ASIC

Australian Securities & Investments Commission

ASIC
PUBLIC STATEMENTS
AND REPORTS

22 JUNE 2018

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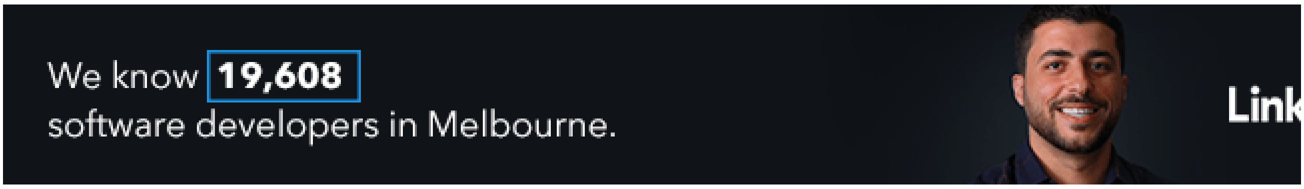
ASIC enforcement outcomes

As at 31 May 2018

		Financial year to date[1]	Since July 2011[2]
		1 Jul 2017 - 31 May 2018	1 Jul 2011 - 31 May 2018
Criminal actions	People convicted	19	160+
	Custodial sentences (including fully suspended)	12	90+
	Non-custodial sentences/fines	7	60+
Civil actions	Civil proceedings completed	27	140+
	Amount ($) in civil penalties	$37.1m	$66.2m+
Administrative actions	People/companies removed or restricted from providing financial services or credit[3]	113	800+
	People disqualified or removed from directing companies	46	390+
Infringement notices	Infringement notices issued	47	370+
	Amount ($) in infringement notices paid	$1.8m	$11.9m+
Enforceable undertakings	Enforceable undertakings secured	24	150+
Compensation	Amount ($) in compensation and remediation for investors and consumers	$321.4m	$1.79bn+
	Amount ($) in community benefit fund payments	$47.9m	$74.9m+

Table notes:
1. Current financial year figures are subject to change. This is due to appeals and delays in data capture.
2. Results since July 2011 have been rounded to significant figures.
3. Results do not include bannings that have not been served.



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BUSINESS BANKING & FINANCE

ANZ review after glitch forces $70m in home loan refunds

By Clancy Yeates
30 January 2014 — 10:10am

ANZ Bank is conducting a sweeping review all of its home loan, savings and small business accounts to ensure they are operating correctly, after a major glitch forced it to refund $70 million to 235,000 home loan customers.

Last week the bank commenced sending out letters to the customers, who were charged incorrect interest rates through their mortgage offset accounts due to processing errors by the bank.

The bank has decided to put all its products under the microscope.
Photo: Ken Irwin

- **Do you know more?** cyeates@fairfaxmedia.com.au

Some of the errors dated back to 2003, and occurred because key processes were carried out manually, leaving the door open to human error.

Customer complaints first alerted the bank to problems with the offset accounts in 2010, which then led to a four-year review led by PwC.

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The head of the bank's Australian operations, Phil Chronican, said the bank had also decided to put all of its products under the microscope as part of a separate review taking in several million accounts.

"Part of our ongoing program of work at the moment is to make sure that all of our accounts are performing in accordance with the terms and conditions documents that are out there," Mr Chronican said in an interview.

The move to carry out the "thorough" internal review of its products is a precautionary measure in response to the problems with its offset accounts, he said. The probe will cost the bank several million dollars in staff hours.

"When you discover an issue of this nature, you want to be 100 per cent sure that you haven't got anything else of that nature in your business, so we've been reviewing all of our products," Mr Chronican said.

"We literally are going through every product, every terms and conditions booklet, and checking the systems against the products against the terms and conditions."

The internal review is taking in all of its deposit products, credit cards and any remaining mortgage products that have not already been assessed.

It has been running for a little more than a year, and he said it had so far not turned up anything ‘‘material’’ aside from some relatively ‘‘small issues’’ in its commercial accounts.

Offset accounts are deposit accounts attached to a mortgage and they are increasingly popular with borrowers trying to repay loans quickly.

The balance in the offset account is deducted from the mortgage balance for interest calculations, but in ANZ’s case key processes were done manually, and not always on time.

‘‘Because the process of linking the accounts was a manual one, in some cases there was a delay between the loan being drawn down and the offset account being properly linked,’’ Mr Chronican said.

‘‘In most cases these things were fixed within a week, but the customer didn’t always get that credit.’’

The average refund to customers affected by the offset account glitch is $300. The bank says it will also reimburse people for foregone interest or money they would have saved on their loans.

It comes after Bank of Queensland was last year forced to refund $34.5 million to customers after interest rate glitches with its offset accounts, while NAB’s British arm was fined 8.9 million pounds by the British regulator for its response to similar mistakes.

Australian banks have not been fined for the errors with their offset accounts by the Australian Securities and Investments Commission, because it believes they have addressed the problems and reimbursed customers.

A senior executive at ASIC, Tim Gough, said he did not think there was a systemic issue with offset accounts, but any manual process had scope for human error.

"To the extent that any manual part of that process is involved, it sets you up for human error,’’ he said.

‘‘You couldn't rule out there being other types of issues where systems did rely on some manual intervention but we don't think there's a particular mortgage offset issue."

A bank would be more likely to face a penalty for an error like this if they had failed to find the error themselves or if they refused to take appropriate action, he said.

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Clancy Yeates

Clancy Yeates writes on business specialising in financial services. Clancy is based in our Sydney newsroom.

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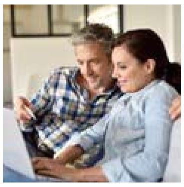

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Thursday 18 January 2018

18-013MR ASIC acts against ANZ for breaching responsible lending laws in its former Esanda car finance business

ASIC today announced a package of regulatory actions against Australia and New Zealand Banking Group Ltd (ANZ) for loans approved through its former car finance business Esanda, including around $5 million in remediation. The loans were submitted by three broker businesses to ANZ.

Civil penalty proceedings

ASIC has commenced civil penalty proceedings in the Federal Court against ANZ, in which ANZ has admitted 24 contraventions of the responsible lending provisions of the *National Consumer Credit Protection Act 2009* (Cth) for car loans approved by Esanda from three broker businesses.

ASIC alleges that between 25 July 2013 and 12 May 2015, ANZ failed to meet its responsible lending obligations when relying only on payslips included in 12 car loan applications to verify the consumer's income, in circumstances where it knew that payslips could be easily falsified and it had reason to doubt the reliability of information from the particular broker businesses.

This action relates to ANZ's own responsible lending obligations, which require lenders to take reasonable steps to verify the information provided by borrowers. ASIC has separately taken action against the broker businesses that were involved in submitting false documents to ANZ (see below).

ASIC and ANZ have filed a Statement of Agreed Facts and Admissions in the Federal Court. They will make joint submissions that an appropriate penalty to be paid by ANZ is $5 million. The penalty amount payable by ANZ will be determined by the Court.

The Court has listed the proceedings for a first Case Management Hearing on Friday 2 February 2018.

Download the originating application

Remediation

ANZ will remediate approximately 320 car loan customers for loans taken out through three broker businesses from 2013 to 2015, totaling around $5 million. The loans are likely to have been affected by fraud. ANZ will:

- offer eligible customers the option of entering into a new loan on more favourable terms than the existing loan
- provide refunds to some customers who have paid their loan out or had the car repossessed
- remove any default listings resulting from the relevant loan.

ANZ is expected to commence contacting customers eligible for remediation in February 2018. Customers can contact ANZ on: 132 373.

ASIC acknowledges ANZ's cooperation with its investigation and in resolving its regulatory concerns.

Background

ASIC has taken separate actions in relation to the three brokers who submitted false documents to ANZ:

- 15-281MR ASIC imposes licence conditions on United Financial Services Pty Ltd
- 16-209MR Former Sydney finance broker sentenced to intensive correction order
- 16-302MR ASIC permanently bans former Sydney finance broker
- 16-456MR Used-car finance broker permanently banned
- 17-134MR ASIC acts against car yard loan-writer
- 17-347MR ASIC permanently bans convicted car yard loan-writer

ASIC's Regulatory Guide 209 *Credit licensing: Responsible lending conduct* sets out practical guidance for lenders and credit intermediaries (including brokers) on how to comply with their responsible obligations.

Editor's note:

On 1 February 2018 the court vacated the case management conference scheduled for 2 February and has listed the proceeding for hearing on liability and penalty on 15 February 2018.

Editor's note 2:

On 15 February 2018, the proceeding was heard in the Federal Court and declarations and orders were made, as agreed by the parties, that:

- ANZ had contravened the responsible lending provisions of the National Consumer Credit Protection Act 2009 (Cth) in respect of 12 car loans approved by Esanda, by failing to take reasonable steps to verify the consumer's income before entering into the loan contract;
- ANZ pay to the Commonwealth of Australia a pecuniary penalty of $5 million in respect of the contraventions; and
- ANZ pay ASIC's legal costs of $120,000.

Download the Order

The court will publish its written judgment in due course.

Last updated: 16/02/2018 10:37

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Wednesday 28 February 2018

18-057MR Court finds ANZ breached responsible lending laws in its former Esanda car finance business

The Federal Court in Melbourne has published its findings and reasons for ordering Australia and New Zealand Banking Group Ltd (ANZ) to pay a penalty of $5 million for breaches of the responsible lending provisions by its former car finance business, Esanda.

The Court's judgment follows ASIC's announcement of a package of actions against ANZ for contraventions of various responsible lending provisions of the National Consumer Credit Protection Act (refer: 18-013MR).

In relation to the civil penalty proceedings, the Court found (in summary):

- in respect of 12 car loan applications from three brokers, ANZ failed to take reasonable steps to verify the income of the consumer because ANZ relied solely on a document which appeared to be the consumer's payslip in circumstances where ANZ:
    - knew that payslips were a type of document that was easily falsified;
    - received the document from a broker who sent the loan application to Esanda; and
    - had reason to doubt the reliability of information received from that broker;
    - income is one of the most important parts of information about the consumer's financial situation in the assessment of unsuitability, as it will govern the consumer's ability to repay the loan;
    - while ANZ did not completely fail to take steps to verify the consumers' financial situation, it inappropriately relied entirely on payslips received from these brokers; and
    - ANZ management did not ensure that relevant policies were complied with and, in the case of the contraventions involving one broker, no action was taken despite management personnel having become aware of the issues about the broker.

The judgment annexes a statement of facts which sets out why ANZ had reason to doubt the reliability of the payslips being provided with the 12 applications, including that one of the brokers had been previously investigated for fraud. ANZ had also become aware of issues with payslips being provided by the brokers that gave it reason to doubt the authenticity of the submitted payslips.

The statement of facts also sets out that reasonable steps to verify a consumer's income would have included requesting from the consumer a bank statement showing a history of salary deposits or substantiating salary deposits in ANZ bank accounts for an existing customer.

In its judgment, the Court made clear that where unlicensed brokers submit loan applications in reliance on the "point of sale" exemption under regulation 23 of the *National Consumer Credit Protection Regulations 2010* (Cth), lenders have a heightened obligation to exercise particular care. This was the basis for the higher penalties imposed on ANZ relating to the loans submitted by one of the brokers under the point of sale exemption.

ASIC Deputy Chairman Peter Kell said, 'A consumer's income is an essential component in determining their ability to repay a loan. Lenders must take reasonable steps to verify a consumer's financial situation, and this includes checking the reliability of documentation that is provided to them. Lenders must be alert to the potential for documents to be falsified and ensure that their controls are sufficiently robust. '

Download the judgment

Remediation

ANZ will be remediating approximately 320 car loan customers for loans taken out through the three broker businesses from 2013 to 2015 which are likely to have been affected by fraud. The remediation will total around $5 million.

ANZ will:

- offer eligible customers the option of entering into a new loan on more favourable terms than the existing loan;
- provide refunds to some customers who have paid their loan out or had the car repossessed; and
- remove any default listings resulting from the loan.

ANZ has commenced contacting some customers eligible for remediation. Customers can contact ANZ on: 132 373.

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ASIC's Regulatory Guide 209 *Credit licensing: Responsible lending conduct* sets out practical guidance for lenders and credit intermediaries (including brokers) on how to comply with their responsible obligations.

Last updated: 28/02/2018 04:19

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Thursday 1 October 2015

15-281MR ASIC imposes licence conditions on United Financial Services Pty Ltd

ASIC has imposed conditions on the Australian credit licence of United Financial Services Pty Ltd (UFS), a finance broker specialising in arranging loans for motor vehicles.

This follows an investigation by ASIC into suspected loan fraud concerning loans submitted by UFS that secured car loans totalling more than $7.8 million in the 18 month period prior to November 2014.

The suspected fraud involved a used car dealership in the Sydney area using false payslips that overstated the consumer's income when providing documents to UFS when it was arranging credit for the consumer. The false payslips were then submitted by UFS with applications for car finance to the Australia and New Zealand Banking Group Limited (ANZ).

ASIC was concerned that UFS was not complying with its obligations as an Australian credit licensee under the *National Consumer Credit Protection Act 2009* to make reasonable inquiries about a consumer's financial situation, and to verify matters such as their income and expenses.

ASIC was concerned that UFS failed to have adequate risk management systems in place to detect the fraud in a timely and effective manner, with this failure meaning the submission of loans with false documents continued undetected by UFS for over 18 months.

ASIC acknowledges the co-operation of UFS in its investigation.

ASIC Deputy Chairman Peter Kell said, 'Brokers and lenders should be alive to the risk of fraud, and verification processes should be designed to ensure that fraud can be detected in a timely manner.

'Brokers and lenders will not meet their responsible lending obligations by using unreliable verification processes.'

The licence conditions will require UFS to appoint an independent consultant to review its arrangements to comply with its general conduct obligations under the *National Consumer Credit Protection Act 2009*, specifically its procedures for:

- monitoring and supervision of UFS representatives; and
- verifying the financial situation of the consumer.

The independent compliance consultant will report to ASIC and UFS will be required to address any deficiencies identified by its review.

ASIC's investigation into the suspected fraud is continuing.

Background

UFS is a credit services business, specialising in the delivery of consumer and commercial finance, including car and personal loans, and insurance products.

Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209) sets out ASIC's expectations concerning responsible lending obligations.

Last updated: 23/03/2016 03:07

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Wednesday 29 June 2016

16-209MR Former Sydney finance broker sentenced to intensive correction order

Former Sydney finance broker, Jennifer Mary Farias, has been sentenced to a one-year intensive correction order in the NSW Local Court after pleading guilty to 3 counts of loan fraud which resulted in her receiving more than $100,000.

She was also ordered to pay compensation totalling $100,000.00 to the credit provider for loan funds and commissions paid to her.

Ms Farias was the director of Motorcycle Finance & Insurance Pty Ltd (MFI), trading as Up N Riding. MFI arranged finance for vehicles such as motorcycles, cars and jet skis on behalf of its clients.

An ASIC investigation revealed that Ms Farias had received $96,270 in loan funds and $10,349.26 in commissions from a credit provider after submitting 10 fraudulent loan applications containing false invoices and false information. Loan funds totalling $20,000 and commissions totalling $4,675.80 were transferred to other persons after being paid to Ms Farias by the credit provider.

The invoices contained false information relied on by the credit provider when approving loans. Ms Farias admitted the relevant loans would not have otherwise satisfied the credit provider's lending policies or would have been subject to more stringent lending policies.

ASIC Commissioner Peter Kell said, 'It is vital that those working within the credit industry act honestly and diligently. ASIC will continue to protect consumers by taking action against those who commit loan fraud.'

Ms Farias entered her guilty plea in the NSW Local Court on 22 March 2016 (refer: 16-085MR).

Background

Since becoming the national regulator of consumer credit on 1 July 2010, ASIC has taken 79 actions involving loan fraud, including 60 actions to ban individuals and companies from providing or engaging in credit services or holding an Australian credit licence. ASIC has also commenced 13 criminal proceedings involving loan fraud.

Last updated: 29/06/2016 11:29

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Monday 12 September 2016

16-302MR ASIC permanently bans former Sydney finance broker

ASIC has permanently banned former Sydney finance broker, Jennifer Farias, from engaging in credit activities and providing financial services.

The bannings follow an ASIC investigation and criminal action against Ms Farias who pleaded guilty in the NSW Local Court in the Downing Centre in Sydney to three charges of loan fraud.

ASIC's Deputy Chairman Peter Kell said, 'ASIC's action in this matter demonstrates how serious we are about tackling loan fraud. We won't hesitate to take action against dishonest brokers who falsify documents and remove them from the industry.'

Ms Farias has the right to appeal to the Administrative Appeals Tribunal for a review of ASIC's decision.

Last updated: 13/09/2016 10:07

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Wednesday 21 December 2016

16-456MR Used-car finance broker permanently banned

ASIC has permanently banned Vaughn Thomas Hopkins from engaging in credit activities. Mr Hopkins, a former Victorian-based finance broker, arranged finance for consumers buying vehicles from Combined Motor Traders, a Cranbourne used-car dealership, between 2014 and 2015.

ASIC found that Mr Hopkins knowingly provided false information to Esanda, a division of ANZ Banking Group Ltd, in support of car finance applications for nine of his clients. All nine applications contained false payslips, and in three of the applications Mr Hopkins also falsely inflated his clients' assets. Each of the nine finance applications was approved.

ASIC Deputy Chairman Peter Kell said the banning reinforces the strong message to any broker considering engaging in misleading conduct.

'ASIC will not hesitate to permanently remove those who engage in misleading conduct from the industry,' Mr Kell said.

ASIC's investigations are ongoing.

Mr Hopkins has the right to seek a review of ASIC’s decision to the Administrative Appeals Tribunal.

Last updated: 21/12/2016 03:38

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Thursday 11 May 2017

17-134MR ASIC acts against car yard loan-writer

ASIC has permanently banned Adam Edward Greene from engaging in credit activities. Mr Greene wrote and submitted loans for customers buying vehicles from Combined Motor Traders, a Cranbourne used-car dealership, between 2014 and 2015.

ASIC found that four loans submitted by Mr Greene and approved by Esanda, a division of ANZ, contained false information and two of those loans contained false documents that were not given to him by the applicants.

'Using false information to get a loan for a customer who might not be able to afford it is not a smart sales tactic - it is illegal,' ASIC Deputy Chair Peter Kell said.

'This is not the first time ASIC has identified this type of conduct with car loans. Lenders need to look very carefully at the way they manage the approval of these types of loans, including the way in which car yard employees provide assistance to consumers to obtain finance.'

'If their commission structures are encouraging illegal practices, they should make changes.'

Car dealerships may operate under an exemption, commonly known as the 'point of sale' exemption (POS exemption). The POS exemption allows a car dealership to provide assistance to consumers to obtain finance from licensed credit providers. The proceeds of the finance can only be used to pay for goods and services supplied by the dealership.

ASIC's investigations are ongoing. See 16-456MR.

Mr Greene has the right to seek a review of ASIC's decision to the Administrative Appeals Tribunal.

Background

ASIC has taken actions against a number of other loan-writers, representatives or brokers operating in the car finance market, for conduct such as:

- Obtaining cars for consumers with poor credit histories, by arranging for a third party to sign the loan contract as a borrower (when that person thought they were only a guarantor).
- Arranging for the consumer to buy a car at an inflated sale price, and obtaining a secret profit from the markup in price.
- Financing insurance and warranty products without the knowledge or consent of the consumers.

Examples of related outcomes include:

- Permanently banning four brokers: Mr Eric-John Pryor, Mr Lachlan McDonald (15-189MR) and Mrs Julie Vanzyl (16-116MR), Grant Parker (16-132MR).

- Banning a broker, Ms Rana Hepi, for eight years (15-374MR).

Last updated: 22/06/2017 01:50

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Friday 13 October 2017

17-347MR ASIC permanently bans convicted car yard loan-writer

ASIC has permanently banned Daniel Kenneth Wilson from engaging in credit activities. Mr Wilson wrote and submitted loans for customers buying vehicles from Combined Motor Traders, a Cranbourne used-car dealership, between 2013 and 2014.

ASIC found that five of the loans submitted by Mr Wilson and approved by Esanda, a division of ANZ, contained false information relating to income verification and employment status.

In banning Mr Wilson, ASIC also took into consideration Mr Wilson's adverse criminal record, which included convictions for theft and possessing counterfeit money.

'ASIC will not hesitate to remove those from the industry who think that submitting false information to lenders is an acceptable practice' said ASIC Deputy Chairman, Peter Kell.

'Lenders need to ensure they have proper procedures in place to supervise those submitting loan applications. If commissions are driving fraudulent applications, change needs to occur.'

ASIC's investigations in this matter are ongoing. (Refer: 16-456MR and 17-134MR)

Mr Wilson has the right to seek a review of ASIC's decision to the Administrative Appeals Tribunal.

Background

ASIC has taken actions against a number of other loan-writers, representatives or brokers operating in the car finance market, including:

- permanently banning four brokers: Mr Eric-John Pryor, Mr Lachlan McDonald (15-189MR), Mrs Julie Vanzyl (16-116MR) and Mr Grant Parker (16-132MR).
- banning a broker, Ms Rana Hepi, for eight years (15-374MR).

Car dealerships may operate under an exemption, commonly known as the 'point of sale' exemption (POS exemption). The POS exemption allows a car dealership to provide assistance to consumers to obtain finance from licensed credit providers. The proceeds of the finance can only be used to pay for goods and services supplied by the dealership.

ASIC's MoneySmart website has helpful information for consumers on car loans, as well as the MoneySmart Cars app, which helps people work out the real cost of buying a car.

Last updated: 01/11/2017 09:40

ASIC

Australian Securities & Investments Commission

REPORT 445

Review of interest-only home loans

August 2015

About this report

This report is for holders of Australian credit licences (credit licensees) and highlights the importance of responsible lending practices for interest-only home loans.

It is intended to help credit licensees improve their lending practices by increasing their awareness of their obligations and identifying opportunities for them to improve their practices.

The information gathered through our review has helped inform our strategic response, which is aimed at minimising any potential detrimental impact of interest-only home lending on consumers.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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Contents

Executive summary

1 This report sets out ASIC's findings from a review of home loans with an interest-only period during the initial part of the loan (interest-only home loans). The review looked at the practices of 11 lenders who offer interest-only home loans.

2 The review found examples of practices that place lenders at risk of breaching responsible lending obligations. The report details these findings and sets out a number of actions that Australian credit licensees (credit licensees) should take.

3 All 11 lenders that were included in this review have agreed to implement the actions set out in this report.

Background

4 Home loans are a key financial product through which many Australians purchase one of the most significant assets they will own. Lending practices in relation to home loans are therefore of critical importance to the financial well-being of Australian consumers. Addressing poor lending practices helps ASIC promote investor and financial consumer trust and confidence, which is one of our strategic priorities.

5 Interest-only home loans have grown substantially since 2012. In the December 2014 quarter, the total value of new interest-only home loans issued by banks, credit unions and building societies expanded to $40.1 billion. Interest-only home loans accounted for 43% of all new home loans issued in that quarter. In the March 2015 quarter, interest-only home lending had increased almost 20% from the previous year, and made up around 42% of all new home loans issued in that quarter.

6 In the current environment of low interest rates and strong demand for housing, it is important that credit licensees make robust assessments of the capacity of consumers to make the required repayments, with appropriate buffers in place to account for higher interest rates in the future. It is also important that the length of an interest-only period of a loan is suitable for the consumer in both the short and long term.

