DWYER HARRIS

FINANCIAL SERVICES AND CREDIT
QUARTERLY UPDATE

April 2016

CONSUMER CREDIT

ASIC reports on debt management firms

In January 2016 ASIC released a report on debt management firms, *REP 465 Paying to get out of debt or clear your record: The promise of debt management firms*.

These businesses offer assistance to consumers with debt problems such as adverse credit reports. ASIC has been conducting research in this area for some time.

ASIC's findings were generally negative. Issues identified include opaque and high fees, pressure selling, and a failure to refer consumers to free alternatives.

ASIC notes in the report that there is no uniform regulatory framework applying to the activities of debt management firms in Australia.

While the report does not make any recommendations, ASIC may be laying the groundwork for future regulation of debt management businesses.

Reverse mortgage and SACC disclosure – minor changes

Minor amendments have been made to the mandatory disclosures for reverse mortgages and small amount credit contracts (**SACCs**). The amendments relate to certain agencies referred to in the disclosures. The amendments were made by the *ASIC Credit (Updated details for prescribed disclosure) Instrument 2016/200*.

In the required warning for SACCs on a licensee's website and at the licensee's premises, the reference to a Centrelink phone number is replaced with a reference to a Department of Human Services website.

For reverse mortgages, the reference to the National Information Centre on Retirement Investments has been deleted from the reverse mortgage information statement.

Credit providers affected by these changes should update their standard disclosures.

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

Simple arrangements

ASIC has extended until 1 March 2018 the class order exemption which provides that notice of changes to a credit contract or consumer lease does not need to be given in the case of a simple arrangement which defers or reduces the obligations of the debtor for no more than 90 days.

FINTECH

Backing Australian Fintech

On 20 March 2016 the Treasurer Scott Morrison released *Backing Australian FinTech,* a paper which discusses the fintech opportunity in Australia and identifies policy initiatives being undertaken by the Federal Government in this area, including the establishment of a FinTech Advisory Group to advise the Treasurer.

Some of the other initiatives identified in the statement include:

- **Comprehensive credit reporting and data**: the Government has commissioned a Productivity Commission enquiry into improving data availability and use. In addition, anonymous and non-sensitive public data will be made openly available by default through data.gov.au
- **Financial robo-advice**: a draft regulatory guide has been issued by ASIC. (See further discussion under Financial Advice section below).
- **Insurance**: the Government will consider the impact of allowing licensed brokers to sell policies from unauthorised foreign insurers.
- **Crowdfunding**: the Government has introduced legislation to provide for crowdfunding for equity and is considering amendments which would increase the assets and turnover threshold to $25 million (from $10 million) and reduce the cooling off period to 48 hours. The Government is also going to consult on a potential framework for crowdsourced debt funding during 2016.
- **Blockchain technology and digital currencies**: the Government will work with industry on legislative options to reform the GST law as it applies to digital currencies. The application of AML/CTF laws to digital currencies is under consideration as part of the current statutory review of the AML/CTF Act.
- **Regulatory sandbox**: the Government has been working with ASIC on developing a regulatory sandbox for Australian fintech.
- **Venture capital**: Innovation Australia will be able to issue binding advice in relation to whether business activities are eligible for the Early Stage Venture Capital Limited Partnerships program.

Regulator support for fintech

ASIC and the UK's Financial Conduct Authority (**FCA**), the UK equivalent of ASIC, have signed an agreement to refer to one another innovative businesses seeking to enter the other's market. Under the agreement, the regulators will provide support to those businesses before, during and after authorisation to help reduce regulatory uncertainty and time to market.

Both ASIC and the FCA have also launched Innovation Hubs to help businesses with innovative ideas navigate financial regulation, to support them through the process of authorisation, and for engagement with the regulator.

According to ASIC, the fintech industries are estimated to have revenues of $12.5 billion and $1.3 billion a year in the UK and Australia respectively.

FINANCIAL ADVICE

Robo-advice

ASIC has released consultation paper 254 on regulating digital financial product advice, also known as "robo-advice". Accompanying the consultation paper is a draft regulatory guide on providing digital financial product advice to retail clients. Submissions close on 16 May 2016.

In the draft regulatory guide, ASIC says that robo-advice businesses are unique because they are entirely technology driven.

ASIC expects digital advice licensees to have at least one person who understands the technology and algorithms used to provide digital advice. It would also expect regular reviews of the digital advice generated by algorithms to ensure that it is legally compliant. This would include monitoring and testing the algorithms that underpin the advice.

