



FINANCIAL SERVICES AND CREDIT QUARTERLY UPDATE

July 2016

CONSUMER CREDIT

New layers of regulation proposed for SACCs and consumer leases

In March 2016 the final report was released for the Review of the Small Amount Credit Contract Laws. The report makes a number of recommendations which would increase the level of regulation of small amount credit contracts (**SACCs**) and consumer leases. A total of 24 recommendations were made. The main recommendations are summarised below.

For SACCs:

- Extending the protected earnings amount regulation to cover all consumers.
- Reducing the cap on the total amount of SACC payments from 20% of gross income to 10% of net income.
- If the above recommendation is adopted, removing the rebuttable presumption that a SACC loan is unsuitable if either the consumer is in default under another SACC, or in the previous 90 days, the consumer has had 2 or more other SACCs.

- Requiring that a SACC must have equal repayments over the life of the loan.
- Prohibiting a monthly fee after a SACC is discharged by early repayment.
- Prohibiting unsolicited offers of SACCs to current or previous consumers.
- Prohibiting payments for referrals made to another SACC provider.
- Prohibiting default fees that exceed \$10 per week.

For consumer leases:

- Introducing price controls for consumer leases in the form of a cap determined by adding 4% of the base price of the goods for each month of the lease term to the amount of the base price. Leases with a term of greater than 48 months would be deemed to be 48 months for the purposes of calculating the cap. The base price would be the recommended retail price (**RRP**) or the price agreed in store, where this is below the RRP. Add-on services and features apart from delivery would be included in the cap. The cap would apply to all leases of household goods including electronic goods. Further consultation should take place on whether the cap should apply to

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- consumer leases of motor vehicles.
- Introducing a protected earnings amount for leases of household goods such that lessors could not require payment of more than 10% of net income in rental payments under consumer leases for household goods. The review recommends that the Department of Human Services consider making this mandatory as soon as practicable for Centrepay.
 - Introducing a maximum price limit on early termination fees for consumer leases.
 - Banning the unsolicited selling of consumer leases and addressing current unfair practices used to market these goods.
 - Extending to consumer leases the obligation for SACCs to obtain and consider 90 days of bank statements.
 - Introducing warning statements for lessors under consumer leases which would inform consumers of the availability of alternatives.
 - Requiring consumer leases of household goods to disclose the base price of the goods and the difference between the base price and total payments.

For SACCs and consumer leases:

- Introducing a requirement that the credit provider at the time the assessment is made must document in writing its assessment that a proposed contract or lease is suitable.
- Requiring disclosure of the cost of the contract as an annual percentage rate.
- Extending the existing civil penalty regime in Part 6 of the National Credit Code to consumer leases of household goods and SACCs, and in relation to breaches of some specific obligations by SACC providers and lessors, provide for an automatic loss of the right to their charges under the contract.
- Regulate indefinite term leases.
- Address conduct by licensees adopting practices to avoid the restrictions on the maximum amount that can be charged (i.e., anti-avoidance provisions).

Submissions on the report closed on 17 May. The Government has not yet announced its response to the report.

More tinkering with credit card regulation planned

On 6 May 2016 the Federal Treasurer released the Government's response to the Senate Economics References Committee

report, *Interest Rates and Informed Choice in the Australian Credit Card Market*, which was published on 18 December 2015. Submissions on the Government's response were due by 17 June 2016.

The Government response shows that it is minded to implement further regulation of the credit card market.

The Government contemplates a two phase process for the reforms. For the first phase, the Government is seeking stakeholder feedback with a view to developing and releasing draft legislation shortly.

For the second phase, the Government intends to commence behavioural testing with consumers to determine efficacy in the market and to ensure that the reforms are designed for maximum effect. The decision to implement the second phase measures will be subject to the results of consumer testing and to the extent to which the industry presents solutions itself.

The phase 1 reforms include:

- Tightening responsible lending obligations so that suitability is assessed on a consumer's ability to repay the credit limit within a reasonable period.
- Prohibiting card issuers from making unsolicited credit limit increase offers, including the ability to seek prior consent.
- Prohibiting issuers from backdating interest charges and charging interest on the portion of the balance that has been paid off.
- Requiring issuers to provide consumers with online options to initiate a card cancellation or reduce the credit limit.

The phase 2 proposals for consumer testing include:

- Requiring that card issuers provide information on the annual cost of the consumer's credit card use and prominently display annual fees.
- Issuers must clearly disclose in advertising and marketing material the card's interest rate and annual fee.
- Issuers must provide information about potential savings from switching to lower cost products.
- Issuers must provide consumers with timely electronic notifications regarding the expiry of introductory offers.
- Issuers must provide consumers with alternative payment tools and proactively contact consumers who

persistently make small repayments.

