DWYER HARRIS

FINANCIAL SERVICES AND CREDIT
QUARTERLY UPDATE

April 2019

Dwyer Harris Pty Ltd ABN 56 159 256 121 www.dwyerharris.com

Suite 602, 161 Walker St, North Sydney NSW 2060 Australia

Contents

CONSUMER CREDIT

Mortgage broking disciplinary rules granted interim ACCC authorisation

On 11 April 2019, the Australian Competition and Consumer Commission (**ACCC**) announced that it had granted interim authorisation to allow the Mortgage and Finance Association of Australia (**MFAA**) to continue to administer disciplinary rules enforcing its Code of Practice. The interim authorisation will give the MFAA time to review its Code of Practice in line with recommendations of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the **Banking Royal Commission**). Authorisation by the ACCC removes any risk that the MFAA's disciplinary rules may breach competition provisions of the *Competition and Consumer Act 2010* (Cth). The ACCC will assess the new disciplinary rules and decide whether to authorise them once the review by the MFAA is completed.

Inquiry into credit and financial services targeted at Australians at risk of financial hardship

On 22 February 2019, the Senate Economics References Committee released its report on credit and financial services targeted at Australians at risk of financial hardship. The inquiry was aimed at addressing the gaps left by the Banking Royal Commission, which did not consider marginal credit service providers such as payday lenders, consumer lease providers, and debt advice firms. The report makes various recommendations including:

- the *National Consumer Credit Protection Amendment (Small Amount Credit Contract and Consumer Lease Reforms) Bill 2017* (Cth) exposure draft released by Treasury be introduced;
- Australian Securities and Investments Commission (**ASIC**), ACCC, and Australian Financial Complaints Authority (**AFCA**) supervision and enforcement be strengthened in the area of small and medium credit contract sector and consumer leasing sector;
- the Government implement a recommendation of the Banking Royal Commission by removing point of sale exemptions from the *National Consumer Credit Protection Act 2009* (Cth) (**NCCP Act**);
- the NCCP Act be amended to contain strong anti-avoidance provisions that are capable of capturing both new, emergent credit-like products, and attempts to disguise the nature of existing credit products;
- the Government implement a comprehensive regulatory framework for all credit and debt management, repair and negotiation activities that are not currently licensed by the Australian Financial Security Authority, including for the buy now pay later sector;
- the product intervention power in the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019* (Cth) (which has now been enacted) be extended to cover buy now pay later products; and
- tax and other incentives could be used to encourage mainstream credit providers to offer low interest products to vulnerable Australians.

SACC and consumer leasing Bill

On 18 February 2019, a Labor member of the House of Representatives, Madeleine King MP, introduced a private member's Bill, the *National Consumer Credit Protection Amendment (Small Amount Credit Contract and Consumer Lease Reforms) Bill 2019* (Cth). The Bill replicates the Government's exposure draft legislation released on 23 October 2017 in response to the 2015 review of the small amount credit contract (**SACC**) regime, which has not been progressed by the Government to date. The Bill would amend the NCCP Act to:

- impose a cap on the total payments that can be made under a consumer lease (known as rent-to-buy schemes);
- require SACCs to have equal repayments and payment intervals;
- remove the ability for SACC providers to charge monthly fees in respect of the residual term of a loan where a consumer fully repays the loan early;

- prevent lessors and credit assistance providers from undertaking door-to-door selling of leases at residential homes;
- introduce anti-avoidance protections; and
- increase penalties.

With the announcement of the Federal election to be held on 18 May 2019, this Bill has now lapsed.

ASIC consults on responsible lending guidance

On 14 February 2019, ASIC issued a consultation paper to update its guidance on responsible lending (CP 309). Comments are due by 28 May 2019. For more information see our article here.

Review of financial counselling services

Following the recommendations of the Banking Royal Commission, on 7 February 2019 the Government announced a review on the coordination and funding of financial counselling services. The review will consider current services and the adequacy of appropriate delivery models for future funding of financial counselling services. The review will be led by the Department of Social Services in consultation with Treasury and the Department of the Prime Minister and Cabinet.

FINANCIAL ADVICE

Draft bill and regulations ending grandfathered conflicted remuneration for financial advisers

Following the recommendations of the Banking Royal Commission, on 22 February 2019 the Government released the *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019* (Cth) for consultation. The Bill removes the grandfathering arrangements for conflicted remuneration and other banned remuneration from 1 January 2021 and enables regulations to be made to provide for the transition process.

On 28 March 2019, Treasury released for consultation draft regulations providing details on how previously granfathered benefits must be passed through to the customer and also imposing record keeping obligations on persons required to pass through benefits. Submissions close on 25 April 2019.

In an effort to actively enforce the proposed laws, on 27 February 2019, Treasury issued the *ASIC (Investigation into Grandfathered Conflicted Remuneration for Financial Advice) Direction 2019* requiring ASIC to investigate the extent of compliance with the pass through benefits arrangements.

FINANCIAL MARKETS

Australian Business Securitisation Fund

The *Australian Business Securitisation Fund Act 2019* (Cth) was signed into law on 5 April 2019. The $2 billion Australian Business Securitisation Fund (**ABSF**) will invest in warehouse facilities and securitisations backed by SME loans. The intent is to provide additional funding to smaller banks and non-bank lenders to on-lend to SMEs on more competitive terms. The ABSF will be administered by the Australian Office of Financial Management.