ASIC also expects digital advice licensees to assess their cybersecurity using recognised frameworks and assess their information security arrangements against recognised security standards.

In relation to personal advice, ASIC confirms that personal advice can be given through a computer program and that if there is no individual providing advice, the responsibility for the advice rests with the legal person that gives the advice (for example, the company that operates the robo-adviser).

ASIC says that where the digital advice provider is giving scaled advice it should think very carefully about the way it is communicated with the client and that consideration should be given to how the information is likely to be interpreted by clients.

Not "independent"

ASIC has named several financial services companies for describing their services as "independent" when they were not. Under the *Corporations Act 2001 (Cth)*, a financial services provider is not allowed to call itself independent, except where it does not receive commissions or other benefits and operates without any conflicts of interest. The providers have removed the offending terms from their marketing material and websites.

Labor calls for royal commission

Federal Opposition Leader Bill Shorten announced on 8 April that a Labor Government would "hold a Royal Commission into misconduct in the banking and financial services industry." The move has been supported by the Greens.

FINANCIAL MARKETS

Crowdfunding

Proposed amendments to the *Corporations Act 2001(Cth)* for the new crowdfunding regime were referred to the Senate Economics Legislation Committee on 3 December 2015. The Committee released its report in February, recommending that the Senate pass the Bill.

FINANCIAL PRODUCTS

Double geared margin loans

ASIC announced in January 2016 the outcome of a review of 6 margin lenders which together hold 90% of the market. ASIC's main concern was the prevalence of "double geared" loans where the customer borrowed the funds to buy the shares (such as by drawing down on their mortgage) and then took a margin loan to buy additional shares. ASIC considers that there are greater risks with such loans and was concerned that in some cases the lenders did not take additional steps when approving such loans. As a result of the ASIC review, lenders have made commitments to reduce the risks and one has ceased the practice of double geared loans.

INSURANCE

Retail life insurance reforms

Draft regulations were released by Treasury on 7 April, the *Corporations Amendment (Life Insurance Remuneration Arrangements) Regulation 2016 (Cth).* The regulations are part of the Federal Government's retail life insurance reforms. Submissions are due by 28 April.

CCI offered through car dealers – ASIC not happy

ASIC report 471 *The sale of life insurance through car dealers: Taking consumers for a ride* was released on 29 February 2016. The general tenor of the report can be deduced from the title.

The key findings of the report were:

- Insurers charged consumers substantially more for car yard life insurance than for ADI–distributed life insurance.
- Most insurers charged business use consumers more than personal use consumers (we assume that the 20% cap on consumer CCI commissions has something to do with this).
- Car yard life insurance is often substantially more expensive than term life insurance but provides less cover.
- Single premium policies result in poor outcomes for consumers.
- High volumes of car yard life insurance are sold to young consumers who are unlikely to need it.
- There are poor claims outcomes for consumers (the data given says that

during the financial years 2010 to 2014, only 6.6% of total premiums paid upfront were returned in paid claims).

In its report ASIC says that insurers will need to review and make positive changes to the design and value of car yard life insurance.

ASIC says that it will continue to monitor the practices of insurers and if it forms the view that they have not made adequate changes to address the matters in the report, ASIC will take further action to improve consumer outcomes.

MARKETPLACE LENDING

ASIC guidance issued on marketplace lending

Marketplace lending, also known as peer-to-peer lending, is the subject of a recent ASIC information sheet 213 which sets out the regulatory requirements that apply to the various forms of marketplace lending structures.

ASIC defines marketplace lending as involving the use of an online platform such as websites on which loan requests are made. The loan requests may then be matched against offers to invest.

ASIC's information sheet notes that the most commonly used marketplace lending structure in Australia is a managed investment scheme. However, other models are available such as the issue of derivatives, operating a financial market, and the issue of securities.

ASIC notes that a managed investment scheme will need to be registered if the managed investment scheme offers interests to retail investors and that the responsible entity for a registered scheme must be a public company that holds a financial services licence.

ASIC says that marketplace lending providers acting as responsible entities will generally need a tailored AFS licence authorisation to operate a registered scheme to undertake marketplace lending activities.

ASIC also notes that where loans are made to consumers, persons involved in entering the loan and operating platform would need an Australian credit licence and comply with the obligations in the *National Consumer Credit Protection Act 2009 (Cth)*, including the *National Credit Code*.

