ahead of time. For example, the sudden

failure of a large financial firm could lead to a significant increase in the number of complaints to AFCA, and consequently an increase in the number of applications under the CSLR.

2.33 As such, in circumstances where the annual levy collected for a sub-sector is insufficient or is likely to be insufficient to meet the actual or estimated claims payable for the sub-sector, the CSLR operator may revise its initial estimate of claims and costs and determine a revised estimate of claims and costs for the levy period and sub-sector.

2.34 Where this revised estimate of claims and costs exceeds the sub-sector cap for the sub-sector for the levy period, the CSLR operator must notify the Minister in writing as soon as practicable. This notification empowers the Minister to make a determination to levy further amounts (or exercise the options described in Chapter 1 regarding compensation payments). [*Amendments to the Corporations Act, item 4, subsection 1069C(3)*]

2.35 While empowered to exercise one or a combination of these options (set out below), the Minister is not required to make a determination and the CSLR operator will need to deal with claims and costs in excess of levied amounts in another way. For example, the operator could wait for the next opportunity to make an initial estimate of claims and costs for the next levy period and levy the necessary amounts as part of the regular annual levy. Another option would be for the CSLR operator to draw on the capital reserve to cover excess amounts.

Further levy for a sub-sector

2.36 The Minister may decide to levy further amounts from the relevant sub-sector with the expected shortfall for the levy period in which the revised estimate of claims and costs exceeds the sub-sector levy cap. The Minister's determination takes the form of a legislative instrument. [*Amendments to the Corporations Act, item 4, subsection 1069D(4) and Levy Bill subsection 8(3)*]

2.37 While the amount of further levy may exceed the relevant sub-sector cap, it must not exceed the difference between the revised and the initial estimate of claims and costs for the levy period for the sub-sector. The amount of further levy also cannot exceed the scheme levy cap of \$250 million. [*Amendments to the Corporations Act, item 4, subsection 1069D(4), Levy Bill section 17*]

2.38 As with the regular annual levy, the amount of further levy payable by each firm in the sub-sector will be calculated in accordance with a method prescribed in the regulations. [*Levy Bill, section 14*]

Further levy for another sub-sector

2.39 In addition to imposing a further levy on the relevant sub-sector with the expected shortfall, the Minister may determine to levy further amounts from another sub-sector, including a sub-sector that is not liable

to pay for the initial annual levy. The sub-sectors that are potentially liable to pay will be prescribed in the regulations. The Minister's power to specify sub-sectors that are liable to pay a further levy in this way is limited to those prescribed sub-sectors. *[Amendments to the Corporations Act, item 3, subsection 1069D(5) and Levy Bill section 9]*

2.40 The total amount of further levy imposed on the other sub-sectors must not exceed the difference between the revised and initial estimated claims and costs for that sub-sector where the expected shortfall is expected to exceed the annual sub-sector levy cap for that particular sub-sector for that levy period. *[Amendments to the Corporations Act, item 3, subsection 1069D(5)]*

2.41 Further, the total amounts of further levy imposed through a Ministerial determination must not exceed the scheme levy cap of \$250 million. *[Levy Bill, section 17]*

Levy for accumulated unpaid claims and AFCA accumulated unpaid fees

2.42 The levy framework provides for the levy to be collected to fund compensation for unpaid relevant AFCA determinations that have accumulated since the beginning of the AFCA Scheme (1 November 2018) and up to the commencement of the CSLR ('accumulated unpaid claims').

2.43 Related to the accumulated unpaid claims are the fees that AFCA has incurred in relation to handling these claims where the fees have not been paid by the liable financial firms ('AFCA accumulated unpaid fees'). The levy framework also provides for the levy to be collected for these AFCA fees.

2.44 The levy for both the accumulated unpaid claims and AFCA accumulated unpaid fees is collected as a one-off levy in the initial levy period only. AFCA determinations no longer continue to "accumulate" after the commencement of the CSLR. *[Collection Bill, subsections 11(1) and 12(1)]*

Levy for accumulated unpaid claims

2.45 The accumulated unpaid claims levy is payable by a person if the person is a member of a sub-sector and, if conditions are prescribed in the regulations, the conditions are met in relation to the person, and the person is not in a class of persons prescribed in the regulations. The levy will be imposed on a person if the person meets the criteria at any time in the 12 months preceding the levy period. What constitutes a sub-sector for the purposes of the accumulated unpaid claims levy will be prescribed in the regulations and will draw on the same concepts in place for the ASIC supervisory cost recovery levy framework. *[Levy Bill, subsection 10(1)]*

2.46 The CSLR operator will, in a legislative instrument, specify the total amount of unpaid claims and determine what portion of that specified amount is reasonably attributable to a sub-sector for the initial levy period. The determination must be made within 4 months before the start of the initial levy period. *[Collection Bill, section 11]*

2.47 The amount of accumulated unpaid claims levy payable by a person and a sub-sector for a levy period will be worked out in accordance with a method to be prescribed in the regulations. Before regulations are made, the Minister must be satisfied that the proposed regulations would be consistent with the objectives that the total amount of unpaid claims levy imposed on all persons for a levy period and a sub sector:

- does not exceed the CSLR operator’s determined amount that is reasonably attributable to the sub-sector; and
- does not cause the scheme levy cap to be exceeded.

