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# Regulatory reports, reviews and initiatives

Summary of government and regulatory initiatives with potential impact for the credit industry

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This document provides a very brief and incomplete summary of government and regulatory initiatives with potential impact for the credit industry as at the date of this report.

## 1. Small Business Loans Inquiry (Carnell Report)

On 3 February 2017, Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**) released the Final Report on its Small Business Loans Inquiry.

**ASBFEO's key recommendations**

The Code of Banking Practice (**COBP**) should be amended to include a dedicated section on small business customers dealing with the following.

- For loans below $5 million, where a small business has complied with loan payment requirements and has acted lawfully, the bank must not default a loan for any reason. Any conditions under which banks can unilaterally value existing security assets during the life of the loan, or invoke financial covenants or catch-all 'material adverse change' clauses, must be removed.
- For loans below $5 million, banks must provide a one-page summary of the clauses and covenants that may trigger default or other detrimental outcomes for borrowers.
- For loans below $5 million, banks must put in place a new small business standard form contract that is short and written in plain English.
- External Dispute Resolution schemes should be expanded to include disputes with third parties that have been appointed by the bank, such as valuers, investigating accountants and receivers, and to borrowers who have previously undertaken farm debt mediation.

**Response**

On 28 April 2017, the Australian Bankers Association (**ABA**) released its detailed response to the Carnell Report.

In summary, ABA members proposed:

- in respect of financial covenants triggering loan defaults, to remove these except for property investment and development loans and specialised lending (including invoice discounting);
- to continue to monitor LVR ratios so as to comply with APRA prudential guidance;
- to extend notice periods (eg where a facility is not being rolled over) to 90 days.

The ABA commits to finalising the new COBP by 31 December 2017 with full implementation by 31 December 2018 (ASBFEO wanted implementation by 31 December 2017).

## 2. ASIC flex commissions proposal

In March 2017, ASIC announced that it would restrict flex commission arrangements in the car finance market by imposing a cap of 2% on flex commissions. Unintentionally, the draft prohibition would have applied to all credit contracts and consumer leases regulated by the National Consumer Credit Protection Act (**NCCP**), and may impact lenders involved in mortgage management, servicing, non-bank lending or securitisation even though they are not involved in motor vehicle financing.

Following considerable feedback received on the draft legislative instrument, ASIC now proposes to distinguish between point of sale exempt dealers and licensed brokers, at least when it comes to the introducer fees they charge consumers.

ASIC notes that:

- in light of strong feedback on the 'credit fees and charges' element of the draft legislative instrument, ASIC is proposing that credit providers set the maximum amount a point of sale exempt dealer can charge a consumer for its credit introduction services, which a dealer is open to negotiate downwards; and

- no maximum or other limitation is to be required for a licensed broker charging a client for its services because NCCP fee quote disclosure obligations will apply.

## 3. ASIC Supervisory Cost Recovery Levy

The *ASIC Supervisory Cost Recovery Levy Act 2017* imposes a levy on entities regulated by ASIC to recover its regulatory costs. The *ASIC Supervisory Cost Recovery Regulations 2017* apply either a flat or a graduated levy to entities in each industry sub-sector regulated by ASIC. An entity will be subject to more than one levy if it falls within multiple sub-sectors, depending on the activities it undertakes during a financial year. The type of levy and the formula for calculating the amount of levy payable is different for each industry subsector. The first levy will be imposed in respect of the 2017-18 financial year, which commences on 1 July 2017.

## 4. Retail Banking Remuneration Review (Sedgwick Report)

On 19 April 2017, Stephen Sedgwick published the Final Report of his Independent Review of product sales commissions and product based payments in retail banking in Australia. The Report examines the arrangements that lead to incentives, commissions and bonus payments for retail staff of banks (tellers, sellers and their supervisors and near managers) as well as third parties (including brokers, aggregators, franchises, introducers and referrers).

