DWYER HARRIS

FINANCIAL SERVICES AND CREDIT

QUARTERLY UPDATE

April 2017

CONSUMER CREDIT

ASIC to ban flex commissions

ASIC announced on 3 March 2017 that it will ban flex commissions for regulated consumer finance. ASIC also released a draft legislative instrument for the ban.

Flex commissions are commonly used in automotive finance.

With a flex commission, the rate of commission varies depending on the interest rate or fees charged to the customer. If the introducer can sell a higher interest rate for the loan, the introducer gets a higher commission.

ASIC proposes to allow the introducer the ability offer a lower interest rate than the nominated interest rate, up to a limit of 2% of the rate. In that case the amount of the commission could vary, so that the introducer would be compensating the lender for lower interest charges through a lower commission.

ASIC says that flex commissions are "unfair", because some consumers could end up paying much more in interest than other consumers, and those consumers paying a lot more in interest are "likely to be less financially literate and more likely to be financially vulnerable."

ASIC review of mortgage broker remuneration

ASIC released a report on its review of mortgage broker remuneration (Report 516) on 16 March 2017. The review was requested in November 2015 by the Minister for Small Business and Assistant Treasurer. The purpose of the review was to determine the effect of current remuneration structures on the quality of consumer outcomes.

ASIC gathered data from 17 lenders, 14 aggregators and 44 broker businesses. It also conducted consumer surveys.

The report notes the importance of brokers in the home loan market, with about 54% of home loans for the reviewed lenders coming via brokers in 2015.

ASIC found that most brokers received an upfront and trail commission from the lender; ASIC calls this the "standard model" of commission. The standard model

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also includes commission clawbacks and reduced commissions where the broker arranges a discount on the interest rate. According to ASIC, the "standard model of upfront and trail commissions creates a conflict of interest."

ASIC identifies two kinds of conflict of interest. The first is a "product strategy conflict" where the broker could recommend a loan that is larger than what the consumer needs or affords, to maximise the commission. The second is a "lender choice conflict" where the broker is incentivised to recommend a loan from a particular lender because of a higher commission, even though that loan might not be the best loan for the consumer.

ASIC believes that changes could be made to the standard commission model to reduce the risk of brokers seeking to "inappropriately maximise their commissions".

As well as standard commissions, ASIC found that volume based commissions and campaign based commissions were also paid. ASIC says that its data shows that these bonus commissions "may affect broker behaviour". Loyalty programs and travel and hospitality-related benefits were also used.

ASIC found that consumers who use brokers tend to be younger (by about 2 years) and have incomes around $6000 lower, and that loans through brokers tended to be larger and were more likely to be interest-only. However there was not much difference in interest rates between broker and non-broker channels. Brokered loans were more likely to go into default but this finding varied between lenders and the difference was reduced when consumer characteristics were taken into account.

ASIC took the opportunity in the report to criticise both lenders and brokers for deficiencies in "responsible lending" practices, finding that a significant number of loans had consumer expenses which were stated to be equal to the HEM benchmark.

The report found that competition in the market is affected by ownership relationships between lenders and aggregators.

ASIC thinks that lenders should be "primarily competing" on the best home loan and customer service rather than by offering higher commissions.

ASIC noted that customer owned banking institutions had less access to brokers and suggested that they found it harder to compete on commissions and other benefits.

The review found that referrers received similar rates of commission to brokers, though they did much less work.

ASIC has made six proposals:

1. Changing the standard commission model so that brokers are not incentivised purely on the size of the loan.
2. Moving away from bonus commissions and payments.
3. Moving away from soft dollar benefits.
4. Providing clearer disclosure of ownership structures of industry participants in marketing material and at distribution points.
5. A new "public reporting regime" on broker remuneration, the pricing of brokered home loans and loans provided through other distribution channels, and the distribution of loans by brokers between lenders.
6. Industry participants to place greater emphasis on "fostering a consumer-centric culture" and making good consumer outcomes as "guiding factor" in the design of remuneration arrangements Lenders should also improve oversight of brokers.

The ASIC report is now open for comment until 30 June.

ASIC surveillance and remediation for home loans

On 3 April 2017 ASIC announced it would be conducting targeted industry surveillance to examine if lenders and mortgage brokers are inappropriately recommending interest-only loans.

In the announcement ASIC also said that 8 lenders previously examined by ASIC in its review of interest only loans had improved their responsible lending practices to use actual expenses of borrowers rather than obtaining a single monthly expenses figure and relying on benchmarks. These lenders will review cases where customers experience financial difficulty and provide tailored remediation where appropriate.

