DWYER HARRIS

FINANCIAL SERVICES AND CREDIT

QUARTERLY UPDATE

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CONSUMER CREDIT

Credit card reforms

The next round of changes to consumer credit laws is coming, with the release of draft legislation on credit card reforms. Treasury unveiled a package of documents on 14 August 2017 including a draft Bill, draft regulations and explanatory materials.

The key reforms introduced by the draft Bill are:

- tightening responsible lending obligations for credit card contracts;
- banning unsolicited credit limit offers for credit card contracts;
- simplifying interest charge calculations; and
- requiring online methods for reducing credit limits and terminating credit card contracts.

Please see our in-depth article here for more information about this reform.

ASIC bans flex commissions

ASIC is banning "flex commissions" from 1 November 2018. Details of the ban are set out in a legislative instrument published on 5 September 2017, the *ASIC Credit (Flexible Credit Cost Arrangements) Instrument 2017/780* (the **Instrument**). Home loans are excluded from the ban.

The Instrument amends the *National Consumer Credit Protection Act 2009 (Cth)* to provide that a "regulated person" must not give the introducer (or an associate) under a "flexible credit cost arrangement" any benefit (monetary or non-monetary) if the amount of the benefit is determined by the annual percentage rate under the contract (or the rental charge payable, in the case of a consumer lease), and where the introducer or an associate has determined, proposed or influenced the amount of the annual percentage rate or rental charge.

A "regulated person" affected by the ban will be an Australian credit licensee that has entered into a flexible credit cost arrangement in relation to a credit contract or a consumer lease, where the licensee is or will be the credit provider or lessor under the credit contract or consumer lease.

A regulated person would also include an exempt special purpose funding entity which is a party to a flexible credit cost

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

Suite 602, 161 Walker St
North Sydney NSW 2060
Australia
T +61 2 8912 2500 F +61 2 9460 1416

arrangement, directly or through a credit licensee.

A "flexible credit cost arrangement" is defined in the Instrument as a contract, arrangement or understanding (other than a servicing agreement) between a regulated person and an introducer for the introducer or an associate to provide credit services in relation to a credit contract or consumer lease, where the introducer or associate can "determine, propose or influence" the annual percentage rate under a credit contract, or the rental charge for a consumer lease.

There is a limited exemption that allows the introducer to reduce the annual percentage rate by a maximum of 200 basis points below the base rate, or by more than 200 basis points if the benefits given are the same as if the contract had been written at 200 basis points below the base rate. A similar exemption applies for consumer leases, where the discount is 4% of the rental charges.

Employees and directors of the regulated person, and related bodies corporate of the regulated person (and their employees and directors) are also exempt from the ban.

Credit contracts and consumer leases entered into before the commencement of the ban on 1 November 2018 will not be affected.

The Instrument also prohibits a regulated person from giving the introducer (or an associate) under a flexible credit cost arrangement any form of benefit where fees and charges payable to the introducer (or an associate) exceed the "specified fees and charges".

This provision applies when the introducer or associate is providing credit services in relation to a credit contract or consumer lease as a representative of the credit provider or lessor, or is a linked supplier of the credit provider or lessor.

The "specified fees and charges" are the greater of $0 and the amount (if any) specified by a regulated person as the maximum amount of fees and charges payable to the introducer (before any determination, proposal or influence by the introducer or an associate).

The specified fees and charges set by the regulated person must not be determined by reference to the loss or potential loss of revenue to the introducer or an associate that results from the ban on flex commissions.

ASIC has created civil and criminal penalties that will apply for breaching its new order.

For more information, see our article on flex commissions here

ASIC examines zero balance credit card offers

ASIC is currently reviewing credit card promotions that offer zero interest on balance transfers to assess whether banks are deliberately targeting interest-free promotions at customers who are likely to end up taking longer to pay off their debts.

ASIC has sought data from 12 lenders including the Commonwealth Bank, NAB, Westpac, ANZ, Citibank, HSBC and Macquarie Bank. The banks are required to provide ASIC with data on how quickly their credit card customers are repaying their debts and what customers are paying in interest and fees over a five-year period. ASIC intends to examine the customers' incomes and investigate how consumers behave when banks charge no interest on the debt for a fixed period before reverting to charging a higher interest rate. ASIC expects to report on its findings next year.

Online gambling and lines of credit

The *Interactive Gambling Amendment Act 2017 (Cth)* takes effect from 13 September 2017, with a six month transition period.

The Act will prohibit wagering operators from providing or offering credit, in connection with interactive wagering services, to customers physically present in Australia.

Wagering operators are prohibited from promoting or facilitating the provision of credit, other than by way of credit cards, via third parties in connection with interactive wagering services. Credit cards issued by gambling service providers, or by related companies, are not exempt from the prohibition. There are criminal and civil penalties for contravention of the credit prohibition.

COMMERCIAL FINANCE

Small business loan contract changes

ASIC announced on 24 August 2017 that the big four banks had agreed to specific changes to eliminate "unfair" terms from their small business loan contracts. The four banks will contact customers who entered into or renewed a small business loan from 12 November 2016 (when the unfair contract terms law for small business commenced) to notify them about the changes to their loans.

The changes include:

- removing "entire agreement" clauses that exclude statements or representations made to borrowers outside the written contract;
- limiting the operation of indemnification clauses;
- removing material adverse change default event clauses;
- limiting unilateral variation clauses to specific circumstances; where the variation would cause a customer to terminate the contract, the banks will provide a period of between 30 and 90 days to do so; and
- limiting the use of financial indicator covenants to certain classes of loans (e.g. property development and specialised lending such as margin loans). Financial indicator covenants will not be applied to property investment loans.

ASIC will monitor the use of these clauses to determine if they are in fact applied or relied on in an unfair way.

ASIC says that it will publish more detailed information about the changes agreed with the big four banks so that other lenders to small business can consider whether changes to their contracts may be required. Clearly the expectation is that these changes will be adopted by all lenders to small business.