MUTUAL BANKING

Senate report released

The report of the Senate's Economics References Committee on cooperatives, mutual and member owned firms was released in March 2016.

There are 17 recommendations in the report. These include an amendment to the corporations legislation to define a mutual enterprise.

The Committee also recommends that APRA set a target date for the outcome of discussions with the cooperative and mutuals sector on the issues of capital raising and bring those issues to a timely conclusion.

Another recommendation is that the Federal Government look at amendments to the *Corporations Act 2001 (Cth)* that would give cooperative and mutual enterprises a mechanism to access a broader range of capital raising and investment opportunities.

PAYMENT SYSTEMS

ePayments Code amendments for electronic communication

The ePayments Code has been amended. The changes commenced on 29 March 2016. Apart from some minor updates such as hyperlinks in the Code, the only change of substance relates to electronic communication with consumers.

The Code now allows for information to be given to a user electronically by sending the information by:

- a form of electronic communication nominated by the user;
- notifying the user that the subscriber has made the information available electronically; or
- in another manner agreed with the user.

With a facility designed exclusively for electronic use, information may now be given electronically by:

- sending the information using electronic communication;

- using electronic communications to notify the user that the information is available electronically; or
- another manner agreed with the user.

There are conditions attached to electronic communication in these ways.

Updated class order relief for non-cash payment facilities

ASIC has previously issued class orders exempting certain non-cash payment facilities from provisions of the *Corporations Act 2001 (Cth)* that would otherwise apply to them as financial products.

ASIC has issued a new class order covering loyalty schemes, road toll facilities, low value non-cash payment facilities, gift facilities, prepaid mobile facilities, and travellers cheques.

The *ASIC Corporations (Non-cash Payment Facilities) Instrument 2016/211* replaces previous class orders for these products which were to expire.

The new class order extends the previous exemptions for these products for three years. In the meantime, the regulators are considering the recommendations of the Financial System Inquiry in relation to the regulation of non-cash payment facilities. These recommendations included strengthening consumer protection by mandating the e-Payments Code and introducing a separate prudential regime with two tiers for purchased payment facilities.

Surcharging controls enacted

The *Competition and Consumer Amendment (Payment Surcharges) Bill 2015 (Cth)* has passed through the Parliament and received assent. The legislation introduces price controls for payment surcharging and came into effect on 25 February 2016.

PERSONAL PROPERTY SECURITIES

PPSA case highlights importance of registering lease security interest

A recent case in the New South Wales Supreme Court demonstrated the importance of registration of security interests arising under under equipment leases. The case is *Forge Group Power Pty Limited (in liquidation) (receivers and managers appointed) v General Electric International Inc* [2016] NSWSC 52.

Horizon Power commissioned Forge Group to design and build a temporary power station near Port Hedland in Western Australia and to supply the equipment to be installed. Forge Power rented four mobile gas turbine generators from GE.

Forge Power went into voluntary administration soon after the turbines had been installed in 2014, and later in 2014 went into liquidation.

The leases of the turbines were not registered on the Personal Property Securities Register.

Forge Power sought declarations that the interest of GE under the leases vested in Forge Power immediately before the appointment of the administrators.

Under the PPSA, the interest of the lessor under a “PPS lease” is a security interest. However if goods become fixtures to the land, they fall outside the PPSA.

The judge held that the PPSA provisions would apply if the lease of the turbines was a PPS lease and if the turbines had not become fixtures to the property.

The question of whether the lease was a PPS lease depended on whether GE was regularly engaged in the business of leasing goods. If it was, then the lease would be a PPS lease. It was agreed that GE was engaged in such business outside Australia but it was disputed whether GE was regularly engaged in the business of leasing goods in Australia. The judge held that in testing whether a person is or is not regularly engaged in the business of leasing goods, regard is to be had to activity wherever it occurs, not only in Australia, and that the test applies at the time the lease was entered into. The judge found that GE was regularly engaged in the business of leasing goods.

The judge also decided that the turbines had not become fixtures to the property. The judge held that the common law concepts of fixtures apply and that the objective intention of the parties was that the turbines would not become fixtures.

PRUDENTIAL STANDARDS

Net Stable Funding Ratio - consultation package

On 31 March 2016 APRA released for consultation a discussion paper on the Net Stable Funding Ratio implementation. Also covered the paper are proposed options for the future operation of a liquid assets requirement for foreign bank branches in Australia.