7 A key difference between interest-only and principal-and-interest home loans is their overall cost, with interest-only home loans being more expensive in the long term: see Figure 1. The use of an interest-only home loan means that a consumer is in practice trading the benefit of lower repayments during the initial interest-only period (including the possible alternative use of money saved in this way) for a higher total cost.

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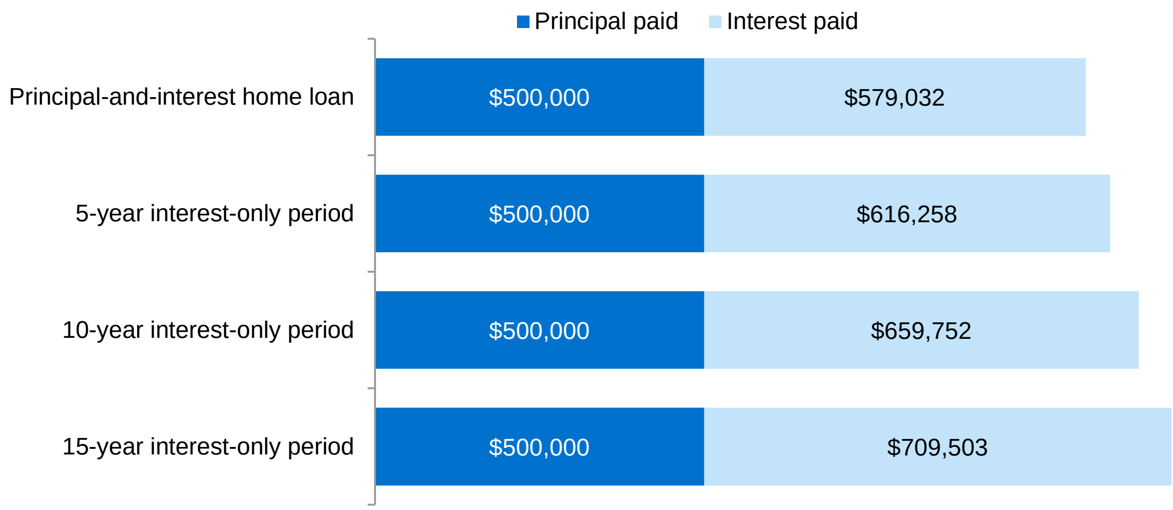
Figure 1: Comparison of interest payments on principal-and-interest and interest-only home loans[1]



Source: Based on a $500,000 home loan over 30 years. Assumes constant interest rate of 6%. Monthly repayment figures determined using the MoneySmart mortgage calculator. Interest is calculated by compounding on the same frequency as the repayment (monthly).

8 In July 2010 the *National Consumer Credit Protection Act 2009* (National Credit Act) introduced responsible lending obligations for lenders and credit assistance providers. Among the responsible lending obligations is the requirement for lenders and credit assistance providers to make reasonable inquiries and verifications to assess whether a contract would be unsuitable for a consumer.

9 These obligations commenced on 1 July 2010 for credit assistance providers and credit providers that are not authorised deposit-taking institutions (ADIs) or registrable corporations, and on 1 January 2011 for all other credit providers and credit assistance providers. We have issued guidance in Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209), and continue to monitor lending practices and take regulatory action where non-compliance has been observed.

Purpose of ASIC's review

10 The purpose of our review was to improve responsible lending standards, for both interest-only home loans and consumer loans more generally, by highlighting issues with current practices observed across a sample of lenders.

11 While consumers may generally be well placed to meet their repayments on an interest-only home loan in the current environment, they may find it challenging when market conditions change, which is inevitable over the full term of a home loan. The Reserve Bank of Australia (RBA) has noted that

[1] All graphs in this report are based on data collected in our survey, unless otherwise noted.

the recent decline in home loan interest rates can be expected to boost demand for housing further, and will also make it easier for existing borrowers to service their debts.[2] The RBA also found that indicators of household stress are currently at low levels, but that they could increase if labour market conditions weaken further than currently envisaged.[3]

12 Accurately assessing a consumer's ability to service and ultimately to repay a loan without hardship, including under periods of economic stress, is an inherent component of sound credit risk management, particularly for home loans.[4] The Australian Prudential Regulation Authority (APRA) announced on 9 December 2014 that it had written to all ADIs to set out plans for a heightened level of supervisory oversight on home lending for the period ahead.[5] This message was emphasised by the Chairman of APRA in a recent speech.[6]

13 We monitor lenders' compliance with the responsible lending obligations under the National Credit Act when providing home loans regulated by that Act. These obligations require lenders to offer credit products only when the consumer can meet the repayments without substantial hardship and the proposed product meets their requirements and objectives. Under the National Credit Act, credit licensees must:

(a) make reasonable inquiries about a consumer's requirements and objectives;

(b) make reasonable inquiries about a consumer's financial situation; and

(c) take reasonable steps to verify the consumer's financial situation.

When we observe non-compliance with responsible lending, we will take regulatory action.

14 Against this background, we commenced a detailed review of the interest-only home lending market to assess compliance with the responsible lending obligations. The review complements action taken by other regulators.

15 The review involved two aspects:

(a) We collected data on the market for interest-only home loans for the last three years—2012, 2013 and 2014—from 11 lenders, broken down by criteria such as consumer demographics, loan-to-valuation ratios (LVRs) and distribution channels.

(b) Concurrently, we also conducted a thorough review of over 140 individual interest-only home loan files from the same 11 lenders.

[2] RBA, *Financial Stability Review* (PDF, 1.2M), March 2015, p. 2.
[3] RBA, *Financial Stability Review* (PDF, 1.2M), March 2015, p. 39.
[4] Prudential Practice Guide APG 223 *Residential mortgage lending*. See also Financial Stability Board, *FSB Principles for Sound Residential Mortgage Underwriting Practices* (PDF, 79.14Kb), April 2012.
[5] APRA, *APRA outlines further steps to reinforce sound residential mortgage lending practices*, Media Release No. 14.30, 9 December 2014.
[6] W Byres, 'Sound lending standards and adequate capital: preconditions for long-term success', speech to COBA CEO and Director Forum, Sydney, 13 May 2015.

16 Further information about the methodology of this review is detailed in the appendix.

17 Addressing poor responsible lending practices will reduce the risk of excessive or unnecessary defaults by consumers in the home lending market, and will result in consumers obtaining a home loan product that is more likely to meet their needs.

Data review findings

18 We conducted a review for the three-year period 2012–14 of 11 lenders. The review provided data on the market for interest-only home loans, including analysis of the types of consumers who use these loans. Differences observed in the data between interest-only and principal-and-interest home loans for an individual lender, or between different lenders, can give an indication of areas warranting further exploration or assessment.

19 Our key findings from the data review were:

(a) The majority of interest-only home loans were extended to investors; however, a substantial proportion of interest-only home loan approvals (41% in the December 2014 quarter) were for owner-occupiers.[7]

(b) A greater proportion of the total number of interest-only home loans was sold through third-party or broker channels, compared to direct channels (see Figure 6).

(c) The average value of interest-only home loans was substantially higher than principal-and-interest home loans for both owner-occupiers and investors (see Figure 7), and this was especially so for loans provided through direct channels in comparison with third-party channels.

(d) Overall, there was a smaller proportion of interest-only home loans in higher LVR categories when compared to principal-and-interest home loans (see Figure 10).

(e) A diverse group of consumers tended to take out interest-only home loans. In general, interest-only home loans were more popular with consumers who earned more money, but a substantial proportion (29%) of owner-occupiers with interest-only home loans earned less than $100,000 (see Figure 11).

(f) Consumers with interest-only home loans were, on average, further ahead in reducing the balance of their loan when including funds held in offset accounts related to the home loan, than those with principal-and-interest home loans.

[7] This is consistent with data collected by APRA from all ADIs.

Key findings—Responsible lending

20 Our review identified some practices where lenders may be at risk of not complying with their responsible lending obligations. In particular, we found that:

(a) in 40% of the files reviewed, the affordability calculations assumed the borrower had longer to repay the principal on the loan than they actually did (by using the full term of the loan to calculate principal repayments, rather than the residual term);

(b) in over 30% of files reviewed, there was no evidence that the lender had considered whether the interest-only home loan met the borrower's requirements; and

(c) in over 20% of files reviewed, lenders had not considered the borrower's actual living expenses when approving the loan, but relied instead on expense benchmarks.

21 Sections B–G of this report detail the practices we reviewed and our assessment of how they meet the responsible lending obligations under the National Credit Act, and set out our key findings in this area.

22 We identify where lenders may be at risk of not complying with their obligations and suggest various actions lenders should take, including more robust compliance processes. RG 209 sets out our expectations about the procedures lenders should have in place to ensure they are complying with the responsible lending obligations.

23 The findings in Sections B–G relate to both the data provided in response to our survey and the file reviews we conducted. The case studies are based on examples of lender conduct identified through the file reviews.

24 In relation to the obligation to make reasonable inquiries about a consumer's requirements and objectives, our key findings were that:

(a) only a few lenders had procedures to consistently identify and record the consumer's requirements and objectives; and

(b) even where the consumer's requirements and objectives were recorded, the stated analysis could be inadequate to explain why a loan on the terms provided was suitable for the consumer.

25 For example, we reviewed numerous files where the stated requirement or objective of the consumer was 'to purchase a property', with no information stating the reason an interest-only home loan had been selected. Statements of this type do not support the decision to provide an interest-only home loan rather than another type of loan, and are inadequate as they suggest that the consumer did not have any requirements or objectives for the loan itself or the features or terms on which it was offered.

26 Credit licensees also have an obligation to ensure the consumer can afford repayments under a proposed loan. The obligation requires credit licensees to understand the consumer's individual financial situation, particularly their income and expenditure. We found that lenders were using the following practices (which, in our view, makes it unlikely they were complying with their obligations):

(a) *Relying on an expenditure benchmark*—Some lenders relied on a benchmark rather than conducting inquiries into the consumer's actual expenses.

(b) *Ignoring information provided by the consumer*—Three lenders stated that they always used an expenditure benchmark when assessing the consumer's ability to service the loan, even when the consumer's declared expenses were higher than the benchmark.

(c) *Requesting information about expenses in a way that was simplistic or ambiguous*—Some lenders asked consumers to state their expenses as a lump sum, or to only state their basic expenses, without any explanation as to what was meant by 'basic'. We consider these approaches may result in lenders not obtaining accurate information.

27 In general, we consider that the obligation to make reasonable inquiries is scalable. What a credit licensee needs to do to meet these obligations for a particular consumer will vary depending on the circumstances. We would expect that credit licensees would make many, if not all, of the inquiries in RG 209.33, as entering into an unsuitable home loan can have a potentially large negative financial impact on a consumer.

28 More extensive inquiries are likely to be necessary if the potential negative impact of an unsuitable credit contact is likely to be relatively serious for the consumer. This would include situations where the consumer's income is relatively low, and they would therefore have a more limited capacity to change their spending patterns than consumers on higher incomes, or where the size of a loan is large relative to the consumer's income.

29 We also found that lenders had poor and inconsistent practices for recording inquiries into the consumer's requirements, objectives and financial situation. Where lenders do not have appropriate processes in place to capture this information, it can be difficult for them to show that they are in fact meeting their responsible lending obligations: see RG 209.38.

Recommended actions and lender responses

30 We were disappointed to observe that the practices of many lenders appeared to fall short of our expectations, which are detailed in RG 209 and previous responsible lending reports.

31 Table 1 sets out our key findings and suggests actions credit licensees should take to reduce their risk of non-compliance with the responsible lending obligations. During the course of this review, all lenders advised us that they intend to change, or have already commenced the process of changing, their practices in this area. For example:

(a) all lenders (in addition to the four who already use this method) have committed to move to assessing interest-only home loans using the 'residual term' method of calculating repayments;[8]

(b) all lenders (in addition to the one who introduced this practice in December 2014) have committed to moving to use an income-adjusted benchmark when considering a consumer's expenses; and

(c) most lenders who offered longer interest-only periods have committed to reducing the maximum interest-only period offered to owner-occupiers to five years.

32 While these actions result from our review of interest-only home loans, some will have a broader application to other credit products, where they address practices that are not specific to interest-only home loans. All lenders and brokers should consider the extent to which these actions are relevant to their practices and conduct, to ensure they are compliant with RG 209.

[8] See paragraph 247(a) for an explanation of the 'residual term' method.

Table 1: Responsible lending key findings and actions

Section	Finding	Action
B	**Finding 1: Lack of evidence of inquiries into requirements and objectives** Nearly all lenders in our review did not keep sufficient evidence of inquiries into consumer's requirements and objectives when entering an interest-only home loan. While requirements and objectives for an interest-only home loan may be more apparent for investors, it is not always clear how an interest-only home loan meets the requirements of an owner-occupier.	**Action 1** To comply with responsible lending obligations, lenders should ensure that they make reasonable inquiries into a consumer's requirements and objectives and document the result of these inquiries. For interest-only home loans, lenders should consider whether specific features, benefits and costs associated with the loan (including, when refinancing a loan, the benefits and costs of the new loan) meet the consumer's objectives. **Action 2** To comply with responsible lending obligations, lenders should ensure that the period of interest-only repayments offered on a proposed loan is aligned with the particular consumer's requirements and objectives. We encourage lenders to review their policies regarding the maximum length of interest-only periods offered, particularly to owner-occupiers. Interest-only periods greater than five years for owner-occupiers will be at high risk of non-compliance with the responsible lending obligations unless there is clear demonstration that the length of the interest-only period is aligned with that particular consumer's requirements and objectives.
C	**Finding 2: Affordability and interest-only home loans** Lenders did not always ensure that the consumer had sufficient income (i.e. an appropriate income surplus) above their expenses and loan repayments, so that they could withstand a reasonable fluctuation in income or expenses or an interest rate rise. There was substantial variation in how lenders applied interest rate buffers. Some lenders applied a buffer to the proposed loan only and not to existing debt that may also be affected by interest rate rises.	**Action 3** To comply with their responsible lending obligations, lenders should ensure adequate policies and processes are in place to assess a consumer's ability to meet their financial obligations under the credit contract, including reasonable consideration of the effect of future interest rate rises on the proposed credit contract and existing credit contracts.

Section	Finding	Action
D	**Finding 3: Variation in treatment of volatile and irregular income** There is variation between how lenders treat volatile and irregular income sources. We found examples in the file reviews of the higher income figure being used for serviceability assessments where there was a substantial difference between previous years' incomes. Rental income is typically discounted by 20% to allow for property expenses and periods of non-occupancy. However, we saw examples in the file reviews where the property-related expenses would likely be greater than 20% of rental income.	**Action 4** Where consumers have uncertain, volatile or irregular income, lenders should: • review their policies for how they assess volatile or irregular income sources to ensure they meet the responsible lending obligations and ensure prudent credit risk management; • appropriately discount or disregard high or volatile income where there is uncertainty that the income would be likely to continue at the same level; • for rental income, ensure the level of discounting is sufficient to allow for property expenses, including maintenance, strata fees, managing agent fees and periods of non-occupancy; and • where they have a policy of using a negative gearing benefit in serviceability calculations, ensure it is consistent with the inquiry and verification obligations under the National Credit Act, taking into account that individual consumer's income, financial circumstances and objectives. To demonstrate compliance with the responsible lending obligations, lenders should record the inquiries they make and the basis on which they have adopted the relevant income figure to assess a consumer's capacity to meet their financial obligations under the credit contract.

Section	Finding	Action
E	**Finding 4: Lack of evidence of inquiries into expenses and reliance on benchmarks** We found that, in general, lenders did not demonstrate that they had made sufficient inquiries into a consumer's expenses and relied heavily on expense benchmarks to estimate living expenses. Expense benchmarks are not a replacement for proper inquiries into a consumer's actual expenses.	**Action 5** Lenders must make reasonable inquiries into a consumer's actual expenses, including both fixed expenses (such as rent, repayment of existing debts and child support, and recurring expenses such as insurance) and living expenses (such as food and utilities). Lenders must also take reasonable steps to verify the information obtained. To demonstrate that they have met their responsible lending obligations, lenders must document the inquiries and verification undertaken. **Action 6** Where lenders rely on benchmarks to verify a consumer's living expenses, lenders can reduce their risk of non-compliance with the responsible lending obligations by using income-adjusted benchmarks (reflecting the reality that higher-income consumers generally have higher living expenses). If a consumer's actual living expenses are higher than the benchmark, lenders must not use the lower benchmark figure in the serviceability calculation unless there are reasonable (and documented) grounds for doing so. **Action 7** Lenders should take reasonable steps to verify the amount of existing debt and the repayment amounts that the consumer is committed to. **Action 8** Lenders should take steps to identify inconsistencies in information provided by consumers and make further inquiries to accurately assess the affordability of the proposed loan. The outcome of any additional steps taken should be documented.

Section	Finding	Action
F	**Finding 5: Capacity to pay after interest-only period not based on residual-term payments** A number of lenders calculated affordability using repayments that are artificially low, as they are based on principal-and-interest repayments being made over the full term of the loan, rather than the residual term remaining after the interest-only period. This practice increases the risk to borrowers with longer interest-only periods.	**Action 9** Lenders should review their methodology for assessing the affordability of interest-only home loans to ensure it complies with the responsible lending obligations. Lenders should assess a consumer's capacity to make the principal-and-interest repayments over the residual term of the loan (after the interest-only period lapses), as this will better reflect a consumer's ability to meet their financial obligations under an interest-only home loan.
G	**Finding 6: Lack of flexibility for hardship variations for interest-only home loans** We found that financial hardship policies for most lenders did not distinguish between interest-only and principal-and-interest home loans. However, a small number of lenders applied more restrictive options for borrowers seeking hardship variations under an interest-only home loan.	**Action 10** Lenders should: • review their systems, policies and processes for hardship variations for interest-only home loans; • have a variety of options available to consumers who are in financial hardship; and • assess the most appropriate outcome of a hardship application on a case-by-case basis.

Note: All lenders in this review have agreed to implement these actions.

Lessons for consumers

33 Consumers should carefully consider whether an interest-only home loan is suitable for them and assess whether they will be able to comfortably meet the higher repayments once the loan reverts to principal-and-interest repayments. When considering their requirements and objectives, consumers should take into account that, in the long term, they will pay more interest under an interest-only home loan.

34 Consumers may take out interest-only home loans to take advantage of the flexibility around repayments. However, overconfidence bias (see paragraph 111(b)) may result in consumers overestimating their own future behaviour and likelihood of making additional repayments. In light of this, consumers may wish to consider whether a principal-and-interest home loan would better suit their objectives.

35 When refinancing, consumers should specifically consider the benefits of the new loan in comparison to the old loan, such as savings in cost. If refinancing from one interest-only home loan to a new interest-only home loan, a consumer should consider the effect of the cumulative period of interest-only repayments on their level of equity in the relevant property, and the higher amount of interest that will be paid under an interest-only home loan.

Our further work

36 We identified a number of areas where the surveyed lenders may not have been complying with their statutory responsible lending obligations. We are currently undertaking further surveillance, enforcement and other regulatory action in these areas, which will be made public at a later date.

37 While all of the 11 surveyed lenders have either made or committed to making changes to their procedures, we are concerned that other lenders may have practices with similar shortcomings, and are therefore failing to meet the responsible lending obligations.

38 We expect all lenders to review their procedures in light of our findings to ensure they are meeting their obligations. RG 209 and our other work in this area has set out clear guidance and we consider that lenders have had ample opportunity to ensure their practices are compliant.

39 Where we identify breaches of the law, we will consider enforcement action or other appropriate regulatory action.

40 We have updated our consumer information on our MoneySmart website (moneysmart.gov.au) to help consumers make decisions about their home loan and highlight important things to consider when deciding between interest-only and principal-and-interest home loans.

41 We will continue to monitor and assess lending standards of licensees and compliance with the responsible lending obligations more generally (in addition to interest-only home loans). We will also continue to work with other members of the Council of Financial Regulators in the area of home lending.

A Interest-only home lending environment

Key points

This section sets out the regulatory framework that applies to interest-only home loans. It reports findings on the industry profile and trends in interest-only home lending that have been formed from analysis of our survey.[9] This survey data complements data from APRA on the growth of interest-only home loans, and provides information about this lending at a more granular level.

There has been substantial growth (by number and value) of interest-only home loans approved for both investors and owner-occupiers. The total value of new interest-only home loans approved by ADIs accounted for around 42% of all new home loans issued in the March 2015 quarter.

The majority of interest-only home loans are extended to investors; however, a substantial proportion of interest-only home loans (41% of the total number of new loans approved in the December 2014 quarter) are with owner-occupiers.

A greater proportion of the total number of interest-only home loans is sold through third-party channels, compared to direct channels.

The average value of interest-only home loan amounts is substantially higher than that for principal-and-interest home loans for both owner-occupiers and investors. The extent of the differential is greater through direct channels than third-party channels.

Overall, there were a smaller proportion of interest-only home loans in higher LVR categories when compared to principal-and-interest home loans.

The demographics of consumers taking out interest-only home loans are diverse. Consumers' motivations concentrate around flexibility of repayment and taxation treatment for investment, but may also be influenced by behavioural factors.

The regulatory framework

Regulatory bodies

42 A number of regulatory bodies are responsible for the regulation of the home lending industry. These bodies work together to maintain appropriate lending standards relating to home lending.

[9] For further information on the survey methodology, see the appendix.

RBA

43 The RBA is responsible for the stability of the Australian financial system. It is also responsible for monetary policy, which involves setting the cash rate to meet an agreed medium-term inflation target. It regularly provides public commentary on the state of the economy and on factors affecting financial stability, including those in the home lending sector.

APRA

44 APRA is responsible for the prudential regulation of banks, credit unions, building societies, insurers and superannuation entities. It establishes and enforces prudential standards to ensure that financial promises made by institutions are met. In the home lending sector, this includes reviewing lenders' home loan approval standards, as well as developing guidelines for prudent lending practice. APRA sets out its expectations on sound risk management practices for home lending in Prudential Practice Guide APG 223 *Residential mortgage lending*.

45 APRA announced on 9 December 2014 that it had written to all ADIs to set out plans for a heightened level of supervisory oversight on mortgage lending for the period ahead. This message was emphasised by the Chairman of APRA in a recent speech.[10]

ASIC

46 We are the primary conduct regulator for markets, financial services and consumer credit. This entails ensuring industry compliance with the consumer protection provisions of the *Australian Securities and Investments Commission Act 2001*, which prohibit misleading and unconscionable conduct, as well as the more specific licensing and responsible lending obligations for lenders and mortgage brokers under the National Credit Act.

National Credit Act

47 The National Credit Act commenced in 2010 and introduced licensing requirements, general conduct obligations and responsible lending obligations for both lenders and mortgage brokers. The introduction of these credit reforms led to improvements in industry practice.

48 We have published specific guidance for industry regarding our expectations about compliance with the responsible lending obligations: see RG 209.

49 The responsible lending obligations require credit licensees to ensure that consumers:

(a) do not enter loans that do not meet their requirements and objectives; or

[10] W Byres, 'Sound lending standards and adequate capital: preconditions for long-term success', speech to COBA CEO and Director Forum, Sydney, 13 May 2015.