COMMERCIAL FINANCE

Small business ombudsman review of small business loans

The report of the Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**) review into small business loans was released by the Federal Government on 3 February 2017.

The review considered the submissions of 23 bank customers, and conducted a “deep dive” forensic analysis of 6 of those customer files. ASBFEO also conducted a survey of the 25 members of the Australian Bankers’ Association (**ABA**) (receiving 10 responses).

Based on this work, ASBFEO has made a number of recommendations. The review has proposed ambitious timeframes for implementation of its recommendations, with a 1 July 2017 commencement date proposed for a number of them.

The report recommendations are set out below.

1. Strengthening the ABA’s six-point plan by publishing individual bank implementation plans.

2. The revised Code of Banking Practice 2017 be approved and administered by ASIC. The Code must be written in plain English and include a dedicated section on small business, clarifying how breaches will be enforced.

3. For all loans below $5 million, where a small business has complied with loan payment requirements and has acted lawfully, the bank must not default a loan for any reason. Any conditions must be removed where banks can unilaterally:

    - value existing security assets during the life of the loan; or

    - invoke financial covenants or catch-all ‘material adverse change’ clauses.

4. A minimum 30-business day notice for all changes to general restriction clauses and covenants (except for fraud and criminal actions) be added to give borrowers more time to respond and react to a potential breach of conditions.

5. For loans below $5 million, banks must provide borrowers with decisions on roll over at least 90 business days before loans mature, so borrowers can organise alternative financing. A longer period of time should be given for rural properties and complex businesses that would take longer to sell or refinance.

6. For loans below $5 million, banks must provide a one-page summary of the clauses and covenants that may trigger default or other detrimental outcomes for borrowers.

7. For loans below $5 million, banks must put in place a new small business standard form contract that is short and written in plain English.

8. All banks must provide borrowers with a choice of valuer, a full copy of the instructions given to the valuer and a full copy of the valuation report.

9. Every borrower must receive an identical copy of the instructions given to the investigating accountant by the bank and the final report provided by the investigative accountant to the bank.

10. Banks must implement procedures to reduce the perceived conflict of interest of investigating accountants subsequently appointed as receivers.

11. The banking industry must fund an external dispute resolution one-stop-shop with a dedicated small business unit that has appropriate expertise to resolve disputes relating to a credit facility limit of up to $5 million.

Small business unfair contract terms

ASIC and ASBFEO have conducted a joint review of small business standard form contracts since the introduction of the unfair contract terms (**UCT**) legislation for small business contracts in November 2016.

The results of the survey were published by ASIC on 9 March 2017.

According to ASIC, “lenders need to immediately take steps to ensure their standard form loan agreements fully comply with the new legislation.”

In fact there is no legal obligation of lenders to take such steps. However, if the term of a small business finance contract is found by a court to be unfair, the legal effect is that the term is void.

The review looked at small business loan contracts from 8 lenders. It found a failure to take sufficient steps to comply with the UCT legislation.

Clauses of concern for ASIC and ASBFEO included:

- terms that give lenders a "very broad discretion" to unilaterally vary terms and conditions of the contract;
- terms that provide for loan 'default' (such as non-monetary default) in a "very broad range of circumstances", rather than where the borrower has materially defaulted on their obligations;
- terms that absolve the lender from responsibility for conduct, statements or representations that the lender makes to borrowers outside of the contract (otherwise known as 'entire agreement clauses'); and
- terms that "too broadly indemnify the lender" against losses, costs, liabilities and expenses.

Senate Select Committee on lending to primary producers

On 16 February 2017 the Senate established the Select Committee on Lending to Primary Production Customers.

The Committee is to inquire and report on the regulation and practices of financial institutions in relation to primary production industries, with particular reference to:

- lending, foreclosure and default practices, including constructive and non-monetary default processes;
- the roles of other service providers including valuers and insolvency practitioners, and the impact of these services;
- the appropriateness of internal complaints handling and dispute management procedures; and
- the appropriateness of loan contract terms particular to the primary production industries.

The Committee is due to report by 18 October 2017.

APRA releases proposal for data collection on agricultural lending

APRA has released a discussion paper on the collection of agricultural lending data (**ALD**) to be administered by APRA. Submissions are due by 28 April 2017.

The proposed ALD collection will be in a new form which will collect data on a set of measures relating to agricultural lending by State or Territory and by 15 industry classifications. Reporting will be on an annual basis for the year ending 30 June and financial corporations with assets below $50 million will not be required to report.

FINANCIAL ADVICE

Life insurance remuneration

The *Corporations Amendment (Life Insurance Remuneration Arrangements) Act* 2017 (Cth) received assent on 22 February 2017.