FINANCIAL MARKETS

Crowdfunding update

The new crowd-sourced funding regime came into effect on 29 September 2017. For more details see our article here

On 21 September 2017 ASIC released guidance for public companies and crowd-funding platform operators: Regulatory Guide 261 *Crowd-sourced funding: Guide for public companies* (RG 261) and Regulatory Guide 262 *Crowd-sourced funding: Guide for intermediaries* (RG 262).

ASIC also published a template CSF offer document to help companies prepare their CSF offers.

ASIC reports on corporate finance regulation

ASIC published its seventh report on the regulation of corporate finance issues on 28 August 2017. The report covers the period January to June 2017 and includes guidance about ASIC's regulation of fundraising transactions, mergers and acquisitions, corporate governance issues, related party transactions, and financial reporting. It also includes information on the implementation of the industry funding model for ASIC and the new regime for crowd-sourced funding by public companies.

National Housing Finance and Investment Corporation consultation

Treasury released a consultation paper on the proposed National Housing Finance and Investment Corporation (**NHFIC**) on 22 September 2017. The NHFIC is part of the Federal Government's housing affordability initiatives announced in the 2017-18 Budget. The initiatives also include a $1 billion National Housing Infrastructure Facility (**NHIF**) and an affordable housing bond aggregator. The consultation paper seeks feedback on the potential structure and governance of the NHFIC and the operation of the NHIF and the affordable housing bond aggregator. Comments are due by 20 October 2017.

ASIC consults on proposed financial benchmark regulatory regime

On 17 July 2017 ASIC released a consultation paper on its proposed rules for the administration of licensed financial benchmarks and regulatory guidance on how ASIC would administer the proposed financial benchmark regulatory regime. Submissions on the consultation paper closed on 21 August. The consultation paper also includes draft ASIC rules and a proposed regulatory guide.

FINANCIAL SYSTEM

Exposure draft of BEAR released

On 22 September 2017, Treasury released an exposure draft of the *Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Bill 2017 (Cth)* (the **BEAR Bill**) for limited public consultation. For background information on the Banking Executive Accountability Regime (**BEAR**) see our publication *The BEAR Necessities*.

The BEAR will apply to authorised deposit-taking institutions (**ADIs**) being banks, building societies and credit unions and their subsidiaries. The exposure draft has some important changes from the proposals in the earlier consultation paper, particularly for smaller ADIs, with the BEAR Bill providing that:

- the Minister has the power to exempt an ADI, or a class of ADI, from the application of the BEAR. This could mean that smaller ADIs might be relieved of the significant compliance burden posed by the BEAR to enhance competitiveness, or ADIs which have not been the subject of instances of adverse conduct might be given an exemption for "good behaviour" and thus incentivise a compliance culture;
- similarly, the Minister has the power to exempt a subsidiary of an ADI, or a class of subsidiaries of ADIs, from the application of the BEAR. This could include, for example, subsidiaries which are not related to the ADI's financial services business, or subsidiaries which provide services to the institutional or wholesale markets;
- the proportion of an accountable person's remuneration to be deferred is scalable, based on the size of the ADI, with smaller ADIs being able to defer less of an executive's variable income. Reduced deferment of remuneration may make smaller ADIs an attractive option to potential executives, and assist their competitiveness in the labour market; and
- the maximum civil penalty available where an ADI has not met its BEAR obligations will depend on the size of the ADI, with large ADIs being exposed to penalties of up to 1 million penalty units (at present $210 million); medium ADIs will have penalties of up to 250,000 penalty units (at present $52.5 million); and for small ADIs the maximum penalty will be up to 50,000 penalty units (at present $10.5 million). The Minister will determine by legislative instrument what constitutes a small, medium and large ADI.

In addition, APRA will have enhanced examination powers to investigate potential breaches of the BEAR. ADIs and accountable persons are unable to be indemnified against the financial consequences of contravening the BEAR.

The period for public consultation has closed, and the BEAR Bill is expected to be introduced into Parliament soon. The BEAR is intended to commence on 1 July 2018.

APRA consultation on new banks

On 15 August 2017 APRA released a discussion paper on proposed revisions to the licensing framework for ADIs. APRA is proposing to introduce a phased approach to authorisation to make it easier for applicants to go through the ADI licensing process. This will include a new Restricted ADI licence. APRA may consider a similar phased approach in other prudentially-regulated sectors in the future.

Before granting a Restricted ADI licence, APRA will assess information on the applicant's structure, ownership, governance, and business plan. Applicants will have to provide details of their strategy to meet the ADI prudential framework, and an exit plan. An applicant will be required to have at least $3 million plus wind-up costs as a minimum amount of start-up capital. Directors and senior management will need to meet APRA's fit and proper standards. Applicants will also be required to demonstrate the capability to deliver reliable records or systems to provide information that is required under the Financial Claims Scheme.

APRA proposes that a Restricted ADI would not be allowed to actively conduct banking business. There would be a limit on the maximum size of deposits from a single depositor ($250,000) and on the aggregate amount of deposits ($2 million), as well as minimum capital adequacy and liquidity holdings, restricted product and service offerings, and reporting and disclosure requirements. APRA believes that these restrictions will create an incentive for a Restricted ADI to complete its business and systems development and progress to full operation.

Subject to these restrictions, APRA proposes that some prudential requirements that apply to regular ADIs will not be fully applicable to a Restricted ADI.

APRA plans to limit the Restricted ADI licence period to a maximum of two years, which is the expected timeframe for an institution to fully meet the prudential framework. APRA will assess the institution's progress during the Restricted ADI licence phase. If it is clear that the Restricted ADI will not fully develop its capabilities and resources by the end of the

Restricted ADI licence phase, APRA will require the institution to exit the banking industry.

Reducing restrictions on the use of the term 'bank'

On 17 July 2017 Treasury released draft legislation (the *Treasury Laws Amendment (2017 Measures No.8) Bill 2017 (Cth)*) that will enable non-bank ADIs to use the term 'bank'.