The Report makes 21 recommendations for change. Although the extent of change will vary, almost every bank may change at least some of its practices to comply with these recommendations.

According to Sedgwick, adoption of the recommendations will mean that:

- in-scope retail bank staff (importantly, mortgage sellers) and their managers will no longer receive incentives based directly or solely on sales performance; and

- instead, eligibility to receive any personal incentive payments will be based on an assessment of an individual's contribution across a range of measures, of which sales (if included at all) will not be the dominant component; and the maximum available payments will be scaled back significantly for some roles.

## 5. Report of the Independent Review of the Code of Banking Practice (Khoury Report)

The Final Report, released in February 2017, makes 99 recommendations as to how the COBP should be amended or otherwise improved. These include:

- revising and re-drafting the COBP in a modern structure and using plain, accessible language;

- amending the definition of 'small business' in the COBP;

- including a new provision that obliges signatory banks to provide an applicant for consumer credit with the bank's 'not unsuitable assessment' prepared in accordance with the NCCP;
- prohibiting banks from enforcing a facility if the customer has complied with loan repayment obligations and has acted lawfully;
- obliging banks to inform a guarantor where the borrower has been in continuing default for more than 2 months or where the borrower's credit contract has changed due to financial hardship;
- requiring banks to have recourse to security provided by the borrower before a guarantor's security, unless the guarantor and borrower agree otherwise;
- rendering a guarantee unenforceable if the bank fails to comply with any pre-execution COBP requirements;
- obliging banks to set default fees that are reasonable having regard to the bank's costs.

Khoury supported many of the recommendations for small business credit contracts outlined in the Carnell Report.

On 30 June 2017, the ABA said that the industry's Code of Banking Practice was on track to be finalised by the end of 2017, with redrafting well underway to make it more accessible to customers and small businesses.

## 6. ASIC Enforcement Review: Breach reporting

On 11 April 2017, Treasury has released a consultation paper on breach reporting by financial services and credit licensees.

For AFS licensees, the view is that self-reporting of breaches of the Corporations Act should still be limited to significant breaches, but that significance should be determined by reference to an objective standard.

There is also a proposal to make the 10 business day timeframe for reporting of a breach commence from when the AFS licensee becomes aware or has reason to suspect that a breach has occurred, may have occurred or may occur rather than when the licensee determines that the relevant breach has occurred and is significant (for example, after an investigation).

For credit licensees, the Review recommends that a regime for breach reporting equivalent to that for financial services licensees be introduced. It is not clear how the proposal would relate to the penalty cap given to credit providers who make an application for a penalty before a borrower under section 116 of the National Credit Code (**NCC**).

## 7. Privacy Amendment (Notifiable Data Breaches) Act 2017

This law (to commence in February 2018) establishes a mandatory data breach notification scheme requiring agencies and organisations regulated by the Privacy Act to provide notice to the Australian Information Commissioner and affected individuals of an '*eligible data breach'.*

An eligible data breach will occur where:

- there is unauthorised access to or disclosure of information and a reasonable person would conclude that access or disclosure would be likely to result in serious harm to any of the individuals to whom that information relates; or

- information is lost in circumstances where such unauthorised access or disclosure is likely to occur and a reasonable person would conclude that, assuming such access or disclosure did occur, it would be likely to result in serious harm to any of the individuals to whom that information relates.

## 8. ASIC review of mortgage broker remuneration

ASIC undertook an industry-wide review of mortgage broker remuneration. On 16 March 2017, ASIC released its Final Report which found that the current mortgage broker remuneration and ownership structures create conflicts of interest that may contribute to poor consumer outcomes.

The Report outlines a number of proposals for industry aimed at improving consumer outcomes, including:

- improving the standard commission model for mortgage brokers;
- moving away from bonus commissions and soft-dollar benefits;
- increasing the disclosure of mortgage broker ownership structures; and
- improving the oversight of mortgage brokers by lenders and aggregators.