The Act removes the exemption of life insurance commissions and other benefits from the ban on "conflicted remuneration" in the Future of Financial Advice (**FOFA**) provisions of the Corporations Act.

It also authorises ASIC to make a legislative instrument to permit benefits to be paid, provided certain requirements are met. ASIC can specify the rate of commission and the amount of clawbacks.

The proposed ASIC legislative instrument will commence on 1 January 2018 and will:

- phase-down upfront commissions paid to advisers to a maximum of 60% of the premium in the first year of the policy, from 1 January 2020;
- introduce a maximum rate of 20% of the renewal premium for ongoing commissions; and
- introduce a two year commission 'clawback' period, which will clawback 100% of an upfront commission in the first year and 60% of an upfront commission in the second year when a policy lapses.

CommInsure report

The Commonwealth Bank has a released a report by Deloitte on its findings in a review of claims handling processes at CommInsure (The Colonial Mutual Life Assurance Society Limited (**CMLA**)).

The Deloitte review had two objectives. First, to identify if there were any “systemic” issues in how the claims handling processes historically declined life insurance claims. Second, to identify if the current claims handling processes were designed in a way that could systematically deliver poor customer outcomes.

The first part of the review involved a review of 797 declined life insurance claims. The review did not “identify any systemic issues relating to historically declined claims”. Nonetheless there were 41 of these files where Deloitte referred the files back to CMLA for reassessment.

The review also did not find any evidence that current claims handling processes were designed in a way which could systematically deliver poor customer outcomes, but did identify a number of areas where execution of claims handling processes could be enhanced.

ASIC report into CommInsure

On 23 March 2017 released a report on its investigation into CMLA.

ASIC’s key findings were:

- CMLA used some out of date medical definitions in its trauma policies (but they were disclosed in the PDS and policies).
- There was no evidence to support allegations that CMLA claims managers applied undue pressure on doctors to change their medical opinions.
- CMLA needs to make improvements to its claims handling processes (which CMLA has acknowledged).
- ASIC is continuing to investigate whether CMLA advertising of life policies was misleading or deceptive.

Professional standards

The legislation to enforce professional conduct standards for financial advisers has now been enacted.

The *Corporations Amendment (Professional Standards of Financial Advisers) Act* 2017 (Cth) received assent on 22 February 2017. The new Act will:

- require financial advisers to meet education and training standards and comply with a code of ethics;
- require Australian financial services licensees to ensure that their financial advisers comply with the education standards and are covered by a compliance scheme;
- restrict the use of ‘financial adviser’ and ‘financial planner’;
- amend the content requirements for the register of financial advisers;
- impose sanctions where a financial adviser or licensee fails to comply; and
- establish a standards body to develop and set the education standards and code of ethics.

There will be transitional arrangements for existing financial advisers.

ASIC issues updated guidance for advisers

ASIC has updated its regulatory guide RG 175 *Licensing: Financial product advisers – conduct and disclosure.* The updates are generally technical in nature.

The updated guide clarifies that while the best interests duty and the appropriate advice requirement are separate obligations, “it is unlikely that advice which fails to meet the best interests duty will be appropriate.”

Financial Advisers Consultative Committee

ASIC announced on 29 March 2017 that it had established a Financial Advisers Consultative Committee to improve that financial advice industry’s engagement with the regulator.

ASIC report on oversight of financial advisers

On 17 March 2017 ASIC released a report on its review of how effectively Australia's largest banking and financial services institutions (the big 4 banks and AMP) oversee their financial advisers. The project involved 3 phases.

In the first phase, ASIC directed the institutions to identify and provide information about advisers whose past conduct had been identified as non-compliant. A total of 185 advisers were considered for further regulatory enforcement action.

In the second phase, ASIC engaged with each of the institutions to oversee the development and implementation of a framework for large-scale customer review and remediation. Compensation arising from the non-compliant conduct identified was approximately $30 million in total as at

31 December 2016.

In the third phase, ASIC selected 10 advice licensees and undertook a review of their monitoring and supervision processes. ASIC was concerned with how referees were contacted when hiring advisers, and that recruiting licensees rarely received effective responses to requests for advisers' previous audit reports.

FINANCIAL MARKETS

Increasing transparency of beneficial ownership of companies

In May 2016 the Federal Government announced that it would explore options for a beneficial ownership register for companies.

On 13 February 2017 Treasury released a consultation paper on the proposed register. Submissions closed on 13 March.

In the UK since April 2016, companies have been required to maintain a People with Significant Control (**PSC**) register and since 30 June 2016, companies must annually file relevant information from their PSC register with the UK Companies House. This information is then searchable by the public free of charge.