Section 66 of the *Banking Act 1959 (Cth)* (the **Banking Act**) currently contains a restriction on the use of certain words and expressions, including the terms 'bank', 'banker' and 'banking'. Under a new section 66AA, it will no longer be an offence for an ADI to assume or use the words 'bank', 'banker' or 'banking' in relation to its financial business if the person is an ADI and APRA has not issued a determination prohibiting the use of the term 'bank' by that person. Amendments to section 66 will provide that decisions taken by APRA in relation to section 66 will not be reviewable under Part VI of the Banking Act.

FINTECH

Open banking

An independent review has been established by the Federal Government to recommend the best approach to implement Open Banking in Australia. On 20 July 2017, the Treasurer announced the appointment of Mr Scott Farrell as the independent expert to lead the review. A Treasury secretariat will support Mr Farrell. The review will consult with interested parties.

On 20 July 2017, the Treasurer also announced the terms of reference for the review. The review is required to make recommendations to the Treasurer on:

- The most appropriate model for the operation of Open Banking in the Australian context, clearly setting out the advantages and disadvantages of different data-sharing models.
- A regulatory framework under which an Open Banking regime would operate and the necessary instruments (such as legislation) required to support and enforce a regime.
- An implementation framework (including roadmap and timeframe) and the ongoing role for the Government in implementing an Open Banking regime.

The review will report to the Treasurer by the end of 2017.

The review published a brief issues paper on 9 August which summarised the issues to be examined in the review as follows:

- What data should be shared, and between whom?
- How should data be shared?
- How to ensure shared data is kept secure and privacy is respected?
- What regulatory framework is needed to give effect to and administer the regime?
- Implementation – timeline, roadmap, costs.

ASIC guidance on initial coin offerings (ICO's)

On 28 September 2017, ASIC issued guidance about the potential application of the *Corporations Act 2001 (Cth)* (the **Corporations Act**) to raising funds through an initial coin offering (**ICO**). Information sheet 225 (INFO 225) covers:

- What is an ICO and its legal status?
- When could an ICO be an offer of a managed investment scheme?
- When could an ICO be an offer of a share in a company?
- When could an ICO be an offer of a derivative?
- When could an ICO be an offer of a non-cash payment facility?
- When could a platform for offering ICOs become a financial market or crowd-sourced funding platform regulated by ASIC?
- When would laws prohibiting misleading or deceptive conduct apply to an ICO?
- How can prospective ICO issuers obtain informal assistance from ASIC?

Some of the key points in the information sheet are as follows:

- If the value of the digital coins acquired in an ICO is affected by the pooling of funds from contributors or use of those funds under the arrangement, then the ICO is likely to fall within the requirements relating to managed investment schemes.
- If the rights attached to the coin are similar to rights commonly attached to a share, such as if there appears to be ownership of the body, voting rights in decisions of the body or some right to participate in profits of the body, then it is likely that the coins could fall within the definition of a share.

- If an ICO produced a coin that is priced based on factors such as a financial product or underlying market or asset price moving in a certain direction before a time or event which resulted in a payment being required as part of the rights or obligations attached to the coin, this may be a derivative.
- If the ICO or underlying coin is found to be a financial product (whether it is a managed investment scheme, share or derivative), then any platform that enables investors to buy (or be issued) or sell these coins may involve the operation of a financial market.

INSOLVENCY

Illegal phoenix activity reforms and director identification number

Treasury has issued a consultation paper on a package of reforms to combat illegal phoenix activity. Phoenix activity is the stripping and transfer of assets from one company to another by individuals or entities to avoid paying liabilities.

One major reform proposed is the introduction of a director identification number (**DIN**) which will identify directors with a unique number and interface with other government agencies and databases to allow regulators to map the relationships between individuals and entities and individuals and other people.

The consultation paper also canvasses a number of other measures to deter phoenixing including:

- specific phoenix conduct offences to better able regulators to take action against those who engage in phoenixing activities;
- the establishment of a dedicated phoenix hotline to provide the public with a single point of contact for reporting illegal phoenix activities;
- the extension of penalties that apply to those who promote tax avoidance schemes to capture advisers who assist phoenix operators;
- stronger powers for the Australian Taxation Office (**ATO**) to recover a security deposit from suspected phoenix operators which can be used to cover outstanding tax liabilities;
- making directors personally liable for GST liabilities as part of extended direct penalty provisions;
- preventing directors from backdating their resignations to avoid personal liability or from resigning and leaving the company with no directors; and
- prohibiting related entities to the phoenix operator from appointing a liquidator.

The consultation paper also seeks input on how best to identify high risk individuals, who will be subject to new preventative and early intervention tools including;

- a next cab off the rank system for appointing liquidators;
- allowing the ATO to retain tax refunds; and
- allowing the ATO to commence immediate recovery action following the issuance of a director penalty notice.

Submissions to the consultation are open until 27 October 2017

New insolvent trading safe harbour and ipso facto provisions now law

Two major insolvency law reforms, the insolvent trading safe harbour and a restriction on the enforcement of ipso facto clauses have now passed into law. The safe harbour reforms are now in effect, and the ipso facto reforms will commence on 1 July 2018, if not proclaimed earlier.

The safe harbour provisions provide directors with an exception from insolvent trading liability where they are developing courses of action which are reasonably likely to lead to a better outcome for the company than administration or liquidation. The ipso facto provisions are intended to restrict contractual parties from exercising their rights solely as a consequence of the company entering into administration, a scheme of arrangement, receivership, or the appointment of another form of managing controller.

INSURANCE

CCI sales reform

ASIC has announced that banks have agreed to a deferred-sales model for consumer credit insurance (**CCI**) sold with credit cards over the phone and in branches. Under this model, consumers will not be offered a CCI policy for their credit card until at least four days after they have applied for their credit card over the phone or in a branch. ASIC believes that this will reduce the risk of a consumer feeling pressured to purchase a CCI product, or a CCI product that does not meet their needs. The new model will be incorporated into the revised Code of

Banking Practice.

