Ultima
Legal & Advisory

FINANCIAL SERVICES AND CREDIT
QUARTERLY UPDATE

March 2015

FINANCIAL SYSTEM

Financial System Inquiry

The Financial System Inquiry final report was released on 7 December 2014.

The Federal Government has announced that it intends to consult with industry and consumers before making any decisions on the report's recommendations. The consultation period ends on 31 March 2015.

Following the end of the consultation period we expect to see announcements from the Government on any recommendations which will be adopted.

Some of the key recommendations in the report include:

- abolishing limited recourse borrowing by superannuation funds;
- requiring superannuation trustees to preselect a comprehensive income product for members' retirement;
- providing all employees with the ability to choose a superannuation fund;
- public offer superannuation funds to have a majority of independent directors;
- introduce a separate prudential regime for purchased payment facilities;
- more limits on surcharging;
- introducing a "product intervention" power for regulators;
- improving guidance and disclosure for general insurance;
- strengthening ASIC funding and powers;
- increasing the time for industry to implement complex regulatory change;
- extending unfair contract terms laws to small business;
- technology neutrality for future regulation;
- renaming "general advice"; and
- requiring advisers and mortgage brokers to disclose ownership structures.

CONSUMER CREDIT

The Cash Store

The Federal Court decisions in *The Cash Store* case are the first significant court rulings on the responsible lending obligations under the credit legislation.

The decisions help to understand what is involved in meeting the responsible lending steps of making reasonable inquiries about a customer's requirements and financial

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situation, and taking reasonable steps to verify the customer's financial situation.

The first decision was handed down in August 2014 (*Australian Securities and Investments Commission v The Cash Store Pty Ltd (in liquidation)* [2014] FCA 926).The court found that "reasonable inquiries" about a customer's financial situation must include inquiries about the customer's current income and living expenses.

The lender was also found to have engaged in unconscionable conduct by selling useless consumer credit insurance (the insurer since then has agreed to refund the premiums).

RG 209 is ASIC's published guidance on the responsible lending requirements of the credit legislation. ASIC updated the guideline following the first decision.

Penalties of over $18 million were imposed in the second decision delivered 19 February 2015. (*Australian Securities and Investments Commission v The Cash Store Pty Ltd (in liquidation) (No 2)* [2015] FCA 93).

Payday lending

ASIC released a report of its survey of 13 payday lenders on 17 March 2015. ASIC reviewed 288 customer files from these lenders, who were estimated to cover about 75% of the payday loan industry.

The focus of the review was on the new regulatory regime for small amount credit contracts (**SACCs**) introduced in 2013.

Some of the key findings of the report were:

- lenders were generally aware of the requirement to obtain and consider bank account statements for the prior 90 days;
- no evidence was found that protective earnings amount provisions were not being complied with, but some lenders were not complying with their own policies in relation to lending to Centrelink recipients;
- some payday lenders set the loan term for credit contracts at more than 12 months where the file indicated the consumer wanted a shorter term loan (the effect of a term longer than 12 months is that the loan is not regulated as a SACC);
- on premises warning statements were in some cases not sufficiently prominent;
- nearly two thirds of the 288 files reviewed indicated that the lender had entered into a SACC with a consumer who appeared to trigger the presumption that the loan was unsuitable;
- payday lenders continue to inappropriately use high-level statements such as "personal" to describe the loan purpose;
- record keeping was incomplete and inconsistent; and
- issues relating to use of third party software providers used to obtain the bank statements that must be reviewed for SACCs.

Interest only loans

ASIC announced in December 2014 that it would be conducting surveillance into the provision of interest only loans, as part of a broader regulator review of home lending standards.

According to the ASIC press release, 42.5% of new housing loan approvals by banks (owner-occupied and housing investment) were for interest-only loans in the September 2014 quarter.

ASIC's press release suggests that its concern is to ensure that lenders are not putting consumers into unsuitable loans.

Hardship arrangements

ASIC has extended until 1 March 2016 an existing exemption from the National Credit Code requirement to provide a written notice of changes to a credit contract or consumer lease as a result of a hardship application by the customer.

The National Credit Code requires that a credit provider that enters into an agreement with the debtor to change a credit contract or consumer lease as a result of a hardship notice by the debtor must, not later than 30 days after the date of the agreement, provide a written notice setting out particulars of the change in the terms.

The exemption only applies to simple arrangements, which means an agreement that defers or reduces the obligations of the customer for a period of no more than 90 days.

FINANCIAL ADVICE

FOFA

The Future of Financial Advice (**FOFA**) regulatory debacle continues.

In November 2014 the Senate disallowed the "streamlining" regulations which had been introduced by the Coalition Government to reflect its policy on FOFA. The disallowed regulations had amended the original provisions introduced into the Corporations Act by the former Labor Government. As a result of the disallowance, the original provisions became reinstated.