The consultation paper raises a number of questions including:

- whether listed companies should be exempt;
- how a beneficial owner should be defined;
- the beneficial owner information that should be captured; and
- how the information should be recorded and maintained.

Social impact investing

Social impact investments are "investments made with the intention of generating measurable social and/or environmental outcomes in addition to a financial return."

The Treasury released a *Social Impact Investing Discussion Paper* in January to explore ways the Australian Government can develop the social impact investing market. Submissions closed on 27 February.

The paper sees delivery of social and environment outcomes as a function of government; social impact investing "has the potential to complement (but not replace) the Australian Government's existing role and responsibilities across many portfolios."

The paper sets out 4 proposed principles which would guide the Australian Government's participation in the social impact investment market:

1. Social impact investments should only proceed when they represent value for money: that is, when the expected benefits for the Australian Government outweigh the costs.
2. Social impact investments should include outcomes-based measurement to monitor the progress, risk and returns of the investment and a robust and transparent evaluation method to determine the investment's impact and efficacy.
3. The risks and returns of a social impact investment should be fairly shared between the Australian Government, investors and service providers.
4. Social impact investments should have a strong case for being able to successfully address social and/or environmental problems which are priorities for the Government.

The paper also looks at removing regulatory barriers to social impact investing.

Crowdfunding web page

ASIC has launched a webpage with information on the new crowd-sourced equity funding laws which take effect from 28 September 2017.

FINANCIAL PRODUCTS

Consultation on stapled securities

Treasury has released a consultation paper on stapled structures (where two or more securities are "stapled" together so that they can't be bought or sold separately). A common stapled structure is where investors buy shares in a company and units in a trust, and where the company carries on trading operations and the trust holds the assets and receives income. These structures are often tax driven. Submissions are due by 20 April.

Extended relief for foreign collective investment schemes for two years

ASIC has extended Class Order *Foreign collective investment schemes* ([CO 04/526]) for two years. The class order provides relief for foreign collective investment schemes from the requirement to register as a managed investment scheme or obtain an AFSL where the applicable overseas regulatory regime delivers equivalent regulatory outcomes.

FINANCIAL SERVICES

Risk management for responsible entities

ASIC released Regulatory Guide RG 259 *Risk Management systems of responsible entities* on 27 March 2017.

Responsible entities are required to have adequate risk management systems.

The guide outlines ASIC's expectations for responsible entities to have:

- overarching risk management systems in place;
- processes for identifying and assessing risks; and
- processes for managing risks.

The guide also includes additional good practice guidance which is not mandatory for responsible entities.

FINANCIAL SYSTEM

Consultation on member-owned firms

The Federal Government has announced a consultation on reforms to support cooperatives, mutuals and member-owned firms.

Mr Greg Hammond OAM will be appointed as an independent facilitator to conduct consultations on the recommendations of the Senate Economic References Committee report on cooperative, mutual and member-owned firms and assist in developing a Government response to deliver meaningful reforms for the sector.

Mr Hammond will make recommendations to the Government on whether there should be regulatory changes to improve access to capital and whether 'mutual enterprise' should be explicitly defined in the Corporations Act. Mr Hammond is expected to report by 14 July 2017.

Code of Banking Practice review

The Report of the Independent Review of the Code of Banking Practice (**Code**) was released on 20 February 2017.

The review was conducted by Mr Phil Khoury.

There are 99 recommendations. Some of the key recommendations of the report are to amend the Code to include the following:

- plain English language;
- expanding the definition of small business and new obligations in relation to small business loans;
- making it mandatory to provide consumers with a suitability assessment;
- additional responsible lending and ongoing obligations in relation to credit cards;
- prohibiting enforcement of a credit facility for an individual or small business if the customer has met payment obligations and acted lawfully;
- co-debtors should have to receive a "substantial" benefit from the credit facility;
- banks should have recourse to the assets of an individual borrower before they can have recourse to the guarantor's security (unless the borrower and guarantor agree);
- an obligation to identify and contact individual customers at high risk of financial difficulty; and
- a bank must appoint a Customer Advocate.

On 28 March 2017 the Australian Bankers' Association released its response to the review, supporting (or supporting in principle) 80 of the 99 recommendations. In its press release announcing its response, the ABA highlighted the following changes which consumers could expect:

- Plain English language so that Australians can better understand their banking rights and responsibilities.
- An easier way to cancel credit cards or reduce the credit limit, and a commitment by banks when offering cards to assess someone's ability to pay the full credit limit in a reasonable time period.
- A new dedicated section for small businesses, and a commitment by

banks to simplify terms and conditions and give more notice when loan contracts change.
- Increased help for people experiencing, or at risk of, financial difficulty, so they can take control of their finances.