It is interesting that the Government is exploring behavioural testing of proposed regulation before proceeding with implementing it. Perhaps this is recognition that well-intentioned consumer protection initiatives do not always achieve the intended results.

Mortgage broker remuneration

ASIC is seeking detailed information from a number of lenders including the big four banks regarding payments made to mortgage brokers. The information request is for the purpose of assessing how incentives influence broker behaviour.

Consumer groups have claimed that in order to maximise their commission, some mortgage brokers encourage customers to take on more debt than they "need". ASIC will also look at the quality of loans written through brokers.

COMMERCIAL FINANCE

Asset-backed financing

In the 2016 Federal Budget, the Government announced that it will clarify the tax treatment of asset-backed financing arrangements so that they are treated in the same way as financing arrangements based on interest-bearing loans or investments. The Government believes that this will improve access to more diverse sources of capital in Australia. The changes will apply from 1 July 2018.

Impairment of loans review

The Parliamentary Joint Committee on Corporations and Financial Services delivered its final report to the Senate on 4 May 2016 in relation to the impairment of customer loans.

The inquiry looked at the alleged practice of lenders using a constructive default (security revaluation) process to impair commercial loans, deliberately reducing by valuation the value of securities held by the lender, thereby raising the loan to value ratio, resulting in a loan impairment.

The Committee also looked at the role of property valuers in such processes, the use of non-monetary default conditions, the role of insolvency practitioners, the extent to which borrowers were given an opportunity to rectify genuine defaults, and related matters.

Among the recommendations made by the Committee include:

- Regulations to prevent banks profiting from default or impaired loans.
- Revising banking codes of practice to require that there is a dialogue with the borrower at least six months before expiry of the term of a loan.
- Where monetary default has not occurred, that a minimum of three months' notice be given if the decision is made not to roll over the loan if the customer is meeting all terms and conditions of the loan.
- Banking codes should include explicit customer protections relating to revaluation, non-monetary defaults and impairment.
- Responsible lending provisions which apply under the NCCP Act to consumer loans should be extended to small business loans.
- Legislation to prohibit conflicted remuneration for all bank staff and to require bank officers to act in the best interests of small business customers.
- Nationally consistent arrangements should be put in place for farm debt and small business debt mediation.
- Where an ADI is intending to appoint a receiver from the same company engaged as an investigative accountant, the borrower should be given an opportunity to request an alternate company if concerned about a conflict of interest.
- In addition to being required to sell assets for fair market value, a receiver should be required to sell a business as a going concern where possible.

FINANCIAL ADVICE

Accountants' exemption ends

On 1 July 2016 the licensing exemption ended for accountants providing advice on the establishment of SMSFs.

Since 1 July 2013, accountants and other advisers have been able to apply for a limited Australian financial services licence to provide advice on SMSFs.

FINANCIAL MARKETS

Asia Regional Funds Passport

ASIC will receive \$6.4 million over the next four years to implement a regulatory framework for participation in the "Asia Region Funds Passport" initiative, which aims to increase access for Australian fund managers to grow Asian markets by

allowing for cross-border offers of collective investments. It is proposed that the cost of this measure will be offset in part by a fee that would have to be paid by funds using the passport.

Financial benchmarks regulation proposed

A consultation paper on financial benchmarks was released by the Council of Financial Regulators (CFR) on 31 March 2016. CFR is the coordinating body of Australia's financial regulatory agencies and includes the Reserve Bank, APRA, ASIC and Treasury.

Financial benchmarks such as the Bank Bill Swap Rate (BBSW), Commonwealth Government Securities (CGS) yields and the S&P/ASX 200 equity index are indices used as reference prices for financial instruments or contracts and for the measurement of performance of investment funds. The CFR believes there is a need for reform of regulation of these benchmarks. The paper proposes:

- to make administration of a significant benchmark a financially regulated activity;
- to impose binding requirements on submitters to a significant benchmark which is calculated based on submissions;
- creating a legal power to compel submission to a significant benchmark; and
- to introduce a specific offence of benchmark manipulation.

The closing date for submissions on the paper was 29 April 2016.

FINANCIAL PRODUCTS

Farm management deposits

Previously announced changes to the farm management deposit (FMD) scheme took effect from 1 July 2016.

The upper limit which applies to FMDs has increased from \$400,000 to \$800,000.