The deferred-sales model will not apply to CCI sold online, or to CCI sold with home loans and personal loans.

ASIC has also established a CCI Working Group which includes representatives from the banking industry and consumer advocates. The CCI Working Group first met on 27 July 2017. It will determine how the deferred-sales model for CCI will work, and also consider other measures to promote "good consumer outcomes" for CCI sold with credit cards and other loan products, including sales practices for CCI on credit cards sold online, and with other loan products in all sales channels.

ASIC says that it has also commenced surveillance into past CCI practices by the banks.

Reform of add-on insurance sold in car yards

ASIC released a consultation paper on 24 August 2017 (CP 294) on the sale of add-on insurance and warranties through car yard intermediaries.

The consultation paper proposes a "deferred sales model" to insert a pause into the sales process for add-on insurance and warranties regulated by the Corporations Act, other than comprehensive insurance and compulsory third party (**CTP**) insurance products. The deferral period proposed would be at least 4 days and not more than 30 days. In the case of mechanical breakdown insurance and warranties, ASIC proposes that where these products are sold with cars that are still covered by the manufacturer's warranty, a different deferral period could apply.

It is also proposed in the paper that there be specific requirements for the supervision and monitoring of the insurance or warranty provider's authorised representatives, because of the risks to consumers in this distribution channel. ASIC believes that current supervision practices could be improved by requiring providers to properly identify and address risks in the car dealer distribution channel. Examples of requirements that could be introduced include detailed reviews of penetration rates, post-sale interviews with consumers, shadow shopping, strict accreditation checks, and having greater visibility over complaints. They could also include deterrence measures such as removing or suspending authorisations and commission clawbacks.

ASIC has sought feedback on the consultation paper, with submissions closing on 23 October.

MANAGED INVESTMENTS

Asia region funds passport and corporate collective investment vehicles

On 25 August 2017, Treasury released draft legislation to introduce an Asia Region Funds Passport (**ARFP**) and Corporate Collective Investment Vehicles (**CCIV**). Submissions were due by 25 September 2017.

The ARFP legislation will implement the Memorandum of Cooperation on the Establishment and Implementation of the Asia Region Funds Passport (the **MOC**) which was signed by Australia in April 2016. The other member parties to the MOC are Japan, South Korea, New Zealand and Thailand. Other countries may join in the future.

The ARFP will allow collective investment schemes regulated in one country to be passported or sold to investors in other countries in the region. This will occur through mutual recognition where jurisdictions agree to recognise aspects of each other’s regulatory systems. There will be host economy requirements applying to the operation and sale of collective investment schemes which schemes from participating countries will not have to meet. Each participating country will be required to incorporate the MOC passport rules into its domestic law.

The ARFP provisions will be in a new Chapter 8A of the Corporations Act. It will set out how Australian collective investment vehicles may be registered by ASIC as passport funds, and the process by which foreign passport funds may notify ASIC of their intention to offer interests in their funds to Australian investors. It will also amend other provisions of the Corporations Act to clarify how those provisions will apply to foreign passport funds.

The CCIV legislation will introduce a new form of corporate collective investment vehicle for Australia.

Currently Australian funds management is generally conducted through a managed investment scheme, which uses a trust-based structure. CCIVs will have a corporate structure, which means that they will have the legal form of a company limited by shares and with most of the characteristics of a public company.

The CCIV regime is also intended to support the ARFP, because it will enable Australian fund managers to use a vehicle that complies with ARFP requirements and will be familiar to the corporate style of collective investments which are common in Asia.

The CCIV framework is modelled on the UK's Open-Ended Investment Companies regime. The Government believes that this will make it more recognisable for offshore investors and fund managers.

Under the proposed legislation, a company may register as a CCIV if it is a company limited by shares operated by a single corporate director. The corporate director must be a public company holding an Australian financial services licence which authorises it to operate a CCIV. The CCIV will not be permitted to have any officers or employees other than the corporate director. The corporate director will owe duties to the members of the CCIV which will take precedence over the duties of the corporate director to its own shareholders.

The corporate director will be permitted to appoint an agent to do anything it is authorised to do.

The CCIV will be required to have at least one sub-fund at all times, and may be open or closed ended. The Constitution of the CCIV will have to include certain prescribed content requirements.

While retail CCIVs will be subject to the full regulatory framework, wholesale CCIVs will be subject to minimal requirements. A retail CCIV must have a depository holding the assets of the CCIV on trust for the CCIV and supervising certain aspects of the corporate director's responsibilities, and will also be required to have a compliance plan.

PAYMENTS

Cap on credit card surcharges commences

From 1 September 2017, the ban on excessive surcharges for card transactions applies to all businesses across Australia (the ban has already applied to large merchants since 1 September 2016). The ban restricts the amount that a business can charge customers for using EFTPOS, MasterCard, Visa and American Express cards issued by Australian banks. In summary, businesses can only pass on external costs charged by their financial institution, and not their own internal costs, when determining the surcharge that they will impose. Where a business wishes to set a single surcharge across multiple payment methods, the surcharge must be set at the level of the lowest cost method, not an average. Businesses should have received merchant statements from their financial institution setting out the cost of acceptance for each payment method.

Guidance material has been published online by the Australian Competition and Consumer Commission.

PRIVACY

New draft guidance for Notifiable Data Breaches

The Office of the Australian Information Commissioner (**OAIC**) has released a new draft resources to assist organisations with the Notifiable Data Breaches scheme which is due to commence on 22 February 2018. The draft resources include guidance on assessing a suspected data breach, what to include in an eligible data breach statement, and exceptions to the notification obligations.

They also include a draft online form to assist organisations in preparing a statement about an eligible data breach to the Australian Information Commissioner, and a new chapter to the OAIC's Guide to privacy regulatory action on data breach incidents.