The Code will now be redrafted in plain English to reflect the recommendations which have been adopted. The ABA signaled that there would likely be a 12 month transition period for the new Code.

Remuneration review

The Australian Bankers' Association announced a 6 point reform plan in April 2016 to address conduct and culture issues in banks.

As part of the plan, Mr Stephen Sedgwick AO was appointed to conduct an independent review of product sales commissions and product based payments to retail banking bank staff and third parties.

Mr Sedgwick released an issues paper on 17 January 2017. Submissions were due by 10 February.

The paper includes information on current remuneration practices in retail banking and also a set of issues on which submissions were sought:

- The role of targets.
- Does size of rewards or their structure matter most?
- Should bank obligations be strengthened?
- What is the difference between a 'sales' and a 'service' culture?
- What role might the remuneration arrangements for very senior managers play in conditioning the behaviour of frontline staff?
- Issues specific to remuneration of third parties.
- What is a poor customer outcome (and what is the link to agent remuneration)?

FINTECH

ASIC information sheet on blockchain

ASIC released an information sheet on distributed ledger technology (**DLT**) (commonly known as blockchain) on 20 March 2017. It sets out 6 questions to help evaluate the use of DLT for a business:

- How will the DLT be used?
- What DLT platform is being used?
- How is the DLT using data?
- How is the DLT run?
- How does the DLT work under the law?
- How does the DLT affect others?

INSOLVENCY

Corporate insolvency reforms

Treasury has released draft legislation to amend Australia's corporate insolvency laws.

A safe harbour for directors is proposed which would exclude personal liability for insolvent trading if the company is undertaking a restructure, in certain circumstances.

The other reform is to make unenforceable those clauses in contracts (called 'ipso facto' clauses) which allow a contract to be terminated solely due to an insolvency event, if a company has entered into a formal insolvency process. There will be some exceptions.

The closing date for submissions is 24 April.

INSURANCE

ACCC and add-on insurance

In October 2016 ASIC released a report into sales of add-on insurance by car dealers. The report described the market for products such as consumer credit insurance and extended warranty sold by car dealers as a "market that is failing consumers." High commissions were among the factors that led to this conclusion. ASIC gave an ultimatum to insurers: those "who fail to address our findings will be subject to further regulatory action by ASIC."

To address ASIC concerns about high commissions, a group of 16 insurers lodged an application last year with the Australian Competition and Consumer Commission (the **ACCC**) seeking authorisation to implement a 20% cap on commission paid to distributors of "add-on" insurance products through car dealers.

ACCC authorisation is necessary because the arrangement could otherwise be an illegal cartel.

ASIC supported the cap on commissions, but said that it was not the complete solution.

On 17 February 2017 the ACCC issued a draft determination proposing to deny authorisation. In its press release the ACCC said that the proposed cap was unlikely to result in a public benefit.

PAYMENTS

Apple Pay collective bargaining

The ACCC issued a determination on 31 March 2017 denying authorisation to a consortium of banks to collectively bargain with Apple and collectively boycott Apple Pay.

The ACCC was not satisfied that the likely benefits from the proposed conduct would outweigh the likely detriments. It found that if the applicants had been successful in obtaining NFC access on iPhones, this would affect Apple's current integrated hardware and software strategy for mobile payments and operating systems and impact how Apple competed with Google.

The ACCC noted that digital wallets and mobile payments are in their infancy and subject to rapid change. There was a range of alternative devices being released to allow mobile payments, and it was therefore uncertain how competition might develop.

The ACCC also commented that Apple Wallet and other multi-issuer digital wallets could increase competition between the banks by making it easier for consumers to switch between card providers.

PERSONAL PROPERTY SECURITIES

Amendments for PPS leases

The *Personal Property Securities Amendment (PPS Leases) Bill* 2017 (Cth) introduced on 1 March 2017 will amend the *Personal Property Securities Act* 2009 (Cth) (**PPSA**) to extend the minimum duration of PPS leases from more than one year to more than two years and provide that a lease of an indefinite term will not be deemed to be PPS lease unless and until it runs for a period of more than two years.

The amendments are designed to reduce the risks for small businesses in the short term hire and rental sector who do not register their security interests in goods hired. The interest of a lessor under a PPS lease is deemed to be a security interest. If the interest is not registered on the PPSR, the security interest in the goods will vest in the insolvent estate if the lessee becomes insolvent.