Corporate Collective Investment Vehicle Bill

On 17 January 2019, Treasury released for public consultation two bills covering the tax and regulatory components of the corporate collective investment vehicle (**CCIV**) regime. Submissions closed on 28 February 2019.

FINANCIAL SYSTEM

The Royal Commission Final Report

The Final Report of the Banking Royal Commission was released by the Federal Government on 4 February 2019. The report is in 3 volumes and made 76 recommendations. Some of the key recommendations are listed below.

- **Banking**:
  - a best interests duty for mortgage brokers;
  - regulation of mortgage brokers in the same manner as financial product advisers;
  - borrowers rather than lenders should pay mortgage brokers;
  - removal of the NCCP Act point of sale exemption for suppliers of goods and services;
  - amendments to the Banking Code of Practice (see below under ABA response);
  - not extending the NCCP Act to small business or changing NCCP Act unsuitability obligations;
  - a national scheme of farm debt mediation;
  - amendments to prudential standards regarding valuations of land; and
  - making industry codes enforceable by regulators.

- **Financial advice**:
  - requiring annual client reviews of ongoing fee arrangements;
  - advanced disclosure of any lack of independence;
  - a review of the effectiveness of measures to improve the quality of financial advice;
  - repeal of grandfathering provisions for conflicted remuneration;
  - consider further reducing the cap on life risk insurance commissions;
  - reviewing remaining exemptions to the ban on conflicted remuneration;
  - reference checking and information sharing for AFSL holders in relation to financial advisers;
  - mandating licensee reporting of serious compliance concerns about individual financial advisers;
  - mandatory enquiries by licensees about detected misconduct of a financial adviser; and
  - a new disciplinary system for financial advisers.

- **Superannuation**:
  - Registrable Superannuation Entity (**RSE**) trustees not holding other roles or offices;
  - prohibition on deducting advice fees from a MySuper account;
  - limits to deductions of advice fees levied on non-My Super accounts;
  - prohibiting the hawking of superannuation products;
  - requiring a person to have only one default account;
  - civil penalties for trustees and directors for breaches of best interests obligations; and

- extending the Banking Executive Accountability Regime (**BEAR**) to RSE licensees.

- **Insurance**:
  - prohibition of hawking of insurance products;
  - removing the AFSL exemption for funeral expenses policies;
  - developing a deferred sales model for the sale of any add-on insurance products;
  - capping commissions paid to vehicle dealers for such products;
  - amending the duty of disclosure for consumers so that insurers cannot unduly reject the payment of legitimate claims;
  - amendments to the *Insurance Contracts Act 1984* (Cth) so that insurers can only avoid a life insurance contract on the basis of nondisclosure or misrepresentation if it can show that it would not have entered into a contract on any terms;
  - extending the unfair contract terms provisions to insurance contracts;
  - removing the exemption for handling and settlement of insurance claims from the definition of a financial service;
  - providing for enforceable provisions of industry codes and the imposition of mandatory industry codes;
  - requiring AFSL holders to cooperate with AFCA;
  - extending the BEAR to insurers regulated by the Australian Prudential Regulation Authority (**APRA**);
  - reviewing the merits of legislating universal key definitions for insurance in MySuper group life policies; and
  - amending prudential standards to provide additional scrutiny for related party engagements by RSE licensees.

- **Culture, governance and remuneration**:
  - APRA to give effect to the Financial Stability Board's principles, standards and guidance on sound compensation principles and practices;
  - APRA prudential supervision aims should include not only financial risk but misconduct, compliance and other non-financial risks;
  - updated prudential standards and guidance from APRA on remuneration systems of regulated institutions, including clawback;
  - annual review of remuneration systems for frontline staff by all financial services entities;
  - implementation of the Sedgwick Review recommendations;
  - financial services entities to take steps to assess their culture and governance, identify any problems, and deal with those problems; and
  - APRA should have a supervisory program for building culture that mitigates the risk of misconduct.

- **Regulators**:
  - retaining the "twin peaks" model of financial regulation;
  - ASIC adopting a more assertive approach to enforcement – first considering whether a court should consider the matter, more selective use of infringement notices, considering the deterrence impact of enforceable undertakings and the benefit of obtaining admissions in enforceable undertakings, and separating enforcement and non-enforcement staff;
  - adjusting the roles of APRA and ASIC in relation to superannuation;
  - ASIC given the power to enforce civil penalty provisions in the *Superannuation Industry (Supervision) Act 1993* (Cth);
  - joint administration of the BEAR by ASIC and APRA;
  - a statutory obligation on APRA and ASIC to cooperate and share information, and a joint cooperation memorandum between them;
  - application of the BEAR to APRA and ASIC;

  - regular capability reviews of APRA and ASIC; and
  - a new oversight authority for APRA and ASIC, independent of Government.