SUPERANNUATION

Dashboards

The *Superannuation Legislation Amendment (Transparency Measures) Bill 2016 (Cth)* was introduced into the House of Representatives on 17 March 2016.

The Bill introduces the legislative framework for the Government proposed mandatory dashboard which will provide a comparison of a superannuation product's or investment option's fees, returns and risk. The comparison would be by comparing these features to an industry benchmark.

Trustees of regulated superannuation funds with more than four members will be required to publish a dashboard for each of their funds' 10 largest choice investment options. Pooled superannuation trusts and eligible rollover funds will be exempted from the requirements.

Choice of fund

The *Superannuation Legislation Amendment (Choice of Fund) Bill 2016 (Cth)* was also introduced on 17 March 2016. The proposed legislation would enable employees to choose their own superannuation fund for compulsory employer contributions where they are employed under a workplace determination or enterprise agreement that is made after 1 July 2016.

DISPUTES AND ENFORCEMENT

Code of Banking Practice and its impact on guarantees

A Victorian appeal court has found that a bank's Code of Banking Practice obligation to properly assess a borrower's capacity was also a term of the bank's agreement with the guarantors of the loan. The potential impact of the decision is that guarantees which include the Code of Banking Practice obligation may be challenged by guarantors on the grounds that the bank did not exercise care and skill when approving the loan they guaranteed.

The case is *Doggett v Commonwealth Bank of Australia* [2015] VSCA 351.

Mr Doggett and Mr Sullivan formed a company, Dogvan, to buy an investment property, and they also acted as guarantors on the loan. The investment failed, the bank appointed receivers and managers, and after selling the property, pursued the guarantors for the shortfall of $3.1 million.

Despite having created Dogvan, the borrowing entity that went into default, Doggett and Sullivan ingeniously claimed that the bank owed them a duty as guarantors to exercise care and skill in assessing Dogvan's loan application. Clause 25.1 of the Code of Banking Practice imposes such a duty to the borrower. It was not disputed that this was an obligation owed to the borrower, but the bank disputed that it owed the obligation to the guarantors as well. The guarantors pointed to the terms of the guarantee, which said that the relevant provisions of the Code applied to the guarantee. The court found in favour of the guarantors on this point.

The result of this case is troubling, given that guarantors are for the protection of the lender.

In light of this decision, lenders subject to the Code of Banking Practice should consider the terms of their guarantees and how they incorporate the Code of Banking Practice provisions.

Westpac credit card limit increases

ASIC recently challenged some of the practices of Westpac when processing credit card limit increases. ASIC was concerned that Westpac's largely automated process did not make reasonable inquiries of the cardholder as required by the responsible lending legislation.

Westpac has now changed its credit limit increase processes to ensure that reasonable inquiries are made about a customer's income and employment status before the limit is increased.

It is also conducting a remediation program involving a review of credit limit increases

previously provided where a cardholder experiences financial difficulty. An independent external expert is to provide assurance of the effectiveness of the remediation program.

Westpac has also agreed to make a $1 million payment to support financial counselling and financial literacy initiatives.

ANZ overdraft offers and responsible lending

ANZ has paid infringement notice penalties of $212,500 to ASIC in relation to breaches of responsible lending obligations when making offers to customers for overdraft facilities.

ANZ sent written offers to certain customers for an overdraft facility with a specified limit of either $500 or $1000. Customers offered a $500 limit were not (in the campaign at least) given an option to select a different overdraft amount. Customers offered a $1000 limit were not given an alternative limit option if they responded to the offer by mail or in person at a branch.

ASIC formed the view that this campaign contravened the requirement to make reasonable inquiries about the credit limit that the customer required.

The fact that a customer who received the offer was under no obligation to accept it, and was not prevented from freely approaching the bank at any other time to seek an overdraft of a different amount, does not appear to have been relevant to ASIC's decision.

One would have expected that in formulating the monetary amounts of the offers, the bank had some regard to the likely amount of the overdraft limits that its customers would find convenient or appropriate for their circumstances. If that was the case, the conduct of the bank was nonetheless deemed irresponsible.

The implication from this action is that the bank should only have made an offer after determining in each case whether the customer needed an overdraft, and if so, the amount of the overdraft that the customer needed, or alternatively should only have invited the customer to consider applying for an overdraft without suggesting a particular amount.

