



FINANCIAL SERVICES AND CREDIT QUARTERLY UPDATE

June 2015

CONSUMER CREDIT

Credit card interest rates under scrutiny

Recently there has been comment about the growing gap between the cash rate and credit card interest rates. The Senate on 24 June 2015 referred an inquiry into credit card interest rates to the Senate Economics References Committee. The Committee is due to report by 24 November 2015 and submissions close on 10 August 2015. The terms of reference cover the economic effect of matters including the difference between cash rates and credit card interest rates. The Committee will look at factors such as:

- the costs to credit providers and payments systems, such as borrowings, credit risk and default rates, credit risk pricing, loyalty programs, consumer protection measures, and transaction costs (e.g. interchange fees);
- the costs to consumers; and
- how the enforcement of responsible lending laws and the national consumer credit regime affect consumer costs.

Centrepay deductions

Centrepay deductions for unregulated indefinite term consumer leases and funeral insurance are being phased out. Consumer leases regulated by the National Credit Code will be permitted for deductions, as will scheduled repayments of funeral expenses and pre-paid funeral plans.

Minister for Human Services Senator Marise Payne announced the changes on 22 May 2015.

Centrepay is a free voluntary deduction service that enables Centrelink recipients to have deductions made from their Centrelink payments.

There will be a 12 month transition period from 1 July 2015 for existing contracts.

Review of small amount credit contracts

Under section 335A of the NCCP Act, an independent review of the following matters must be undertaken as soon as practicable after 1 July 2015:

- the provisions of the NCCP Act and the National Credit Code relating to

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- small amount credit contracts;
- whether a national database of small amount credit contracts should be established; and
- whether any additional provisions relating to small amount credit contracts should be included in the NCCP Act and/or the National Credit Code.

The review must be undertaken by 3 persons who, in the Minister's opinion, possess appropriate qualifications to undertake the review.

COMMERCIAL FINANCE

Unfair contract terms and small business

An exposure draft of the legislation to expand unfair contract terms protection to small business was released by Treasury on 28 April and submissions closed on 12 May.

The proposed legislation will apply to a "small business contract", where at least one party employs fewer than 20 persons and the value of the contract is no more than \$100,000 (\$250,000 for contracts of more than one year).

In general terms the rights given to a small business under such a contract would be the same as those of consumers under the existing unfair contract terms laws.

It is expected that the new legislation if passed will come into effect in early 2016.

FINANCIAL ADVICE

Further changes to FOFA provisions

Agreement has been reached between the Federal Government and Opposition on more changes to the future of financial advice (FOFA) provisions in the Corporations Act. The changes were introduced in the *Corporations Amendment (Financial Advice) Regulation 2015* registered on 29 June.

The changes include the following:

- non-cash payment facilities such as travel money cards will now be treated consistently with other simple financial products;
- the modified best interests duty will apply to advice on basic banking products or general insurance even if provided at the same time as advice

- on consumer credit insurance (which is subject to the full best interests duty);
- benefits provided by a retail client to their financial adviser will be exempt from conflicted remuneration provisions; and
- introducing a wholesale and retail client distinction.

FINTECH

About fintech

There is a lot of buzz about "fintech" or financial technology. Fintech uses software in disruptive ways to provide financial services, including payment systems, crowdfunding and peer-to-peer ("P2P") lending.

Sydney as a fintech hub

Last year the Committee for Sydney commissioned KPMG to report on developing Sydney as a fintech hub.

Following the report, Stone & Chalk has been established as a not-for-profit fintech hub in Bridge Street Sydney. Tyro Payments has launched another Sydney fintech hub in Clarence Street.

FINANCIAL PRODUCTS

Innovation and regulation

At the ASIC Annual Forum in March 2015, ASIC Chairman Greg Medcraft announced that ASIC is launching an innovation hub to help make it quicker and easier for innovative start-ups and fintech businesses to navigate the regulatory system administered by ASIC, as follows:

A five-point plan for the hub was laid out by Mr Medcraft at the AFR Banking & Wealth Summit on 28 April 2015.

1. ASIC will participate in other fintech initiatives, such as Stone & Chalk, where appropriate.
2. ASIC will streamline its approach to facilitating business for new business models, including applying for or varying a licence and in granting waivers from the law.
3. ASIC will look at making itself more accessible to new types of businesses.
4. ASIC will adopt a coordinated approach to applying any reforms that may apply to innovative businesses in the future.

5. ASIC will establish a Digital Finance Advisory Committee with members from a cross-section of the fintech community.

Peer-to-peer lending

One type of innovative financial service of interest to ASIC is peer-to-peer lending.

In its recent Report 433 on licensing applications for July to December 2014, released in May 2015, ASIC noted that it continued to see a number of entities seeking to enter the peer-to-peer lending market.