(b) could not meet their repayment obligations, or could only meet them with substantial hardship.

50 In doing this, credit licensees must make reasonable inquiries into an individual consumer's specific circumstances and take reasonable steps to verify their financial situation before making an assessment about their capacity to repay the loan.

51 We continue to monitor responsible lending practices across the credit industry, including in relation to home loans.

Industry profile

Overview of interest-only home loans

52 Interest-only home loans are offered by many ADI lenders and non-ADI lenders to purchase property, to refinance a home loan or for investment purposes secured against property. An interest-only home loan is a loan where, for a set term, the consumer is only required to pay the interest on the principal balance, with the principal amount remaining constant. The principal will only reduce during the interest-only period of the loan term if the borrower chooses to make repayments above the required minimum.

53 An interest-only home loan will normally revert to principal-and-interest repayments at the expiry of the interest-only period. Practically this means that the borrower will either:

(a) increase their repayments to pay off the principal over the residual term;

(b) repay the loan in full; or

(c) refinance the loan (which may include entering another interest-only home loan).

54 The structure of these loans means that, for a given loan size and interest rate, repayment amounts are initially lower on an interest-only home loan than on a principal-and-interest home loan. However, after the interest-only period ends, the repayment amount will increase in order to repay the principal over the residual term.

55 In the current interest rate environment, the difference between an interest-only repayment and a principal-and-interest repayment is substantial. With low interest rates, loan repayments are minimised through the use of interest-only home loans, but if a consumer does not make additional repayments, or use an offset account, the amount paid over the long term will be greater.

56 Interest-only home loans can be combined with an offset account. Consumers may use this account to make additional repayments that may have otherwise been made to a principal-and-interest home loan. Although

many loans will offer a redraw facility, consumers may prefer to use an offset account to make those funds available for another purpose while still reducing the interest payable on the loan.

57 As described at paragraphs 106–113, there are a variety of reasons that consumers, both investors and owner-occupiers, may choose to take out interest-only home loans.

Growth in lending

58 Over the past three years, the value of new home loans approved by banks, credit unions and building societies per quarter has increased by more than 40% in Australia—from $58.4 billion in the March 2012 quarter to $82.3 billion in the March 2015 quarter.[11] In the March 2015 quarter, around 63% of new home loans (by value) were for owner-occupiers, and around 37% were for investors.

Growth of interest-only home loans

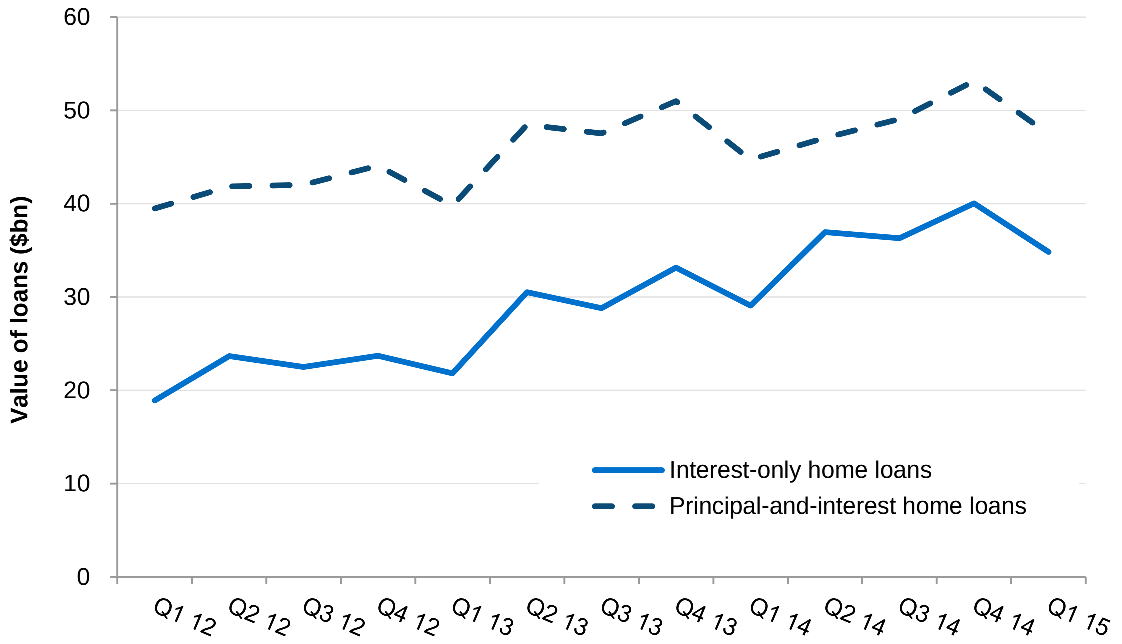
59 The value of new interest-only home loans approved by banks, credit unions and building societies expanded by about 10% from the previous quarter (to $40.1 billion) in the December 2014 quarter. Data collected by APRA shows that new interest-only home loans accounted for around 43% of all home loans issued in that quarter, which was the highest rate recorded to date.[12]

60 In the March 2015 quarter, interest-only home lending for ADIs had increased almost 20% from the equivalent quarter in 2014, and made up around 42% of all new home loans issued in that period.[13] By value, interest-only home lending forms about 37% of housing debt (as at March 2015).[14]

61 There has been substantial growth in interest-only home lending since 2012. Data collected by APRA shows that the value of interest-only home loans approved by ADIs increased by about 84% from the March 2012 quarter ($18.9 billion) to the March 2015 quarter ($34.8 billion). In comparison, principal-and-interest home lending increased by about 20% over the same period: see Figure 2.[15]

[11] APRA, *Quarterly authorised deposit-taking institution property exposures: March 2015* (Excel file, 362kb), statistics, 26 May 2015, Tab 1c.
[12] APRA, *Quarterly authorised deposit-taking institution property exposures: December 2014*, statistics, 24 February 2015.
[13] APRA, *Quarterly authorised deposit-taking institution property exposures: March 2015* (Excel file, 362kb), statistics, 26 May 2015, Tab 1c.
[14] APRA, *Quarterly authorised deposit-taking institution property exposures: March 2015* (PDF file, 695kb), statistics, 26 May 2015, p. 7.
[15] APRA, *Quarterly authorised deposit-taking institution property exposures: March 2015* (Excel file, 362kb), statistics, 26 May 2015, Tab 1c.

Figure 2: Growth in interest-only home loans amongst ADI lenders—2012–15 (new loans approved)



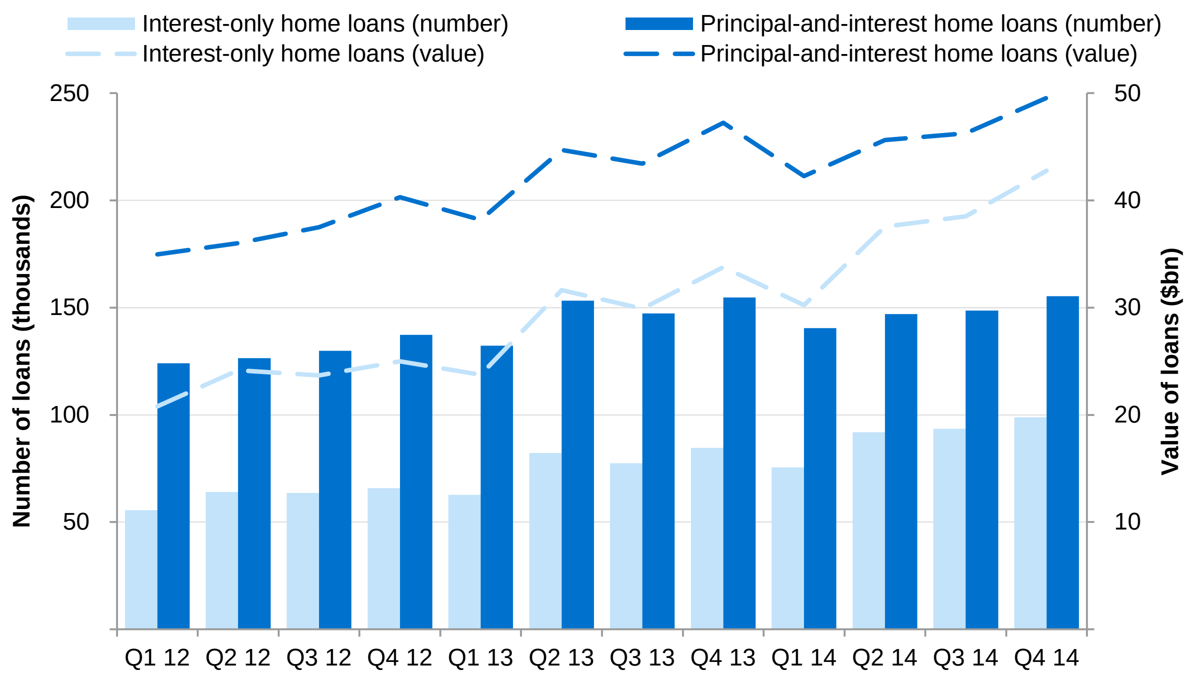
Source: APRA, *Quarterly authorised deposit-taking institution property exposures: March 2015* (Excel file, 362kb), Tab 1c.

62 In comparison, across the 11 lenders we surveyed:

(a) the number of interest-only home loans approved has increased more than 78% since 2012, while the number of principal-and-interest home loans has increased by 25% for the same period; and

(b) interest-only home loans approved in the December 2014 quarter accounted for more than 46% of the total value of new home loans, up from 37% in the March 2012 quarter.

Figure 3: Growth in number and value of interest-only and principal-and-interest home loans—2012–14 (new loans approved)

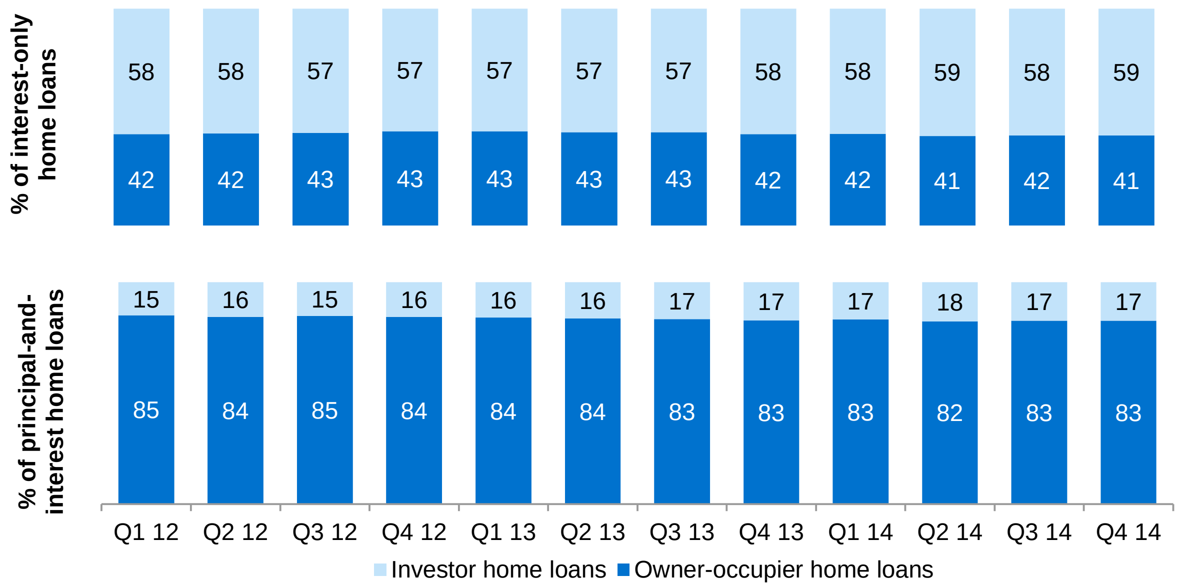


Owner-occupiers and investors

63 While the majority of interest-only home loans are extended to investors, interest-only home loans have become increasingly popular with owner-occupiers. While interest-only borrowing by investors may primarily reflect wealth-building strategies, including the tax-deductible status of interest payments for investment loans, the drivers of the strong growth for owner-occupiers are less clear.

64 Data from our survey shows, however, that the proportion (by number) of interest-only home loans approved for investors and owner-occupiers was relatively stable during 2012–14: see Figure 4. This shows that growth by number of interest-only home loans is broadly similar for both types of consumers.

Figure 4: Proportion of interest-only and principal-and-interest home loans held by owner-occupiers and investors—2012–14 (new loans approved)[16]



Lines of credit

65 A line of credit is a type of credit facility offered by some lenders. A line of credit differs from a conventional home loan in that the borrower does not draw down the whole principal amount initially, but uses the line of credit to borrow amounts up to the agreed credit limit, similar to a credit card. Interest is added to the loan each month and generally the consumer is only required to make minimum interest-only repayments on the credit used.

[16] We note that there were some data quality issues in the way that some lenders recorded owner-occupier and investor loans. However, we expect that the broad trends would not be affected substantially.

66 The borrower may at any time elect to make a repayment of any amount up to the total amount outstanding. Lines of credit can allow consumers to use a single account to combine their home loan and everyday spending.

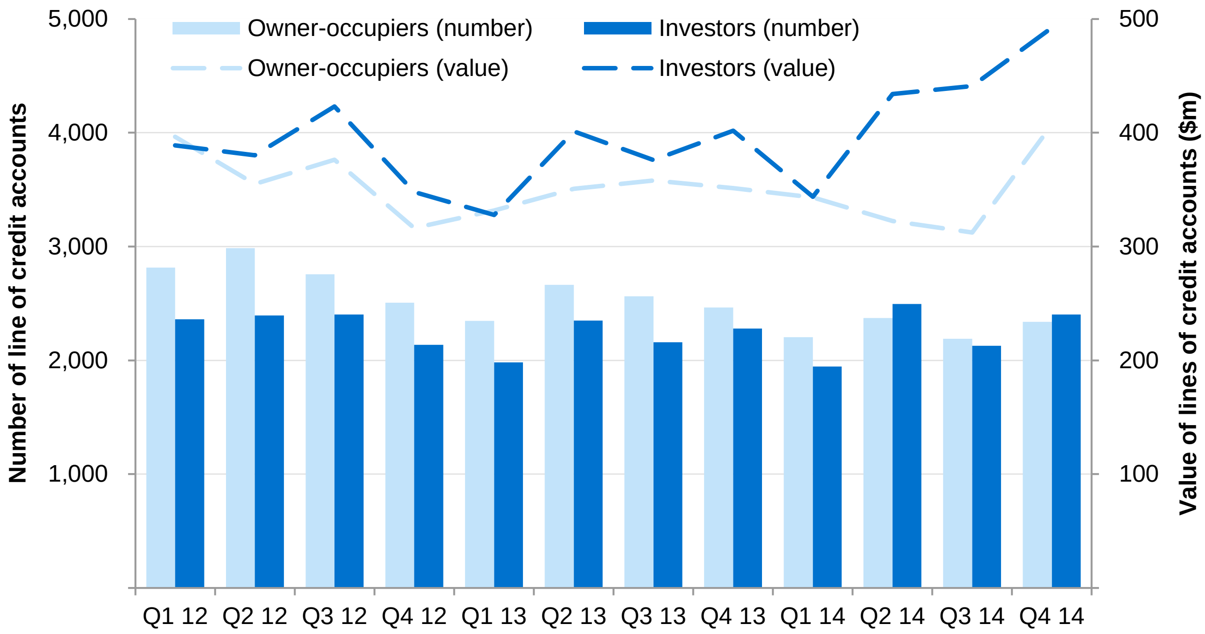
67 Some lenders reported to us anecdotally that interest-only home loans were increasing due to consumers moving from the higher cost lines of credit into the cheaper alternative of interest-only home loans. In effect, borrowers are able to manage their finances in the same way as a line of credit, by utilising an interest-only home loan combined with an offset account.

68 While there has been a reduction in the number of line of credit accounts being approved by the surveyed lenders, this has mostly occurred for owner-occupiers. Additionally, the decrease in owner-occupier line of credit accounts (as a proportion of all approved home loans) has been smaller than the increase in interest-only home loans for owner-occupiers over the same period. Lines of credit for investors have remained largely stable in account numbers, and have increased in value: see Figure 5.

69 While the number of new line of credit account approvals for both owner-occupiers and investors appear to have fluctuated somewhat each quarter during 2012–14, this may be driven somewhat by seasonality.

70 Additionally, we note that the value of new investor line of credit accounts per quarter increased over 2014 from $400 million to $490 million (an increase of more than 20%).

Figure 5: Number and value of new line of credit accounts approved for owner-occupiers and investors—2012–14



Note: This graph is based on nine of the lenders we surveyed. Two of the lenders did not appear to issue line of credit accounts.

Current state of the interest-only home loan market

Sales channels

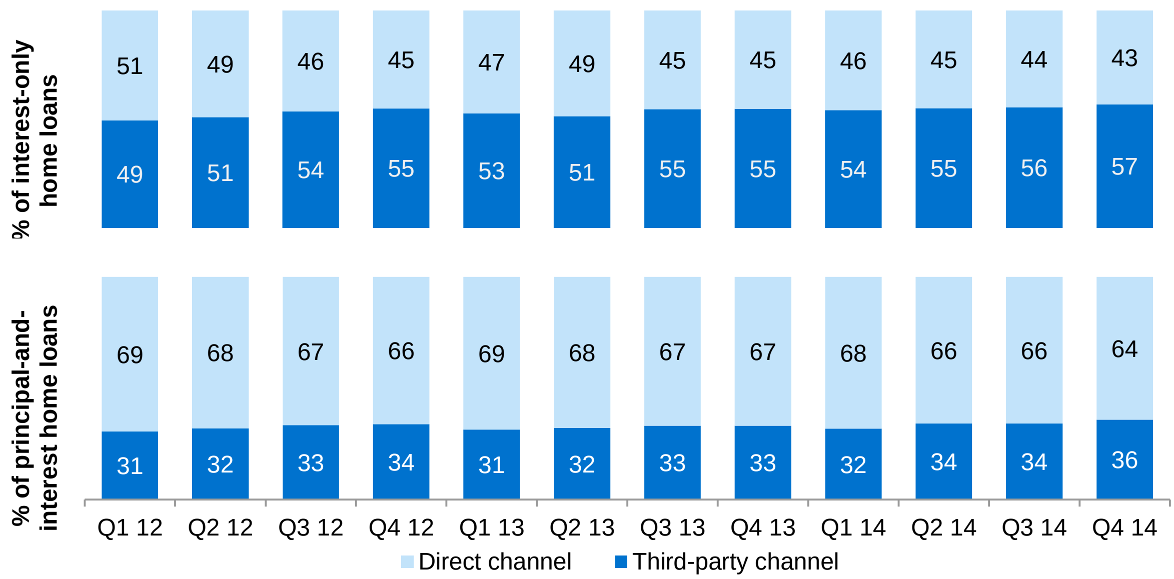
71 Across the surveyed lenders, we found that a greater proportion of interest-only home loans (by number) were sold through third-party channels, compared to direct channels. This indicates that brokers may be one driver of the increase of interest-only home loans.

72 We found that for the surveyed lenders:

(a) in the December 2014 quarter, 57% of the total number of interest-only home loans were sold through third-party channels (up from 49% in the March 2012 quarter); and

(b) approximately a third of all principal-and-interest home loans were sold through third-party channels, with the majority of loans (64%) sold through direct channels in the December 2014 quarter (see Figure 6).

Figure 6: Proportion of new interest-only and principal-and-interest home loans sold through direct and third-party channels—2012–14



Note: One lender did not offer third-party home loans. Another lender's data for third-party home loans is only available for 2014.

Remuneration and incentives

73 While a high proportion of interest-only home loans originate through broker channels, responses from the surveyed lenders showed that incentives or commissions paid to third-party mortgage brokers, or internally to employees, were consistent for both interest-only and principal-and-interest home loans.

74 Some lenders pay commissions to brokers on the balance of the outstanding loan, minus any amounts held in offset accounts; other lenders do not deduct offset balances from the loan amount when calculating commissions.

75 There may be some incentive for a broker to recommend an interest-only home loan, as the principal will not initially be paid down and the trail commission will be paid for a number of years on a higher balance.

76 On average, consumers borrow more under an interest-only home loan—possibly because of the lower initial repayment figure under this type of loan and the effect of ‘present bias’ (see paragraph 111(a)). This may be an incentive for brokers to recommend an interest-only home loan. Conflicts of interest could be generated because of the higher commissions paid to brokers in line with greater loan amounts.

Pricing of interest-only home loans

77 The surveyed lenders reported that there was no difference in the pricing of interest-only and principal-and-interest home loans. The only exception was certain fixed rate interest-only home loans in arrears or in advance, where the interest rate would vary from the principal-and-interest equivalent. Some lenders commented that their line of credit products were priced higher than principal-and-interest or interest-only home loans.

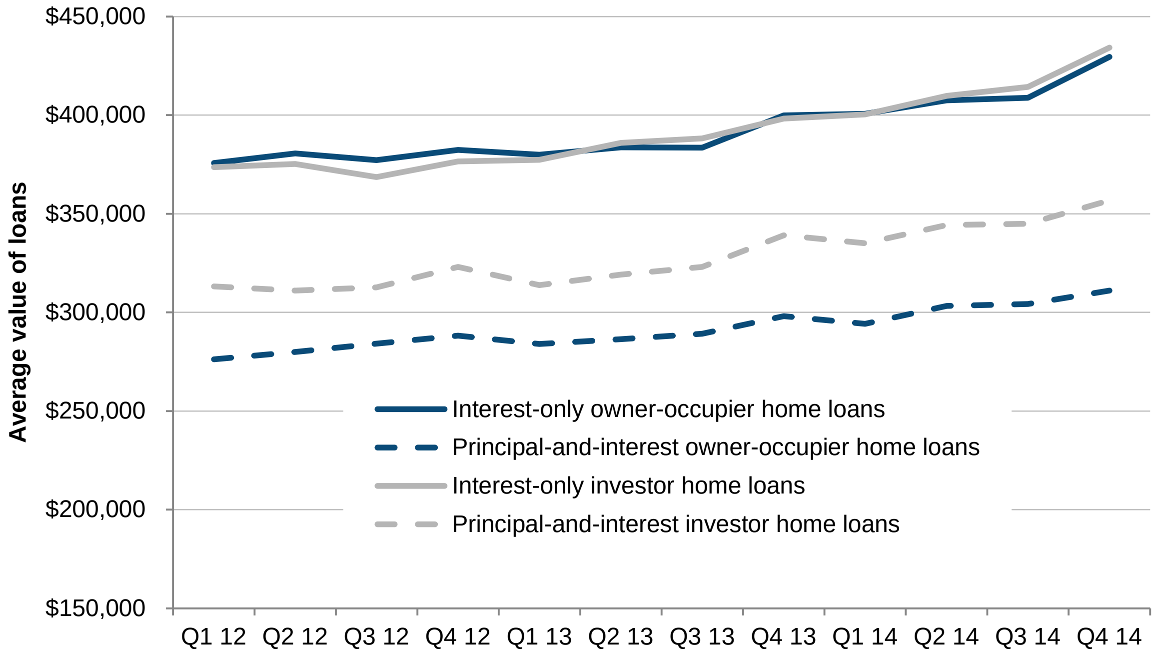
Average value of interest-only home loans

78 We found that the average value of interest-only home loans is substantially higher than that for principal-and-interest home loans, for both owner-occupiers and investors.