[Levy Bill, section 16]

Levy for AFCA accumulated unpaid fees

2.48 The AFCA accumulated unpaid fees levy is payable by a person if the person is a member of a sub-sector and, if conditions are prescribed in the regulations, the conditions are met in relation to the person, and the person is not in a class of persons prescribed in the regulations. These levies will be imposed on a person if the person meets the criteria at any time in the 12 months preceding the levy period. What constitutes a sub-sector for the purposes of the AFCA accumulated unpaid fees levy will be prescribed in the regulations and will draw on the same concepts in place for the ASIC Supervisory Cost Recovery Levy framework. *[AFCA Fees Bill, subsection 8(1)]*

2.49 The CSLR operator will, in a legislative instrument, specify the total amount of AFCA’s accumulated unpaid fees and determine what portion of that specified is reasonably attributable to a sub-sector for the initial levy period. The determination must be made within 4 months before the start of the initial levy period. *[Collection Bill, section 12]*

2.50 The amount of AFCA accumulated unpaid fees levy payable by a person and a sub-sector for a levy period will be worked out in accordance with a method to be prescribed in the regulations. Before regulations are made, the Minister must be satisfied that the proposed regulations would be consistent with the objectives that the total amount of AFCA accumulated unpaid fees levy imposed on all persons for a levy period and a sub-sector.

- does not exceed the CSLR operator’s determined amount that is reasonably attributable to the sub-sector; and
- does not cause the scheme levy cap to be exceeded.

[AFCA Fees Bill, section 11]

When levy is due for payment and late payment

2.51 After the levy amounts have been determined for the levy period, ASIC will issue notices to persons in a sub-sector setting out the amount of levy that is payable in relation to the levy period.

2.52 The ASIC notice will specify the business day on which the levy becomes due and payable. Firms will be given at least 30 days to pay the levy amounts specified in the notice. *[Collection Bill, subsection 13(1)]*

2.53 Unless ASIC provides an extension, a failure to pay the levy by the date specified in the ASIC notice will attract a late payment penalty at the rate of 20 per cent per annum calculated monthly. The late payment penalty for a month is due and payable at the end of the levy month. *[Collection Bill, section 14]*

Use of delegated legislation in the levy framework

2.54 The levy framework involves delegated legislation in a number of instances.

2.55 In the Levy Bill, delegated legislation is used to:

- define what constitutes a levy period for the period that starts on or after the day the Levy Bill commences *[section 7]*;
- define the criteria in relation to what constitutes a sub-sector *[section 7]*;
- prescribe the criteria for a sub-sector for the purposes of the annual levy, the further levy, and the levy for accumulated unpaid claims *[subsections 8(1) and 8(3) and section 10]*;
- prescribe any general conditions which are required to be met for the purposes of the annual levy, the further levy and the levy for accumulated unpaid claims *[subsections 8(1), 9(1) and section 10]*;
- prescribe a class of persons for whom the annual levy, the further levy and the levy for accumulated unpaid claims is not imposed *[subsections 8(1), 9(1) and section 10]*;
- prescribe the method to calculate the amount of annual levy payable by a person in a sub-sector for a levy period *[subsection 12(1)]*;
- prescribe the method to calculate the amount of further levy payable by a person in a sub-sector for a levy period *[subsections 13(1), 14(1) and 15(1)]*;

- prescribe the method to calculate the amount of levy for accumulated unpaid claims payable by a person in a sub-sector for a levy period *[subsection 16(1)]*;
- prescribe an annual sub-sector levy cap for a sub-sector for a levy period *[subsection 17(1)]*.

2.56 In the Collection Bill, delegated legislation is used to:

- prescribe an amount of capital reserve *[section 7]*;
- determine, by legislative instrument, an initial estimate of claims and costs for the levy period and a sub-sector *[subsection 9(1)]*;
- prescribe the method to calculate the portion of ASIC's administrative costs that will be attributable to each sub-sector *[subsection 9(1)]*;
- determine, either by legislative notifiable instrument depending on whether the determination specifies that further levy needs to be imposed, a revised estimate of claims and costs for the levy period and a sub-sector *[subsection 10(1)]*;
- specify, by legislative instrument, the total amount payable under the CSLR as accumulated unpaid claims *[section 11]*;
- specify, by legislative instrument, the total amount payable as AFCA's accumulated unpaid fees *[subsection 12(1)]*;
- determine, by legislative instrument, the portion of the total amount of the AFCA accumulated unpaid claims and fees attributable to a sub-sector for the initial levy period by a legislative instrument *[section 11 and subsection 12(1)]*;
- determine, by legislative instrument, the portion of the total amount of the AFCA's unpaid fees attributable to a sub-sector for a levy period by a legislative instrument *[subsections 12(2) and (5)]*;
- prescribe any approved forms *[section 29]*.