Independent review of the Privacy (Credit Reporting) Code 2014

The OAIC has engaged PriceWaterhouseCoopers to conduct an independent review of the *Privacy (Credit Reporting) Code 2014* (**CR Code**). The CR Code supplements Part IIIA of the *Privacy Act 1988 (Cth)* (**Privacy Act**) and the Privacy Regulation 2013, which regulate the handing of personal information about individuals' activities relating to consumer credit. The review will consider issues arising with regard to the interaction between the Privacy Act and the CR Code, significant issues of concern about the practical operation of the CR Code and requirements (if any) which have not been complied with in practice. A consultation paper has been issued for public comment with submissions due by 17 October 2017.

US credit reporting company Equifax suffered a massive data breach

On 7 September 2017, Equifax, a United States credit reporting company, disclosed that it had been the subject of a hacking attack and data breach, which compromised the financial and personal information of more than 145 million Americans, at least 400,000 people in the United Kingdom and another 100,000 across Canada.

It has been reported that hackers accessed the sensitive data through a software vulnerability, which had not been adequately remedied. Equifax has reported that the breach occurred sometime in mid-May 2017, and that the company first discovered the hack on 29 July 2017.

The company has been criticised for its slow response and lack of urgency in dealing with the cyber-attack. The company and its current and former executives are being questioned by Congress as to why it took six weeks for Equifax to alert the public. The company is facing a wave of class action lawsuits filed by private plaintiffs and State Attorneys-General over the breach. There have also been new calls for legislation to push the credit reporting industry towards better cyber security practices and quicker responses to breaches.

PRUDENTIAL STANDARDS

APRA's crisis management powers

On 18 August 2017 Treasury released for comment the draft *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017 (Cth)*. Submissions on the draft Bill have now closed.

The draft Bill will amend a number of Acts which give powers to APRA.

These amendments will give APRA powers to set requirements on resolution planning and ensure banks and insurers are better prepared for a crisis, and expanded crisis resolution powers to allow APRA to act decisively to facilitate the orderly resolution of a distressed bank or insurer.

According to the draft Explanatory Memorandum, the amendments to be made by the Bill will:

- enhance APRA's statutory and judicial management regimes to ensure their effective operation in a crisis;
- enhance the scope and efficacy of APRA's existing directions powers;
- improve APRA's ability to implement a transfer of financial institutions;
- ensure the effective conversion and write-off of capital instruments to which the conversion and write-off provisions in APRA's prudential standards apply;
- enhance stay provisions and ensure that the exercise of APRA's powers does not trigger certain rights in the contracts of entities within the same group;
- enhance APRA's ability to respond when an Australian branch of a foreign regulated entity (foreign branch) may be in distress;
- enhance the efficiency and operation of the Financial Claims Scheme and ensure that it supports the crisis resolution framework; and
- enhance and simplify APRA's powers in relation to the wind up or external administration of regulated entities, and other related matters.

APRA consults on changes to mutually owned ADIs' capital framework

On 26 July 2017 APRA released a discussion paper on proposed revisions to the capital framework for mutually owned ADIs. The proposed changes would enable them to directly issue Common Equity Tier 1 (**CET1**) capital instruments.

APRA is proposing to amend the Mutual Equity Interest (**MEI**) framework for mutually owned ADIs that it developed in 2014 that enables mutual ADIs to issue Additional Tier 1 and Tier 2 capital instruments that meet requirements for conversion into CET1 capital in certain circumstances. The amendments would allow mutually owned ADIs to issue CET1-eligible capital instruments directly.

The proposed CET1-eligible capital instruments would share many of the same characteristics as ordinary shares. They would be perpetual, subject to discretionary dividends and accounted for as equity. However APRA is proposing some restrictions on the amount that may be included in CET1 and to limit MEI holders' share of residual assets.

Following consideration of submissions, APRA expects to release the final revised prudential standard in late 2017.

APRA's view on home lending

The Chairman of APRA, Mr Wayne Byres, made comment recently on home lending policies and practices of ADIs, and noted that for credit standards to be genuinely raised, attention was needed to both oversight of lending policies and scrutiny of lending practices. APRA has sought assurances from boards that they are actively monitoring credit standards and has also collected data and issued guidance on mortgage risk management. Mr Byres said that serviceability assessments have improved. When looking at actual lending practices, Mr Byres said that APRA had three core expectations.

- Lenders should accurately assess borrower income and living expenses. APRA's recent work showed "the lion's share of loans by the larger lenders are assessed using expense benchmarks, rather than the borrower's own estimates." Mr Byres said that there is nothing wrong in principle with using benchmarks, provided they are not seen as a substitute for proper inquiries of the borrower about their expenses. He said that benchmarks also need to be genuinely representative, incorporate a degree of conservatism, and be responsive to a changing external environment.
- Lenders should have robust controls to check for information on borrowers' pre-existing debts, to ensure that all debt repayments are accurately factored into loan assessments. APRA believes that a move to positive credit reporting is needed to mitigate this shortcoming.
- There should be effective oversight to ensure that lending practices consistently meet standards, with close management of any policy overrides, and well-targeted assurance processes.

APRA consults on superannuation governance proposals

APRA released a letter on 11 August 2017 outlining proposed changes to the superannuation prudential framework to improve operational governance practices of APRA-regulated superannuation trustees (**RSE licensees**). Operational governance relates to how an RSE licensee determines its strategic objectives, undertakes business planning and runs its business operations on a day-to-day basis. The proposed changes include:

- requiring RSE licensees to have an operational governance framework;
- expanding the existing business planning requirements to ensure RSE licensees appropriately implement, monitor and review their business plans in the context of clear strategic objectives;
- requiring RSE licensees to meet minimum expectations when making decisions on fund expenditure; and
- requiring RSE licensees to undertake an outcomes assessment for all members.

APRA says that a detailed package of draft standards and prudential guidance for further consultation will be released in late 2017.