79 Overall, the average value of interest-only owner-occupier home loans has risen at a slightly faster rate (by 14.3% to nearly $430,000) than principal-and-interest home loans (by 12.5% to around $311,000) from the March 2012 quarter to the December 2014 quarter.

80 While the difference between the average value of interest-only and principal-and-interest home loans to investors was less than that for owner-occupiers, a substantial difference is still observed: see Figure 7.

Figure 7: Average value of interest-only and principal-and-interest home loans held by owner-occupiers and investors (at origination of loan)—2012–14



Notes: Average value calculated as the value of loans approved in the quarter for all lenders divided by the number of loans approved by all lenders in the same quarter.

81 In the December 2014 quarter, the average value of interest-only home loans approved to owner-occupiers was almost 40% higher than that of principal-and-interest home loans. For investors during the same period, the average value of interest-only home loans was over 20% higher than principal-and-interest home loans.

82 By examining sales channels, it is evident that the average value of interest-only home loans was higher than principal-and-interest home loans for both third-party and direct channels. Yet the extent of this difference was much greater for direct channel loans than for third-party channel loans.

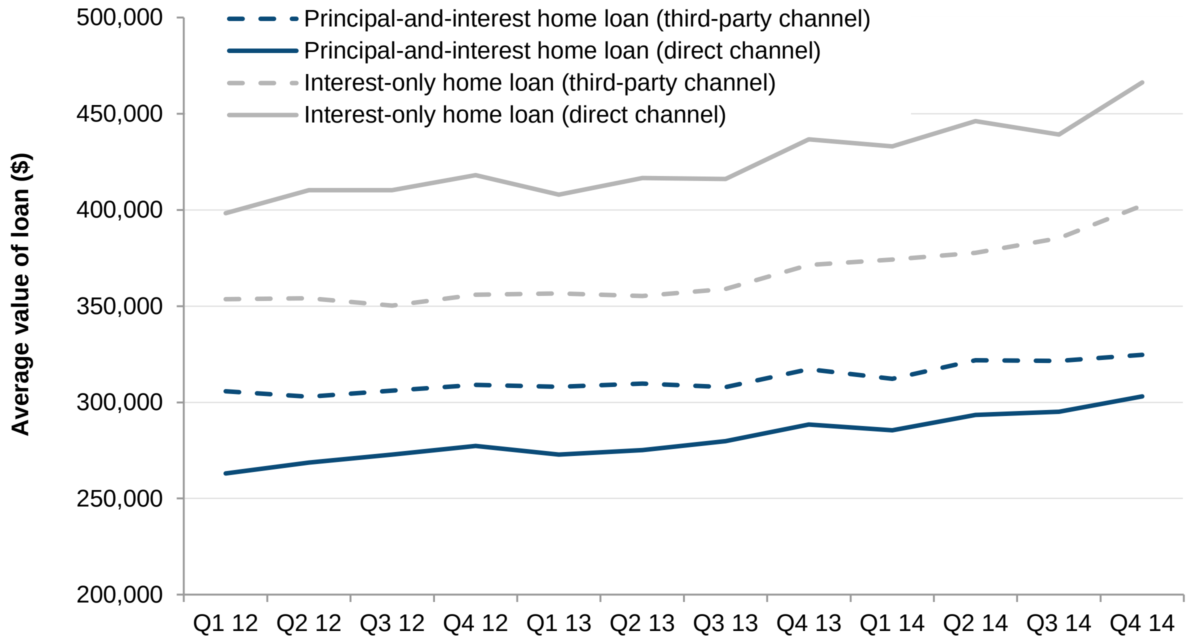
83 Among the surveyed lenders we found the following:

(a) Interest-only owner-occupier home loans from direct channels had the highest average value of all owner-occupier loan types over the survey period, with an average value of $466,000 in the December 2014 quarter (see Figure 8).

(b) While the average value of principal-and-interest owner-occupier home loans from direct channels also increased over the survey period, the increase was much smaller. This heightened the already substantial difference in average value between interest-only and principal-and-interest home loans that originated through direct channels. In the December 2014 quarter, the average value of interest-only owner-occupier home loans was over $160,000 more than the average value of principal-and-interest owner-occupier home loans for direct channels.

(c) The average value of interest-only and principal-and-interest owner-occupier home loans that originated through third-party channels also increased over the survey period, but at a slower rate than those that originated through direct channels. The difference in average value between interest-only and principal-and-interest home loans that originated through third-party channels was also less substantial, with the average value of an interest-only owner-occupier home loan approximately $75,000 more than a principal-and-interest owner-occupier home loan in the December 2014 quarter.

Figure 8: Average value of interest-only and principal-and-interest owner-occupier home loans, by channel type (at origination of loan)—2012–14

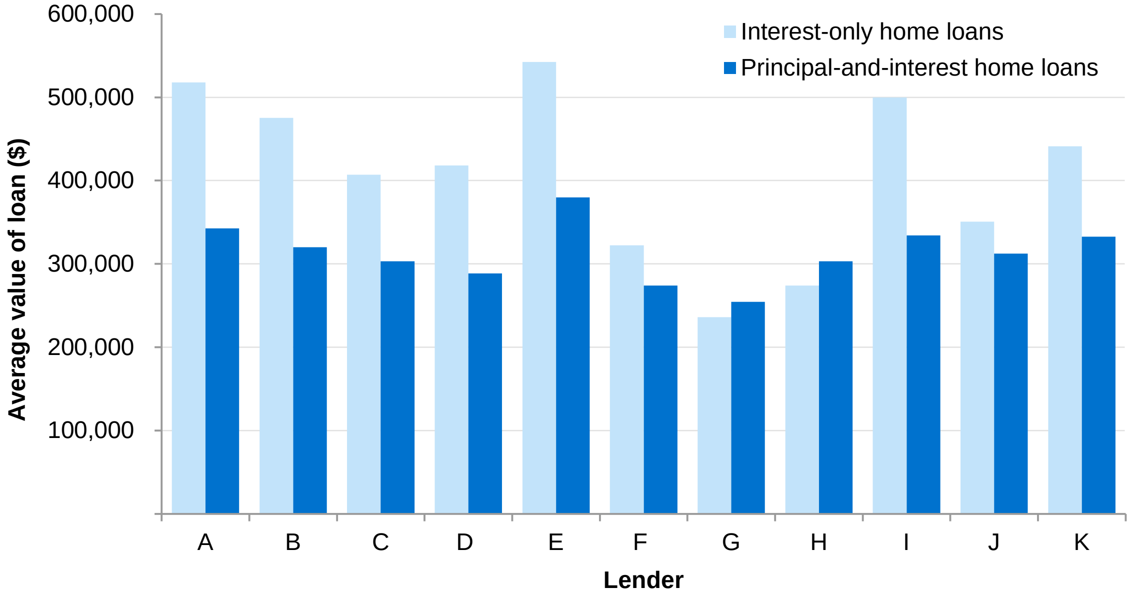


Notes: Average value calculated as the value of loans approved in the quarter for all lenders divided by the number of loans approved by all lenders in the same quarter.

Average value of interest-only home loans by lender

84 On average, the larger lenders had higher average values for interest-only owner-occupier home loans compared to principal-and-interest owner-occupier home loans in 2014. With a few exceptions, the difference in average value between interest-only and principal-and-interest home loans was much lower for small- and medium-sized lenders.

Figure 9: Average value of new interest-only and principal-and-interest owner-occupier home loans approved in the December 2014 quarter, by lender



Notes: Average value calculated as the value of loans approved divided by the number of loans approved.

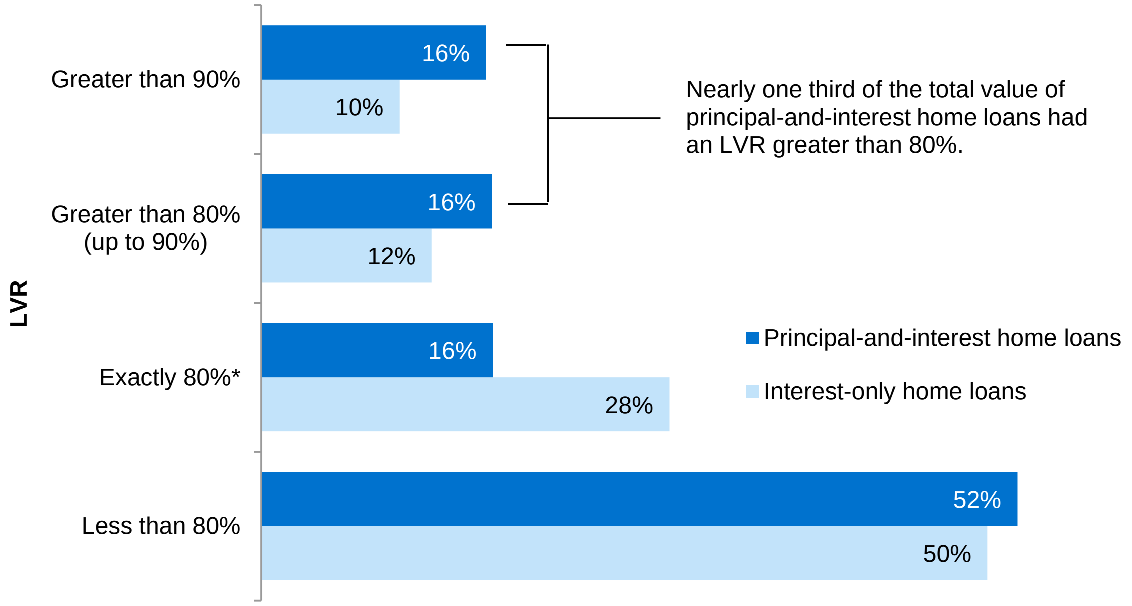
Loan-to-valuation ratios

85 Overall, the surveyed lenders reported a smaller proportion of interest-only owner-occupier home loans in higher LVR categories when compared to principal-and-interest home loans. We found that, for owner-occupiers:

(a) compared to principal-and-interest home loans, a smaller proportion of new interest-only home loans approved had an LVR above 90%—approximately 16% of the total value of new principal-and-interest home loans approved had an LVR of greater than 90%, in comparison to interest-only home loans (10%); and

(b) 78% of the total value of new interest-only home loans approved had an LVR equal to or less than 80% (see Figure 10).

Figure 10: Proportion of new interest-only and principal-and-interest owner-occupier home loans approved in the December 2014 quarter, by LVR



* Many consumers enter loans with an LVR of exactly 80% in order to borrow the maximum amount without incurring lender's mortgage insurance.

86 This pattern may reflect lender risk appetite, or the demographics and behaviour of consumers taking out interest-only home loans, or a combination of both.

Delinquency and default rates

87 We asked the surveyed lenders to provide data on delinquency rates of all outstanding interest-only and principal-and-interest home loans, for both direct and third-party channels. We found that delinquency rates were typically lower for interest-only home loans.[17]

88 Interest-only home loans that originated through third-party channels consistently had lower delinquency rates than principal-and-interest home loans from third-party channels.

89 For direct channels, delinquency rate patterns were not as consistent across the surveyed lenders. Three of the surveyed lenders had notably higher delinquency rates for interest-only owner-occupier home loans that originated through direct channels, while the remaining lenders had lower delinquency rates for interest-only home loans across the board.

90 While current delinquency rates for interest-only home loans are generally lower than principal-and-interest home loans, various factors need to be considered when assessing these results.

[17] One of the surveyed lenders was unable to extract delinquency data at this level of granularity; therefore, the data used is based on 10 lenders.

91 The increasing popularity of interest-only home loans since 2012 means that, for many consumers, their ability to meet repayments over the longer term for this type of loan is untested. For these consumers, the interest-only period (commonly the first 5–10 years) only requires repayments of the interest accruing on the loan. Once the interest-only period ends the repayment amount will increase substantially to ensure that the principal component of the loan can be repaid in the remaining loan term. At this time, there will be a greater risk of consumers having difficulty meeting their principal-and-interest repayments. This risk will be exacerbated where serviceability calculations have not included robust assessment of income and expenses and included appropriate buffers.

92 In addition, the current low-interest rate environment means that interest-only repayments are at record low rates. It is important that these consumers are able to accommodate interest rate rises and continue to service their loans in the longer term.

93 On this basis, the current delinquency rates for interest-only home loans may not accurately reflect the ability of consumers to meet repayments on an ongoing basis, and the likelihood of delinquency in the future.

94 While RBA research also found that interest-only home loans are less likely to enter arrears, they noted the fact that these loans are repaid more slowly, meaning an increase in this type of lending can represent an increase in risk to lenders.[18]

Consumer profile

95 Through this review, we sought to better understand the types of consumers who took out interest-only home loans, as well as their motivations for doing so. International research has found that financial literacy levels and levels of risk aversion can affect a consumer's choice of home loan type. Research conducted in the Netherlands found that:

(a) consumers with higher risk aversion were 97% less likely to choose interest-only home loans;

(b) consumers with higher financial literacy were 55% more likely to choose interest-only home loans;

(c) interest-only home loans were generally more likely to be chosen by wealthier and older consumers; and

(d) interest-only home loans were associated with more expensive homes and higher levels of debt.[19]

[18] M Read, C Stewart & G La Cava, *Mortgage-related financial difficulties: Evidence from Australian micro-level data* (RDP 2014-13), research discussion paper, RBA, November 2014, p. 15.
[19] R Cox, D Brounen & P Neuteboom, 'Financial literacy, risk aversion and choice of mortgage type by households', *Journal of Real Estate Finance and Economics*, vol. 42, issue 4, May 2011.

96 Through our survey, we asked questions to build a picture of consumers who were taking out interest-only home loans. Compared to the Netherlands' research, similar findings in relation to wealthier consumers and higher levels of debt were made.

Demographics of consumers taking out interest-only home loans

97 We found that a diverse group of consumers tended to take interest-only home loans, reflecting the varying reasons consumers may take out these loans.

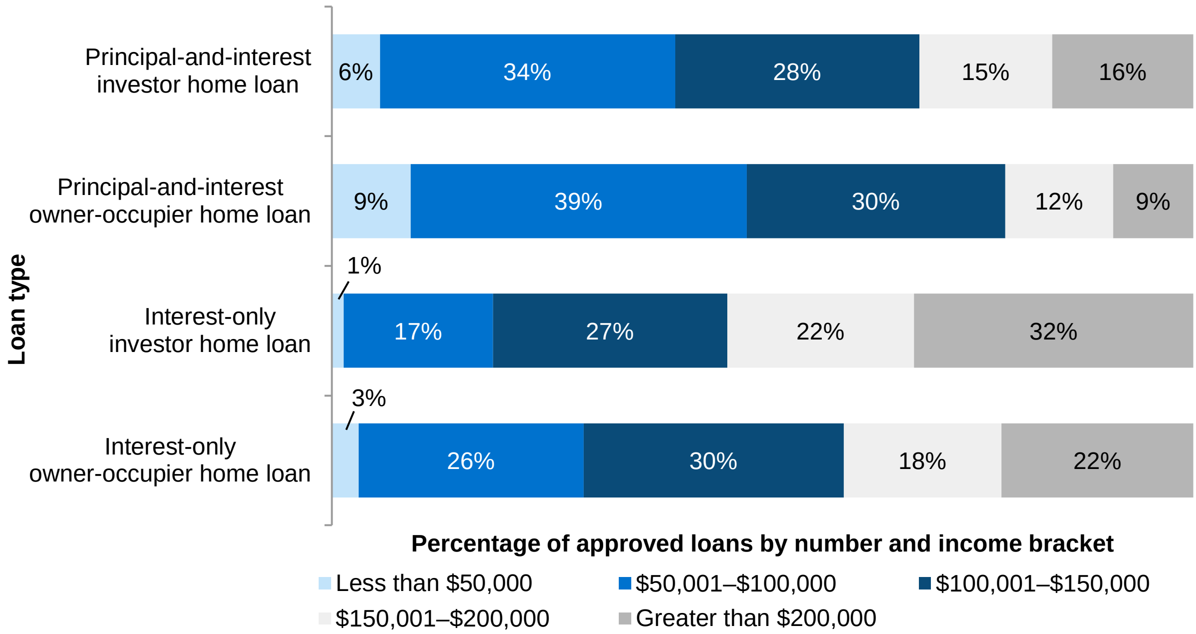
98 Among the surveyed lenders, the most common age group for owner-occupiers taking out interest-only home loans was 35–44, accounting for 34% of these loans. However, there were substantial proportions of owner-occupiers under 35 and over 44 who took out interest-only home loans.

99 In general, interest-only home loans appear to be more popular with people who earn more money.

100 Consumers who earned more than $100,000 per year made up 81% of investors with interest-only home loans and 70% of owner-occupiers with interest-only home loans. Put in context, 51% of owner-occupiers and 59% of investors with principal-and-interest home loans earned over $100,000 per year: see Figure 11.

101 A substantial proportion (32%) of investors in interest-only home loans earned more than $200,000 per year.

Figure 11: Proportion of approved loans for each loan type in 2014, by borrowers' income[20]



Note: Based on 10 lenders. One lender did not provide data for this question. Totals do not always add up to 100% due to rounding.

[20] In our survey 'borrower's income' was defined as the 'total gross annual income of the borrower(s), as recorded during the application process'.

First home buyers

102 We requested data from the surveyed lenders in relation to first home buyers, in order to understand how the trends of first home buyers compared to the overall home owner population, specifically in relation to interest-only home loans.

103 We note that the quality of first home buyer data is restricted by the way in which lenders capture this information.[21] Among the surveyed lenders we found that:

(a) only three of the lenders record data on all first home buyers;

(b) seven lenders only capture first home buyer data in relation to consumers who applied or were approved for the first home owner grant (automatically excluding investor data, as only owner-occupiers are eligible for the first home owner grant); and

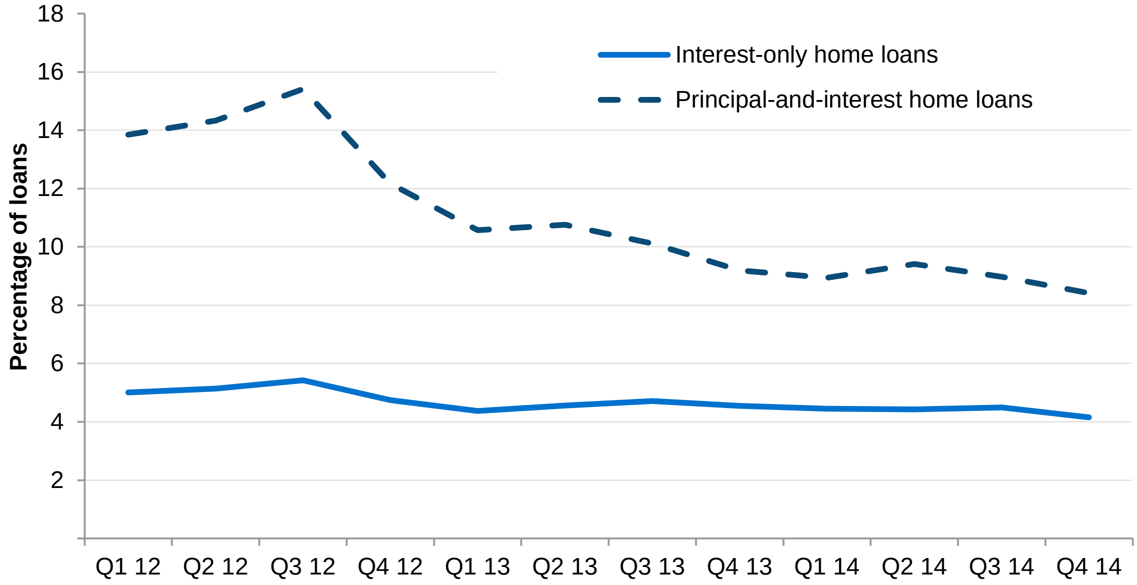
(c) one lender did not keep data on first home buyers and was therefore unable to provide data in response to this part of the survey.

104 Due to the inherent limitations in the available data, it is difficult to draw firm conclusions on first home buyers. While our survey data indicated that the percentage of first home buyers taking out principal-and-interest home loans decreased substantially during 2012–14, this may not be representative of the pattern for all first home buyers. Changes in the first home owner grant eligibility criteria may have contributed at least in part to the decline.[22] However, based on the data available, the proportion of new interest-only home loans stayed relatively stable, compared to the proportion of new principal-and-interest loans: see Figure 12.

[21] Australian Bureau of Statistics, *ABS to adjust first home buyer loan estimates up 20 per cent after investigation*, Media Release No. 12/2015, 4 February 2015.

[22] First home buyer grants are administered state by state. In New South Wales, for example, the First Home Owner Grant scheme ceased on 30 September 2012 and was replaced by the First Home Owner Grant (New Homes) scheme. The new scheme restricts eligibility to new home purchases (excluding the purchase of established dwellings). This scheme restriction was likely a contributing factor to the sharp drop in first home buyers among our surveyed lenders following the October 2012 quarter. It is noted that, throughout 2013 and 2014, the decrease in first home buyers continued while the current grant scheme has remained in place.

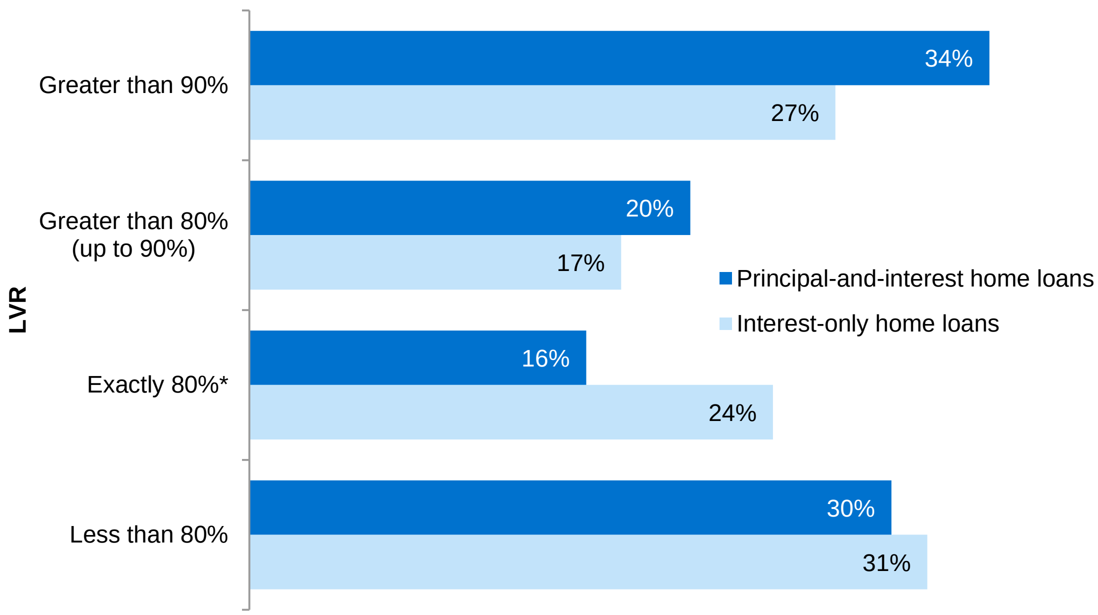
Figure 12: First home buyers as a percentage of all new loans approved from the March 2012 quarter to the December 2014 quarter



Note: Based on 10 lenders. One lender did not provide data for this question.