Farmers will be able to get early access to their funds under exceptional circumstances arrangements without losing their taxation benefits. The farmer will need to establish that the FMD was made in the previous financial year and held for at least six months, and that an area of their farming property has been affected by rainfall deficiencies for six consecutive months. An online rainfall deficiency tool

will be available from 1 July 2016 to allow farmers to determine their eligibility.

Also from 1 July 2016, primary producers who are sole traders or partners in a partnership can use their FMD accounts as an offset against money borrowed for their primary production business. The FMD and loan would need to be held with same financial institution, and it will be up to banks to decide whether they will offer these offset accounts and how they will operate.

Collective investment vehicles

The 2016 Federal Budget included an announcement that a new tax and regulatory framework for collective investment vehicles (CIVs) will be introduced. For income years starting on or after 1 July 2017, a corporate CIV will be introduced. For income years starting on or after 1 July 2018, a limited partnership CIV will be available. Government agencies will receive funding to implement these measures. Investors in the new CIVs will generally be taxed as if they had invested directly. This will allow Australian managed funds to offer investment products using vehicles that are commonly used overseas.

FINTECH

Regulatory sandbox

ASIC has released a consultation paper (CP 260) on a proposed "regulatory sandbox" and other measures to facilitate innovative fintech start-ups.

The "regulatory sandbox" would be an industry-wide licensing waiver for limited financial services provided to a small number of retail clients. The conditions of this proposed waiver would include:

- it would only apply to advice and dealing services through a period of six months;
- the testing business must have a recognised sponsor;
- the service would be limited to 100 retail clients;
- the waiver would allow up to \$10,000 investment per retail client in listed securities, deposits and simple managed investment schemes;
- the service may have an unlimited number of wholesale clients, subject to a total investment cap of \$5 million;
- the testing business would have to comply with a modified set of conduct and disclosure obligations; and

- the testing business must be a member of external dispute resolution scheme, have adequate compensation arrangements and not be an existing licensee.

Businesses would be able to request waivers for testing other services.

ASIC also proposes to provide additional clarity on how it assesses submissions about a responsible manager's knowledge and skills, and to allow small, heavily automated businesses to appoint third parties who provide sign off. Sign off would have to be lodged with ASIC at regular intervals and would only be available to licensees who provide advice or dealing services to limited clients, where at least one responsible manager who makes significant day to day decisions must be nominated.

Comments on CP 260 are due by 22 July 2016.

MAS and ASIC

In related news, the Monetary Authority of Singapore (**MAS**) released its own consultation paper on a proposed regulatory sandbox on 6 June 2016 and on 16 June 2016, MAS and ASIC signed an Innovation Functions Cooperation Agreement to help fintech businesses in Singapore and Australia.

The agreement is intended to assist fintech companies in Singapore and Australia establish initial discussions in each other's market faster and receive advice on required licences. Businesses will need to meet eligible eligibility criteria set by the home regulator in order to qualify for support. The regulator will then be able to refer the applicant to a dedicated team or contact person at the other regulator to help them understand the regulatory framework in the other market they wish to enter.

PAYMENT SYSTEMS

Surcharging standards released

The Reserve Bank has released new standards on surcharging for card payments.

Merchants will not be able to charge more than the merchant's cost of acceptance for the particular card system. Eligible costs are defined in the standards.

The changes take effect for large merchants on 1 September 2016. They will apply to other merchants from 1 September 2017. A large merchant is one which satisfies any two of the following three criteria:

- Consolidated gross revenue for the financial year ended 30 June 2015 of \$25 million or more.
- Consolidated gross assets as of the same date of \$12.5 million or more.
- 50 or more employees (on any basis) as of the same date.

The new regime will be enforced by the Australian Competition and Consumer Commission.

The definition of card acceptance costs will be narrowed from current standards. Acceptable costs will be limited to fees paid to the merchant acquirer or other payment facilitator and certain other "observable costs" paid to third parties for services directly related to accepting cards.

Acquirers and payment facilitators will be required to give merchants an annual statement clearly setting out the average costs of acceptance for each card payment system regulated by the Reserve Bank. Acceptance costs will be expressed in percentage terms.

The Reserve Bank says that the goal of its revised surcharging standard is to "improve price signals" to consumers about the relative costs of different payment methods.

New standards also require that from 1 July 2017, debit cards capable of being visually identified as a debit card must be so identified and prepaid cards capable of being visually identified as prepaid cards must be so identified. From that date, all debit cards and prepaid cards must also be issued with a BIN that allows them to be electronically identified as debit cards and prepaid cards respectively.