- **Other important steps**:
  - establishing a compensation scheme of last resort;
  - requiring self-reporting of contraventions by licensees as recommended by the ASIC Enforcement Review Taskforce in December 2017;
  - eliminating as far as possible exceptions and qualifications to generally applicable norms in legislation governing financial services entities; and
  - legislation governing financial services entities should identify expressly the fundamental norms of behaviour.

Government response to the Royal Commission

On the same day as the Federal Government released the Final Report of the Banking Royal Commission, the Government also released its response to the report.

The Government has acted on all of the recommendations of the Final Report and has generally agreed with or supported them, with the exception of the recommendations in respect of mortgage broker commissions (see next article below).

With the announcement of a Federal election on 18 May and the strong likelihood of a change in Government, the response of the Labor Opposition to the Final Report is also relevant to consider. The Labor response can be accessed here.

Mortgage broker commissions

The Government's initial response to the Final Report of the Banking Royal Commission in respect of mortgage brokers commissions was that the Government would support the recommendations by ending trailing commissions and volume-based bonuses on new loans from 1 July 2020, but allow upfront commissions for 3 years, after which there would be a review by the ACCC and the Council of Australian Financial Regulators to consider the impact of moving to a borrower pays remuneration structure. The Government subsequently announced on 12 March 2019 that mortgage brokers would be allowed to keep both upfront and trailing commissions for at least the next 3 years, after which time both arrangements would be subject to the review.

The Labor Opposition is proposing:

- ending trailing commissions on new loans from 1 July 2020;
- banning payment of any other incentives to brokers by lenders;
- allowing upfront commissions paid by the lender, but capped at a fixed rate of 1.1% so as to be the same across all lenders; and
- regulating that a commission can only apply to the amount drawn down by the borrower, not the total loan amount.

Regulator responses to the Royal Commission

ASIC and APRA have both published information on how they have responded to the recommendations of the Banking Royal Commission.

ABA response to the Royal Commission - Banking Code amendments

In response to the Final Report of the Banking Royal Commission, the Australian Banking Association (**ABA**) announced changes to the Banking Code of Practice (**Code**).

The ABA says that it will support and implement the following recommendations for the Code:

- banks will work with customers in remote areas or who have limited English to identify ways for them to undertake their banking;
- ban informal overdrafts on basic bank accounts;
- abolish dishonour fees on basic bank accounts;
- banks will follow AUSTRAC's guidance about the identification and verification of those identifying as Aboriginal or Torres Strait Islander heritage;
- amend the Code to end charging default interest in areas declared to be affected by drought or other natural disasters; and
- introduce enforceable provisions of the Code, to be identified and agreed with ASIC, backed by legislation.

The ABA has yet to reach a view on the recommendation to amend the definition of small business in the Code to include any business or group employing fewer than 100 full time equivalent employees, where the loan applied for is less than $5 million. The ABA says that more consideration needs to be given to the issue by regulators, the ABA and the small business community. The ABA says that the Banking Royal Commission's recommendation to expand the definition from total borrowings of a business ($3 million total credit exposure) to an assessment on a per loan basis regardless of existing borrowings is a very significant expansion on the current definition, which should be considered carefully before any changes are made.

The ABA also supports the Final Report's recommendation for clearer and improved practices for banks assisting farmers in financial distress.

FINTECH

Global Financial Innovation Network (GFIN)

ASIC announced on 1 February 2019 the launch of the Global Financial Innovation Network (**GFIN**). GFIN is a group of 28 international organisations including ASIC "committed to supporting financial innovation in the interests of consumers."

The GFIN "*seeks to provide a more efficient way for innovative firms to interact with regulators, helping them navigate between countries as they look to scale new ideas … It also aims to create a new framework for co-operation between financial services regulators on innovation related topics, sharing different experiences and approaches*."

As part of the launch, GFIN invited applications from firms to be part of a pilot to test innovative financial products, services or business models across more than one jurisdiction. The deadline for applications was 28 February 2019.

Initial Coin Offerings

The Treasury released an issues paper on initial coin offerings (**ICOs**) on 30 January 2019. Submissions closed on 28 February 2019. The paper was issued to solicit views on:

- the opportunities and risks posed by ICOs;
- whether Australia's regular tree framework is well-placed to allow those opportunities to be harnessed while managing the associated risks; and
- whether there are other actions that could be taken to best position Australia to capitalise on new opportunities.

The paper identifies that one of the key challenges for market participants and regulators in accomodating ICOs within existing frameworks is whether an ICO token is a financial product.

Different approaches by regulators in other countries are discussed. For example, in Switzerland, digital tokens are classified into three categories: payment tokens, utility tokens and asset tokens, and the regulatory regime will depend on the classification. The tax treatment of ICO's is also considered in the paper.

INSURANCE

Life Insurance Code of Practice rewrite postponed

The Financial Services Council (**FSC**) had previously planned to introduce new consumer protections in the Life Insurance Code of Practice from 1 July 2019. The rewrite has now been postponed and instead, the FSC will enact a moratorium on life insurance genetic test results as a binding standard from 1 July 2019, while taking additional time to perform the review of the Code.