105 First home buyers who obtained principal-and-interest home loans as owner-occupiers in the December 2014 quarter were more leveraged than first home buyers obtaining interest-only home loans. Of the first home buyers entering interest-only home loans as owner-occupiers, 44% had an LVR greater than 80%, compared to 54% of those entering principal-and-interest home loans: see Figure 13.

Figure 13: Proportion of owner-occupier first home buyer loans in the December 2014 quarter, by LVR



* Many consumers enter loans with an LVR of exactly 80% in order to borrow the maximum amount without incurring lender's mortgage insurance.

Note: Based on 10 lenders. One lender did not provide information for this question.

Why consumers choose interest-only home loans

106 An interest-only home loan may appeal to consumers for a number of reasons. The motivations for interest-only home loans may differ between investors and owner-occupiers.

107 Through the ASIC survey, lenders reported on reasons why consumers may want to take out interest-only home loans. Some of the lender responses were based on anecdotal evidence.

Owner-occupiers

108 As discussed at paragraph 63, in recent years there has been substantial growth in owner-occupiers taking out interest-only home loans. For owner-occupiers, interest-only home loans may be appealing for the short-term cost savings. Immediate cost savings may be substantial; however, there may be longer term disadvantages for some consumers.

109 The key reasons identified in the survey for owner-occupiers taking out interest-only home loans are as follows:

(a) *Future investment*—Consumers may have a future plan to use their place of residence as an investment. The purpose of the loan may be to finance a property for owner-occupation in the short-term, but if it will be converted to an investment property, an interest-only home loan will allow maximisation of future taxation benefits.

(b) *Flexible repayments*—Consumers may require or desire flexibility with their repayments, and some may wish to make periodic lump sum payments on the home loan due to:

  (i) variable or unpredictable income arrangements, including casual work, self-employment, overtime arrangements, commissions and bonus payments;

  (ii) a temporary reduction in income or cash flow; or

  (iii) moving, furnishing or establishment costs in the early stages of their house purchase.

(c) *Redirect cash flow*—Consumers may desire to use surplus funds for other purposes, including:

  (i) non-recurring expenses;

  (ii) discretionary expenditure, such as a holiday or new car; and

  (iii) other investments.

(d) *Temporary finance*—Consumers may use an interest-only home loan as bridging finance or a construction loan while their property is built. The loan may be used as a bridging loan with the intention of selling another property and then paying down the loan. With a construction loan, the intention is usually to convert to making principal-and-interest repayments once the construction is completed.

In some cases, consumers may prefer to hold surplus funds in an offset account, which reduces the interest payable but remains accessible and can be applied to other purposes.

Investors

110 Interest-only home loans may be particularly appealing to investors, allowing them to minimise repayments in the short term, while the property value hopefully grows in the longer term. In addition to the benefits in relation to flexibility, cash flow and temporary finance, investors will also have the benefit of tax deductibility of the interest paid on an investment loan. They may have a strategy to minimise non-deductible debt and maximise deductible debt.

Behavioural insights

111 Behavioural economics, which describes the mental shortcuts or 'behavioural biases' that people are subject to when considering options or making financial decisions, may provide some insight into why interest-only home loans appeal to some consumers. For example, the decision to take out an interest-only home loan may be influenced by:

(a) present bias, which causes people to value and focus on immediate or 'present' features and costs over less immediate features and costs. This means that a consumer may prefer to make a lower repayment now, even though it will cost them more in the long run; and

(b) optimism and overconfidence bias, which can cause people to underestimate the likelihood of future negative events and overestimate their own abilities. For example, consumers may:

    (i) fail to properly account for income shocks that may affect repayment ability;

    (ii) feel they could achieve a better return on their money by investing it themselves than by making principal repayments on a home loan;[23] and

    (iii) overestimate their future behaviour and self-control. They may believe they will make additional repayments, or save in an offset account.

Offset accounts

112 Consumers with interest-only home loans were, on average, further ahead in reducing the balance of their loan when including funds held in offset accounts related to the home loan, compared to those with principal-and-interest home loans.

[23] K Scanlon, J Lunde & CME Whitehead, 'Mortgage product innovation in advanced economies: more choice, more risk', *European Journal of Housing Policy*, vol. 8, 2008, pp. 109–131.

113 Among large- and medium-sized lenders, the proportion of loan amount outstanding, when funds held in an offset are included, appears to be lower for interest-only home loans compared to principal-and-interest home loans. This is particularly the case for interest-only owner-occupier home loans. The results are more varied among small lenders.

Risks with interest-only home loans

114 The increase in uptake of interest-only home loans by owner-occupiers may be driven partly by the inherent flexibility of such loans. Although interest-only home loans can be appropriate in the right circumstances, they can raise a number of risks, including:

(a) whether the consumer can only afford a home loan because it is interest-only;

(b) whether a consumer can afford and can transition to making the principal-and-interest payments when the interest-only period expires;

(c) whether the consumer understands the effect on the loan of not making principal-and-interest repayments;

(d) the risk of a consumer going into negative equity if there is a significant downturn in the property market; and

(e) whether the consumer understands that an interest-only home loan means that they will pay more interest over the term of the loan.

115 Table 2 sets out the different amounts of interest paid on different types of loan.

Table 2: Comparison of total interest paid over loan term, by length of interest-only period

Length of interest-only period	Amount borrowed	Interest payable over term of loan	Total amount repaid on loan	Additional interest paid compared to principal-and-interest home loan
0 years (principal-and-interest home loan)	$500,000	$579,032	$1,086,232	N/A
5 years	$500,000	$616,258	$1,123,458	$37,226
10 years	$500,000	$659,752	$1,166,952	$80,720
15 years	$500,000	$709,503	$1,216,703	$130,471

Source: Based on a $500,000 home loan over 30 years. Assumes constant interest rate of 6% and monthly fees of $20. Monthly repayment figures determined using the MoneySmart mortgage calculator. Interest is calculated by compounding on the same frequency as the repayment (monthly).

116 With a principal-and-interest home loan, a borrower making scheduled repayments would typically pay off about 10% of the loan's principal over the first five years, establishing a buffer against a fall in house prices. With an interest-only home loan, a consumer is not reducing the amount outstanding on their home loan (unless they make additional repayments).

117 Consumers with interest-only home loans are solely reliant on rising house prices to increase equity in their property during the interest-only period of the loan. They will not build up any buffer to protect against a decline in house prices. The longer the interest-only period is, the greater the effect will be.

118 There is some indication that borrowers are more likely to fall into arrears if they have negative equity in their property. This is likely to be particularly the case if the borrower experiences an ‘ability-to-pay shock’, such as a substantial reduction in income. This is because a borrower with positive equity can sell the mortgaged property to repay the loan, or can refinance. However, these options are unlikely to be available where a borrower has negative equity.[24]

119 In the absence of an ability-to-pay shock, however, the borrower might not default as they could expect house prices to recover and the borrower may consider it preferable to continue to pay the loan.[25]

120 Partly mitigating the risk of negative equity is the fact that initial LVRs tend to be lower on interest-only home loans than on principal-and-interest home loans. Our survey also showed that consumers with interest-only home loans were on average further ahead in reducing the balance of their loan, compared to consumers with principal-and-interest home loans, when including funds held in offset accounts related to the home loan.

[24] M Read, C Stewart & G La Cava, *Mortgage-related financial difficulties: Evidence from Australian micro-level data* (RDP 2014-13), research discussion paper, RBA, November 2014, pp. 3, 26–27.
[25] M Read, C Stewart & G La Cava, *Mortgage-related financial difficulties: Evidence from Australian micro-level data* (RDP 2014-13), research discussion paper, RBA, November 2014, pp. 3, 26–27.

B Responsible lending finding 1: Lack of evidence of inquiries into requirements and objectives

Key points

Nearly all lenders in our review did not keep sufficient evidence of inquiries into consumer's requirements and objectives when entering an interest-only home loan.

In over 30% of files reviewed, there was no evidence that the lender had considered whether the interest-only home loan met the borrower's requirements.

While requirements and objectives for an interest-only home loan may be more apparent for investors, it is not always clear how an interest-only home loan meets the requirements of an owner-occupier.

Lenders must make sufficient inquiries to show that the loan meets the consumer's requirements and objectives.

Regulatory obligations

121 The National Credit Act introduced general obligations for lenders, including an obligation to make reasonable inquiries about the consumer's requirements and objectives for the loan. This obligation applies to all lenders.

122 The Explanatory Memorandum to the National Consumer Credit Protection Bill 2009 states at para 3.68 that:

> the minimum requirement for satisfying reasonable inquiries about the consumer's requirements and objectives will be to understand the purpose for which the credit is sought and determine if the type, length, rate, terms, special conditions, charges and other aspects of the proposed contract meet this purpose or put forward credit contracts that do match the consumer's purpose.

123 RG 209.36 sets out a number of potential inquiries into a consumer's requirements and objectives, depending on the circumstances, which include:

(a) the amount of credit needed or the maximum amount of credit sought;

(b) the timeframe for which the credit is required;

(c) the purpose for which the credit is sought and the benefit to the consumer;

(d) whether the consumer seeks particular product features or flexibility, the relative importance of different features to the consumer, and whether the consumer is prepared to accept any additional costs or risks associated with these features; and

(e) whether the consumer requires any additional expenses and whether the consumer is aware of the additional cost of these expenses being financed.

124 The obligation to make reasonable inquiries about a consumer's requirements and objectives requires finding out sufficient details about why the consumer requires the loan, so that the lender can understand whether the loan offered will meet that purpose.

125 The requirement for lenders to make reasonable inquiries about the consumer's requirements and objectives should result in a consumer being provided with an interest-only home loan because the features of that type of loan meet the consumer's objectives.

Ensuring interest-only home loans meet consumers' requirements and objectives

126 Through our file reviews we found that:

(a) only a few lenders had procedures to consistently identify and record the consumer's requirements and objectives; and

(b) even where the consumer's requirements and objectives were recorded, the stated analysis could be inadequate to explain why a loan on the terms provided was suitable for the consumer.

127 We have made recommendations for how these practices need to change: see Action 1–Action 2. All lenders in the review have agreed to implement these actions.

Requirements and objectives in relation to cost

128 Consistent with RG 209.36, it is expected that lenders would make inquiries into the consumer's requirements and objectives, and why the consumer seeks an interest-only period. If one of a consumer's stated requirements and objectives is to minimise the overall cost of the loan, an interest-only loan would seem at face value to conflict with this objective. Further inquiries are warranted in this circumstance to ensure the proposed loan would be suitable.

129 Interest-only home loans are more expensive than principal-and-interest home loans in the long term. The total interest charged under an interest-only home loan is more than that charged under a principal-and-interest home loan on the same terms (assuming all repayments are made on time, additional repayments are not made on the loan or to an offset account, and the interest rate is the same). The amount the consumer pays under an interest-only home loan will be even greater if the interest rate charged by

the lender for that product is higher than under a principal-and-interest home loan.

130 For example (assuming the same interest rate), on a 30-year loan of $500,000 the consumer will pay approximately:

(a) $37,000 more under a loan with a five-year interest-only period; and

(b) $80,000 more under a loan with a 10-year interest-only period.[26]

131 As described in detail at paragraphs 108–110, lenders suggested that some of the reasons consumers use interest-only home loans are:

(a) if the use of the property will change from owner-occupier to investment, an interest-only home loan may allow maximisation of future taxation benefits, without incurring refinancing costs;

(b) the capacity to make periodic lump sum payments;

(c) a need for lower repayments during the interest-only period, as the surplus funds are being used to build or renovate the home; or

(d) other uses of income from lower repayments during the interest-only period.

132 By electing to pay less during the interest-only period, a borrower will end up paying more over the entire term of the contract. This difference in the amount of interest payable is not transparent to the consumer, as there is no legal obligation on the lender to inform the consumer of the higher cost under an interest-only home loan relative to a principal-and-interest home loan.

133 Further, the motivations for selecting an interest-only home loan (set out in paragraphs 131(c) and 131(d)) depend on the consumer having a reasonable surplus that can be allocated to other uses and available when the loan reverts to principal-and-interest repayments. Where the consumer has only a low surplus in dollar terms it is not readily apparent that they would obtain a significant financial benefit or that there would be a compelling reason for choosing an interest-only home loan.

134 Our survey found that consumers with interest-only home loans are, on average, further ahead in repayments than those with principal-and-interest home loans. This suggests that individual consumers may have different needs; for example, some may use the flexibility provided by lower repayments, while others may not make use of this product feature and instead treat the product as effectively similar to a principal-and-interest home loan.

[26] The comparison assumes that the interest-only and principal-and-interest home loans have the same interest rate and term, and that the borrower makes all repayments when due under the contract. Repayment amounts calculated using the MoneySmart calculator assuming a 6% constant interest rate. It does not take into account the effect of any funds that may be held in an offset account.

135 This analysis shows the need for lenders to carefully consider the consumer's requirements and objectives, to ensure that an interest-only home loan would be suitable for that consumer. Special consideration should also be given to ensure that interest-only home loans with longer terms are consistent with a consumer's requirements and objectives.

Interest-only repayments do not build equity

136 Another feature of interest-only home loans that differentiates them from principal-and-interest home loans is that by not making principal repayments during the interest-only period, a consumer is not building equity in the property through paying down the principal. There is a consequent risk for lenders that a drop in property prices will mean they face a loss in the event of default and sale of the property.

Recording of inquiries into requirements and objectives

137 Most lenders advised that they conduct inquiries into a consumer's requirements and objectives, or that they require brokers to make this inquiry where the application comes through that channel. However, we found that lenders do not have consistent or clear methods of documenting their inquiries into the consumers' requirements and objectives when providing an interest-only home loan. Many files did not have any record of these inquiries.

138 While it may seem reasonable to assume that investors will often seek interest-only home loans, it cannot be assumed that this will always be the case. We found that the percentage of principal-and-interest home loans taken out by investors was between 15% and 18% during 2012–14: see Figure 4. This demonstrates that investors will sometimes choose to pay down the principal of their loan; therefore, it cannot be assumed that an interest-only home loan will meet the needs of an investor without considering their individual requirements and objectives.

139 Through our file reviews we found that:

(a) three lenders used a 'tick box' method to capture consumers' requirements and objectives, in which the consumer's requirements were selected from a menu of options;

(b) one of these three lenders also had an open text field to capture more information about the requirements and objectives, but filling it out was not mandatory and it was only used on one of the 15 reviewed files; and

(c) the remaining lenders had inconsistent practices for how information about the consumer's requirements and objectives was recorded (such as file notes or emails).

140 We consider the absence of a structured process for documenting inquiries into requirements and objectives increases the risk that it will be deemed that those inquiries were not made, given that some files did not include any statement of the consumer's needs in relation to the proposed loan. A simplistic 'tick box' method will not provide evidence that proper inquiries have been made.

141 While we note that some lenders relied on brokers to determine the consumers' requirements and objectives, we found no observable difference between the quality of the record of requirements and objectives according to the distribution channel.

142 Where loans were introduced through brokers, there was little evidence that the lender had obtained information about the broker's inquiries because these inquiries were not documented on the file. Only in a small number of loans was there evidence that the lender had sufficient information on a consumer's requirements and objectives to assess that the loan was suitable.

143 This is a significant issue, given the increase in the percentage of loans arranged through broker channels (see Figure 5), as lenders are not ensuring that brokers take a consistent approach to recording this information.

144 Under s132 of the National Credit Act, lenders must provide the consumer with a copy of the assessment of why the proposed contract is not unsuitable on request. This request can be made well after the credit contract was entered into.

145 If lenders record details on the consumer file about the specific purpose for which the consumer requires the loan, they will be able to demonstrate that they have made reasonable inquiries into a consumer's requirements and objectives, consistent with their statutory obligations.

Adequacy of inquiries into requirements and objectives

146 Where the lender did document their inquiries into the consumer's requirements and objectives, it could be expected that this would demonstrate why a particular loan was chosen. We found that in some files the recorded inquiries did not provide an adequate or clear explanation as to why an interest-only home loan was selected.

147 Our regulatory guidance and recent case law on this point clearly articulates the requirements in this area. RG 209.122 sets out a number of factors a lender or third-party broker could take into account in considering whether a proposed loan meets a consumer's requirements and objectives. In *Australian Securities and Investments Commission v The Cash Store (in liquidation)* [2014] FCA 926 (*ASIC v TCS*), Davies J noted at para [36] that if the recorded 'purpose' for which the consumer sought the loan was too

general, it would not enable the lender to understand the consumer's requirements and objectives.

148 In our file reviews we found instances where:

(a) none of the files reviewed contained any information relating to the reason an interest-only home loan had been selected (three lenders); and

(b) only a few of the files reviewed in each sample included the reason an interest-only home loan had been selected (eight lenders).

149 For example, we reviewed numerous files where the requirement or objective of the consumer was recorded as 'to purchase a property'. This statement does not address whether the consumer had any requirements or objectives in relation to the features of the loan beyond enabling them to purchase the property.

150 A statement that the consumer's objective was only to purchase a property suggests the consumer could be provided with a much wider range of loans than were suitable for their specific needs. For example, it can be inferred from this approach that the consumer was indifferent to the overall price they paid. It is very unlikely that this would be the case in practice.

151 One of the lenders who used the 'tick box' method had several files where this document was completed in a way that was contradictory. The consumer selected competing objectives, as they ticked the box for both 'I want to reduce my home loan quickly' and 'I want to minimise my repayments'. We would expect that a lender provided with such an ambiguous response would follow this up with the consumer to resolve this conflict.

152 Table 3 in RG 209 specifically states that:

> More inquiries about the consumer's requirements and objectives are likely to be necessary where it is evident to you [a credit licensee] that … the consumer has conflicting objectives or the consumer is confused about their objectives (or has difficulty articulating them).

153 The process of establishing the consumer's requirements and objectives should include a determination of, first, what the consumer's objectives are, and then whether those requirements and objectives are met by an interest-only home loan.

Inquiries into requirements and objectives—specific types of loan

154 In the course of our review, we identified two types of loan where lenders may need to make additional inquiries:

(a) interest-only home loans used for refinancing; and

(b) loans with lengthy interest-only periods.

Refinancing with an interest-only home loan

155 Additional inquiries would be warranted where the bulk of the credit being provided under the interest-only home loan is to refinance an existing debt held by the consumer (whether this is an existing principal-and-interest or interest-only home loan). In these transactions it can be presumed that the consumer is seeking some benefit or financial advantage through the subsequent loan that is not available under their existing loan.

156 We found that one lender included a specific question in its application form to inquire about the consumer's requirements and objectives where the consumer was refinancing. It required the benefits from refinancing to be specifically identified (such as savings in costs).

157 We note that consumers may incur significant costs when refinancing, such as:

(a) exit costs from the old loan;

(b) entry costs for the new loan; and

(c) in some cases, a new lender's mortgage insurance premium, where the consumer has to pay the cost of a new premium without receiving a rebate on the premium paid for the old loan.

158 We found that inquiries where the consumer was refinancing were quite limited. For example, some loans proceeded without any identification of the interest rate the consumer was paying under their current loan, and therefore without addressing the consumer's objectives and requirements for the interest rate under the new loan—for example, whether they wanted a lower interest rate or, if they were prepared to accept a higher rate under the new loan, the benefits that justified or explained this decision.

159 Our concerns about the level of inquiries into the consumer's requirements and objectives are compounded where the existing loan being refinanced already has an interest-only period. In these circumstances the effect of the refinance is to extend the interest-only period and further defer the point in time at which the consumer begins accruing equity by reducing the principal. The risks associated with such a transaction may warrant additional inquiries to ensure the terms of the refinance meet the consumer's requirements and objectives.

Loans with lengthy interest-only periods

160 Loans where the interest-only period extends to 10 or 15 years for owner-occupiers also warrant additional inquiries about the consumer's objectives and requirements for the loan.

161 We found substantial differences between lenders on the maximum length of interest-only period that they will offer, ranging from five years to 15 years, and in the level of use of these products between lenders.

162 Among those lenders offering lengthy interest-only periods, there were two lenders who offered interest-only periods for owner-occupiers of up to 15 years and three lenders who offered interest-only periods for investors of up to 15 years.

163 For the two lenders who offered interest-only periods of up to 15 years to owner-occupiers, the following interest-only periods applied to loans approved, as an average over the period 2012–14:

(a) of the first lender's interest-only home loans:

  (i) 16% of owner-occupiers had interest-only periods of 11–15 years and 15% had interest-only periods of 6–10 years; and

  (ii) 23% of investors had interest-only periods of 11–15 years and 20% had interest-only periods of 6–10 years; and

(b) of the second lender's interest-only home loans:

  (i) less than 1% of owner-occupiers had interest-only periods of 11–15 years and 69% had interest-only periods of 6–10 years; and

  (ii) less than 1% of investors had interest-only periods of 11–15 years and 55% had interest-only periods of 6–10.

164 These results can be contrasted with the consumer outcomes from other lenders (again for loans approved, as an average over the period 2012–14). We found:

(a) five lenders did not have any owner-occupier or investor home loans with an interest-only period longer than five years; and

(b) 97% of one lender's interest-only owner-occupier home loans had an interest-only period of five years or less (despite offering longer terms).

165 The two lenders at paragraph 163 also reported high percentages of home loans for first home buyers with interest-only periods of 6–15 years:

(a) the first lender reported 10% of first home buyer interest-only home loans had an interest-only period of 6–10 years, and 15% had an interest-only period of 11–15 years; and

(b) the second lender reported 53% of first home buyer interest-only home loans had an interest-only period of 6–10 years, although none had a longer period than 10 years.

166 It could be expected that, as a class, first home buyers would be more likely to be interested in accruing equity as quickly as possible, which would be inconsistent with such a lengthy interest-only period.

167 The extent of the disparity in consumer outcomes between lenders is substantial: with one lender over 97% of owner-occupiers had a home loan with an interest-only period of less than five years, and with another lender the percentage of interest-only home loans for owner-occupiers with interest-only periods of up to five years was 31%.

168 We consider it is unlikely that consumers would have such different preferences between lenders. This raises the question of whether longer term interest-only periods are being promoted by lenders and brokers for other reasons.

169 The files for the loans with a 10–15 year interest-only period did not specify a reason why such a long term had been selected. We note that one of the reasons lenders gave for consumers using interest-only home loans, as set out in paragraph 131(a), may justify this length of term (i.e. where the use of the property is expected to switch from owner-occupier to investment). However, the other reasons given for providing an interest-only period of any length would ordinarily not apply.

170 From a lender’s perspective, research shows that the probability of entering arrears is higher the more slowly a loan is repaid.[27]

Lender changes

171 Following completion of the survey, most lenders have committed to reduce the maximum interest-only period for owner-occupiers to five years. Lenders that will continue to provide owner-occupiers with interest-only periods greater than five years will take steps to ensure these loans are suitable.

Actions

Action 1

To comply with responsible lending obligations, lenders should ensure that they make reasonable inquiries into a consumer’s requirements and objectives and document the results of these inquiries. For interest-only home loans, lenders should consider whether specific features, benefits and costs associated with the loan (including, when refinancing a loan, the benefits and costs of the new loan) meet the consumer’s objectives.

Action 2

To comply with responsible lending obligations, lenders should ensure that the period of interest-only repayments offered on a proposed home loan is aligned with the particular consumer’s requirements and objectives.