Forge Power appeal

The NSW Court of Appeal has upheld a decision which found that two large GE power turbines were not "fixtures". The lessor of the equipment had failed to register its security interest on the PPSR and the lessee went into administration. If the goods had become fixtures, the PPSA would not have applied, because fixtures are outside the PPSA. The lessor tried to argue that the goods were not fixtures because if the goods were not fixtures, it had lost its security interest under the PPSA. The Court confirmed that the common law concepts in relation to fixtures applied. These look at the objective intention. Using these concepts, the Court decided that it was not the intention that the turbines became fixtures, which meant that the goods were subject to the PPSA, and so the lessor lost its security interest to the lessee.

Using an ABN for a PPSR registration can make it defective

A lessor of equipment, Alleasing, registered on the PPSR its security interest in an equipment lease against OneSteel. Instead of using OneSteel's ACN, it used the ABN of OneSteel for the registration. Under the PPS Regulations, the ACN must be used. As a result of using the ABN, a search of the PPSR using the ACN would not have found the Alleasing registration (even though the ABN included the ACN numbers, plus two more numbers).

OneSteel went into administration. Under the PPSA an "unperfected" security interest vests in the grantor (in this case, OneSteel) when it goes into administration.

There was a dispute between Alleasing and OneSteel. In the court decision, *In the matter of OneSteel Manufacturing Pty Limited (administrators appointed)* [2017] NSWSC 21, the judge found that the Alleasing registration was seriously defective because of its use of the ABN rather than the ACN, and as a result, the registration was not effective. The security interest therefore vested in OneSteel.

PRIVACY

Mandatory data breach notification

The *Privacy Amendment (Notifiable Data Breaches) Act* 2017 (Cth) received assent on 22 February 2017 and will come into force in 12 months from that date. The new Act requires notice to the Office of the Australian Information Commissioner and the affected individuals of certain data breaches.

Metadata and personal information

The Federal Court in the Grubb case (*Privacy Commissioner v Telstra Corporations Limited* [2017] FCAFC 4) decided that certain metadata was not personal information because it was not information about the individual.

Mr Grubb is a journalist who in 2013 requested Telstra to give him access to all metadata regarding his mobile phone. Telstra gave him some data but refused to give him access to its mobile network data, which included metadata. Grubb filed a complaint with the Office of the Australian Information Commissioner. The Privacy Commissioner held that Telstra had breached National Privacy Principle (**NPP**) 6.1, which provided that an organisation that holds "personal information about an individual" must provide the individual with access to the information on request.

Telstra then applied to the Administrative Appeals Tribunal (**AAT**) to set aside the Privacy Commissioner's decision. The AAT held that the information withheld was not "personal information" because it was not information "about an individual".

The Federal Court considered an appeal by the Privacy Commissioner and affirmed the decision of the AAT.

Veda Advantage found to have interfered with privacy

A recent decision of the Australian Privacy Commissioner found that Veda Advantage Information Services and Solutions Ltd (**Veda**) interfered with the privacy of a class of individuals.

The identified class was members of the public seeking to access a free copy of their credit report from Veda.

In *Financial Rights Legal Centre Inc. & Others and Veda Advantage Information Services and Solutions Ltd* [2016] AICmr 88 (9 December 2016), complaints were made on behalf of the class by consumer advocacy groups.

The complaints dated back to August 2014 and included a number of allegations of breaches of the *Privacy Act* 1988 (Cth) (the **Privacy Act**) and the Australian Privacy Principles. These related to matters such as:

- how Veda disclosed the availability of obtaining credit information;
- onerous requirements to obtain a free credit report;
- reports not being provided within the required timeframes;
- the online application form for a free credit report leading to the direct marketing of Veda's fee-based services;
- charging access even when an individual had not requested a credit report within the previous 12 months; and
- not including the individual's VedaScore information in a free credit report.

The Australian Information Commissioner found that Veda:

- failed to prominently state that individuals have a right to obtain their credit reporting information free of charge in certain circumstances, in breach of the Privacy Act;
- failed to take reasonable steps to ensure that free access to credit reports was as available and as easy to identify and access as paid access to credit reports, in breach of the Privacy Act;
- used and disclosed personal information it held about individuals seeking free access to credit reports for the purpose of direct marketing, in breach of Australian Privacy Principles; and
- charged for the expedited delivery of a credit report in breach of the Privacy Act when the individual had not sought access to credit reporting information within the last 12 months.

PRUDENTIAL STANDARDS

Updated APRA guidance on residential mortgage lending

The Australian Prudential Regulation Authority (**APRA**) has updated its Prudential Practice Guide APG 223 *Residential Mortgage Lending*.