ASIC acknowledges peer-to-peer as a 'digital disruption', where technology is driving innovation and says that its responsibilities involve balancing facilitation of innovation in fundraising and improving the efficiency of the economy, while also promoting the confident and informed participation of investors and consumers in the financial system.

ASIC said in its report that it did not generally consider there to be significant regulatory barriers for peer-to-peer lending, but identified the following challenges:

- whether an applicant's business model operates in a manner consistent with the regulatory regime of financial services and product authorisations required;
- how a borrower's creditworthiness is expressed to potential investors; and
- advertising and promotional material that seeks to make comparisons with banks and bank-like deposit products.

Farewell FHSA

The First Home Saver Account (FHSA) scheme has ended. FHSA was a Labor Government initiative introduced in 2008. Under the scheme account holders received a 17% Government co-contribution on deposits (up to about \$1000). The scheme had a low take up rate: less than 50,000 accounts were opened, compared to the forecast of 700,000 accounts by 2012. Abolition of the scheme was announced by the Abbott Government in 2014. All tax concessions relating to FHSAs end on 1 July 2015 and existing FHSAs will cease to have the status of an FHSA.

INSURANCE

Industry reform proposals for retail life insurance

A proposed reform package has been delivered to the Federal Government on retail life insurance by the Association of Financial Advisers, the Financial Planning Association of Australia and the Financial Services Council. The reform proposals followed an ASIC review which identified poor quality advice and a strong correlation between high upfront commissions and poor consumer outcomes. Life insurance is largely exempt from the FOFA ban on conflicted remuneration. The reform package is the result of an industry commissioned review chaired by John Trowbridge.

The Federal Government is considering the industry proposals in the context of its response to the Financial System Inquiry.

The proposals include the following:

- maximum total upfront commission of 60% of the premium in the first year of the policy from 1 July 2018;
- maximum ongoing commission of 20% of the premium in all subsequent years;
- a ban on volume based payments from 1 July 2016;
- transitional arrangements over the period until 1 July 2018; and
- life insurance companies to offer fee-for-service insurance products to support advisers who wish to operate on a fee-for-service basis.

The package also proposes that ASIC would review statements of advice with a view to making disclosure simpler and more effective.

Travel insurance disclosure

ASIC announced on 2 June 2015 that credit card issuers and insurers have made improvements to disclosure for travel insurance provided through credit cards. The changes made followed an ASIC review of 17 credit card brands. The ASIC review was prompted by complaints made to ASIC and disputes data published by the Financial Ombudsman Service. The ASIC announcement says that credit card issuers and insurers have agreed to make improvements including:

- clarifying when insurance cover is activated – in particular where a minimum spend threshold needs to be met to activate cover;

- clarifying if and when using reward points to pay for travel costs will activate insurance cover;
- clarifying whether supplementary cardholders can benefit from the policy; and
- clearer and more prominent information about documents required to make a claim.

The ASIC announcement says that credit card issuers have also made improvements to their websites to make it easier to locate the insurance terms and conditions.

MUTUAL BANKING

Senate inquiry

On 2 March 2015, the Senate referred the role, importance, and overall performance of cooperative, mutual and member-owned firms in the Australian economy for inquiry and report by the Senate Standing Committee on Economics. The Committee is due to report by 30 November. Submissions closed on 1 July 2015.

SUPERANNUATION

Governance changes proposed

In November 2013 the Government released a discussion paper on regulation and governance in the superannuation sector. Governance of the superannuation system was also considered in the recent Financial System Inquiry.

Treasury has now released exposure draft legislation which seeks to improve governance arrangements in superannuation. The draft legislation is open for submissions until 23 July 2015.

The *Superannuation Legislation Amendment (Governance) Bill* would amend the *Superannuation Industry Supervision Act* in relation to APRA regulated superannuation funds. It would require a registrable superannuation entity (RSE), including employer-sponsored funds, to have a minimum of one third independent directors and an independent chair. The new rules would not apply to self-managed super funds.

The Bill proposes that the new governance regime would apply from 1 July 2016. Existing RSE's would have three years to transition.

The Bill also provides for APRA to make prudential standards setting out how funds

and licensees would be required to transition to the new governance regime.

PRUDENTIAL REGULATION

Private health insurance

Legislation passed Federal Parliament in June to transfer prudential regulation of private health insurers to APRA. APRA will create prudential standards for private health insurers and has been engaged in a consultation process with the industry over the content of the standards. APRA has indicated that the substance of any existing obligations will not change from 1 July 2015 following the transfer of supervisory responsibilities to APRA.

PERSONAL PROPERTY SECURITIES

New definition of PPS leases

The *Personal Property Securities Amendment (Deregulatory Measures) Act 2015* received assent on 25 June.

It amends the definition of PPS lease in the *Personal Property Securities Act 2009* so that leases or bailments of serial numbered goods for a term of 90 days or more are no longer deemed to be PPS leases. The effect of this change is that only leases with a term of more than 12 months, or which have an indefinite term, will be PPS leases, regardless of whether or not the goods are serial numbered goods. The provisions will commence after 6 months.