The Government then succeeded in partly rescinding the disallowance and issued new regulations in December 2014 which restored some of the disallowed provisions.

ASIC has announced that it will take a "practical and measured approach to administering the law as it now stands", until 1 July 2015.

Registration of financial advisers

The ASIC register of financial advisers commences on 31 March 2015 and relevant providers must be registered by 30 March. The register will be publicly available for searches.

The *Corporations Amendment (Register of Relevant Providers) Regulation 2015* (Cth) made on 12 February 2015 requires a relevant provider to register with ASIC. A relevant provider is an individual who is:

- a financial services licensee, an authorised representative of a financial services licensee, or an employee or director of a financial services licensee or of a related body corporate; and
- authorised to provide personal advice in relation to relevant financial products to retail clients.

Relevant products are financial products other than basic deposit products, general insurance and consumer credit insurance.

Financial advisers must also provide ASIC with further information in relation to their qualifications, training courses and professional association memberships. This information must be notified between 23 and 30 May 2015.

FINANCIAL PRODUCTS

Term deposits

The definition of "basic deposit product" in the *Corporations Act 2001* (Cth) has been amended by an ASIC class order so that it includes term deposits up to 5 years which can be withdrawn subject to a prior notice period of up to 31 days.

Where the authorised deposit-taking institution (**ADI**) issuer of such a product offers it without a PDS, the depositor must be given information including the discretion of the ADI to delay the withdrawal until the end of the notice period. When the deposit is rolled over, the depositor has a 7 day grace period to withdraw the funds without penalty. Before and after the rollover, the depositor must be given certain statements about their rights.

The ASIC class order (CO 14/1262) relief applies for 18 months from 19 December 2014.

Insurance no-claims discounts

A report by ASIC into no-claims discounts (**NCDs**) for motor vehicle insurance has found that disclosure can be improved and that sales messaging for NCDs is "inconsistent".

NCDs claim to reward customers for careful driving, but ASIC says most consumers with most brands (over 90%) are on the highest NCD rating.

ASIC's report was released on 26 February 2015.

FINANCIAL MARKETS

Derivative transactions reporting

ASIC has amended the *ASIC Derivative Transaction Rules (Reporting) 2013* (Cth) from 9 February 2015. The rules require reporting of certain derivatives transactions.

ASIC also released a guide for entities with reporting obligations, RG 251 *Derivative transaction reporting*.

Collective action by institutional investors

ASIC has released a consultation paper (CP 228) on proposed amendments to its regulatory guide RG 128 *Collective action by institutional investors*. Comments close on 20 April 2015.

Investors acting together may trigger the operation of the takeover and substantial holding provisions in the *Corporations Act 2001* (Cth). ASIC is proposing to update RG 128 to include examples as well as guidance on its approach to enforcement of these provisions.

FINANCIAL PRIVACY

Privacy amendments 1 year on

12 March 2015 marked the first anniversary of the major changes to the *Privacy Act 1988* (Cth) which commenced last year.

The Office of the Australian Information Commissioner (**OAIC**) issued a "report card" on the amended legislation, noting that over the 12 month period, privacy complaints had increased 43% and 104 voluntary data breach notifications were made.

Commercial credit

Before the amendments to the *Privacy Act 1988* (Cth) in 2014, commercial credit was largely untouched by the credit reporting provisions in the Act.

This has now changed. It is not enough anymore to assume that credit is not affected because it is commercial. Instead, credit providers need to look at the particular type of credit information to decide whether it is regulated. For example, identification information about an individual is treated as regulated credit information regardless of whether its use is for consumer or commercial credit.

Under the Act, the general rule is that a credit provider must not disclose credit information to a credit reporting body unless the credit provider is a member of a recognised external dispute resolution (**EDR**) scheme. A new regulation exempts disclosure made in connection with the provision of commercial credit. This means that credit providers that are purely commercial lenders do not have to join an EDR scheme in order to be able to list information with a credit reporting body. The *Privacy Amendment (2015 Measures No. 1) Regulation 2015* (Cth) was made on 26 February 2015.

Mandatory data breach reporting is coming

The Federal Attorney-General announced on 3 March 2015 that the Government will introduce a mandatory data breach notification scheme by the end of 2015, and will consult on draft legislation.

The announcement was made in response to the report of the inquiry of the Parliamentary Joint Committee on Intelligence and Security into the *Telecommunications (Interception and Access) Amendment (Data Retention) Bill 2014* (Cth), which made the recommendation for the introduction of such a scheme by the end of 2015.

Currently there is no requirement under legislation to notify data security breaches, although the OAIC recommends this course in some cases.