APRA updates FAQs on capital adequacy

APRA has updated its frequently asked questions on capital adequacy to provide further information to assist regulated entities in the interpretation of Prudential Standard APS 111 Capital Adequacy: Measurement of Capital (APS 111), GPS 112 Capital Adequacy: Measurement of Capital (GPS 112), and LPS 112 Capital Adequacy: Measurement of Capital (LPS 112) with respect to the requirements for Additional Tier 1 Capital and Tier 2 Capital instruments.

SUPERANNUATION

Superannuation reforms

The Federal Government has announced a package of reforms for APRA regulated superannuation funds, including retail, industry, corporate and public sector funds.

The package will legislate a consistent minimum standard for one-third independent directors, including an independent chair. It will also:

- make super funds more transparent and accountable for how they spend members' money through new reporting of expenses, Annual Member Meetings and a portfolio holdings disclosure regime;
- strengthen APRA's powers to regulate funds and take preventative or corrective action where it finds that a fund is not acting in the best interests of members;
- give workers the right to choose their own superannuation fund if they are currently prevented from doing so because of enterprise bargaining

agreements or workplace determinations;
- close a loophole being used to short-change workers of their full superannuation guarantee entitlements; and
- strengthen all default MySuper products offered.

The Government has introduced 3 Bills to give effect to some of these changes.

Superannuation fees changes commence

New fee and cost disclosure requirements for superannuation funds commenced on 30 September 2017. The details of the changes are in ASIC's Regulatory Guide 97 which you can download here.

The deadline for disclosure of property operating costs in the investment fee or indirect costs has been extended to 30 September 2018. ASIC has also extended the deadline for certain disclosures in periodic statements that require changes to the internal systems of funds. They will have effect for annual statements for the year ending 30 June 2018.

Draft insurance code of practice for superannuation trustees

On 20 September 2017 the Insurance in Superannuation Working Group (**ISWG**) released a draft Code of Practice to apply to superannuation funds that offer insurance. The Code is intended to apply to all APRA-regulated super funds that offer insurance from 1 July 2018, with a transition period of 12 months.

The draft Code outlines a set of industry standards and new measures for all classes of insurance in superannuation, including life, total and permanent disability and income protection.

The Code was developed over the past 10 months by the ISWG with input from insurers, super funds and legal and consumer groups, as well as other stakeholders. The ISWG is comprised of the Association of Superannuation Funds of Australia, the Australian Institute of Superannuation Trustees, the Financial Services Council, Industry Funds Forum and Industry Super Australia.

Key provisions in the draft Code include:

- **Benefit design**: to ensure automatic insurance benefits are appropriate and affordable for the fund's membership generally and for certain segments of members, notably younger members, those making low or infrequent contributions, as well as those nearing retirement.
- **Premium caps**: when designing benefits trustees will be required to consider earnings for segments of members of the fund to ensure the level and cost of cover does not exceed 1 per cent of estimated earnings and 0.5 per cent for members under 25.
- **Cessation arrangements**: (after communicating with members) insurance premiums will stop being deducted 13 months after a member's contributions cease.
- **Duplicate insurance cover**: trustees will be required to ask new members for permission to help them identify any other insurance cover held within superannuation.
- **Member communication initiatives**: to improve understanding about insurance contracts and make the process of opting out of insurance more straightforward.
- **Better claims handling initiatives**: to improve response times and information provided to members.
- **Better data standards and improved transparency arrangements**: to help members make informed decisions and to compare insurance offerings; including the provision of standardised Key Fact Sheets.

The ISWG also issued a consultation paper that sets out the key issues for industry feedback.

AML/CTF

AML/CTF Act amendments introduced

The *Anti-Money Laundering and Counter-Terrorism Financing Amendment Bill 2017 (Cth)* has been introduced into the House of Representatives. The Bill will expand the scope of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth)* (**AML/CTF Act**) to include regulation of digital currency exchange providers. It will also increase enforcement powers by expanding the range of regulatory offences for which the AUSTRAC Chief Executive Officer (**CEO**) is able to issue infringement notices, and allow the CEO to issue a remedial direction to a reporting entity to retrospectively comply with an obligation that has been breached. The Bill will also give police and customs officers broader powers to search and seize physical currency and bearer negotiable instruments and establish civil penalties for failing to comply with questioning and search powers. On the deregulation side, the Bill will de-regulate the cash-in-transit sector, insurance intermediaries and general insurance providers.

The Bill has been referred to the Senate Legal and Constitutional Affairs Legislation Committee for inquiry. The Committee is due to report by 16 October 2017.

DISPUTES AND ENFORCEMENT

ASIC Enforcement Report

ASIC has released its enforcement report for the period 1 January 2017 to 30 June 2017. ASIC has continued to focus on culture and incentives that result in poor financial advice, irresponsible lending and mis-selling to retail investors and consumers. In the next six months ASIC's enforcement activity will focus on: the risk and integrity of financial market benchmarks; corporate culture and governance; responsible lending practices; failure of financial advisers to act in the best interest of clients; conduct in the credit repair industry; and instances where fees are paid for delivery of ongoing advice services to customers but no advice is provided.

AUSTRAC takes civil penalty proceedings against CBA, "coat tails" shareholder class action filed and ASIC and APRA investigate

It has not been a good few months for the Commonwealth Bank of Australia (**CBA**).

AUSTRAC civil penalty proceedings

On 3 August 2017, AUSTRAC commenced widely publicised proceedings against the CBA, seeking civil penalties. AUSTRAC's claim alleges that on 53,700 occasions CBA's intelligent deposit machines (**IDMs**) allowed criminals, such as drug syndicates and organised crime gangs, to launder large amounts of cash between November 2012 and September 2015.

CBA's IDMs could accept up to $20,000 per deposit and there was no limit on the number of transactions a depositor could make in one day. Essentially, IDMs facilitate anonymous cash deposits. Although deposits could only be credited to CBA accounts, deposits could be made by a customer of another financial institution, and CBA has no records of the depositor's details for the threshold transaction reports for such deposits. Once credited to the CBA account, the funds were immediately able to be transferred within Australia or overseas.