Claims handling consultation paper

The Government response to the Banking Royal Commission Final Report agreed to remove the exclusion of insurance claims handling from the definition of 'financial service'. On 1 March 2019, Treasury released a consultation paper on the implementation of this change. Treasury proposes to remove Regulation 7.1.33 of the Corporations Regulations, which exempts claims handling, and also use existing legislative powers to define the activity of handling or settling an insurance claim as a 'financial service' for the purposes of the *Corporations Act 2001* (Cth) (the **Corporations Act**). This could be enacted in legislation or regulations.

MUTUALS

Mutual Reforms Act

The *Treasury Laws Amendment (Mutual Reforms) Act 2019* (Cth) received assent on 4 April 2019. The Act gives effect to the recommendations of the Report on *Reforms for Cooperatives, Mutuals and Member-owned Firms* (the Hammond Report) to:

- introduce a definition of a mutual entity into the Corporations Act;
- remove the uncertainty for transferring financial institutions and friendly societies with respect to the demutualisation provisions in the Corporations Act; and
- expressly permit mutual entities registered under the Corporations Act to issue equity capital without risking their mutual structure or status.

Debt and equity tax regulations for mutually-owned ADIs

On 21 January 2019, Treasury released for public consultation an exposure draft of the *Treasury Laws Amendment (2019 Measures No. #) Regulations 2019* (Cth). The draft regulations propose to rectify the disadvantage for mutually-owned authorised deposit-taking institutions (**ADIs**) under existing tax regulations which treat certain capital instruments convertible into ordinary shares differently from similar capital instruments issued by mutually-owned ADIs. The draft regulations extend the operation of the tax regulation to ensure equivalent treatment between these capital instruments. The consultation period ended on 11 February 2019.

PAYMENTS

ePayments Code review

On 6 March 2019, ASIC released for consultation a review of the ePayments Code (**Code**). A consultation paper (CP 310) has been released for feedback from stakeholders. Comments were due on 5 April 2019. The consultation paper considers:

- future proofing the Code;
- complaints handling;
- unauthorised transactions;
- data reporting;
- mistaken Internet payments;
- small business access to Code provisions; and
- other aspects of the Code that may need updating.

In relation to future proofing the Code, the consultation paper identifies a number of recent developments including the New Payments Platform (**NPP**), mobile and other non-device-based payments, biometric authentication and electronic receipts.

Looking at complaints handling, the consultation paper queries the justification for having two complaints handling regimes in the Code.

As to unauthorised transactions, ASIC notes the emergence of account aggregator entities which generally access the customer's bank account by asking the customer to enter their Internet banking credentials. The review considers whether there are more effective ways to allow for these services to operate without breaching the passcode security requirements in the Code.

The consultation paper also considers whether the process for mistaken internet payments could be simplified, and whether ADIs should have a role in mitigating preventing those payments.

PERSONAL PROPERTY SECURITIES

PPSR 7th anniversary

On 30 January 2019, the Personal Property Securities Register (**PPSR**) turned 7 years old. The default registration period for PPSR registrations is 7 years, and so registrations began to expire from that date. Once a registration lapses, it cannot be extended. Only current registrations can be amended or renewed.

PRIVACY AND DATA

Tougher penalties and enhanced enforcement regime for the Privacy Act

On 25 March 2019, the Government announced that it will introduce amendments to the *Privacy Act 1988* (Cth) to increase penalties for breaches and to expand the powers of the Office of the Australian Information Commissioner (**OAIC**). Draft legislation will be available for consultation in the second half of 2019 and will cover the following:

- increase penalties for all entities covered by the Act, which includes social media and online platforms operating in Australia;
- provide the OAIC with new infringement notice powers backed by new penalties for failure to cooperate with efforts to resolve minor breaches;
- expand other options available to the OAIC to ensure breaches are addressed through

third-party reviews, and/or publish prominent notices about specific breaches and ensure those directly affected are advised;
- require social media and online platforms to stop using or disclosing an individual's personal information upon request;
- introduce specific rules to protect the personal information of children and other vulnerable groups; and
- any relevant findings of the current Digital Platforms inquiry by the ACCC (final report due in June 2019).

Draft Consumer Data Rights rules

On 29 March 2019, the ACCC released for consultation draft rules for the Consumer Data Right (**CDR**) in banking. Comments are due on 10 May 2019.The draft rules deal with the following:

- services that must be provided by data holders and accredited persons for CDR data requests;
- CDR data requests: product data requests, consumer data requests by CDR consumers, and consumer data requests by accredited persons on behalf of CDR consumers;
- rules on how persons can become accredited persons including ancillary matters, such as revocation and suspension of accreditation, obligations of accredited persons, and the Register of Accredited Persons; and
- dispute resolution, privacy safeguards, outsourcing, data standards and miscellaneous matters, such as review of decisions, reporting, record keeping and audit, and civil penalty provisions.

It is intended that these rules will be amended at a later time to deal with non-banking sectors of the economy.

Updated guidance for managing information security risks

On 25 March 2019, APRA released for consultation proposed cross-industry *Prudential Practice Guide 234 Information Security* (CPG 234), which will replace the existing CPG 234.

The updated CPG 234 has been developed to help industry implement CPS 234, APRA's new cross-industry prudential standard on information security, which comes into effect from 1 July 2019. It also provides guidance on addressing several common information security weaknesses that APRA has observed through its regular supervisory activities. The guidance should assist entities with protecting against the rise in information security risks, including cyber-crime.