Digital currency

On 5 May 2016, the Federal Government announced its response to the Senate Economics References Committee report on digital currencies.

The Government confirmed its position that consumers should not be subject to GST twice when using digital currency to purchase goods or services and will legislate to amend the GST treatment of digital currencies. Any such changes will be subject to formal agreement of the States

and Territories.

The recently established Fintech Advisory Group will act as a task force to gather further information on the uses, opportunities and risks associated with digital currencies.

The Government also indicated its support for a review of the application of the AML/CTF Act to digital currency exchanges.

PRIVACY

Veda Advantage investigation

An investigation has been opened by the Office of the Australian Information Commissioner (**OAIC**) in relation to the use of personal information by a subsidiary of Veda Advantage, Inivio, for direct marketing. The investigation is in response to a complaint by an individual who received direct marketing from ANZ. Veda claims that information is used in accordance with the *Privacy Act 1988 (Cth)* and that individuals may opt out of receiving marketing communications at any time. It is reported that the OAIC has asked Veda whether Veda disclosed the complainant's credit information or personal information to any third party and has asked Veda to explain if credit reporting information was disclosed to ANZ, how this was authorised under section 20G of the *Privacy Act 1988 (Cth)*.

SUPERANNUATION

Budget changes

The 2016 Federal Budget announced a number of proposed changes to the superannuation system. The main changes proposed include the following:

- From 1 July 2017, there will be a maximum amount of \$1.6 million that can be transferred from accumulation phase into pension phase. Tax will apply to amounts transferred in excess of this amount, similar to the excess contributions tax. Persons with pension account balances that exceed \$1.6 million will be required to reduce the balance to below the threshold by 1 July 2017.
- There will be a lifetime non-concessional cap from 1 July 2017 of \$500,000, replacing the annual cap of \$180,000.
- There will be a 30% tax on concessional contributions for those earning over \$250,000 per annum from 1 July 2017.

- The annual limit on concessional contributions will be reduced from \$30,000 for those under age 50 or \$35,000 for ages 50 and over to \$25,000.
- From 1 July 2017 all individuals up to age 75 will be able to claim an income tax deduction for personal superannuation contributions and individuals will be able to make additional concessional contributions where they have not reached their concessional contributions limit in previous years.
- The income tax exemption for assets being used to fund transition to retirement income streams will be removed from 1 July 2017.
- From 1 July 2017, the Division 293 threshold will be reduced from \$300,000 to \$250,000. This is the point at which additional contributions tax must be paid.

AML/CTF

Review report released

The report of the statutory review of the *Ani-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth)* (the **AML/CTF Act**) was released on 29 April 2016.

The report includes a number of key findings and 84 recommendations. From an industry standpoint, some of the important key findings include:

- The AML/CTF Act and Rules are too complex.
- Industry requires more assistance to understand and comply with their obligations.
- More exemptions could be provided for services that pose a low ML/TF risk.
- Other services that pose a high ML/TF risk should be regulated, such as digital currencies and services provided by lawyers and accountants.
- Reporting obligations are onerous and should be streamlined.
- AML/CTF program requirements are too complex.

Recommendations in the report include:

- Simplifying the AML/CTF Act and making it more principles based.
- Simplifying the AML/CTF Rules and drafting them in plain language.
- Co-designing future reforms in partnership with industry.
- Providing regulated businesses with enhanced feedback.
- Capturing high ML/TF risk services.

- Reconsidering regulation of low ML/TF risk services.
- Minimising the regulatory burden of customer due diligence obligations, including enhancing the ability of business to rely on the customer due diligence conducted by other regulated businesses.
- Simplifying AML/CTF program obligations.
- Simplifying and rationalising compliance reporting.
- Enhancing the registration framework for remitters.
- Repealing the *Financial Transactions Reports Act 1988 (Cth)*, which continues to have a limited application.

The Government says it will carefully consider the report and consult closely with industry on the design of any reforms.

DISPUTES AND ENFORCEMENT

Productivity Commission to review regulation of the Australian Consumer Law

The Federal Treasurer has referred to the Productivity Commission a request to review the enforcement and administration arrangements underpinning the Australian Consumer Law.

One of the objectives of the study is to examine the effectiveness of the "multiple regulator" model where the law is enforced by the ACCC and State and Territory consumer agencies, but also by ASIC in relation to financial products and services.

The Productivity Commission has been asked to report to the Government by March 2017.

ASIC gets new powers and funding

On 20 April 2016 the report by the committee reviewing the capability of ASIC was released. The review had been commissioned in July 2015. The Federal Government also published its response to the report. In its response, the Government announced a number of other initiatives to bolster ASIC.