AML/CTF

Proposed changes to customer identification requirements

In response to industry consultations, AUSTRAC has proposed changes to the customer identification requirements in the AML/CTF Rules. The draft changes are open to public consultation from 10 June 2015 to 8 July 2015.

The first proposed change relates to the electronic-based safe harbour procedure for customers that are low ML/TF risk. Currently the rule requires verification of the name and residential address of the customer using reliable and independent electronic data from at least two separate data sources, and then either verifying the customer's date of birth from at least one reliable and independent electronic data source, or that the customer has a transaction history for at least the past three years.

Under the proposed new rule, the reporting entity would need to verify the customer's name and date of birth using reliable and independent electronic data, and then either the customer's residential address, or that the customer has a transaction history for at least the past three years, or both. The name, date of birth and residential address would need to be confirmed from at least two separate data sources.

The second proposed change is to generally remove the word 'from' and replace it with 'about' in Chapter 4 of the AML/CTF Rules with regard to customer identification. This will allow reporting entities to obtain identifying information about a customer either directly from the customer or by other means.

The third proposed change is to apply any existing exemption from customer identification to beneficial owner and PEP identification requirements.

DISPUTES AND ENFORCEMENT

Make it Mine Finance

The Federal Court has found that Make It Mine Finance Pty Ltd (**MIM**) breached responsible lending and other consumer credit obligations in *Make It Mine Finance Pty Ltd, in the matter of Make It Mine Finance Pty Ltd* [2015] FCA 393.

ASIC launched civil action against MIM in November 2014.

The company admitted to the misconduct and most of the key issues in the proceedings were undisputed.

MIM's contracts were initially not set up as consumer leases - ownership passed to the customer after 12 months. As such they were instalment sales, and so had to include the disclosures required for instalment sale contracts. Because they did not include those disclosures, MIM breached the disclosure obligations in the National Credit Code.

For a time MIM was also operating without a credit licence, and so it was found to be in breach of the requirement not to engage in credit activity without a credit licence.

MIM's responsible lending practices were also deficient. Applications were online or by phone. The customer only had to confirm they were on Centrelink and was then approved. There were no questions about expenses or other aspects of the consumer's financial situation and no steps

were taken to verify any financial information. The court found breaches of the responsible lending requirements in relation to this process.

The court has not yet awarded penalties.

The judge made some interesting observations about the responsible lending obligations, saying "the relevant statutory provisions are shrouded in conceptual imprecision", and that the "concept of unsuitability ... is not defined" and its ambit is "unclear".

BOQ

ASIC announced in late May that Bank of Queensland (**BOQ**) had changed its lending practices following concerns raised by ASIC. BOQ was using a benchmark figure, the Henderson Poverty Index (**HPI**), to estimate living expenses of consumers applying for home loans rather than asking them about actual expenses. ASIC's view was that this was not consistent with responsible lending obligations. BOQ has now updated its home loan application form to ask about expenses and will use the higher of declared expenses or an appropriate benchmark. BOQ will also continue to review the circumstances of borrowers approved under the former procedure who go into hardship or default, to ensure that they have not been disadvantaged by a loan provided prior to the change in policy.

Cash Converters settles

Settlement was reached in June 2015 in the class action led by Maurice Blackburn against Cash Converters. The class action was taken on behalf of approximately 37,000 customers alleging that the amounts charged under their credit contracts exceeded the New South Wales cost cap of 48% which operated before the introduction of similar price controls in the national consumer credit legislation in 2013. The settlement provides for Cash Converters to pay \$20 million into a fund for distribution to members of the class. Cash Converters will also pay legal fees capped at \$3 million. The settlement is without admission of liability on the part of Cash Converters.

Culture regulation

In an address to the Senate Estimates Committee on 3 June 2015, ASIC Chairman Greg Medcraft announced that ASIC intends to incorporate culture into its role as a conduct regulator. He said that ASIC plans to target areas where poor

practices may increase the potential for poor conduct.

Under section 12.2 of the Commonwealth Criminal Code, a company can be responsible for a breach of certain Commonwealth laws if its culture encouraged or tolerated the breach. ASIC's view is that when an officer breaches a law that ASIC administers and culture is responsible, then the officers and the firm should be responsible and subject to civil penalties and administrative action or sanctions as accessories.

ASIC has appointed Dr Simon Longstaff of the St James Ethics Centre to ASIC's External Advisory Panel.

UNCLAIMED MONEYS

Draft legislation released

Draft legislation and regulations to enact the previously announced changes to unclaimed moneys laws were released by Treasury in May. Submissions closed on 26 June. The changes to the law will among other things extend the required period of inactivity before bank accounts and life insurance policies can be deemed unclaimed to 7 years.

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