PRUDENTIAL

APRA consultation on shareholding rules

On 2 April 2019, APRA announced that it was consulting on draft rules to give clarity to owners of new entrant financial sector companies on whether they are likely to be approved under the *Financial Sector (Shareholdings) Act 1998* (Cth) (the **FSSA**).

The FSSA was amended in 2018 to introduce a new streamlined "fit and proper" test for shareholders of new or recently established ADIs and life insurers with assets below $200 million, and general insurers with assets below $50 million.

The draft rules prescribe further matters relevant to the FSSA amendments, including factors for consideration in the "fit and proper" test, the calculation methodology for the asset threshold and annual reporting obligations to APRA. Submissions will close on 27 May 2019.

APRA consultation on BEAR

On 1 April 2019, APRA announced that it was consulting on a draft schedule that further informs on what kinds of variable remuneration are covered or excluded by the BEAR reforms.

APRA proposes a structure-neutral approach for medium and small ADIs. Irrespective of the organisational structure or whether the ADI is a locally incorporated ADI or foreign ADI, where an individual has both an accountable person role with an ADI (or subsidiary of an ADI) and another role, only the portion of the individual's variable remuneration that relates to the accountable person role would be subject to the deferral requirements under BEAR.

APRA expects this draft schedule will not result in any large ADI (i.e. major bank) initiating any changes to the amount of deferred remuneration, as the draft schedule does not apply to them. Submissions will close on 30 April 2019 and APRA will release the final schedule before 1 July 2019 (the commencement date of the BEAR for medium and small ADIs).

Updated prudential standard on credit risk management

On 25 March 2019, APRA released a discussion paper proposing changes to *Prudential Standard APS 220 Credit Quality* (APS 220), which requires ADIs to control credit risk by adopting prudent credit risk management policies and procedures.

The discussion paper addresses the following areas:

- Credit risk management – Broader coverage to include credit standards and the ongoing monitoring and management of an ADI's credit portfolio in more detail. It also incorporates enhanced Board oversight of credit risk and the need for ADIs to maintain prudent credit risk practices over the entire credit life-cycle.
- Credit standards – Incorporates outcomes from APRA's recent supervisory focus on credit standards and also addresses recommendation 1.12 from the Banking Royal Commission in relation to the valuation of land taken as collateral by ADIs.
- Asset classification and provisioning – Provides a more consistent classification of credit exposures, by aligning recent accounting standard changes on loan provisioning requirements, as well as other guidance on credit related matters of the Basel Committee on Banking Supervision.

The proposed reforms are due to be implemented from 1 July 2020, while an accompanying prudential practice guide and revised reporting standards will be released for consultation later this year.

In a related development, APRA has also released a letter to the industry expressing concerns related to ADIs' increasing exposure to funding agreements with third party lenders, including peer to peer (P2P) lenders.

APRA's policy priorities

APRA has announced its policy priorities for 2019 in a paper available here.

For ADIs, APRA will progress changes to the ADI capital framework, designed to embed the Basel III reforms, make the framework more flexible and internationally comparable, and ensure ADIs remain on track to meet the "unquestionably strong" capital ratio benchmarks. APRA will also update prudential standard APS 220 on credit risk management, including recommendations relating to valuations as recommended by the Final Report of the Banking Royal Commission.

Regarding superannuation, APRA's plans include ensuring superannuation trustees are

prepared to implement the new member outcomes assessments from 1 July, completing the post-implementation review of the prudential framework introduced in response to 2013's Stronger Super reforms, and consulting on proposals to address areas where changes are needed. APRA also plans to update superannuation data collection, with a focus on expanding the information collected on choice products.

In the insurance sector, APRA will consult the industry on plans to apply the capital framework for life and general insurance to private health insurance (**PHI**), as part of Phase Three of APRA's PHI Roadmap, and will also release a discussion paper examining how the prudential framework for insurance may need to be modified in light of the new accounting standard, AASB 17.

Countercyclical capital buffer on hold

On 29 January 2019, APRA announced its decision to keep the countercyclical capital buffer (**CCyB**) for ADIs on hold at zero per cent. The CCyB is an additional amount of capital that APRA can require ADIs to hold at certain points in the economic cycle to bolster the resilience of the banking sector during periods of heightened systemic risk. APRA reviews the buffer quarterly. It has been set at zero per cent of risk-weighted assets since it was introduced in 2016.

Review of prudential measures for residential mortgage lending risks

In an information paper released on 29 January 2019, APRA has detailed its objectives for its interventions in the residential mortgage lending market in recent years. APRA says that between 2015 and 2018, ADIs have lifted the quality of their lending standards, but also notes that the rate of growth of lending to investors fell considerably, and the proportion of loans written on an interest only basis roughly halved.