The Australian Law Reform Commission (**ALRC**) in its 2008 report into privacy recommended that notice should be provided to the affected individual when a data breach causing a real risk of serious harm occurred. The ALRC recommended that notification be compulsory unless determined by the regulator to be contrary to the public interest or if it would impact upon a law enforcement investigation. It remains to be seen if the draft legislation will take this approach.

Mandatory reporting of breaches could result in substantial additional administrative burdens for organisations having to notify affected customers (and possibly regulators).

Regulatory action policy

The OAIC released its regulatory action policy in November 2014. It sets out the OAIC's approach to using its regulatory powers.

The policy states that the preferred regulatory approach of the OAIC is to work with entities to facilitate legal and best practice compliance. If it is going to make a public statement in connection with privacy regulatory action, the OAIC says that it will aim to contact the respondent entity in advance of making the statement if it is possible and appropriate in the circumstances.

Tax file numbers

The *Privacy (Tax File Number) Rule 2015* was published by the Privacy Commissioner on 20 February 2015. The rule replaces the former *Tax File Number Guidelines 2011*.

The main purpose of the rule is to regulate collection, storage, use, disclosure, security and disposal of tax file number (**TFN**) information of individuals.

The only change of substance from the previous guidelines is that the rule authorises use and disclosure of TFN information by the TFN recipient for the purpose of giving an individual any information that the TFN recipient holds about the individual. (It was not intended that the former TFN guidelines would prevent such disclosure).

A breach of the TFN rule is an interference with privacy under the *Privacy Act 1988* (Cth).

MUTUAL BANKING

Alliance Banks

On 1 March 2015 an innovative new transaction for mutuals was completed when four credit unions transferred their deposits and loans (with some limited loan exceptions) to Bendigo and Adelaide Bank.

The former credit unions ceased to be ADIs and cancelled their financial services and credit licences, and now act as agents of Bendigo under a franchise agreement, trading as Alliance Banks. They remain mutuals (i.e. customer owned companies).

PAYMENT SYSTEMS

Credit card issuing

Amendments to the *Banking Regulations 1966* (Cth) which took effect on 1 January 2015 have opened up credit card issuing and acquiring to non-ADIs.

Before the amendment, credit card business was designated as banking business under the regulation, which meant that credit card issuers and acquirers had to be regulated by APRA.

The reforms allow non-ADIs to become credit card issuers and card acquirers in the Visa and MasterCard credit card schemes. The card schemes are responsible for determining which entities may become card issuers or acquirers under their schemes, subject to a risk management framework imposed by the Reserve Bank of Australia (**RBA**).

The RBA has varied the access regimes for the MasterCard and Visa credit card systems and revoked the access regime for the Visa debit system, also with effect from 1 January 2015.

PRUDENTIAL REGULATION

Mortgage lending practices

APRA wrote to ADIs in December 2014 setting out steps it intended to take to reinforce sound residential mortgage lending practices.

APRA indicated that it would be paying particular attention to higher risk mortgage lending, such as high LVR loans, and said that growth in lending to property investors above a threshold of 10% would be an important risk factor for APRA in considering the need for further action.

APRA also stated that in its view, loan affordability tests for new borrowers should incorporate an interest-rate buffer of at least 2% above the loan product rate and a floor lending rate of at least 7% when assessing serviceability.

RFCs

From 1 July 2015, registered financial corporations (**RFCs**) will not be allowed to offer or accept new “at-call” accounts and will only be allowed to continue to operate at-call accounts in existence at 30 June 2015 until 31 December 2015.

AML/CTF

Beneficial owners and PEPs

Changes to the AML/CTF Rules apply from 1 June 2014. The key changes to the rules relate to beneficial owners of customers and “politically exposed persons” or PEPs.

Reporting entities are required to collect from the customer and take reasonable measures to verify the full name and date of birth or residential address of each beneficial owner of a customer. Beneficial owners are individuals who ultimately own or control the customer.

Politically exposed persons are individuals such as senior government officials and judges, their immediate family members and close associates. Reporting entities are required to have appropriate risk

management systems to determine whether a customer or a beneficial owner is a PEP.

AUSTRAC has released a draft guidance note on key terms used in the definition of PEP.

Another change in the amended rules is a requirement that reporting entities collect and verify the full name of the settlor of a trust.

A transitional safe harbour applies to the period from 1 June 2014 to 31 December 2015. The safe harbour limits the right of the regulator (AUSTRAC) to take enforcement action unless AUSTRAC is satisfied that the reporting entity has failed to take reasonable steps to comply with the new provisions.

PERSONAL PROPERTY SECURITIES

Review of the PPSA

The *Personal Property Securities Act 2009* (Cth) (the **PPSA**), Australia's national law governing security interests over personal property, commenced on 30 January 2012.