We encourage lenders to review their policies regarding the maximum length of interest-only periods offered, particularly to owner-occupiers. Interest-only periods greater than five years for owner-occupiers will be at high risk of non-compliance with the responsible lending obligations unless there is clear demonstration that the length of the interest-only period is aligned with that particular consumer’s requirements and objectives.

[27] M Read, C Stewart & G La Cava, *Mortgage-related financial difficulties: Evidence from Australian micro-level data* (RDP 2014-13), research discussion paper, Reserve Bank of Australia, November 2014, p. 15.

C Responsible lending finding 2: Affordability and interest-only home loans

Key points

Lenders did not always ensure that the consumer had sufficient income (i.e. an appropriate income surplus) above their expenses and loan repayments, so that they could withstand a reasonable fluctuation in income or expenses or an interest rate rise.

There is substantial variation in how lenders apply interest rate buffers. Some lenders apply a buffer to the proposed loan only and not to existing debt that may also be affected by interest rate rises.

Regulatory obligations

172 Before entering into a credit contract with a consumer, lenders must make an assessment that the loan meets the consumer's requirements and objectives and that the consumer can comply with their financial obligations without significant hardship, based on reasonable inquiries and verification.

Assessing ability to pay (serviceability)

173 We found that lenders generally used three kinds of serviceability models to assess a consumer's ability to repay a home loan. The models are:

(a) net income surplus model;

(b) debt service ratio model; and

(c) surplus / uncommitted monthly income model.

174 While the methodology varies between these methods, they all assess a consumer's income, living expenses, existing debt commitments and the proposed loan repayments.

175 In order to be approved for a loan, the consumer must also have a positive surplus after further adjustments have been applied to account for possible increases in repayments due to interest rate rises over the term of the home loan.

176 Two main tools are used for this purpose:

(a) *Buffer*—This is a percentage amount added to the current interest rate offered to that consumer to allow for increases in interest rates. The lenders surveyed used a buffer of between 1.5% and 2.3%. APRA has advised lenders that they should have a minimum interest rate buffer of at least 2%.[28]

[28] APRA, *APRA outlines further steps to reinforce sound residential mortgage lending practices*, Media Release No. 14.30, 9 December 2014. As a result of this, many lenders are likely to have increased their buffers since the time of our survey.

(b) *Floor rate*—This is the minimum interest rate at which serviceability will be assessed, and is higher than the interest rate applied under the contract. There was substantial variation in the floor rates used by the lenders surveyed, with the rate ranging from 6.8% to 8%. The floor rate of lenders has historically been higher at different points in the interest rate cycle. APRA has advised lenders that they should have a minimum floor rate of at least 7%.[29]

177 For example, if a lender has a buffer of 1.5% and a floor of 8%, and the interest rate offered to a consumer is 5%, the applicable interest rate for the serviceability would be the floor rate of 8%, because it is higher than the actual interest rate plus the buffer. Alternatively, if a lender had a buffer of 2.3% and a floor rate of 6.8%, at an interest rate of 5% to the consumer, the loan would be assessed at 7.3% (the actual interest rate plus the buffer).

178 The use of a buffer or floor rate interacts with the inquiries into the consumer's income and expenditure to determine the level of risk in the transaction. The more robust the serviceability assessment, the greater the extent to which a surplus is available to meet increases in interest rates.

179 The smaller the surplus calculated for a particular borrower's financial situation (especially if a benchmark figure has been used as the basis for assessing the consumer's expenses, and that figure is lower than the consumer's actual expenses), the more important the level of buffer or floor rate applied. In these situations, the buffer or floor rate may in practice be covering the risk of both an increase interest rates and that the consumer's expenditure is greater than that relied on through the use of a benchmark. This analysis highlights the fact that, in addition to using appropriate buffers and floor rates, robust processes for assessing the consumer's ability to repay the loan are also essential for sound responsible lending practices.

Lack of an absolute floor on interest rates

180 One lender surveyed did not have a floor rate and relied on the interest rate buffer, meaning that in the current environment, the interest rate used to assess capacity to pay (i.e. current interest rate plus a buffer) would be substantially less than the floor rate of all other lenders. Better practice would be for lenders to adopt an appropriate floor on interest rates.

Applying a buffer to existing debt

181 There is substantial variation in policies regarding how lenders apply the interest-rate buffer. Some lenders apply an interest-rate buffer to both the consumer's existing debts (such as loans outstanding on existing owner-occupied or investment properties), as well as to the proposed new loan.

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[29] APRA, *APRA outlines further steps to reinforce sound residential mortgage lending practices*, Media Release No. 14.30, 9 December 2014. As a result of this, some lenders are likely to have increased their floor rate since the time of our survey.

However, some lenders apply an interest rate buffer to the proposed loan only and do not apply the buffer to existing debt.

182 A consistent application of a buffer would mean that the effect of interest rate rises is considered in relation to all variable rate debts of a consumer (i.e. where the repayment amount may vary with interest rate rises). Failing to apply a buffer to a consumer's existing debts with variable interest rates may affect serviceability substantially.

183 For example, Table 3 demonstrates a hypothetical scenario where a consumer with two investment properties applies for a loan to purchase a home to reside in.

184 In the hypothetical example, the consumer's new loan is $1.2 million over 30 years, with a five-year interest-only period. She has two investment properties, with outstanding debts of $350,000 and $480,000. The current interest rate on both of her existing home loans and her current application is 5.5%. The consumer earns $150,000 net salary per year, and also receives $70,200 per year in gross rental income. For the purposes of serviceability, the lender reduces her rental income by 20%, resulting in net monthly income (from salary and rent) of $17,180.

185 If the interest rate buffer was only applied to the new loan, the consumer would be considered to have a monthly surplus of $526. However, if the interest rate buffer was applied across existing debts, she would *fail* serviceability by $485 per month.

Table 3: Effect of applying a buffer to existing debts (based on a monthly income of $17,180)

Monthly expense type	Cost (buffer of 2% applied only to new debt)	Cost (2% buffer applied to all variable interest rate debts)
Living expenses	$2,400	$2,400
Investment property A	$2,418	$2,830
Investment property B	$2,958	$3,557
New home loan (this application)	$8,878	$8,878
Total monthly expenses	*$16,654*	*$17,665*
Surplus (monthly income of $17,180 minus total monthly expenses)	**$526**	**−$485**

Notes: This is a hypothetical scenario and is not based on any loan file we reviewed. Repayment amounts have been calculated using ASIC's MoneySmart mortgage calculator. Assumes that investment property A has 20 years of repayments remaining and investment property B has 25 years of repayments remaining. Each home loan has a monthly fee of $10. Does not take into account negative gearing.

Action

Action 3

To comply with their responsible lending obligations, lenders should ensure adequate policies and processes are in place to assess a consumer's ability to meet their financial obligations under the credit contract, including reasonable consideration of the effect of future interest rate rises on the proposed credit contract and existing credit contracts.

D Responsible lending finding 3: Variation in treatment of volatile and irregular income

Key points

There is variation between how lenders treat volatile and irregular income sources.

We found examples in the file reviews of the higher income figure being used for serviceability assessments where there was a substantial difference between previous years' incomes.

Rental income is typically discounted by 20% to allow for property expenses and periods of non-occupancy. However, we saw examples in the file reviews where the property-related expenses would likely be greater than 20% of rental income. Discounting of 20% may not be adequate to cover property expenses in all cases.

Regulatory obligations

186 Lenders must ensure that consumers do not enter credit contracts where they cannot meet their repayment obligations, or could only meet them with substantial hardship.

187 Credit providers must therefore assess an individual consumer's specific financial circumstances, including by making reasonable inquiries about their income, and by taking reasonable steps to verify that income.

Employment income

188 We found that:

(a) lenders generally made appropriate inquiries into a consumer's income and took steps to verify their income; and

(b) there were inconsistencies in the treatment of irregular or volatile income sources.

189 Through the file reviews, we generally found that lenders undertook inquiries into and verification of both employer-paid and self-employed income. To verify income they typically obtained:

(a) recent payslips detailing regular salary or wage income;

(b) a written statement from the consumer's employer or accountant confirming income;

(c) tax returns;

(d) bank statements to confirm regular salary or wage income credits; and/or

(e) other documents relating to income, such as trust statements and business activity statements.

190 It was standard practice for some lenders to verify the consumer's employment by contacting their employer by phone, using publicly available contact details and therefore confirming their employment, tenure, status, and salary. We note that failure to confirm employment by contacting the employer directly increases the risk of fraud, through the use of manufactured payslips.

191 There was only one lender who did not consistently keep evidence of income on file. We will be working further with this lender to ensure their record-keeping has improved and that they can demonstrate compliance with their responsible lending obligations.

Rental income

192 Where the consumer was an investor, the surveyed lenders all stated that they would include the rent from the investment property in the consumer's income when carrying out the serviceability assessment.

Verification of rental income

193 Our file reviews found that rental income from an existing property (with a documented rental history) is normally verified by one or more of the following documents:

(a) a current lease agreement;

(b) bank statements confirming rental deposits;

(c) taxation returns showing rental income; and

(d) rental statements from a managing agent.

194 Where a new investment property was being purchased, lenders assessed future rental income through:

(a) an assessment of likely rental amount contained in the valuation report; or

(b) a rental appraisal from a third party, such as a real estate agent.

195 Lenders that rely on statements about future rental income may need to consider the qualifications and financial interests of the person making the statement. For example, there is a risk that a real estate agent may overstate the possible rent in order to encourage the consumer to use their services rather than those of a competitor.

196 We found an application where the lender had obtained two different rent assessments, and used the higher assessment for the purposes of assessing the consumer's capacity. While this approach may have been justified, there was no analysis in the file to support this decision. Given that, in this particular example, if the lower rental assessment had been used the consumer would have failed serviceability, we consider the reason for choosing the higher assessment is important.

Discounting rental income

197 While projected rental income is included as part of a consumer's income, all surveyed lenders stated that they discount the figure by 20% to allow for costs associated with the property. These costs typically include maintenance, strata fees, managing agent fees, taxes, and periods of non-occupancy.

198 The use of a 20% rule may not always accurately reflect an individual's circumstances. For example, in one file we reviewed, the annual rental income was approximately $22,000. Strata fees were over $2,700 per year. The use of a 20% figure only left a balance of $1,700, which would likely be insufficient in many cases to meet costs, such as agent fees and insurance for the property, and cover the risk of gaps between tenants.

Volatile or irregular income sources

199 We found substantial variation among lender practices in how they treat volatile or irregular income sources, such as self-employment, trust income and distributions, bonuses, commission, overtime, and investment earnings. Some lenders took an average of the income over the last two years from the irregular source, even where the most recent year's income was lower. Other lenders calculated capacity on the basis of the consumer's most recent income in the year before the loan application.

200 Simplistic approaches to assessing irregular income may result in unreliable assumptions being made about the consumer's capacity to pay. It may be preferable for lenders to further investigate the reasons the consumer's income has fluctuated in order to better assess likely future income and make a more robust assessment of their capacity to pay. APRA considers that ADI lenders should 'haircut' (i.e. apply a discount to) any volatile income sources.[30]

[30] W Byres, 'Sound lending standards and adequate capital: preconditions for long-term success', speech to COBA CEO and Director Forum, Sydney, 13 May 2015.

Case study 1: Assessment of self-employed income

A self-employed consumer applied for a $650,000 loan, with a two-year interest-only period, to refinance the home he resides in. He also borrowed an additional amount to undertake some renovations. The consumer supplied his most recent income tax statement for one year, and the lender determined that his net monthly income for that year was $5,500.

The lender did not obtain any verification of the consumer's income from other years to determine the consistency of that income. The lender used $5,500 per month as the consumer's estimated income for the purposes of assessing affordability, without considering how self-employed income might be prone to fluctuations.

The lender determined that the consumer could afford the loan repayments, with a surplus of $34 per month. The assessment did not take into account the likelihood that a sole trader will have different income each year, and if the consumer's income is reduced, he may not be able to afford the loan repayments.

Negative gearing

201 Through the survey, we found that eight lenders took into account anticipated future tax benefits from negative gearing in assessing capacity to pay. One lender did not use negative gearing benefits in their automated assessment, but was able to take it into account for manual assessments or reviews, meaning that it was likely to be used where an application initially failed serviceability and was referred for manual assessment. Two lenders did not use negative gearing benefit at all in their serviceability calculations.

Lender changes

202 Some lenders are changing their policy during 2015 so that the negative gearing benefit is no longer taken into account in assessing capacity to pay. This means that the financial benefits from assumed negative gearing tax flows have been removed from calculations, reducing the consumer's surplus for the purpose of assessing the amount they can borrow.

Action

Action 4

Where consumers have uncertain, volatile or irregular income, lenders should:

- review their policies for how they assess volatile or irregular income sources to ensure they meet the responsible lending obligations and ensure prudent credit risk management;

- appropriately discount or disregard high or volatile income where there is uncertainty that the income would be likely to continue at the same level;
- for rental income, ensure the level of discounting is sufficient to allow for property expenses, including maintenance, strata fees, managing agent fees and periods of non-occupancy; and
- where they have a policy of using a negative gearing benefit in serviceability calculations, ensure it is consistent with the inquiry and verification obligations under the National Credit Act, taking into account that individual consumer's income, financial circumstances and objectives.

To demonstrate compliance with the responsible lending obligations, lenders should record the inquiries they make and the basis on which they have adopted the relevant income figure to assess a consumer's capacity to meet their financial obligations under the credit contract.

E Responsible lending finding 4: Lack of evidence of inquiries into expenses and reliance on benchmarks

Key points

We found that, in general, lenders did not demonstrate that they had made sufficient inquiries into a consumer's expenses and relied heavily on expense benchmarks to estimate living expenses.

In over 20% of files, lenders had not considered the borrowers' actual living expenses when approving the loan, but instead relied on expense benchmarks.

Expense benchmarks are not a replacement for proper inquiries into a consumer's actual expenses.

We found that:

- three lenders relied on a benchmark figure of typical household living expenses for the purposes of assessing capacity;
- some lenders made inquiries into the consumer's expenses, but relied on the benchmark figure even when the consumer's declared living expenses were higher than this amount;
- some files for these lenders did not have any evidence to show that the lender had made any inquiries at all into the consumer's living expenses; and
- some lenders used a benchmark figure even when it was unreasonably low and unlikely to reflect the consumer's actual expenditure.

Regulatory obligations

203 Lenders must ensure that consumers do not enter credit contracts where they cannot meet their repayment obligations, or could only meet them with substantial hardship. In doing this, lenders must make reasonable inquiries into an individual consumer's specific circumstances, including the nature and level of their expenses.

204 The obligation to make reasonable inquiries about the consumer's financial situation has been the subject of judicial consideration in *ASIC v TCS*. Davies J observed at [42] that:

> Assessing whether there is a real chance of a person being able to comply with his or her financial obligations under the contract requires, at the very least, a sufficient understanding of the person's income and expenditure. It is axiomatic that 'reasonable inquiries' about a customer's financial situation must include inquiries about the customer's current income and living expenses. The extent to which further information and additional inquiries may be needed in order to assess the consumer's financial

> capacity to service and repay the proposed loan and determine loan suitability will be a matter of degree in each particular case.

205 While this case addressed conduct in relation to the provision of small amount credit contracts to consumers, the court's observations are equally applicable to other forms of credit. In particular, there is no reason why the responsible lending obligations should be interpreted by lenders in a way that means they do not have to inquire into the consumer's income and expenses.

206 Given the requirement for lenders to inquire into the consumer's expenditure, it follows that sole reliance on a benchmark figure, such as the Household Expenditure Measure (HEM) benchmark or Henderson Poverty Index, to estimate a consumer's financial circumstances will not be sufficient for a lender to meet their responsible lending obligations. Lenders may use appropriate benchmarks as a verification tool to complement robust inquiries.

207 The Explanatory Memorandum to the National Consumer Credit Protection Bill 2009 states at para 3.141:

> Reasonable inquiries about the consumer's financial situation could ordinarily include inquiries about the amount and source of the consumer's income, determining the extent of fixed expenses (such as rent or contracted expenses such as insurance, other credit contracts and associated information) and other variable expenses of the consumer (and drivers of variable expenses such as the number of dependents and the number of vehicles to run, particular or unusual circumstances). The extent of inquiries will however depend on the circumstances.

208 RG 209 sets out the expectation that lenders cannot solely rely on benchmark-derived living expense figures, and must also make inquiries about the consumer's actual living expenses. It states at RG 209.105:

> Use of benchmarks is not a replacement for making inquiries about a particular consumer's current income and expenses, nor a replacement for an assessment based on that consumer's verified income and expenses.

209 We note that this approach is broadly consistent with that of APRA (in relation to ADIs). APG 223 states at paragraph 38:

> ADIs typically use the Household Expenditure Measure (HEM) or the Henderson Poverty Index (HPI) in loan calculators to estimate a borrower's living expenses. Although these indices are extensively used, they might not always be an appropriate proxy of a borrower's actual living expenses, which are likely to be considerably higher. APRA therefore expects ADIs to use a borrower's declared living expenses as a more representative measure of their actual living expenses than the HEM or HPI indices, which may nonetheless contribute to the serviceability assessment.

210 In general, we consider that the obligation to make reasonable inquiries is scalable. What a lender needs to do to meet these obligations in relation to a particular consumer will vary depending on the circumstances. We would expect that credit lenders would make many, if not all, of the inquiries in

RG 209.33, as entering into an unsuitable home loan can have a potentially large negative financial impact on a consumer.

211 More extensive inquiries are likely to be necessary where the potential negative impact on the consumer is likely to be relatively serious if the credit contract or consumer lease is unsuitable. This would include situations where the consumer’s income is relatively low, and they would therefore have a more limited capacity to change their spending patterns than consumers on higher incomes. We note, as set out in Figure 11, that 29% of interest-only owner-occupier home loans were provided to consumers with an income of $100,000 or less. Another situation is where the size of a loan is large relative to the consumer’s income.

Evidence of inquiries into living expenses

212 We found that nearly all lenders failed to demonstrate that they had made inquiries into the consumer’s regular living expenses. They generally relied on a benchmark as a surrogate for the consumer’s actual expenses. Lenders most frequently used the HEM benchmark.

213 We also found that there was inconsistent reliance on bank statements to establish the consumer’s spending and savings patterns. Some loan files had no bank statements at all, even though this would generally be the most direct way of verifying the consumer’s financial circumstances.

214 Three lenders advised that they use a benchmark figure for living expenses in all cases—that is, regardless of the consumer’s actual expenditure. Of these lenders:

(a) one relied on the HEM benchmark with no indication that actual living expenses were accounted for;

(b) one stated that they identify consumers with unusually high expenses and refer them for manual assessment; and

(c) one stated they allow for discretionary expenses to be added to the serviceability calculator.

215 We have made recommendations for how these practices need to change: see Action 5–Action 8. All lenders in the review have agreed to implement these actions.

216 We have previously resolved concerns with Bank of Queensland about the use of benchmarks.[31] In our view, the Bank’s reliance on a benchmark and lack of inquiry into actual expenses was not consistent with their responsible lending obligations. In November 2014, we updated RG 209 to clarify that

[31] Media Release (15-125MR) *ASIC concerns prompt Bank of Queensland to improve lending practices* (25 May 2015).

credit licensees cannot rely solely on benchmark living expense figures, and must make inquiries about a consumer's actual living expenses.

217 At the other end of the spectrum, the file reviews found that some lenders used an application form that required the consumer to state their expenses for each item on a comprehensive list that covered basic expenses (such as housing, food and clothing) and other expenses (including education, childcare, medical expenses, insurance premiums, car costs, and internet, mobile and phone costs). We consider that this approach would be more likely to prompt the consumer to consider the amount they spend in relation to each item on the list, which is supported by recent research into peoples' ability to predict their own future spending and the impact of 'unpacking' costs.[32] We also consider that unpacking a consumer's expenses may enable lenders to better identify possible anomalies in spending patterns than if there is no breakdown in expenses. The more comprehensive the list of expenditure items, the less likely it is that a consumer will unintentionally underestimate particular individual items.

218 A third group of lenders used a form that asked for expenditure without any detailed breakdown. They used different approaches, including asking the consumer to:

(a) state their expenses as a single amount;

(b) only state their basic expenses; or

(c) provide a breakdown between basic and discretionary expenses.

219 We consider this approach increases the risk of an amount being used that underestimates the consumer's actual expenses. This risk may arise because consumers may:

(a) have different understandings of what constitutes 'basic' or 'minimum' expenses for the purposes of the application;

(b) state a lower amount if they consider this will assist the loan being approved; or

(c) underestimate their expenses when asked to provide a figure as a total sum.[33]

220 As set out in RG 209, the lender may decide to rely on the benchmark if, after reasonable inquiries, the consumer's declared expenses are lower than the relevant benchmark (to address the risk the consumer has understated their expenses or that they may increase).

221 In each case, the assessment relies on a lender making proper inquiries into a consumer's expenses. Lenders should not simply discount the consumer's

[32] J Peetz, R Buehler, D Koehler & E Moher, 'Bigger not better: Unpacking future expenses inflates spending predictions', *Basic and Applied Social Psychology*, vol. 37, 2015, pp. 19–30.
[33] J Peetz, R Buehler, D Koehler & E Moher, 'Bigger not better: Unpacking future expenses inflates spending predictions', *Basic and Applied Social Psychology*, vol. 37, 2015, pp. 19–30.

actual (higher) expenses in preference for a benchmark figure. To do so may create a risk that the consumer will be unable to meet the repayments under the home loan.

Lender use of benchmarks as a substitute for inquiries

222 Eight lenders advised that they use the consumer's declared expenses where they are higher than the benchmark the lender uses. However, the consumer outcomes in the file reviews suggest there was an inconsistency between the stated policy and actual practice.

223 Through the file reviews we found that:

(a) there was only one lender where a benchmark was rarely relied on;

(b) two of the eight lenders used the benchmark every time, and did so even where the consumer's declared expenses were higher than the benchmark; and

(c) one lender used a benchmark in almost all of the loan assessments.

224 It could be expected that, if these lenders had made reasonable inquiries, they would identify differences in the spending patterns of their consumers, and that therefore a benchmark would be used only rarely.

225 We consider that these results raise an important question about whether those lenders with substantial levels of apparent consistency between the benchmark and the consumer's stated expenses are making reasonable inquiries into the consumer's expenses, or in fact defaulting to the benchmark as a substitute for making such inquiries. If lenders are simply relying on a benchmark it is likely that some consumers would have higher expenses than the benchmark figure, and therefore may have been provided with a loan with repayments that they cannot afford without making substantial adjustments to their expenses.

226 Even where the application form requested a figure for living expenses, we found cases in our file reviews where there were no documents to indicate that the lender had made reasonable inquiries into these expenses. In some files the loan was approved even though the question on the application form about living expenses was left blank by the consumer—including, in one instance, on a form that specifically stated that the consumer must answer this question.

227 As set out in RG 209, the use of benchmarks is not a replacement for making inquiries about a particular consumer's income and expenses.

Use of an income-adjusted HEM benchmark

228 The HEM benchmark was developed in 2011 by the Melbourne Institute of Applied Economic and Social Research at the University of Melbourne. It represents a low-end estimate of the spending habits of Australian families. It uses median expenditure on goods and services with variations according to whether they are characterised as 'absolute basics' or 'discretionary basics'.