SUPERANNUATION

Improving super accountability and member outcomes reforms

The *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Act 2019* (Cth) was signed into law on 5 April 2019. The Act makes various legislative amendments:

- to replace the current 'scale test' with an 'outcomes test' which will require each trustee of a regulated superannuation fund that includes a MySuper product to make an annual determination on whether the financial interests of the beneficiaries of the fund are being promoted by the trustee;
- to give APRA improved power to refuse to authorise a RSE licensee to offer a MySuper product or to cancel an existing authority;
- to impose civil and criminal penalties on directors of RSE licensees who fail to execute their responsibilities to act in the best interests of members;
- to strengthen APRA's supervision and enforcement powers when a change of ownership or control of an RSE licensee takes place;
- to give APRA a broad power to issue a direction to an RSE licensee where APRA has prudential concerns;
- to require RSE licensees to make publicly available their portfolio holdings;
- to require RSE licensees to hold annual members' meetings; and
- to provide APRA with the ability to obtain information on expenses incurred by RSEs and RSE licensees in managing or operating the RSE.

Protecting Your Super (low balance and inactive accounts) reforms

The *Treasury Laws Amendment (Protecting Your Superannuation Package) Act 2018* (Cth) was signed into law on 12 March 2019 for commencement on 1 July 2019. The Act seeks to protect low balance and inactive accounts by:

- limiting the amount of fees that can be charged by a trustee of a superannuation fund for MySuper or choice products to 3% of the balance of the account if the balance is less than $6,000;
- prohibiting superannuation funds and approved deposit funds from imposing exit fees when a member disposes of all or part of their interest in a fund;
- preventing superannuation funds from providing insurance such as death, total and permanent disability or income protection insurance on an opt-out basis under certain circumstances;
- requiring retirement savings account providers and superannuation providers to pay the balance of MySuper or choice accounts to the Commissioner of Taxation, where the account is inactive and the balance is less than $6,000; and
- requiring the Commissioner of Taxation to consolidate any amounts received into a person's superannuation account that will have a balance of $6,000 or more once consolidated.

CFR and ATO report on SMSF borrowing arrangements

A report released on 22 March 2019 by the Council of Financial Regulators (**CFR**) and the Australian Taxation Office (**ATO**) has found that assets held by self-managed superannuation funds (**SMSFs**) under 'limited recourse borrowing arrangements' (**LRBAs**) are unlikely to pose systemic risk to the financial system at this time.

The report found that LRBAs form a relatively low proportion of SMSF assets overall. Only around 8.9% of SMSFs now have a LRBA, holding 5.2% of total SMSF assets or 1.4% of total superannuation assets.

Commenting on the report, the Federal Government announced it will not be making any changes to LRBAs and will instead request that the CFR and the ATO continue to monitor LRBAs in the superannuation system and report back again in 3 years.

The Labor Opposition believes that limited recourse borrowing by SMSFs crowds-out first homebuyers, increases risks of financial system instability, and threatens to undermine the integrity of the superannuation system. Labor has proposed prospectively restoring the prohibition on direct borrowing by superannuation funds for housing investments. While the proposal seems aimed at prospectively banning LRBAs involving residential property, at this stage it is unclear whether the ban would also apply to any other investment types (e.g., commercial property).

AML/CTF

Rules amendments

The *Anti-Money Laundering and Counter-Terrorism Financing Rules Amendment Instrument 2019 (No. 1)* has been registered. The amendment reduces the customer verification period for online gambling accounts from 90 days to a maximum of 14 days. Reporting entities that commence to provide online gambling services to a customer on or after 26 February 2019 will be required to carry out the applicable customer identification procedure within 14 days. Where a reporting entity commenced to provide online gambling services to a customer before that date, the specified period remains 90 days.

The *Anti-Money Laundering and Counter-Terrorism Financing Rules Amendment Instrument 2019 (No. 2)* has also been registered. This instrument makes further amendments but in unrelated areas. The amendments include relief for custodian customers from certain identification, verification and ongoing customer due diligence requirements, and updates to the distribution requirement for an exemption from applicable customer identification procedures for charitable share sales.

DISPUTES AND ENFORCEMENT

New Enforcement Approach and review from APRA

On 16 April 2019, APRA released details on the future role and use of enforcement activities to prevent and address serious prudential risks, and to hold entities and individuals to account.

The new Enforcement Approach means APRA will act well before financial, operational or behavioural risks present an imminent threat to financial viability. Where entities or individuals are failing to meet prudential obligations, APRA will act quickly and forcefully, and be willing to set public examples to deter unacceptable practices from occurring in the future. APRA will be deliberately strategic in how it uses its formal enforcement powers and more innovative in using the full extent of its toolkit to deliver prudential outcomes, including through the increased deployment of intermediate and administrative tools.

Issues that will lead APRA to consider enforcement action will include instances where an entity or individual has not:

- adequately prevented or addressed prudential risks; or
- conducted business with honesty and integrity, or with due skill, care and diligence; or
- dealt with APRA in an open, cooperative and constructive way;

and in such cases:

- there has been an adverse impact on financial soundness, stability or, in the case of superannuation, the interests of members; or
- the risk or behaviour could have, or could have had, an adverse impact on financial soundness, stability or, in the case of superannuation, the interests of members; or
- APRA's ability to make an accurate and timely assessment of an entity's prudential risk profile has been, could be or could have been impeded.