Bruce Whittaker, a PPSA legal expert, was appointed to conduct a review of the PPSA in April 2014. His final report was completed in February 2015 following an open consultation process.

It is a very detailed lawyer's analysis which examines many issues that have arisen in the implementation of the PPSA since its commencement.

One recommended change we noted is to delete the definition of "fixture" in the PPSA. The PPSA does not apply to security interests over fixtures. Fixtures usually begin as goods (which are subject to the PPSA) but when they are attached to land and become fixtures, the PPSA no longer applies. The definition of fixtures in the PPSA does not reflect the common law definition of fixtures, which has led to uncertainty as to how the law operates. This can be a major concern for financiers dealing with large items of equipment which are placed on property but never intended to become part of the property. By deleting the definition in the legislation, the old accepted common law definition of fixtures will apply instead.

The Federal Government is reviewing the recommendations. We expect that there will be some amendments to the legislation introduced as a result of the review.

DISPUTES AND ENFORCEMENT

Enforceable undertakings

In February 2015 ASIC updated its guide on its approach to accepting enforceable undertakings, RG 100 *Enforceable undertakings*. The updated regulatory guide includes guidance on independent experts and publicity for enforceable undertakings.

ASIC often uses enforceable undertakings as an alternative to prosecution. Enforceable undertakings sometimes include a requirement that an independent expert review the actions promised to be taken by the entity signing up to the undertaking.

The updated regulatory guide sets out criteria that ASIC will use when determining the independence of an expert.

If the enforceable undertaking includes reporting by the independent expert, ASIC says that it will make publicly available a summary of the final report, or a statement referring to the content of the report. ASIC may also issue a media release on these matters.

Class actions on late fees

New class actions are being launched in relation to credit card late payment fees.

ACA Lawyers has announced class actions against HSBC and GE Capital. The lawyers claim that late fees charged by these companies are unlawful penalties.

Harbour Litigation Funding is financing the class actions.

According to its website, ACA Lawyers is also commencing similar actions against the major telcos in relation to their late payment fees.

Maurice Blackburn is pursuing a class action against NAB in relation to bank fees. Registrations to join the class action closed on 27 January 2015. Maurice Blackburn has also filed actions against number of other banks, including ANZ.

The ANZ case is now awaiting a decision of the Court of Appeal.

Class-action lawyers clearly see late fees as a fertile ground for claims. Actions against other businesses charging such fees may therefore emerge in coming months.

Collections guidance for consumers

ASIC and the ACCC have jointly released a guide for consumers on debt collection, *Dealing with debt collectors: Your rights and responsibilities*. The guide is available on ASIC's MoneySmart website. The guide includes a sample form of letter that can be used to make a complaint about harassment.

FOS

Changes to the Financial Ombudsman Service (**FOS**) terms of reference were approved in December 2014 and came into effect on 1 January 2015.

Changes include:

- creation of a role of Adjudicator to deal with disputes classified as "fast track". Operational guidelines will set out the fast track process;
- disputes involving recovery of a debt from a small business under a credit facility that exceeds $2 million will be excluded from FOS jurisdiction;
- FOS jurisdiction will be expanded to include loss of profits/business interruption insurance for general insurance disputes lodged on or after 1 January 2016;
- FOS may allow a financial service provider to sell an asset that is the subject of a dispute. During the first 12 months of operation, this discretion may only be exercised by an Ombudsman;
- FOS can join another financial services provider that is a member of FOS to a dispute where it would lead to a more efficient and effective resolution; and
- FOS may now review disputes involving an investment purchased directly or indirectly through a platform offered in Australia.

CIO (formerly COSL)

The former Credit Ombudsman Service Limited (**COSL**) has changed its name to Credit and Investments Ombudsman Limited (**CIO**).

Members of CIO should update their credit guides and other documentation that refers to COSL.

CIO has also excluded two "well-known" credit repair companies from using its services. CIO said that its decision was based on evidence that they had pursued multiple complaints for an improper purpose (for example, delaying or obstructing CIO's process).

OTHER

Unclaimed moneys

The Federal Government will amend banking and insurance legislation so that bank accounts and life insurance policies must be inactive for seven years (rather than the current three years) before they are transferred to the government. The changes were announced by the Prime Minister and Assistant Treasurer on 18 March 2015.

The proposed changes restore the position that previously applied.

The amendments will also exempt children's bank accounts from unclaimed moneys legislation.

The Government will remove the requirement for ASIC to publish the Unclaimed Money Gazette and will restrict freedom of information requests generally to an individual's own details. This is in response to concerns about identity theft and businesses exploiting this information to charge people for the recovery of their own money.

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