229 The HEM benchmark takes the median expenditure on absolute basic goods and services and combines this with the 25th percentile of expenditure on discretionary basic goods and services.[34] As an example, food purchased from the supermarket and children's clothes are absolute basics, while a meal at a restaurant or adult clothes are considered discretionary basics.

230 The use of these figures for the HEM benchmark means that it is unlikely to be a reliable proxy for an individual consumer's actual expenses. In simple terms, the use of these percentile figure means that:

(a) 50% of consumers can be expected to have expenditure on 'absolute basic' goods and services that is higher than the HEM benchmark; and

(b) 75% of consumers can be expected to have expenditure on 'discretionary basic' goods and services that is higher than the HEM benchmark.

231 Most lenders use a single HEM benchmark figure, which varies depending on the number of adults and children the consumer supports, and is also expressed as a figure that does not vary according to income.

232 However, the Melbourne Institute found that the higher the consumer's income, the more money they would spend on both 'absolute basic' and 'discretionary basic' goods and services. It found that, in comparison with a household income of $20,000 a year, 'Households on about $75,000 a year would double the spending on absolute basics … but increase spending on discretionary basics more than fivefold.'[35]

233 For consumers with an income above $75,000 per year, expenditure would still increase but at a slower rate. Household expenditures 'increase rather rapidly initially when moving from the bottom of the household income distribution, but the growth rate then tapers off.'[36]

234 The Melbourne Institute publishes an income-adjusted HEM benchmark, which is scaled by income bands and reflects different spending habits in

[34] Melbourne Institute of Applied Economic and Social Research, *The development of a Household Expenditure Measure*, final report, The University of Melbourne, May 2011, p. 11.
[35] Melbourne Institute of Applied Economic and Social Research, *The development of a Household Expenditure Measure*, final report, The University of Melbourne, May 2011, p. 33.
[36] Melbourne Institute of Applied Economic and Social Research, *The development of a Household Expenditure Measure*, final report, The University of Melbourne, May 2011, p. 33.

each band. The income-adjusted HEM benchmark has been available to lenders since 2011.

235 We found that the use of the single HEM benchmark figure, rather than the income-adjusted HEM benchmark, was likely to result in a figure for living expenses that was substantially lower. The outcome can be shown by comparing the figures allocated for living expenses in some of the files we reviewed with the income-adjusted HEM benchmark, as set out in Table 4.

Table 4: Living expenses used in loan assessments compared to income-adjusted HEM benchmark

Family unit	Location	Age(s)	Gross annual income band	Figure used for living expenses	Income-adjusted HEM benchmark
Single with no dependants	Perth	35	$80,000 to $90,000	$14,004 per annum $1,167 per month	$21,476 per annum $1,790 per month
Single with no dependants	Brisbane	46	$50,000 to $60,000	$14,088 per annum $1,174 per month	$17,004 per annum $1,417 per month
Single with one dependant	Sydney	51	$70,000 to $80,000	$18,872 per annum $1,573 per month	$23,244 per annum $1,937 per month
Couple with no dependants	Melbourne	34 and 36	$100,000 and over	$25,620 per annum $2,135 per month	$35,412 per month $2,951 per month
Couple with two dependants	NSW (other than Sydney)	31 and 33	$100,000 and over	$34,296 per annum $2,858 per month	$42,484 per annum $3,540 per month
Couple with three dependants	Melbourne	35 and 41	$100,000 and over	$41,580 per annum $3,465 per month	$45,500 per annum $3,792 per month

236 Case study 2 illustrates the difference between using the single HEM benchmark figure compared to the income-adjusted HEM benchmark.

Case study 2: Income-adjusted HEM benchmark

A consumer applied for a $1.6 million home loan to be repaid over 30 years with a five-year interest-only period, in order to refinance her Melbourne-based home. The consumer is single, and has one dependent child. The lender did not keep a record to show any type of inquiries into the consumer's living expenses, but instead used the default benchmark living expenses for one adult and one dependant of $1,450 per month.

The consumer's gross annual salary is over $200,000. If the lender used the income-adjusted benchmark the consumer's living expenses would be estimated at $2,375 per month. If the income-adjusted benchmark had been adopted the consumer would have had failed serviceability by over $700 per month.

237 Currently the income-adjusted HEM benchmark has a maximum income band of '$100,000+' and will not differentiate in the spending patterns of persons regardless of how much they are earning in excess of $100,000.

While the differential is likely to be less for income bands over $100,000, due to the tapering off of increased spending,[37] it is worth noting this limitation. This is particularly critical for couple borrowers, many of whom will tend to have high household incomes if both are employed.

Lender changes

238 Using an income-adjusted benchmark for assessing minimum consumer expenses was adopted by one lender in our review. Following our review, all other lenders involved have now committed to introducing an income-adjusted benchmark.

Inquiries into the consumer's existing debts

239 We found that lenders generally had documentation of a consumer's existing liabilities to third parties. For example, information in relation to personal loans, other home loans and credit card debts was typically included in the loan application, with evidence of inquiries into the amount of the debt outstanding and the regular payments the consumer was making.

240 However, in the files we reviewed, lenders often failed to verify or confirm the amounts the consumer was paying—for example, by obtaining bank statements, loan account or credit card statements.

241 Verification of these liabilities would be straightforward, given that consumers can commonly access these statements online, and can therefore provide copies without any undue delay to their application. Nevertheless, lenders often failed to confirm the amounts the consumer was paying.

Accurately assessing the consumer's financial situation

242 We found examples of applications where there was a failure to identify and resolve inconsistencies in the documents on the file, and therefore a failure to make reasonable inquiries into the consumer's financial situation. If there are anomalies in the application it is not reasonable for the lender to rely on only one part of the information without making additional inquiries.

243 Examples of the types of inconsistencies are illustrated in the following case studies.

[37] Melbourne Institute of Applied Economic and Social Research, *The development of a Household Expenditure Measure*, final report, The University of Melbourne, May 2011, p. 33.

Case study 3: Childcare expenses

The borrowers were a couple who were both working full-time. They had three children under 13. There was no amount allocated for childcare costs, and no record of any inquiries into the parents' arrangements for looking after the children outside school hours and whether or not they were in fact incurring childcare expenses.

Case study 4: Motor vehicle expenses

A borrower's living expenses were stated as $1,167 per month or $14,004 a year. The application form showed that the borrower owned four vehicles, and another document on the lender's files showed that the applicant incurred annual motor vehicle expenses of about $6,600 (or 47.1% of the attributed living expenses).

It meant the consumer had only $617 a month attributed for living expenses (other than in relation to the cars). The low nature of this figure warranted further inquiries.

244 We note that RG 209 specifically addressed the issue of inconsistencies, stating at RG 209.39 that the process of making inquiries and verifying the information obtained will in many cases raise additional issues (e.g. if the information received is inconsistent with other information the lender has on the consumer). RG 209.39 stipulates that lenders' processes should be flexible and allow for additional inquiries to be made as needed.

Actions

Action 5

Lenders must make reasonable inquiries into a consumer's actual expenses, including both fixed expenses (such as rent, repayment of existing debts and child support, and recurring expenses such as insurance) and living expenses (such as food and utilities). Lenders must also take reasonable steps to verify the information obtained.

To demonstrate that they have met their responsible lending obligations, lenders must document the inquiries and verification undertaken.

Action 6

Where lenders rely on benchmarks to verify a consumer's living expenses, lenders can reduce their risk of non-compliance with the responsible lending obligations by using income-adjusted benchmarks (reflecting the reality that high-income consumers generally have higher living expenses).

If a consumer's actual living expenses are higher than the benchmark, lenders must not use the lower benchmark figure in the serviceability calculation unless there are reasonable (and documented) grounds for doing so.

Action 7

Lenders should take reasonable steps to verify the amount of existing debt and the repayment amounts that the consumer is committed to.

Action 8

Lenders should take steps to identify inconsistencies in information provided by consumers and make further inquiries to accurately assess the affordability of the proposed loan. The outcome of any additional steps taken should be documented.

F Responsible lending finding 5: Capacity to pay after interest-only period not based on residual-term payments

Key points

In 40% of the files reviewed, the affordability calculations assumed the borrower had longer to repay the principal on the loan than they actually did.

A number of lenders calculate affordability using repayments that are artificially low, as they are based on principal-and-interest repayments over the full term of the loan, rather than the residual term remaining after the interest-only period. This practice increases the risk to borrowers with longer interest-only periods.

Lenders can minimise the risk of consumers not being able to afford repayments once the interest-only period expires by assessing the consumer's ability to meet the loan repayments required when the loan reverts to principal-and-interest repayments.

Regulatory obligations

245 Lenders must ensure that consumers do not enter credit contracts where they cannot meet their repayment obligations, or could only meet them with substantial hardship. In relation to interest-only home loans, the obligation therefore requires lenders to assess the consumer's capacity to meet both the initial (interest-only) repayments and the higher (principal-and-interest) repayments arising at the expiry of the interest-only period.

246 If lenders do not properly assess the consumer's capacity in relation to the different repayments during and after the interest-only period, there is a risk the consumer will be unable to meet the higher repayments.

Method for calculating repayments

247 We found that lenders have different ways of assessing a borrower's capacity to service the loan, depending on how the repayments they used for this purpose are calculated. Lenders use two different methods:

(a) *The 'residual term' method*—The repayments used for the purposes of assessing the consumer's capacity are calculated on a principal-and-interest basis on the residual term of the loan once the interest-only period has expired. For example, if a consumer applies for a 30-year loan, with an interest-only period of 10 years, the assessment is based on principal-and-interest repayments over the residual term of 20 years.

(b) *The 'full term' method*—The repayments are calculated on a principal-and-interest basis on the full term of the loan. For example, if a consumer applies for a 30-year loan with an interest-only period of 10 years, the assessment is based on principal-and-interest repayments over a 30-year period, even though the principal-and-interest period is only 20 years.

248 Calculating the repayments using the full-term method means that the repayments used for assessment are lower than those calculated using the residual-term method. In addition, the repayments are artificially low, being less than the repayments the consumer would in fact be required to make once the interest-only period has expired.

249 Table 5 demonstrates the variation in repayments between the residual-term and full-term methods. It shows how the full-term method can artificially increase the consumer's surplus. The longer the interest-only period of the loan, the greater the distortion between the repayments used by the lender in their serviceability calculation and the repayments the consumer will have to make.

Table 5: Comparison of serviceability assessment made using the full-term and residual-term method, by interest-only period

Length of interest-only period	Monthly repayments using residual-term method	Monthly repayments using full-term method	Increase in consumer's apparent surplus if full-term method is used
5 years	$3,242	$3,018	$224
10 years	$3,602	$3,018	$584
15 years	$4,239	$3,018	$1,221

Source: Figures calculated using MoneySmart mortgage calculator. Based on a $500,000 home loan over 30 years. Assumes constant interest rate of 6% and monthly fees of $20. Interest is calculated by compounding on the same frequency as the repayment (monthly).

250 We found that five lenders used the full-term method, and therefore did not test the consumer's capacity against the actual amount of the repayments the consumer would be required to make when the interest-only period expires.

251 In contrast, six lenders calculated affordability using the residual-term method. This approach is more closely aligned with a consumer's actual financial commitments under the credit contract.

252 The following case studies illustrate the outcomes in individual cases, from the files reviewed by us in the course of this review.

Case study 5: Full-term method

A couple applied for a $1 million loan to be repaid over 30 years with a 10-year interest-only period, in order to purchase a property to live in.

The lender assessed the couple's capacity to pay using the full-term method. The lender determined that they had a surplus of $446 per month.

If the couple's ability to repay the loan had been assessed using the residual-term method, the couple would have an estimated monthly serviceability shortfall of $727. Therefore, if any buffers applied were not sufficient to make up the shortfall, the couple would be unlikely to be able to meet their repayments after the interest-only period expires without making significant adjustment to their expenses.

Case study 6: Residual-term method

A consumer was assessed for his ability to repay a loan of $1.5 million over 30 years, with a 10-year interest-only period. His capacity to pay was assessed using the residual-term method.

The lender determined that the consumer would have an approximate monthly surplus of $6 and the loan was approved on this basis. For the first 10 years of the loan the consumer is estimated to have over $3400 surplus per month, which he may choose to put in an offset account in order to minimise the interest on his loan. His actual surplus may be higher if interest rates do not rise to the level of the buffer applied in the serviceability calculation.

Effect of method used on loan amount

253 The use of the residual and full-term methods affects the amount that the consumer is eligible to borrow.

254 If the full-term method is used, a consumer can borrow more under an interest-only home loan compared to what would be available to them if the residual-term method was used, but there would be no difference in the maximum amount the consumer can borrow compared to a principal-and-interest home loan from the same lender.

255 Consistent with this analysis, the five lenders who use the residual-term method reported that the maximum amount a consumer could borrow was less for an interest-only home loan, because they would be assessed at a higher repayment figure that reflected the repayments required over the remaining term.

256 One lender stated:

> It is possible for a borrower with the same income to be approved for a principal-and-interest loan for a larger amount of money than an [interest-only] loan, as the principal and interest repayments are lower than [interest-only] repayments due to the term used. [We] may also consider a higher loan amount, commensurate to a higher LVR, where the client will be paying principal and interest rather than interest-only.

257 In contrast, the lenders who assessed capacity to pay using the full-term method reported no difference in the loan amount the consumer would be

eligible for, whether they took a principal-and-interest or interest-only home loan.

258 The average value of interest-only home loans approved to owner-occupiers was almost 40% higher than that of principal-and-interest home loans among the surveyed lenders in the December 2014 quarter: see Figure 7. There are a number of drivers that may affect the average value of interest-only and principal-and-interest home loans, including demographics of consumers taking out interest-only home loans (see paragraphs 97–101) and common behavioural biases, such as present bias (see paragraph 111).

Lender changes

259 All lenders involved in this review have advised us that they will move away from using the full-term method, and implement a system to assess capacity to pay using the residual-term method.

Action

Action 9

Lenders should review their methodology for assessing the affordability of interest-only home loans to ensure it complies with the responsible lending obligations.

Lenders should assess a consumer's capacity to make the principal-and-interest repayments over the residual term of the loan (after the interest-only period lapses), as this will reflect a consumer's ability to meet their financial obligations under an interest-only home loan.

G Responsible lending finding 6: Lack of flexibility for hardship variations for interest-only home loans

Key points

We found that financial hardship policies for most lenders did not distinguish between interest-only and principal-and-interest home loans.

However, a small number of lenders applied more restrictive options for borrowers seeking hardship variations under an interest-only home loan.

Lenders should have a variety of options available to consumers who are in financial hardship, and assess the most appropriate outcome on a case by case basis.

Regulatory obligations

260 Under the National Credit Code, at Sch 1 to the National Credit Act, lenders are required to consider whether to vary the payments under a loan where the borrower is unable to meet their repayment obligations due to hardship. Depending on when the loan was entered into, a monetary threshold for hardship applications may apply.[38] Industry codes of practice also include standards for members relating to financial hardship.[39]

Hardship variations

261 The surveyed lenders were asked for information on the way applications for hardship variations are assessed for interest-only home loans, and whether there were any differences between these procedures and those for principal-and-interest home loans.

262 All 11 lenders surveyed stated that applications for hardship are assessed in the same way, regardless of whether the consumer is making interest-only or principal-and-interest repayments at the time. This is supported by the hardship policies from each lender.

263 However, we found that, in practice, two lenders offered fewer options to assist borrowers under interest-only home loans.

[38] For loans entered into before February 2013, the procedures only apply to loans where the amount borrowed was less than $500,000. However, lenders may still to agree to a hardship variation even if the loan amount exceeds the threshold.
[39] Clause 28 of the Code of Banking Practice 2013; cl 24 of the Customer Owned Banking Code 2014.

264 Most lenders reported that during the interest-only period of a loan, a consumer in hardship may be offered the option to reduce or postpone payments. The borrower would then have the option of paying the additional amounts as a result of the reduced or deferred payments through:

(a) a lump sum payment at the end of the hardship relief period;

(b) a repayment over a set period of time; or

(c) a capitalisation of the arrears:

  (i) over the remaining period of the loan; or

  (ii) combined with an extension of the loan term.

265 In relation to interest-only home loans we found that:

(a) one lender required borrowers to pay back the deferred payments as a lump sum at the end of the hardship relief period; and

(b) one lender would not extend the loan term for interest-only home loans (but would do so for principal-and-interest home loans).

266 It is likely that the cause of financial hardship that prompts the consumer to seek a change in repayments will also mean that they are not in a position to repay a lump sum at the end of the variation period. For example, consumers may have a period of temporary unemployment. A consumer in this position is unlikely to be able to afford to both repay the deferred payments as a lump sum and to make the usual payments under the contract.

267 We consider that the inflexible application of an approach to hardship variations can place a short-term focus on the assistance provided, rather than matching the terms on which a variation is provided to the consumer's circumstances. Responding to a financial hardship request in a pre-determined manner may result in poor outcomes for both borrowers and lenders.

268 To improve outcomes available to consumers, lenders should consider the effect of any system limitations on the type of hardship variations they will provide to consumers and assess the most appropriate outcome of a hardship application on a case-by-case basis.

Action

Action 10

Lenders should:

- review their systems, policies and processes for hardship variations for interest-only home loans;
- have a variety of options available to consumers who are in financial hardship; and
- assess the most appropriate outcome of a hardship application on a case-by-case basis.

Appendix: Methodology

What we did

269 We selected 11 credit licensees of varying sizes to participate in the review, representing a broad cross-section of businesses that were active in providing interest-only home loans, including both ADI and non-ADI lenders. These licensees either provided credit through mortgage brokers, directly to consumers, or through a combination of channels.

270 Conducted between December 2014 and June 2015, our review of interest-only home loans involved two phases:

(a) a survey to industry designed to collect data on trends and practices in relation to interest-only home loans and assess responsible lending policies (Phase 1); and

(b) a targeted file review to assess compliance with the responsible lending obligations (Phase 2).

Phase 1: Survey data on trends and practices

271 In early 2015, we prepared a survey to collect data from industry on aggregated trends for interest-only home loans, as well as information on individual lenders' loan books. The survey also requested data on the arrangements lenders have in place to ensure compliance with their responsible lending obligations.

272 We note that there were some data quality issues in the way that some lenders recorded owner-occupier and investor loans. However, we expect that the broad trends would not be affected substantially.

Phase 2: Targeted file review

273 In addition to the information collected through the industry survey, we obtained and reviewed 140 actual loan files for interest-only home loans in order to review compliance with responsible lending obligations in practice. The files reviewed related to home loans for both owner-occupiers and residential property investment.

274 We conducted the file reviews in collaboration with APRA, to enable both regulators to gain an in-depth understanding of practices for interest-only home lending, and to view the issues from both a prudential and conduct regulation standpoint. A number of the file reviews were conducted at the lenders' premises.

Key terms

Term	Meaning in this document
ADI	Authorised deposit-taking institution—has the meaning given in s5 of the National Credit Act
APG 223 (for example)	An APRA prudential practice guide (in this example numbered 223)
APRA	Australian Prudential Regulation Authority
ASIC v TCS	*Australian Securities and Investments Commission v The Cash Store (in liquidation)* [2014] FCA 926
broker	Generally, a member of the sector of the credit industry that provides independent home loan credit assistance (i.e. home loan credit assistance where the credit assistance related to credit secured by real property and neither the licensee nor its representatives will be the credit provider)
capacity to pay	A consumer's ability to meet required repayments on their loan
consumer	A natural person or strata corporation Note: See s5 of the National Credit Act
credit	Credit to which the National Credit Code applies Note: See s3 and 5–6 of the National Credit Code
credit assistance	Has the meaning given in s8 of the National Credit Act
credit contract	Has the meaning in s4 of the National Credit Code
credit licence	An Australian credit licence under s35 of the National Credit Act that authorises a licensee to engage in particular credit activities
credit licensee	A person who holds an Australian credit licence under s35 of the National Credit Act
credit provider	Has the meaning given in s5 of the National Credit Act
full-term method	A method of assessing the consumer's capacity to pay, based on repayments that are calculated on a principal-and-interest basis over the full term of the loan.
general conduct obligations	The obligations under s47(1) of the National Credit Act
HEM benchmark	Household Expenditure Measure benchmark
interest-only home loan	A home loan on which only interest is paid during a set period. The loan will revert to principal-and-interest repayments at the end of the interest-only period.

Term	Meaning in this document
interest-only period	The period of time during which the consumer is only required to make payments covering the interest of their loan
investor	A consumer who has acquired a home loan for the purpose of purchasing a property that is intended to be rented to a third party
lender	A credit provider
licensee obligations	The obligations of a credit licensee as set out in s47 and 48 of the National Credit Act
loan origination	Process by which a lender determines whether and under what conditions to make a loan
LVR	Loan-to-valuation ratio. The ratio of the amount of the loan outstanding to the value of the property securing the loan.
National Credit Act	*National Consumer Credit Protection Act 2009*
National Credit Code	National Credit Code at Sch 1 of the National Credit Act
person	Has the meaning given in s5 of the National Credit Act
principal-and-interest home loan	A home loan on which the consumer is required to make payments over the term of the loan that pay off interest as well as the principal of the loan
RBA	Reserve Bank of Australia
residual-term method	A method of assessing the consumer's capacity to pay, based on repayments that are calculated on a principal-and-interest basis on the residual term of the loan, once the interest-only period has expired
responsible lending obligations	The legal obligations set out in Ch 3 of the National Credit Act
RG 209 (for example)	An ASIC regulatory guide (in this example numbered 209)
s132 (for example)	A section of the National Credit Act (in this example numbered 132), unless otherwise specified
serviceability assessment	A lender's assessment of a consumer's ability to meet the required repayments on a loan, based on an assessment of income, expenses, and buffers
surplus	The level of funds a consumer is deemed to have remaining after taking into consideration income, expenses, and buffers

Related information

Headnotes

affordability, credit, interest-only period, investor, home loan, repayments, responsible lending, requirements and objectives, serviceability, owner-occupier, principal-and-interest home loan

Regulatory guides

RG 209 *Credit licensing: Responsible lending conduct*

Legislation

Australian Securities and Investments Commission Act 2001

Explanatory Memorandum to the National Consumer Credit Protection Bill 2009, paras 3.68, 3.138 and 3.140

National Credit Act, s132; National Credit Code

Cases

ASIC v TCS

Media releases

15-125MR *ASIC concerns prompt Bank of Queensland to improve lending practices*

ABS Media Release No. 12/2015, *ABS to adjust first home buyer loan estimates up 20 per cent after investigation*

APRA Media Release No. 14.30, *APRA outlines further steps to reinforce sound residential mortgage lending practices*

Other documents

APG 223 *Residential mortgage lending*

APRA, *Quarterly authorised deposit-taking institution property exposures: March 2015*

APRA, *Quarterly authorised deposit-taking institution property exposures: December 2014*

W Byres, ‘Sound lending standards and adequate capital: preconditions for long-term success’, speech to COBA CEO and Director Forum Code of Banking Practice 2013

R Cox, D Brounen & P Neuteboom, 'Financial literacy, risk aversion and choice of mortgage type by households', *Journal of Real Estate Finance and Economics*

Customer Owned Banking Code 2014

S Drummond, 'Interest rate rises may leave banks exposed', *Sydney Morning Herald*

Financial Stability Board, *FSB Principles for Sound Residential Mortgage Underwriting Practices*

Melbourne Institute of Applied Economic and Social Research, *The development of a Household Expenditure Measure*

J Peetz, R Buehler, D Koehler & E Moher, 'Bigger not better: Unpacking future expenses inflates spending predictions', *Basic and Applied Social Psychology*

M Read, C Stewart & G La Cava, *Mortgage-related financial difficulties: Evidence from Australian micro-level data* (RDP 2014-13)

RBA, *Financial Stability Review*, March 2015

K Scanlon, J Lunde & CME Whitehead, 'Mortgage product innovation in advanced economies: more choice, more risk', *European Journal of Housing Policy*

ASIC
Australian Securities & Investments Commission

ASIC media releases are point-in-time statements. Please note the date of issue and use the internal search function on the site to check for other media releases on the same or related matters.