The new approach draws on the results of APRA's own Enforcement Review. APRA announced that it would implement all the recommendations of the review, including:

- adopting a "constructively tough" appetite to enforcement and setting it out in a board-endorsed enforcement strategy document;
- ensuring APRA supervisors are supported and empowered to hold institutions and individuals to account, and strengthening governance of enforcement-related decisions;
- combining APRA's enforcement, investigation and legal experts in one strengthened support team, and ensuring resources are available to support the pursuit of enforcement action where appropriate; and
- strengthening cooperation on enforcement matters with ASIC.

APRA is also currently undergoing a Capability Review which will take into account the new Enforcement Approach in its findings.

Compulsory cooperation with AFCA

On 5 April 2019, the *Treasury Laws Amendment (AFCA Cooperation) Regulations 2019*

(Cth) were registered. The regulations require financial services licensees to take reasonable steps to cooperate with **AFCA** in resolving complaints, including by:

- giving reasonable assistance to AFCA in resolving the complaint;
- identifying, locating and providing to AFCA any documents and information that AFCA reasonably requires for the purposes of resolving the complaint; and
- giving effect to any determination made by AFCA in relation to the complaint.

Design and Distribution Obligations and Product Intervention Powers

The *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (Cth) was signed into law on 5 April 2019. The new design and distribution obligations which commence on 6 April 2021 apply to offers of financial products that require disclosure under the Corporations Act, including products that require disclosure to investors, for instance by way of PDS. The obligations are designed to promote the suitability of financial products targeted at consumers. The Act also gives ASIC a product intervention power commencing on 6 April 2019 for both financial products and credit products where there is a risk of significant consumer detriment.

Bigger penalties law now in force

The *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019* (Cth) came into force on 13 March 2019. The Act implements recommendations of the ASIC Enforcement Review Taskforce, which the Government established in October 2016, to strengthen penalties for corporate and financial sector misconduct.

There are many detailed amendments in the Act to the Corporations Act, the ASIC Act and the NCCP Act, but in broad terms the amendments:

- update the maximum penalties for certain offences in ASIC administered legislation;
- expand the civil penalty regime so that a number of new contraventions become civil penalty provisions;
- introduce ordinary criminal offences that sit alongside and complement a number of strict and absolute liability offences;
- introduce a new formula to calculate the maximum financial penalty for criminal offences in the Corporations Act;
- introduce and apply a new objective only test to all dishonesty offences under the Corporations Act;
- subject all offences with strict or absolute liability, and certain other offences, to a penalty notice regime;
- introduce disgorgement remedies in civil penalty proceedings brought by ASIC under the Corporations Act, ASIC Act and NCCP Act; and
- require the courts to give priority to compensating victims over ordering the payment of financial penalties, aligning the Corporations Act with the ASIC Act and NCCP Act.

ASIC has highlighted the following features of the legislation:

- maximum prison penalties for the most serious offences will increase to 15 years. These include breaches of director's duties, false or misleading disclosure and dishonest conduct;
- civil penalties for companies will significantly increase, now to be capped at $525 million;
- maximum civil penalties for individuals will increase to $1.05 million and can also take in to account profits made; and
- civil penalties will apply to a greater range of misconduct, including a licensee's failure to act efficiently, honestly and fairly, failure to report breaches and defective disclosure.

Inquiry into financial services dispute resolution

The Senate referred to the Legal and Constitutional Affairs References Committee the matter of the resolution of disputes with financial service providers. Submissions to the Committee closed on 1 March 2019 and the Committee released its report on 8 April 2018. Key recommendations from the report include:

- establishing an industry levy, to apply to the largest financial institutions on the ASX, that would raise funds for the legal assistance and financial counselling sectors to enable these sectors to provide assistance to consumers and small businesses that have disputes with financial service providers;
- improving access to legal assistance services for small businesses;
- requiring Australian Credit Licence holders to comply with model litigant obligations throughout the internal and external dispute resolution processes;
- requiring Australian Financial Services Licence holders to cooperate with AFCA in dispute resolution (already implemented, see above);
- amending the *Bankruptcy Act 1966* (Cth) to prevent causes of action relating to consumer credit protections from vesting in the trustee in bankruptcy;
- improving home repossession processes by requiring that creditors engage with customers at an earlier stage via mediation;
- increasing the level of compensation available to consumers via AFCA;
- extending the membership of AFCA to debt management firms, registered Debt Agreement Administrators, 'buy now pay later' providers, FinTechs and emerging players, small business lenders and professional indemnity insurers of financial service providers; and
- establishing a retrospective compensation scheme independent of AFCA to allow victims of alleged misconduct by banks who received a past external dispute resolution determination that was manifestly unjust to apply to the scheme for a review with the consent of the bank.

Whistleblower law enacted

On 12 March 2019, the *Treasury Laws Amendment (Enhancing Whistleblower Protections) Act 2019* (Cth) was signed into law. The Act amends the *Corporations Act 2001* (Cth) to consolidate and broaden the whistleblower protection regime for the corporate and financial sector and amends the *Taxation Administration Act 1953* (Cth) to create a whistleblower protection regime for disclosures of breaches of tax laws and tax avoidance.

From 1 January 2020, all public companies, large proprietary companies, and corporate trustees of registrable superannuation entities will be required to have a whistleblower policy. A small proprietary company that becomes a large proprietary company after 1 January 2020 will have an additional six months to establish a whistleblower policy.