2.57 In the AFCA Fees Bill, delegated legislation is used to:

- prescribe the criteria for a sub-sector for the purposes of the AFCA accumulated unpaid fees and AFCA unpaid fees *[subsections 8(1) and 9(1)]*;
- prescribe any general conditions which are required to be met for the purposes of the AFCA accumulated unpaid fees and AFCA unpaid fees *[subsections 8(1) and 9(1)]*;

- prescribe a class of persons for whom the AFCA accumulated unpaid fees and AFCA unpaid fees is not imposed [*subsection 8(1) and subsection 9(1)*];
- prescribe the method to calculate the amount of AFCA's unaccumulated unpaid fees levy payable by a person in a sub-sector for a levy period [*subsection 11(1)*];
- prescribe the method to calculate the amount of initial and further AFCA's unpaid fees levy payable by a person in a sub-sector for a levy period [*subsections 12(1) and 12(2)*];

2.58 Broadly, these delegated powers have been inserted to provide the ability to prescribe technical details of the levy framework in relevant regulations and legislative instruments. A number of the instruments will involve complex mathematical formulas and methods to calculate the distribution of amounts payable by sub-sector.

2.59 Further, it is also appropriate to utilise delegated legislation to set parameters around certain concepts in the levy framework, for example what is a sub-sector. This is necessary to provide the Government with the flexibility to make timely changes to the criteria as needed and required. The need for timely changes might arise where a sub-sector is no longer required to be subject to the levy framework or if a new sub-sector is required to be added to the levy framework. This reflects the need for the to adapt and respond to changes to the financial system.

2.60 Other than the notifiable instrument made under section 10 of the Levy Bill, which itself does not trigger a levy, all of the above instruments are subject to disallowance and therefore will be subject to appropriate parliamentary scrutiny.

Ministerial determination

2.61 The levy framework provides that where the CSLR operator determines that a revised estimate of claims and costs exceeds the annual sub-sector cap, the Minister may determine to levy further amounts in excess of the sub-sector cap by a legislative instrument.

2.62 The Minister may levy further amounts against the sub-sector in excess of its annual sub-sector cap or levy further amounts against another sub-sector (including a sub-sector that not liable to the initial annual levy).

2.63 As explained in Chapter 1, given the forward-looking nature of the levy framework, it is appropriate for the Minister to intervene in certain special circumstances where additional funding is required to meet the higher than the initial estimated claims and costs.

2.64 Additional funding may be needed where, for example, a large financial firm becomes insolvent, or where a "black swan event" occurs in

the financial services industry. These circumstances may lead to a significant increase in the number of complaints made to AFCA and, consequently, applications for compensation under the CSLR.

2.65 As these circumstances can't be predicted, the Ministerial determination is necessary to ensure that the CSLR operator has the funds needed to provide consumers with compensation as quickly as possible.

Other features of the levy framework

2.66 The levy framework also includes a number administrative features that are closely based on the ASIC Supervisory Cost Recovery framework. Some of these administrative features include:

- a person subject to the levy is required to provide ASIC with information in an approved form. The information obtained would be relevant for the purposes of calculating the levy in accordance with the levy framework. The approved forms will be prescribed in the regulations. *[Collection Bill, sections 8 and 29]*
- ASIC, by issuing a written notice, can require a person to substantiate the information that it has provided to ASIC for the purposes of the levy framework. The firm must comply with this notice and commits an offence if they fail to comply. *[Collection Bill, sections 19 to 21]*
- a person will be subject to a shortfall penalty where, on the basis of false or misleading information it provided to ASIC, the amount of levy paid by the person fell short of the levy which it should have been liable for. The penalty would be an amount equal to twice the amount of the shortfall. *[Collection Bill, section 15]*
- ASIC, on behalf of the Commonwealth, can waive the whole or part of payment of a levy, the late payment penalty, and the shortfall penalty, if it is satisfied that there are exceptional circumstances justifying the waiver. *[Collection Bill, section 15]*
- a person who is affected and dissatisfied with ASIC's decision to waive a levy or penalty imposed under the levy framework can request an internal review of the decision. After receiving such a request, ASIC must review their decision within 30 business days, and either confirm, revoke or vary their decision. If no internal review decision is made within 30 business days, ASIC is taken to have confirmed the original decision. ASIC should give the affected person notice and reasons of their decision. ASIC's internal review

decisions can be reviewed by the Administrative Appeal Tribunal. *[Collection Bill, sections 23 and 24]*

- any levy imposed, the late payment penalty and the shortfall penalty are payable to ASIC on behalf of the Commonwealth. ASIC, as an agent of the Commonwealth, is also authorised to bring proceedings in the name of the Commonwealth to recover these amounts when they become due and payable as debts to the Commonwealth. *[Collection Bill, sections 16 and 18]*
- in circumstances where the obligations under the levy framework are imposed on a partnership, an unincorporated association, a RSE licensee or multiple trustees, the obligations extend to each relevant member of these entities and can be discharged by any member of the entity on behalf of all the members. *[Levy Bill, section 18 and Collection Bill, sections 25 to 28]*