AUSTRAC also alleges that there was significant structuring of transactions (where amounts of cash are deposited just under the reporting threshold of $10,000 so as to avoid triggering reporting requirements). AUSTRAC's claim states that from late 2014 to August 2015, approximately $20.59 million was deposited, mostly in a structured fashion through IDMs, into 30 bank accounts, of which 29 were in false names. Approximately $20.56 million was transferred overseas.

CBA is required to have a Joint Anti-Money Laundering and Counter-Terrorism Financing Program (**Program**). AUSTRAC alleges that CBA failed to comply with its Program on 9 separate occasions in not carrying out a risk assessment prior to the rolling out of IDMs; not carrying out a risk assessment in response to the large increase in the use of IDMs; and consequently failing to implement appropriate risk based systems to mitigate the higher money laundering/counter terrorism financing risks of the IDMs, even after it had been warned by law enforcement of significant instances of money laundering through its IDMs.

In addition, AUSTRAC also alleges CBA failed to:

- report within the statutory timeframe 53,506 threshold transaction reports for deposits made through IDMs over the $10,000 reporting amount (which amount to a total value of $624.7 million). The civil penalty for these contraventions could amount to hundreds of millions of dollars;
- file suspicious matter reports on 174 occasions where CBA suspected structuring; and
- monitor customers engaged in suspicious activity with a view to mitigating and managing the ML/TF risk, and in many instances did not carry out enhanced customer due diligence as required by the AML/CTF Rules.

AUSTRAC is seeking declarations, civil penalties and costs. The matter is currently before Justice Yates in the Federal Court of Australia. CBA is scheduled to file its defence on 15 December 2017.

ASIC launches investigation

ASIC announced on 11 August 2017 that it had commenced inquiries into the circumstances surrounding the claims made in the AUSTRAC proceedings. In particular, ASIC is examining whether:

- officers and directors complied with their duties under the Corporations Act;
- CBA complied with its continuous disclosure obligations;
- CBA complied with its licensing obligations, including the obligation to act efficiently, honestly and fairly; and
- CBA complied with its financial reporting obligations, including reporting contingent liabilities.

APRA Prudential Inquiry

APRA has established an independent prudential inquiry into CBA focusing on governance, culture and accountability (**Inquiry**). The independent panel members are Ms Jillian Broadbent AO, Dr John Laker AO and Professor Graeme Samuel AC (**Panel**). The Inquiry's terms of reference are to examine the frameworks and practices in relation to governance, culture and accountability within the CBA group, so as:

- to identify, in light of a number of incidents in recent years that have damaged the reputation and public standing of the CBA group, any core organisational and cultural drivers within CBA that have contributed to these incidents;
- to assess, at a minimum, whether any of the following areas, or their implementation, are conflicting with sound risk management and compliance outcomes:
    - the group's organisational structure, governance framework, and culture;
    - the group's framework for delegating risk management and compliance responsibilities;
    - the group's financial objectives;
    - the group's remuneration frameworks;
    - the group's accountability framework; and
    - the group's framework for identification, escalation and addressing matters of concern raised by CBA staff, regulators or customers;
- to consider, where CBA has initiatives underway to enhance the areas reviewed above, whether these initiatives will be sufficient to respond to any shortcomings identified and, if not, to recommend what other initiatives or remedial actions need to be undertaken;
- to recommend, to the extent that there are other shortcomings or deficiencies identified above that are not already being addressed by CBA, how such issues should be rectified.

The terms of reference specifically state that the Inquiry should not make specific determinations regarding matters currently the subject of legal proceedings, other regulatory reviews or investigations by regulators other than APRA, or customers' individual cases.

The Panel will submit a progress report to APRA by 31 January 2018, and a final report by 30 April 2018.

Shareholder class action over the CBA money laundering failures commences

Plaintiffs' law firm Maurice Blackburn has commenced a class action stated to be worth hundreds of millions of dollars against CBA. The allegations against CBA include that the bank engaged in misleading or deceptive conduct and breached its continuous disclosure obligations in relation to its non-compliance with the AML/CTF Act. CBA has indicated that it intends to vigorously defend the claim.

The class definition is persons who acquired an interest in fully paid ordinary shares in CBA during the period 1 July 2015 to 1pm on 3 August 2017 and who have suffered loss or damage because of the CBA's conduct.

The case is structured on an open class basis which means anybody who purchased shares during the relevant period is automatically included in the class unless they opt out. The case is being funded by litigation funders IMF Bentham.

One of the key elements of the plaintiffs' claim will be CBA's $5 billion rights issue in 2015 with the allegation that the failure to inform investors of the issues surrounding AML/CTF compliance at the time of the rights issue misled shareholders. Maurice Blackburn alleges that the rights issue documentation did not disclose any potential problems with money laundering but indicated that there had been compliance with the CBA's AML/CTF obligations. The plaintiffs claim that investors who relied on those documents were misled.

The matter is before Justice Yates in the Federal Court of Australia, Victorian Registry, and has been set down for its first case management hearing on 25 October 2017.

CBA refunds over $10 million for mis-sold consumer credit insurance

CBA will refund over 65,000 customers approximately $10 million after selling them unsuitable consumer credit insurance (**CCI**) in association with CBA's credit card products and home loans.

CBA sold its CCI product, which covers credit card payments in the case of unemployment or illness, to 65,000 customers who were unlikely to meet the employment criteria and would be unable to claim the insurance. CBA will remediate customers who purchased CCI between 2011 and 2015 who were either unemployed or students and therefore not eligible to claim for unemployment or temporary and permanent disability cover.

In respect of CCI and home loans, between 2007 and 2015, CBA did not adjust the amount of cover under the CCI policy where the amount the customer borrowed was less than the original loan amount. CBA is also refunding approximately $586,000 in premiums to around 10,000 customers after it over-insured these customers for amounts greater than their loans. In some cases, cover was provided and paid for before a loan was drawn down.