BBSW actions

In the last quarter, ASIC has commenced legal action against both ANZ and Westpac in relation to alleged manipulation of the Bank Bill Swap Reference Rate (**BBSW**).

Legal proceedings against ANZ were commenced on 4 March 2016. Action commenced against Westpac on 5 April 2016.

In both actions, the essence of ASIC's claim is that the bank traded in a manner intended to create an artificial price for bank bills so as to move the BBSW higher or lower, with the objective of maximising its profit or minimising its loss to the detriment of those holding opposite positions.

ASIC is claiming that this was unconscionable conduct. It is seeking pecuniary penalties against the banks and orders requiring them to implement compliance programs.

Macquarie Bank licence conditions

Additional licence conditions have been imposed by ASIC on Macquarie Bank under its Australian financial services licence. The additional conditions were announced by ASIC on 17 March 2016. They follow an investigation by ASIC of breach reports lodged by Macquarie in respect of client money provisions in the *Corporations Act 2001(Cth)* between 2004 and 2014.

The new conditions require Macquarie to have an ASIC approved expert review, assess and report on Macquarie's procedures for ensuring compliance with those client money provisions, and to make recommendations for improvements.

Macquarie lodged an application to the Administrative Appeals Tribunal (**AAT**) for review of ASIC's decision to impose conditions on its licence and sought a stay of ASIC's decision until the termination of its application. The AAT has granted the stay application.

Fair Go Finance

Fair Go Finance has agreed to pay infringement notice penalties of $34,000 and to refund approximately 550 consumers around $34,500 following an ASIC investigation into the company's Flexi Loan product, a form of small amount credit contract (**SACC**).

The infringement notices related to two specific Flexi Loan contracts. A penalty of

$17,000 was charged in each case.

In the case of one contract, it was alleged that part of the credit provided was to refinance an amount of credit provided under another SACC.

For the other contract, the contravention alleged was that the establishment fee exceeded the permitted limit of 20% of the adjusted credit amount.

Fair Go Finance has withdrawn the Flexi Loan product.

Nimble

ASIC has secured an enforceable undertaking from SACC loan provider Nimble. As part of the undertaking, Nimble as agreed to refund over 7000 customers more than $1.5 million and to engage an independent external compliance consultant to review its current business operations and compliance with the credit legislation and to report to ASIC. The refund program is to be overseen by Deloitte. Nimble will also make a $50,000 contribution to Financial Counselling Australia.

ASIC says that Nimble did not properly assess the financial circumstances of many consumers, relying on algorithms which did not properly take financial information into account. It found that Nimble did not consistently recognise where consumers had repeat loans from short-term lenders within a short period of time.

In addition, ASIC was concerned that Nimble was not making reasonable inquiries about consumers' requirements and objectives because it relied on a drop down menu on its website for the loan purpose which contained four broadly worded options only, one of which was "temporary cash shortfall".

BMW Finance

BMW Australia Finance has paid $390,000 in penalties imposed by ASIC and has had conditions placed on its Australian credit licence. The licence conditions stipulate that BMW Finance must appoint a compliance consultant to conduct a review of BMW Finance policies and procedures on a quarterly basis for 12 months to ensure compliance with consumer credit legislation. The consultant is required to report to ASIC.

ASIC found that BMW Finance had failed to comply with the responsible lending obligations over a period from November 2014 to May 2015.

Issues included a failure to make reasonable inquiries about, and take reasonable steps to verify, consumers' stated living expenses, income and cash at bank.

BMW Finance was found to have also failed to make sufficient inquiries about consumers' capacity to repay substantial balloon payments due at the conclusion of the term.

ASIC also concluded that BMW Finance failed to assess credit contracts as unsuitable and entered into unsuitable credit contracts when the documentation given by consumers showed that there was insufficient income available after expenses to service the monthly loan repayments.

Another finding was that BMW Finance failed or delayed in providing statutory disclosures after repossession of the vehicle or the voluntary surrender of the vehicle security by the consumer.

Repo trouble

Capital Finance Australia, a Westpac subsidiary, has paid penalties of $493,000 under infringement notices issued by ASIC in relation to its repossession practices.

ASIC found that between March and June 2015, Capital Finance failed on 55 occasions to provide consumers with default notices prior to commencing enforcement proceedings to repossess vehicles. Further, ASIC found that Capital Finance on three occasions did not provide consumers with the required information setting out consumers' rights and options available to them, within the required timeframe after repossession.

Contact us

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

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