The Act sets out at a high level what a whistleblower policy should contain. These are:

- information about the protections available to whistleblowers, including protections under the law;
- information about to whom disclosures that qualify for protection under the law may be made, and how they may be made;
- information about how the company will support whistleblowers and protect them from detriment;
- information about how the company will investigate disclosures that qualify for protection under the law;
- information about how the company will ensure fair treatment of employees of the company who are mentioned in disclosures that qualify for protection under the law, or to whom such disclosures relate;

- information about how the policy is to be made available to officers and employees of the company; and
- any matters prescribed by the regulations (no regulations have yet been prescribed).

The Act also includes the following provisions which will commence on 1 July 2019:

- broadening the whistleblower definition to include both current and former employees, officers, and contractors, as well as their spouses, dependants, and other relatives, and anonymous disclosures;
- extending the protections to whistleblower reports that allege misconduct or an improper state of affairs or circumstances about any matter covered by financial sector laws and all Commonwealth offences punishable by imprisonment of 12 months or more;
- creating civil penalty provisions, in addition to the existing criminal offences, for causing detriment to (or victimising) a whistleblower and for breaching a whistleblower's confidentiality;
- giving protections for whistleblowers in certain circumstances if they go public with concerns about dangers to the public or matters in the public interest;
- providing whistleblowers with easier access to compensation and remedies if they suffer detriment; and
- removing the requirement for a whistleblower report to satisfy a 'good faith' test to access the protections, though a report solely about a personal workplace grievance is not covered by the protections.

ASIC will be responsible for enforcing the new corporate whistleblower protection regime, including where a whistleblower may suffer detriment for alleging breaches of laws outside of ASIC's regulatory responsibilities. ASIC plans to issue regulatory guidance on the requirement for a whistleblower policy, and will consult publicly in the second half of 2019.

Enforceability of financial services industry codes

The Government has adopted a recommendation of the Banking Royal Commission that some provisions of financial sector codes should be enforceable. On 18 March 2019, Treasury released a consultation paper setting out questions to inform the development of legislation to enact the Government's commitment. Submissions closed on 12 April 2019.

AFCA Scheme Amendment Authorisation

On 19 February 2019, the Treasuer issued the *AFCA Scheme (Additional Condition) Amendment Authorisation 2019* (Cth). The new authorisation conditions require AFCA to deal with complaints about conduct by financial firms dating back to 1 January 2008. This expanded jurisdiction will operate for a period of 12 months from 1 July 2019.

Citibank investor refunds

Following an investigation, ASIC announced that Citigroup will refund more than $3 million to retail customers for losses arising out of structured product investments offered between 2013 and 2017. Citigroup will also write to customers remaining in the products to provide them an opportunity to exit early without cost. As a result of ASIC's investigation, Citigroup ceased selling structured products to retail clients under a general advice model.

ASIC was concerned that while Citigroup considered its financial advisers to be providing general advice, elements of its practice may have led some customers to believe that Citigroup was providing personal advice. Financial advisers have higher obligations and disclosure requirements when providing personal advice.

Citigroup's practices included its advisers asking customers about their personal circumstances, such as their tolerance for risk, and providing financial education about benefits and risks to customers who had no previous experience of investing in structured products.

Responsible lending class action against Westpac

Maurice Blackburn has launched class action against Westpac on behalf of persons who entered into unsuitable loans secured by residential property with Westpac from January 2011 and who have suffered, or are likely to, suffer loss. It is alleged that Westpac failed to comply with its responsible lending obligations in respect of loans issued on or after 1 January 2011 and that Westpac entered into loans when the loans were unsuitable for the borrower.

ASIC update on fees for no service

On 11 March 2019 ASIC released an update on the fees for no service review programs by the big 4 banks, Macquarie and AMP. ASIC considers that the institutions are taking too long.

ASIC to appeal Westpac subsidiaries Federal Court decision

ASIC has announced that it is appealing the decision of Justice Gleeson regarding Westpac Securities Administration Limited (**WSAL**) and BT Funds Management Limited (**BT Funds**). In his 21 December 2018 decision, Justice Gleeson held that WSAL and BT Funds breached the Corporations Act but that ASIC did not make out its case that personal advice was provided to 15 customers. ASIC says that its decision to appeal the decision in relation to personal advice reflects its desire to "obtain further clarity and certainty concerning the difference between general and personal advice for consumers and financial services providers."

Commonwealth Financial Planning Limited required to stop charging fees

Commonwealth Financial Planning Limited (**CFPL**) entered into a court enforceable undertaking (**EU**) with ASIC in April 2018 (varied in December 2018) in relation to CFPL's fees for no service conduct. ASIC announced on 4 February 2019 that CFPL failed to provide ASIC with an attestation and an acceptable Final Report from the independent expert, as required under the EU. As a result, CFPL was required under the EU to immediately take all necessary steps to stop charging or receiving ongoing service fees from its customers and not enter into any new ongoing service arrangements with customers.

Contact us

Patrick Dwyer
Legal Director
patrick.dwyer@dwyerharris.com
0406 404 892

Kathleen Harris
Legal Director
kathleen.harris@dwyerharris.com
0400 133 775