The announcements include the adoption of industry funding or user pays for ASIC, which will commence in the second half of 2017. The Government says that industry funding will "establish price signals to drive economic efficiencies in the way resources are allocated within ASIC."

The Government will commit \$61.1 million to enhance ASIC's data analytics and surveillance capabilities and improve information systems. An additional \$57 million will be provided for surveillance and enforcement on an ongoing basis. The Government says that this will enable ASIC to increase surveillance and enforcement activities, particularly in areas of financial advice, responsible lending, life insurance and breach reporting.

A further \$9.2 million will be provided to ASIC and Treasury to accelerate the implementation of certain measures recommended by the Financial System Inquiry, including a product intervention power for ASIC, product distribution obligations for industry, a review of ASIC's enforcement regime, and strengthening consumer protections in the ePayments Code.

The Government has also asked ASIC to work with the Financial Ombudsman Service on a review of its small business jurisdiction. A panel of eminent persons will be established to review the role, powers and governance of all financial external dispute resolution and complaints schemes and assess the merits of better integrating them. The panel will report back to the Government by the end of 2016.

The Government intends to recommend the extension of the appointment of the current ASIC Chairperson, Mr Greg Medcraft, for 18 months to oversee the implementation of these reforms, and also intends to appoint another ASIC Commissioner who will have experience in the prosecution of crimes in the financial services industry.

ASIC enforcement priorities

ASIC's report 476 on enforcement outcomes from July to December 2015 released on 30 March 2016 details its enforcement activity during this period and also sets out its enforcement priorities for the next six months. The enforcement focus in the next six months will be on market integrity, corporate governance and financial services.

In the financial services area, ASIC says that it is conducting a significant number of investigations and risk-based surveillances of financial advice providers, targeting a range of misconduct including charging clients for financial advice when no advice was provided, compliance with the future of financial advice (FOFA) laws, and progressing court proceedings commenced by ASIC to wind up land banking schemes and their developers or promoters.

Breach of best interests duty alleged

ASIC has taken its first civil penalty action against a financial services licensee in relation to alleged breaches of the best interests duty. This duty was introduced under the FOFA amendments to the *Corporations Act 2001 (Cth)*. The amendments seek to ensure that financial advisers act in the best interests of the client.

The defendant NSG Services is alleged to have failed to take reasonable steps to ensure that its advisers complied with the best interests duty. ASIC also alleges that:

- NSG did not properly train its advisers and that its written policies relating to compliance and risk management were inadequate and not followed or enforced;
- on eight specific occasions, clients were sold insurance and/or advised to rollover superannuation accounts where the clients were committed to costly, unsuitable and unnecessary financial arrangements; and
- regular performance reviews were not conducted and disciplinary action for non-compliant advices was not taken.

NAB – BBSW

Following on from its actions commenced against ANZ and Westpac in March and April, on 7 June ASIC commenced legal proceedings against NAB for unconscionable conduct and market manipulation in relation to the bank's role in setting the BBSW from 2010 to 2012.

ANZ late fee refunds

ASIC announced that ANZ was refunding about 25,000 customers who were mistakenly charged over limit and late fees on credit cards and overdrawn fees on debit cards. The affected customers also held an ANZ Access Basic account and as such were eligible for fee reductions and waivers. The error was explained as a breakdown in the interaction between automated and manual processes. ANZ has now implemented an automated solution. The amount involved is approximately \$5 million.

HSBC enforceable undertaking

HSBC has given an enforceable undertaking to ASIC to resolve concerns raised by ASIC regarding advice given to clients about retail structured products between 2009 and 2013.

HSBC conducted a file review following surveillance by ASIC and found that there were potential deficiencies in about 464 of the 557 files reviewed. HSBC lodged a breach notification with ASIC.

The enforceable undertaking requires HSBC to implement a remediation plan, assess whether clients sold other products may have been affected, and to appoint an independent expert to report to ASIC on HSBC's actions.

Rescue Credit refunds

Rescue Credit has repaid over \$35,000 to consumers following intervention by ASIC. Rescue Credit has also appointed an independent consultant to review its overall compliance arrangements and a sample of consumer files over a period of 12 months. The independent consultant will report its findings to ASIC. According to ASIC, Rescue Credit may have breached obligations under the credit legislation by applying fees and charges to medium amount credit contracts in excess of the maximum annual cost rate of 48%, providing unsuitable loans to consumers who had defaulted on existing credit contracts or who were experiencing financial hardship, and failing to provide consumers with direct debit default notices.

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