In its updated guide, APRA has included some additional guidance as follows:

- Failure to meet responsible lending obligations can expose an ADI to potentially significant risks, and a prudent ADI would conduct a periodic assessment of compliance with responsible lending conduct obligations to ensure it does not expose itself to significant financial loss.
- APRA expects ADIs to undertake a new serviceability assessment whenever there are material changes to current or originally approved loan conditions. This will include a change in repayments from principal and interest to interest only or an extension of an existing interest only period.
- Changing serviceability policies based on competitor policies as the primary justification would be seen by APRA as indicative of weak risk governance.
- It would be prudent for ADIs to monitor the level of lending to borrowers with minimal income buffers.
- ADI serviceability policy should incorporate an interest-rate buffer of at least 2%. ADIs should also incorporate a minimum floor assessment interest rate of at least 7%.
- ADIs should use a suitably prudent period for assessing repayment of credit cards or other revolving personal debts when calculating borrower expenses.
- For interest only loans APRA expects ADIs to assess capacity based on repayments of principal and interest for the principal and interest period.
- For rental properties, prudent serviceability policies would incorporate a minimum haircut of 20% of expected rental income. Good practice would be to place no reliance on a borrower's potential ability to access future tax benefits from operating a rental property at a loss.
- Relying solely on benchmarks of expenses generally would not meet APRA's requirements for sound risk management.
- Prudent practice would include a reasonable estimate of housing costs even if a borrower who intends to rely on rental property income to service the loan does not currently report any personal housing expenses.
- Any loan approved outside an ADI serviceability criteria parameter should be captured and reported as an override.
- APRA expects interest only periods offered on residential mortgage loans to be of limited duration.
- Loans to SMSFs that are secured by residential mortgages are to be treated as non-standard eligible mortgages for the purposes of capital adequacy.

Limits on interest only residential mortgage lending

By a letter to ADIs on 31 March 2017, APRA has introduced additional supervisory measures for residential mortgage lending practices.

A focus of the letter is interest-only lending, which APRA notes now represents nearly 40 per cent of the stock of residential mortgage lending by ADIs. APRA expects ADIs to:

- limit the flow of new interest-only lending to 30 per cent of total new residential mortgage lending;
- place strict internal limits on the volume of interest-only lending at loan-to-value ratios (LVRs) above 80%; and
- ensure there is strong scrutiny and justification of any instances of interest-only lending at an LVR above 90%.

On other matters, APRA expects ADIs to:

- manage lending to investors in such a manner so as to comfortably remain below the previously advised benchmark of 10% growth;
- review and ensure that serviceability metrics, including interest rate and net income buffers, are set at appropriate levels for current conditions; and
- continue to restrain lending growth in higher risk segments of the portfolio (e.g. high loan-to-income loans, high LVR loans, and loans for very long terms).

APRA letter to ADIs on counterparty credit risk

On 6 March 2017 APRA released a letter to ADIs regarding implementation of proposed revisions to counterparty credit risk requirements.

SUPERANNUATION

Innovation super income streams

Draft regulations have been issued by Treasury for new design rules for lifetime superannuation income stream products. The draft regulations are open for submissions until 12 April.

Productivity Commission draft report on default super funds

The Productivity Commission released a draft report on alternative default models for superannuation on 29 March 2017. The Commission proposes 4 alternative models. Under current arrangements, most employees can choose their fund but if they do not make an active choice, employers are required to nominate a default fund. The rules about nomination of a default fund vary significantly depending on industrial awards, agreements, contracts and other employment arrangements. Submissions are due on the draft report by 28 April 2017.

Subplan information disclosure requirements

Under the *Superannuation Industry (Supervision) Act* 1993 (Cth), the trustee of a superannuation fund is required to make "transparency information" publicly available on the fund's website and keep it up-to-date. Transparency information is prescribed under the *Superannuation Industry (Supervision) Regulations* 1994 (Cth).

Currently there is transitional relief from these provisions in relation to employer subplans under ASIC Class Order [CO 14/509]. This relief will expire from 1 July 2017, and trustees of super funds with employee subplans will then be required to make all transparency information available in relation to a subplan. However trustees will be permitted to redact information that is personal to a beneficiary or former beneficiary.

Transparency information to be disclosed includes the trust deed, governing rules, actuarial report for a defined benefit fund, product disclosure statement, annual report and summary of significant event notices in the previous 2 years.

ASIC has written to trustees reminding them of the deadline for compliance.

DISPUTES AND ENFORCEMENT

ASIC proceedings against Westpac on responsible lending

Proceedings have been lauhnched by ASIC against Westpac alleging breaches of responsible lending obligations in relation to home lending.