ASIC's key recommendations will likely spell the end of volume-based incentives, which may have the potential to encourage mortgage brokers to lend more than necessary in order to meet loan volume targets.

These recommendations may form the basis for voluntary industry reform.

## 9. Review of the Financial System External Dispute Resolution and Complaints Framework (Ramsay Report)

Key recommendations from final report issued in May 2017 include:

- establishing a single EDR body for all financial disputes to replace FOS and CIO;
- higher monetary limits and compensation caps for consumer disputes (other than superannuation disputes) and for small business disputes (other than credit facility disputes);
- no monetary limits or compensation caps for disputes about whether a guarantee should be set aside where it has been supported by security over the guarantor's primary place of residence; and
- requiring financial institutions to report to ASIC in a standardised form on their IDR activity, including the outcomes for consumers in relation to complaints raised at IDR.

Contrary to the Carnell Report recommendation, the Panel found that EDR scheme membership is not required for valuers, investigating accountants or receivers appointed by a bank. Further, the Panel stated that there is no reason why credit representatives should continue to be required to hold EDR membership.

On 2 February 2017, the Review's Terms of Reference were extended to making recommendations on the establishment, merits and possible design of a last resort compensation scheme and considering the merits and issues involved in providing access to redress for past disputes.

## 10. Amendments to the AML/CTF Rules

In April 2016, the Attorney-General's Department released its *Report on the Statutory Review of the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 and Associated Rules and Regulations* (Report).

The Report set out 84 recommendations aimed at strengthening Australia's AML/CTF regime and implementing a more efficient and effective regulatory framework.

In response to this, the Australian Transaction Reports and Analysis Centre (**AUSTRAC**) released a set of proposed amendments to the *Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No.1)* (Cth) (**AML/CTF Rules**) on 24 April 2017. AUSTRAC anticipates that these amendments will provide regulatory benefits to industry.

Key amendments include:

- expanding the exemptions from the requirement to collect and verify information about beneficial owners in Rule 4.12.2 to apply to subsidiaries of foreign listed public companies;
- inserting a new Part 4.15 to provide for alternative identification procedures, including self-attestation for customers that a reporting entity is unable to identify using the usual customer identification procedure. These might include homeless persons, people living in remote areas, and people affected by natural disasters. Such procedures would only be able to be used in circumstances of low ML/TF risk.
- requiring a reporting entity to identify, mitigate and manage ML/TF risk for new designated services, delivery methods and technologies, and changes in the nature of the business relationship, control structure or beneficial ownership of its customers;
- requiring a reporting entity to be able to demonstrate the independence of any reviewer of Part A of its AML/CTF Program.

## 11. Credit Cards: improving consumer outcomes and enhancing competition

In August 2017 Treasury released a consultation bill which if adopted will:

- require that affordability assessments be based on a consumer's ability to repay the credit limit within a reasonable period;
- prohibit unsolicited offers of credit limit increases;
- simplify how interest is calculated, including prohibiting backdating interest charges; and
- require online options to cancel cards or to reduce credit limits.

## 12. SACCs (small amount credit contracts)

In February 2017 the government stated that Treasury is drafting legislation to implement recommendations made in a review of SACC laws completed in April 2016. Consumer groups have for pressed for the completion of the drafting.

## 13. AFS and ACL Licensing - Treasury Taskforce Positions and Consultation Paper 3

The paper makes six recommendations.

- ASIC should be able to take action if it suspects the controllers of an Australian financial services licence (AFSL) are not 'fit and proper' upon their application (or change of control of the AFSL).
- There should be a statutory obligation for controllers of an AFSL to notify ASIC if there is a change of a control.
- AFS licence application assessments should be aligned with the enhanced credit license requirements adopted in 2010.
- ASIC should also have the power to cancel or suspend an AFSL if the licensee fails to commence business within six months.
- Penalties for false or misleading statements in financial services and credit should be aligned.
- Misleading or false statements in an AFSL application should be a "specific basis for refusing to grant the licence".
- Applicants should be required to confirm that there have been no material changes to information given in the application before the licence is granted.

