

MEMORANDUM OF ADVICE

Legality of Compensation Scheme of Last Resort

B F Quinn KC
Little Collins Chambers

Instructed by:
Simon Carrodus
Hamilton Locke
Level 19, Riverside Centre, 123 Eagle Street
Brisbane QLD 4000

MEMORANDUM OF ADVICE

Legality of Compensation Scheme of Last Resort

A. Background

1. My instructing solicitors act for the Association of Independently Owned Financial Professionals (**AIOFP**). AIOFP is a peak body established in 1998 to provide representation specifically for financial services professionals who conduct independently owned practices under their own Australian Financial Services Licenses as opposed to those operating within practices owned by financial institutions. One of the objectives of AIOFP is to represent the interests of its members in making representations to government and financial services industry regulators in relation to the current regulatory environment and in respect of desirable or proposed law reform that may affect its membership.
2. AIOFP has sought my advice in respect of any potential legal challenges that may be available to the compensation scheme established by the Commonwealth government known as the Compensation Scheme of Last Resort (**CSLR**), or at least those aspects of the CSLR that impose financial burdens upon its members.
3. CSLR was ostensibly a response to a recommendation contained in the Ramsay Review, which was in turn a report supplementing the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.¹ CSLR was established as an element of the national external dispute resolution framework for cases of financial misconduct in the provision of financial products and services causing loss to retail clients. The Australian Financial Complaints Authority (**AFCA**) handles consumer complaints about financial products and services where financial loss has occurred. If a complaint cannot be resolved, AFCA may award compensation. If the relevant financial services provider becomes insolvent during the process, the retail client may be eligible for CSLR compensation.

¹ It is not the purpose of this memorandum to critique the extent to which CSLR reflected the recommendations to which it purportedly responded; nor the extent to which CSLR reflected any commitments made by government about the proposed operation or effect of the CSLR.

4. The critical aspect of CSLR from the perspective of AIOFP membership is that it is funded by revenue raised by way of levies imposed upon, amongst other financial industry participants, financial service professionals. Specifically, CSLR is funded by a levy on four defined sub-sectors of the financial services industry: credit intermediaries, credit providers, licensees providing financial advice, and securities dealers.
5. The statutory framework for operating and funding CSLR consists of:
 - (a) *Financial Services Compensation Scheme of Last Resort Levy Act 2023* (Cth) (**Levy Act**);
 - (b) *Financial Services Compensation Scheme of Last Resort Levy (Collection) Act 2023* (Cth); and
 - (c) *Financial Services Compensation Scheme of Last Resort Levy Regulations 2023* (Cth) (**Levy Regulations**).
6. The Levy Act and the Levy Regulations together set out the levies used to finance CSLR; while the *Financial Services Compensation Scheme of Last Resort Levy (Collection) Act* contains provisions concerned with structural and mechanical aspects of the levy collection system. This advice is concerned chiefly with the Levy Act and Levy Regulations.

B. Purpose of Advice

7. I have been asked for my opinion as to whether there are any arguments available to AIOFP to challenge the legality and validity of CSLR, or at least the imposition of levies upon AIOFP members and other industry participants in order to finance CSLR.
8. I have already provided my views in conference with my instructing solicitor and representatives of AIOFP on 18 February 2025. This memorandum confirms those views. It is not intended to be a comprehensive, reasoned advice, but rather provides a summary of the views expressed in conference.
9. I note that I have not been asked to opine about the fairness and equity of CSLR, or to express any view as to its economic or social policy objectives, save to the extent that these may be relevant to questions of validity and legality.

C. Summary of Advice

10. Consistent with my advice provided in conference on 18 February 2025, in my view there is no arguable basis upon which AIOFP could challenge the legality or validity of CSLR or, more specifically, the legislative components of CSLR that impose levies.
11. The provisions that impose levies to fund CSLR are contained in the Levy Act and the Levy Regulations. These are supported by section 51(ii) of the *Constitution of the Commonwealth of Australia* (**Constitution**) (the taxation power). They satisfy the well-established requirements of laws with respect to taxation enacted under that placita. Further, in accordance with section 55 of the Constitution, the Levy Act and the Levy Regulations contain *only* provisions with respect to the imposition of levies, and not other aspects of CSLR.
12. The broad social or economic policy objectives of such laws, or the fairness and equity of the imposts prescribed thereunder, are not relevant to the validity of the laws, and are not matters upon which I can usefully comment.

D. General Operation of CSLR

13. CSLR is operated by CSLR Ltd, a special purpose company established by the government, which commenced operations on 2 April 2024. CSLR is not a regulatory authority or government agency. Rather, it is an independent, not-for-profit company authorised by the Australian government to operate the compensation scheme for the benefit of eligible consumers in cases where losses caused by wrongdoing in the financial services industry cannot be recovered from the wrongdoer or any other source (for example, because of insolvency).
14. Generally speaking, the levies are scaled to the size of each contributor. The total annual levy that may currently be imposed for any levy period across all sub-sectors must not exceed \$250 million, and there is a sub-sector levy cap of \$20 million for each sub-sector. Unless the Minister for Financial Services exercises their discretion to raise a “special levy”, this sub-sector cap of \$20 million is presently the maximum levy that may be imposed during the annual levy period for all sub-sector members.