ASIC claims that Westpac breached these obligations by using a benchmark instead of actual expenses declared by borrowers when assessing the ability of borrowers to repay the loan.

ASIC also alleges that Westpac approved loans where a proper assessment of the borrower's ability to repay would have shown a monthly deficit.

In the case of certain home loans with an interest only period, ASIC says that Westpac failed to have regard to the higher repayments at the end of the interest only period when assessing ability to repay.

ASIC relies on 7 specific loans in its claim.

Westpac says that it will defend the proceedings and that all of the 7 loans relied on by ASIC in the proceedings are currently meeting or ahead in repayments.

Westpac denies that it relied solely on benchmarks and denies that it did not have regard to the customers' declared expenses in its suitability assessment.

ASIC supervisory levies: draft legislation

On 22 February 2017 Treasury released drafts of the proposed legislation for industry funding of ASIC. Submissions closed on 10 March.

The proposed Bills establish the overarching framework for the model. The Government is continuing to consult on the mechanisms that will be used to calculate the levies payable by each class of regulated entity, with this detail to be included in subsequent draft regulations.

There will also be public consultation on the regulations to support the model.

Industry funding is scheduled to begin in the second half of 2017.

Fines for Fast Access Finance

The Federal Court has fined 3 Fast Access Finance companies a total of $730,000 for engaging in unlicensed credit activity.

The companies operated using a structure where consumers seeking small value loans signed documents which purported to be for the purchase and sale of diamonds. The Court had earlier found in 2015 that this was a sham and that the transactions were in fact regulated consumer loans.

Tabcorp whacked with $45 million civil penalty over AML/CTF breaches

Tabcorp has been ordered by the Federal Court of Australia to pay a civil penalty of $45 million, the highest in corporate Australian history, for breaches of AML/CTF obligations. With legal costs, the total bill is expected to be more than $95 million.

Justice Perram found that Tabcorp failed to:

- have a compliant AML/CTF program for over 3 years;
- give AUSTRAC reports about suspicious matters on time or at all on 105 occasions;
- identify a customer who collected $100,000 in winnings; and
- enrol with AUSTRAC on time.

Citibank refunds fees

ASIC has announced that Citigroup Pty Ltd (**Citibank**) has refunded about $5 million to 230,000 customers for failing to properly disclose that credit card international transaction fees apply to Australian dollar transactions in the case where the merchant uses an entity based overseas to process its transactions. Citibank had failed to properly disclose this when it amended its disclosure about the changes to fees, which were introduced in 2016. ASIC believed that this may have led customers to think that international transaction fees would be charged only when the transaction was made in a foreign currency or with an overseas merchant.

FOFA laws breached

In *Australian Securities and Investments Commission v NSG Services Pty Ltd, in the matter of NSG Services Pty Ltd* [2017] FCA 345, the Federal Court found that financial advice firm NSG Services Pty Ltd (**NSG**) breached the best interests obligations of financial services licensees, introduced under the Future of Financial Advice (**FOFA**) reforms. This is the first time that a licensee has been found liable by a court for a breach of the FOFA provisions. The decision is the result of proceedings commenced by ASIC in June 2016. A decision will be handed down later on the amount of the penalty.

The case involved financial advice provided by NSG advisers on 8 occasions between July 2013 and August 2015. The Court found that the advisers had failed to take reasonable steps to ensure that they provided advice that complied with the best interests obligations and to ensure that the advice they gave was appropriate to clients. These breaches in turn meant that NSG was liable as a licensee by failing to ensure that its representatives complied with these provisions. NSG agreed with ASIC to accept that it had contravened the legislation.

Channic penalty judgment

The Federal Court has awarded penalties totaling $778,000 against the defendants in the Channic case on responsible lending.

In *Australian Securities and Investments Commission v Channic Pty Ltd (No 5)* [2017] FCA 363 handed down on 7 April 2017, Justice Greenwood also ordered that 8 of the credit contracts which were the subject of the case were to be set aside and the consumers relieved of all liability. The defendants were also ordered to pay $420,000 towards the costs of ASIC.

The Court noted that the maximum penalty for breach of the relevant provisions was $220,000 for an individual and $1.1 million for a body corporate. The Court also noted that the credit legislation does not set out any factors to be taken into account by the Court when exercising its discretion on the award of a penalty for a breach of the responsible lending obligations.

In the judgment the judge held that the scheme of the responsible lending provisions is to protect the consumer from the burdens of a potentially “unsuitable”contract. The judgment includes a commentary on the relevant factors that the judge considered when assessing the amount of the civil penalties, and so the decision will be important for future cases when penalties are assessed for responsible lending contraventions.

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