## 14. ASIC'S Search Warrant Powers - Treasury Taskforce Positions and Consultation Paper 2

This paper discusses a proposal to enhance and consolidate ASIC's search warrant powers.

## 15. Industry Codes – Treasury Taskforce Positions and Consultation Paper 4

This paper discusses a proposal that key industry codes should be subject to ASIC approval and that industry members be obliged to subscribe.

## 16. Australian Consumer Law – Proposed Threshold Increase Potential Business Finance Impacts

A review of the Australian Consumer Law has proposed an increase in the threshold of 'consumer' from $40,000 to $100,000.

This increase would apply to goods and services, whether acquired for consumer or business purposes (subject to a few exceptions).

The increase would impact the scope of goods or services subject to the consumer guarantees and other ACL statutory rights.

## 17. Banking Executive Accountability Regime – 13 July 2017 – Consultation Paper

In the 2017-18, the Government announced that it will introduce a new Banking Executive Accountability Regime (**BEAR**).

The intention of the BEAR is to enhance the responsibility and accountability of ADIs and their directors and senior executives. The BEAR will provide greater clarity regarding their responsibilities and impose on them heightened expectations of behaviour in line with community expectations.

Where these expectations are not met, APRA will be empowered to more easily remove or disqualify individuals, ensure ADIs' remuneration policies result in financial consequences for individuals, and impose substantial fines on ADIs. ADIs will be required to register individuals with APRA before appointing them as senior executives and directors.

## 18. Empowering consumers through open banking

The Review into Open Banking released an Issues Paper in August 2017 with submissions due by 22 September 2017.

Open Banking is about giving Australians greater access to their own banking data. Proponents claim it has the potential to transform the way in which Australians interact with the banking system and will encourage development of improved systems and products.

## 19. Merger of EDR Schemes

A transition team will be put in place to ensure that the Australian Financial Complaints Authority (**AFCA**) is operational by 1 July 2018.

Provided the legislation to create AFCA passes parliament, the transition team will focus on overseeing the operational transition from the current schemes and bodies to AFCA, while consulting "extensively" with the Financial Ombudsman Service, the Superannuation Complaints Tribunal, the credit and Investments Ombudsman as well as industry and consumer stakeholders.

## 20. APRA Supervisory Power over Non-ADI Lenders

The draft *Treasury Laws Amendment (Non-ADI Lender Rules) Bill 2017* was released for public comment in July 2017. The Bill proposes to:

- provide APRA with a power to make rules concerning the lending activities of non-ADI lenders for the purpose of addressing financial stability risks ('non-ADI lender rules'), provide APRA with a new power to issue a direction to a non-ADI lender should the entity fail to comply with a non-ADI lender rule, and introduce penalties for non-ADI lenders that fail to comply with a direction by APRA; and

- amend the *Financial Sector (Collection of Data) Act 2001* to allow APRA to collect data from non-ADI lenders for the purposes of monitoring their activities and determining when to use its new powers.

## 21. Banks to overhaul consumer credit insurance (CCI) sales processes

ASIC has convened CCI Working Group to progress a range of reforms.

Significantly, this includes a deferred-sales model for CCI sold with credit cards over the phone and in branches. This will mean that consumers cannot be sold 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.

The ABA is likely to incorporate these measures into the revised Code of Banking Practice and may accelerate their introduction so that they commence in the first half of 2018 and well before the new code is fully in place.

## 22. APRA consults on phased licensing for ADIs

On 15 August 2017 APRA released a discussion paper on proposed revisions to the licensing framework for authorised deposit-taking institutions (**ADI**s). The proposals introduce a phased approach to authorisation by reducing barriers to new entrants being authorised to conduct banking business, including those with innovative or otherwise non-traditional business models or those leveraging greater use of technology.