15. At a general level, the levy process involves the following steps:
 - (1) CSLR Ltd calculates the levy estimate for each period in advance;
 - (2) the levy estimate is recorded in the Federal Register of Legislation as a legislative instrument, along with an explanatory memorandum;
 - (3) the instrument is tabled in each House of Parliament, with each House being served with a 15-day disallowance period;
 - (4) after the disallowance period, ASIC determines the levy for each liable entity, based upon the applicable sub-sector caps and the entity's size; and
 - (5) ASIC sends an invoice to each entity and collects payment for the government.
16. It is not necessary for present purposes to provide further detail regarding matters such as how the levy system has altered since its inception (over different "levy periods"), exactly how the levies are calculated, or what costs, expenses and losses the levies may be applied to. Suffice to say that ASIC acts as the oversight body for CSLR Ltd, ensuring it performs its functions in accordance with legislative requirements, and determining and collecting the levies that resource CSLR.
17. Not all participants in the financial services industry are subject to the levies resourcing CSLR. In particular, I am instructed that while many losses suffered by retail clients are caused by the conduct of those responsible for the promotion and operation of managed investment schemes or other investment vehicles, financial services professionals rather than those persons and entities are levied.

E. Characterisation and Validity of Relevant Provisions

18. Section 19 of the Levy Act empowers the making of regulations "required or permitted by this Act to be prescribed by the regulations" and prescribing matters "necessary or convenient to be prescribed for carrying out or giving effect to this Act". This has been done. I have considered the Levy Regulations and, in my view, they appear to fall within the regulation making power of section 19. Accordingly, I will address the validity of the Levy Act and Levy Regulations together below.

19. Section 51(ii) of the Constitution provides the Commonwealth with power to legislate with respect to taxation. Section 55 provides that laws imposing taxation “shall deal only with the imposition of taxation, and any provision therein dealing with any other matter shall be of no effect”.
20. In considering the validity of the Levy Act and Levy Regulations I applied the following principles relevant to the taxation power.
21. First, in characterising a law purportedly passed under the taxation power, a court is permitted to look *only* at the law imposing the levy, without taking into account any broader legislative scheme or policy objectives which the levy is intended to resource or support: see generally *Fairfax v Federal Commissioner of Taxation* (1965) 114 CLR 1; *Northern Suburbs General Cemetery Reserve Trust v Commonwealth* (1993) 176 CLR 555. The task of characterisation thereby precludes consideration of the underlying purpose or broader policy objectives of CSLR and involves analysis only of the components of the legislative regime purporting to impose levies.
22. Secondly, “taxation” within the meaning of section 51(ii) is a compulsory exaction of money enforceable by law, that is not a payment for services rendered or a penalty: see *Matthews v Chicory Marketing Board (Vict)* (1938) 60 CLR 263 at 276 (Latham CJ); *Air Caledonie International v Commonwealth* (1988) 165 CLR 462 (**Air Caledonie**) at 466 (the Court); *Australian Tape Manufacturers Association Ltd v Commonwealth* (1993) 176 CLR 480 (**Australian Tape Manufacturers**) at 500 (Mason, Brennan, Deane and Gaudron JJ). The levies imposed by the Levy Act and Levy Regulations are not payments for services rendered and nor are they fines or penalties. They are exactions of money in the nature of tax, and thus prima facie supported by the taxation power.
23. Thirdly, there was once a debate about whether an impost had to be for a public purpose and exacted by a public authority to be supported by the taxation power. However, the High Court ultimately held that this was not the case: see *Air Caledonie* at 466; *Australian Tape Manufacturers* at 500, 504-505. Thus, a law will not lose its character as being with respect to taxation merely because the relevant levy is collected by a corporate entity rather than a government agency or where it involves “an expropriation from one group for the benefit of another as an incident of legislative regulation of interests on a subject-matter within power, with a view to bringing about what is

conceived to be an equitable outcome”.² It follows that the establishment and use of CSLR Ltd as a collection entity and the fact that the beneficiaries of CSLR levies are aggrieved retail clients rather than the general public, are not matters that alter the character of the levies to something other than taxes within the meaning of section 51(ii) of the Constitution.

24. Fourthly, in order to be a valid exercise of legislative power under section 51(ii) of the Constitution, a tax cannot be “arbitrary”: see *MacCormick v Federal Commissioner of Taxation* (1984) 158 CLR 622 (**MacCormick**). This condition of validity does not permit any analysis of the fairness of the tax or of whether it targets some persons to the detriment of others on grounds that seem unreasonable, discriminatory, harsh or unjust. Rather, in order that it not be arbitrary in the constitutional sense, it is simply necessary that the tax be based upon ascertainable criteria. That is, liability must be imposed by reference to criteria which are sufficiently general in their application, and which mark out the objects and subject matter of the tax, such that the tax is “contestable” and not dependent upon the mere opinion or preference of government agencies: see *MacCormick* at 639-641; *Australian Tape Manufacturers* at 525. The Levy Act and the Levy Regulations do set out ascertainable criteria to be followed in calculating the relevant levies. The reasonableness or fairness of the criteria are not relevant to validity. It follows that the legislation is not beyond power on the basis that it is arbitrary.
25. Fifthly, as required by section 55 of the Constitution, the Levy Act and the Levy Regulations deal only with the imposition of the levies deployed for the CSLR, and not the other elements or features of the CSLR scheme. There is thus no invalidity on that basis.
26. In summary, there is no arguable basis upon which AIOFP could challenge the legality or validity of the legislative components of CSLR that impose levies.

21 February 2025


B F Quinn KC

Liability limited by a scheme approved under professional standards legislation.

² *Australian Tape Manufacturers* at 504-505.