Australian Financial Complaints Authority (AFCA) legislation introduced

On 14 September 2017, the Federal Government introduced legislation to establish the Australian Financial Complaints Authority (**AFCA**). AFCA will be a new one-stop shop for financial and superannuation complaints, to replace the Financial Ombudsman Service (**FOS**), Credit & Investments Ombudsman (**CIO**) and Superannuation Complaints Tribunal (**SCT**). The Bill has been referred to the Senate Economics Legislation Committee which is currently holding hearings in respect of the Bill. Some of the issues raised during these hearings which are unresolved include: the proportion of costs to be borne by individual institutions, with the suggestion of a size based formula so that smaller institutions are not disadvantaged, and a user pays model resulting in those institutions with the most complaints bearing the costs (and thus rewarding an absence of complaints). The representation of small business on AFCA and compensation limits for small business are also matters of concern to small business advocates. The Senate Economics Legislation Committee is due to report on 17 October 2017. At the time of writing there has been no further report from the Ramsay Committee on a proposed compensation scheme of last resort.

ANZ pays a further $10.5 million to consumers for OnePath breaches

ANZ has paid an additional $10.5 million in compensation to 160,000 superannuation customers who were affected by breaches within the OnePath group between 2013 and 2016. This further compensation mainly relates to incorrect processing of superannuation contributions and failure to deal with lost inactive member balances correctly. This latest payment is part of a remediation program arising out of a review of OnePath's business activities.

QBE refunds $15.9 million in add-on insurance premiums

QBE Insurance (Australia) Ltd (**QBE**) will refund more than 35,000 customers who purchased QBE Guaranteed Asset Protection (**GAP**) and CCI up to $15.9 million where that insurance provided little or no benefit to the consumer.

The GAP and CCI were sold through car dealerships between 2011 and 2017. ASIC says that the GAP was sold in situations where there was unlikely to be a gap between the insured value of the car and the loan balance, the insurance duplicated existing cover held by consumers, or provided consumers with more insurance than they needed. Similarly, ASIC found the CCI was sold to young people who had no dependents and who were unlikely to need cover.

QBE has agreed to refund the premiums paid by customers who were unlikely to need GAP; refund all insurance customers at least one year's premium because new for old cover under their comprehensive motor insurance would provide similar cover; partially refund customers who paid for more cover than they needed; refund customers under 25 years the cost of the life or trauma insurance element of their CCI premium; for customers who paid off their loan early, partially refund the insurance premium from the date the loan was paid off, and make a $50,000 payment to Financial Literacy Australia.

The Rental Guys refund more than $100,000 to vulnerable consumers

Consumer rental company The Rental Guys has paid $100,000 to regional customers after ASIC found that it had failed to meet its responsible lending obligations when renting white goods and furniture. ASIC was concerned that The Rental Guys failed to make proper enquiries, conduct verification and carry out unsuitability assessments when entering into new contracts with certain customers. The customers, who were mainly from regional indigenous communities in New South Wales, were charged higher rates and gave up their rights to own goods that they had under their original contract.

ASIC issues market integrity report for January to June 2017

ASIC has issued its market integrity report for the period January to June 2017. The report covers standards and education activities undertaken by ASIC, with a particular focus on distributed ledger technology and cyber resilience, behavioural change and enforcement actions for the period.

For the remaining part of 2017, ASIC will continue to focus on technology and cyber resilience, conduct that enhances market integrity across all market based activities, and reviewing market activity in the OTC sector of the market, primarily in fixed income, currencies and commodities, and equity derivatives.

ASIC enforcement review examines ASIC's power to ban senior officials in the financial sector

The ASIC enforcement review task force has issued a consultation paper making preliminary recommendations and seeking submissions on changes to ASIC's power to ban senior managers from continued employment in financial services businesses. The taskforce perceives that the current law is deficient in that:

- while ASIC can ban a person from providing financial services, it does not have the power to prevent a person from having a role in managing a financial services business; and
- ASIC does not have an express power to ban senior office holders and managers in circumstances where they did not provide financial services (the person was not strictly involved in the contravention of a financial services law) but were managing or overseeing the conduct of a financial services business that exhibited non-compliance with financial services laws.

The task force's preliminary position is to propose two key changes. These are:

- ASIC should have the power to ban a person from:
    - performing a specific function in a financial services business, including managing a financial services business; and
    - performing any function in a financial services business.

  Equivalent powers should apply to ASIC powers in respect of credit activities;

- ASIC's banning power should be enlivened where ASIC has reason to believe that the person is not:
    - a fit and proper person to provide a financial service or to perform the role of officer or senior manager in a financial services business; and/or
    - adequately trained, or not competent, to provide a financial service or financial services, or to perform the role of officer or senior manager in a financial services business.

In respect of credit, the existing powers of ASIC to ban where ASIC has reason to believe that a person is not fit and proper, inadequately trained or competent would be extended to those who perform the role of an officer or a senior manager in a credit business.

The paper also proposes that the power to ban would also apply in respect of officers, partners or trustees who had on more than one occasion been involved in a financial services or credit licensee that has been the subject of a report by the Australian Financial Complaints Authority regarding a failure to comply with a determination of that authority, or a corporation that was wound up and a liquidator lodged a report about the corporation's inability to pay its debts.

Finally, and most controversially, ASIC wishes to expand its banning power so that it can ban a person where a person has breached his or her directors' and officers' duties under section 180 (care and diligence), section 181 (duty of good faith) and for directors, officers and employees a breach of section 182 (improper use of position) and section 183 (improper use of information) of the Corporations Act.

These proposals represent a significant expansion of who would be subject to ASIC's banning powers and the threshold "triggers" for ASIC to use the banning power. This is especially so with the inclusion of section 180, as this would equate to banning from the financial services or credit industry based on a negligence standard.

Contact us

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

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