Monday 3 April 2017

17-095MR ASIC announces further measures to promote responsible lending in the home loan sector

ASIC today announced a targeted industry surveillance to examine whether lenders and mortgage brokers are inappropriately recommending more expensive interest-only loans. With many lenders, including major lenders, charging higher interest rates for interest-only loans compared with principal-and-interest loans, lenders and brokers must ensure that consumers are not provided with unsuitable interest-only loans.

Building on earlier work on home lending standards, ASIC is also announcing that eight major lenders will provide remediation to consumers who suffer financial difficulty as a result of shortcomings in past lending practices.

Interest-only loans

ASIC will shortly commence a surveillance to identify lenders and mortgage brokers who are recommending high numbers of more expensive interest-only loans. Data will be gathered using ASIC's compulsory information-gathering powers from large banks, other banks, mutual banks and non-bank lenders.

In an environment where many interest-only loans are now clearly more expensive than principal-and-interest loans, lenders and mortgage brokers must carefully consider the implications of providing borrowers with interest-only loans. While interest-only loans may be a reasonable option for some borrowers, for the vast majority of owner-occupiers in particular, an interest-only loan will not make sense.

Past lending practices

In 2015, ASIC conducted a review of how lenders provide interest-only home loans. ASIC found that lenders were not properly inquiring into a consumer's actual living expenses when assessing their capacity to make repayments. ASIC's review led to industry-wide improvements by lenders: see 15-220MR *Lenders to improve standards following interest-only loan review*.

As part of today's announcement, eight lenders examined by ASIC have improved their practices for enquiring about expenses to determine the consumer's financial situation and capacity to make repayments. Rather than obtaining a single monthly living expense figure and then relying on a benchmark figure to assess suitability, borrowers' actual figures for different categories of living expenses (e.g. food, transport, insurance, entertainment) will now be obtained. This will provide lenders with a better understanding of consumers' expenses.

In addition to typical hardship processes, lenders will individually review cases where consumers suffer financial difficulty in repaying their home loans, and determine whether they have been impacted by shortcomings in past lending practices. Where appropriate, consumers will be provided with tailored remediation, which may include refunds of fees or interest.

As interest rates are currently at record lows, and were falling in the lead up to 2015 and during 2016, ASIC does not expect lenders to identify high numbers of consumers who are now experiencing financial difficulty due to past lending decisions. Nevertheless, these additional actions will ensure that consumers are not disadvantaged.

To ensure that these remediation programs are operating effectively, ASIC is requiring lenders to audit their processes.

ASIC Deputy Chairman Peter Kell said, 'Home loans are the biggest financial commitment most people will ever make. In assessing whether borrowers can meet loan repayments without substantial hardship in the short and longer term, it is important that lenders can collect and rely on information which provides an accurate view of the consumer's financial situation. This is especially the case when interest rates are at record low levels'.

'Lenders and mortgage brokers must also ensure that consumers are being provided with the home loan product that meets their needs. Lenders and mortgage brokers need to think twice before recommending that a consumer obtain a more expensive interest-only loan'.

Background

In 2015, ASIC reviewed interest-only loans provided by 11 home lenders, and issued REP 445 Review of interest-only home loans (Refer: REP 445) in 2015, which made a number of recommendations for home lenders to comply with their responsible lending obligations (Refer:15-297MR).

In REP 445, ASIC gave guidance on how lenders can make proper inquiries into a borrower's actual expenses.

ASIC's monitoring of lenders' home lending practices continues. ASIC will carry out further reviews to ensure that industry standards are improved where necessary. ASIC will also take enforcement action as appropriate.

Any consumer with concerns about their ability to make home loan repayments should contact their lender in the first instance. Consumers can also access free external dispute resolution, through either the Financial Ombudsman Service (FOS) or Credit and Investments Ombudsman (CIO).

The eight lenders are:

- Australia and New Zealand Banking Group Limited
- Bendigo and Adelaide Bank Limited
- Commonwealth Bank of Australia
- Firstmac Limited
- ING Bank (Australia) Limited
- Macquarie Bank Limited
- National Australia Bank Limited
- Pepper Group Limited.

ASIC has also provided guidance to industry in Regulatory Guide 209 Credit licensing: Responsible lending conduct (Refer: RG 209).

Responsible lending is a key priority for ASIC in its regulation of the consumer credit industry. The changes made by the eight reviewed lenders continue a number of developments and outcomes involving responsible lending:

- Treasury releases ASIC's Review of Mortgage Broker Remuneration.
- ASIC filed civil penalty proceedings against Westpac in the Federal Court on 1 March 2017 for alleged breaches of the National Consumer Credit Protection Act 2009 (refer: 17-048MR).
- Cairns-based car yard lender, Channic Pty Ltd, and broker, Cash Brokers Pty Ltd, breached consumer credit laws (refer: 16-335MR). Part of the court's judgement was that the broker did not meet all of the necessary responsible lending obligations before providing credit assistance because he did not consider the borrower's insurance expenses, which was required under the credit contract and represented a significant portion of the borrower's income.

- ANZ paid a $212,500 penalty for breaching responsible lending laws when offering overdrafts (refer: 16-063MR).
- Payday lender Nimble to refund $1.5 million following ASIC probe (Refer: 16-089MR).
- BMW Finance pays $391,000 penalty for breaching responsible lending and repossession laws (refer: 16-019MR).
- Westpac pays $1 million following ASIC's concerns about credit card limit increase practices (refer: 16-009MR).
- Bank of Queensland Limited improved its lending practices following ASIC's concerns about the way it assessed applications for home loans (Refer: 15-125MR).
- The Cash Store Pty Ltd and Assistive Finance Australia Pty Ltd failed to comply with their responsible lending obligations. The Federal Court awarded record civil penalties (refer: 15-032MR).
- Wide Bay Australia Ltd (now Auswide Bank Ltd) made changes to their responsible lending policy as a result of ASIC's intervention (refer: 15-013MR).

Last updated: 22/06/2017 01:56

ASIC
Australian Securities & Investments Commission

ASIC media releases are point-in-time statements. Please note the date of issue and use the internal search function on the site to check for other media releases on the same or related matters.

Tuesday 9 February 2016

16-027MR Payday lender penalised for overcharging consumers

Following ASIC intervention, Fair Go Finance Pty Ltd has paid $34,000 in infringement notices for overcharging interest and establishment fees on payday loans. Fair Go Finance will also refund approximately 550 consumers around $34,500 for the interest and fees it collected from consumers in excess of the maximum amount allowed under the *National Consumer Credit Protection Act 2009* (National Credit Act).

An ASIC investigation into Fair Go Finance's 'Flexi Loan' product identified that the loans were set up in a manner that attempted to avoid the protections offered to consumers under the National Credit Act.

Although the credit contracts stated the loans could be repaid over a three year period, in practice the consumer was required to repay the loan over a substantially shorter period (which could be as short as 19 days). Consumers were also charged a default fee if they failed to meet the shorter repayment terms.

ASIC identified that Fair Go Finance charged establishment fees of more than twice the 20% maximum allowed. Furthermore, in a number of instances the total amount repaid by consumers over the term of the loan exceeded the maximum amount allowed under the National Credit Act.

Following ASIC's intervention, Fair Go Finance withdrew the Flexi Loan product.

'Some payday lenders are still attempting to avoid key protections for consumers of small amount loans,' ASIC Deputy Chair Peter Kell said.

'ASIC will continue its focus on the payday lending market so that vulnerable consumers are not denied important protections under the law.'

ASIC acknowledges Fair Go Finance's co-operation in this matter. Fair Go Finance is taking action to repay consumers and ensure its staff are aware of their responsibilities under the National Credit Act. An external compliance consultant has also been engaged to undertake a review of Fair Go Finance's business operations and to report back to ASIC.

Download the infringement notices

Background

Fair Go Finance holds an Australian credit licence.

Payment of an infringement notice is not an admission of a contravention of the National Credit Act. ASIC can issue an infringement notice where it has reasonable grounds to believe a licensee has contravened certain consumer protection laws.

ASIC's payday lending work

ASIC has had a particular focus on the payday lending sector in recent years including taking action to address avoidance models. Some outcomes are listed below:

- Fast Access Finance (15-278MR)
- PAID International (formerly First Stop Money) (refer: 15-262MR)
- Money3 (15-168MR)
- Cash Store (15-032MR)
- Fast Easy Loans (refer: 14-328MR)
- Cash Loan Money Centres and Sunshine Loans (refer: 14-278MR)
- Cash Stop Financial Services (refer: 14-035MR)

Last updated: 23/03/2016 03:05

M01290224

Infringement notice

section 331 of the Act
paragraph 40(a) of the Regulations

Date of issue: 5 February 2016

Unique identification code: R20160000044788

TO: Australia New Zealand Banking Group Limited (ACN 005 357 522) (**ANZ**):

1. I, David John McGuinness, give this infringement notice under regulation 39 of the *National Consumer Credit Protection Regulations 2010* (Cth) (the **Regulations**).

2. I have reasonable grounds to believe that you have contravened the *National Consumer Credit Protection Act 2009* (Cth) (the **Act**) as follows:

   During the period 10 November 2014 to 27 February 2015, as a holder of an Australian Credit Licence No 234527 pursuant to s 35 of the Act, you engaged in conduct contrary to s 128 of the Act, by entering into a credit contract (the **Contract**) on 27 February 2015 with Melissa Lee Higgins (the **Customer**) without, pursuant to s 128, having made the inquiries and verification in accordance with section 130(2) of the Act, in particular, reg 28JA of the Regulations.

   The Contract was a credit contract within the meaning of s 4 of the National Credit Code (contained in Schedule 1 of the Act). The Contract was for an overdraft facility known as 'ANZ Assured' (**overdraft facility**) and was linked to the Customer's account number 276092364. The credit limit of the overdraft facility was $500.

   You sent to the Customer a pre-approved offer from ANZ to enter into the Contract on or about 29 January 2015. The Customer applied to enter into the Contract by returning the signed acceptance form by mail. The Contract was entered into on or about 27 February 2015. Prior to entering into the Contract with the Customer, you did not make any (or any adequate) inquiry as required by ss 128, 130(2) and reg 28JA.

Penalty under this notice

3. The penalty for the alleged offence under this notice is $8,500 for an individual or $42,500 for a body corporate.

   The applicable penalty in this notice is $42,500.

   This penalty can be paid by (**see attached invoice for payment options**).

4. If you pay the penalty stated in this notice within the time for payment mentioned below then (unless this notice is subsequently withdrawn and any penalty paid refunded):

   (a) any liability you have for the alleged contravention of the provision will be discharged;

   (b) no civil proceedings will be brought against you by the Commonwealth for the alleged contravention;

(c) you will not be taken to have admitted guilt in respect of the alleged contravention; and

(d) you will not be taken to have been found guilty of the alleged contravention.

Consequences of failure to pay penalty under this notice

5. If you do not pay the penalty specified in this notice within the time for payment mentioned below, civil proceedings maybe brought against you for the alleged contravention.

6. The maximum penalty that a court may impose for this offence is 2,000 penalty units for an individual and 10,000 penalty units for a body corporate.

Time for payment

7. The time for payment is:

(a) within 28 days after the day on which the notice is given to you; or

(b) if you apply for a further period of time in which to pay the penalty, and the application is granted — within the further period allowed; or

(c) if you apply for a further period of time in which to pay the penalty, and the application is refused or is taken to have been refused — within the later of:

(i) 7 days after:

(A) the day you receive the notice of refusal; or

(B) the application is taken to have been refused; and

(ii) 28 days after the day on which the infringement notice was given to you; or

(d) if you apply for permission to pay the penalty by instalments, and the permission is granted — in accordance with the permission; or

(e) if you apply for permission to pay the penalty by instalments, and the permission is refused or is taken to have been refused — within the later of:

(i) 7 days after:

(A) the day you receive the notice of refusal; or

(B) the application is taken to have been refused; and

(ii) 28 days after the day on which the infringement notice was given to you; or

(f) if you apply for the notice to be withdrawn, and the application is refused or is taken to have been refused — within the later of:

(i) 7 days after:

(A) the day you receive the notice of refusal; or

(B) the application is taken to have been refused; and

(ii) 28 days after the day on which the infringement notice was given to you.

Further penalty for continuing offence

8. If the alleged contravention of the civil penalty provision continues beyond 27 February 2015 a further penalty may be imposed even if the penalty imposed by this notice is paid.

Applying to have this notice withdrawn

9. Within 28 days after you receive this notice, you may apply to the **Credit Infringement Notice Officer** to have this notice withdrawn.

(the Credit Infringement Notice Officer is the nominated person)

Applying for more time to pay the penalty under this notice

10. Within 28 days after you receive this notice, you may apply to the nominated person for a further period of up to 28 days in which to pay the penalty under this notice.

Applying to pay the penalty under this notice by instalments

11. Within 28 days after you receive this notice, you may apply to the nominated person for permission to pay the penalty under this notice by instalments.

Requirements for applications

12. An application to have this notice withdrawn, or for more time to pay the penalty under this notice, or for permission to pay the penalty under this notice by instalments:

    (a) must be in writing; and

    (b) must include the unique identification code set out at the top of this notice; and

    (c) must include your reasons for making the application; and

    (d) for an application for permission to pay the penalty under this notice by instalments — include the proposed amount and frequency of instalments; and

    (e) may be made by forwarding your application to:

        Credit Infringement Notice Officer

        Australian Securities and Investments Commission

        GPO Box 9827

        Melbourne VIC 3001

        or by facsimile: (03) 9280 3444

        or by email: CreditInfringementNotices@asic.gov.au

Signed:

....

David John McGuinness

To: Australia New Zealand Banking Group
ACN 005 357 522

Address: Australia New Zealand Banking Group
ANZ Centre
Level 5, 833 Collins Street
DOCKLANDS VIC 3008

Infringement Notice Unique Identification Code:	R201600000044788
Account Number:	66005357522
Issue Date:	05/02/2016

INVOICE

Infringement Notice Penalty **$42,500.00**

This invoice is issued for payment of the penalty under infringement notice R201600000044788

To stop further action being taken in relation to the alleged offence/ civil penalty contravention described in the infringement notice, ensure payment of the penalty is made within 28 days of receipt of the infringement notice.

For assistance, contact Georgina Thomas on (03) 9280 4107

This notice may not include all monies owed to ASIC.
Not Subject to GST, (Treasurer's Determination Exempt Taxes, Fees and Charges).

Payment Slip

Account Number: 66005357522

Recipient: Australia New Zealand Banking Group

Due this notice: $42,500.00

PAYMENT OPTIONS

POST billpay

Billpay Code: 8929
Ref: 669005357522335

Australia Post,
Present this payment slip. Pay by cash, cheque or EFTPOS.

Phone
Call 13 18 16 to pay by MasterCard or Visa

Online
Go to postbillpay.com.au to pay by MasterCard or Visa

Electronic Funds Transfer
ASIC's account details are:

BANK:	Reserve Bank of Australia
BSB:	093003
BANK ACCOUNT:	317118
ACCOUNT NAME:	ASIC Collectors rec.Acc.
REFERENCE:	6690053575223

B PAY

Biller Code: 17301
Ref: 6690053575223

Use these details for phone or internet banking. Call your financial institution to pay from your cheque, savings or credit card account. For info; www.bpay.com.au

Mail
Mail this payment slip and cheque (do not staple) to ASIC, Locked Bag 5000, Gippsland Mail Centre VIC 3841

Aus Post Barcode: *814 129 0006690053575223 35

M01290223

Infringement notice

section 331 of the Act
paragraph 40(a) of the Regulations

Date of issue: 5 February 2016

Unique identification code: R20160000042694

TO: Australia New Zealand Banking Group Limited (ACN 005 357 522) (**ANZ**):

1. I, David John McGuinness, give this infringement notice under regulation 39 of the *National Consumer Credit Protection Regulations 2010* (Cth) (the **Regulations**).

2. I have reasonable grounds to believe that you have contravened the *National Consumer Credit Protection Act 2009* (Cth) (**the Act**) as follows:

   During the period 10 November 2014 to 27 February 2015, as a holder of an Australian Credit Licence No 234527 pursuant to s 35 of the Act, you engaged in conduct contrary to s 128 of the Act, by entering into a credit contract (the **Contract**) on 27 February 2015 with Paul Damian Brown (the **Customer**) without, pursuant to s 128, having made the inquiries and verification in accordance with section 130(2) of the Act, in particular, reg 28JA of the Regulations.

   The Contract was a credit contract within the meaning of s 4 of the National Credit Code (contained in Schedule 1 of the Act). The Contract was for an overdraft facility known as 'ANZ Assured' (**overdraft facility**) and was linked to the Customer's account number 266417989. The credit limit of the overdraft facility was $1,000.

   You sent to the Customer a pre-approved offer from ANZ to enter into the Contract on or about 29 January 2015. The Customer applied to enter into the Contract by returning the signed acceptance form by mail. The Contract was entered into on or about 27 February 2015. Prior to entering into the Contract with the Customer, you did not make any (or any adequate) inquiry as required by ss 128, 130(2) and reg 28JA.

Penalty under this notice

3. The penalty for the alleged offence under this notice is $8,500 for an individual or $42,500 for a body corporate.

   The applicable penalty in this notice is $42,500.

   This penalty can be paid by (**see attached invoice for payment options**).

4. If you pay the penalty stated in this notice within the time for payment mentioned below then (unless this notice is subsequently withdrawn and any penalty paid refunded):

   (a) any liability you have for the alleged contravention of the provision will be discharged;

   (b) no civil proceedings will be brought against you by the Commonwealth for the alleged contravention;

(c) you will not be taken to have admitted guilt in respect of the alleged contravention; and

(d) you will not be taken to have been found guilty of the alleged contravention.

Consequences of failure to pay penalty under this notice

5. If you do not pay the penalty specified in this notice within the time for payment mentioned below, civil proceedings maybe brought against you for the alleged contravention.

6. The maximum penalty that a court may impose for this offence is 2,000 penalty units for an individual and 10,000 penalty units for a body corporate.

Time for payment

7. The time for payment is:

   (a) within 28 days after the day on which the notice is given to you; or

   (b) if you apply for a further period of time in which to pay the penalty, and the application is granted — within the further period allowed; or

   (c) if you apply for a further period of time in which to pay the penalty, and the application is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of refusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you; or

   (d) if you apply for permission to pay the penalty by instalments, and the permission is granted — in accordance with the permission; or

   (e) if you apply for permission to pay the penalty by instalments, and the permission is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of refusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you; or

   (f) if you apply for the notice to be withdrawn, and the application is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of refusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you.

Further penalty for continuing offence

8. If the alleged contravention of the civil penalty provision continues beyond 27 February 2015 a further penalty may be imposed even if the penalty imposed by this notice is paid.

Applying to have this notice withdrawn

9. Within 28 days after you receive this notice, you may apply to the **Credit Infringement Notice Officer** to have this notice withdrawn.

   (the Credit Infringement Notice Officer is the nominated person)

Applying for more time to pay the penalty under this notice

10. Within 28 days after you receive this notice, you may apply to the nominated person for a further period of up to 28 days in which to pay the penalty under this notice.

Applying to pay the penalty under this notice by instalments

11. Within 28 days after you receive this notice, you may apply to the nominated person for permission to pay the penalty under this notice by instalments.

Requirements for applications

12. An application to have this notice withdrawn, or for more time to pay the penalty under this notice, or for permission to pay the penalty under this notice by instalments:

    (a) must be in writing; and

    (b) must include the unique identification code set out at the top of this notice; and

    (c) must include your reasons for making the application; and

    (d) for an application for permission to pay the penalty under this notice by instalments — include the proposed amount and frequency of instalments; and

    (e) may be made by forwarding your application to:

       Credit Infringement Notice Officer

       Australian Securities and Investments Commission

       GPO Box 9827

       Melbourne VIC 3001

       or by facsimile: (03) 9280 3444

       or by email: CreditInfringementNotices@asic.gov.au

Signed:

....

David John McGuinness

To:	Australia New Zealand Banking Group ACN 005 357 522
Address:	Australia New Zealand Banking Group ANZ Centre Level 5, 833 Collins Street DOCKLANDS VIC 3008

Infringement Notice Unique Identification Code:	R2016000000 42694
Account Number:	66005357522
Issue Date:	05/02/2016

INVOICE

Infringement Notice Penalty $42,500.00

This invoice is issued for payment of the penalty under infringement notice R201600000042694

To stop further action being taken in relation to the alleged offence/ civil penalty contravention described in the infringement notice, ensure payment of the penalty is made within 28 days of receipt of the infringement notice.

For assistance, contact Georgina Thomas on (03) 9280 4107

This notice may not include all monies owed to ASIC.
Not Subject to GST, (Treasurer's Determination Exempt Taxes, Fees and Charges).

Payment Slip

Account Number: 66005357522

Recipient: Australia New Zealand Banking Group

Due this notice: $42,500.00

PAYMENT OPTIONS

POST billpay

Billpay Code: 8929
Ref: 669005357522335

Australia Post,
Present this payment slip. Pay by cash, cheque or EFTPOS.

Phone
Call 13 18 16 to pay by MasterCard or Visa

Online
Go to postbillpay.com.au to pay by MasterCard or Visa

Electronic Funds Transfer
ASIC's account details are:

BANK:	Reserve Bank of Australia
BSB:	093003
BANK ACCOUNT:	317118
ACCOUNT NAME:	ASIC Collectors rec.Acc.
REFERENCE:	6690053575223

B PAY

Biller Code: 17301
Ref: 6690053575223

Use these details for phone or internet banking. Call your financial institution to pay from your cheque, savings or credit card account. For info; www.bpay.com.au

Mail
Mail this payment slip and cheque (do not staple) to ASIC, Locked Bag 5000, Gippsland Mail Centre VIC 3841

Aus Post Barcode: *814 129 0006690053575223 35

M01290222

Infringement notice

section 331 of the Act
paragraph 40(a) of the Regulations

Date of issue: 5 February 2016

Unique identification code: R20160000044822

TO: Australia New Zealand Banking Group Limited (ACN 005 357 522) (**ANZ**):

1. I, David John McGuinness, give this infringement notice under regulation 39 of the *National Consumer Credit Protection Regulations 2010* (Cth) (the **Regulations**).

2. I have reasonable grounds to believe that you have contravened the *National Consumer Credit Protection Act 2009* (Cth) (the **Act**) as follows:

   During the period 10 November 2014 to 27 February 2015, as a holder of an Australian Credit Licence No 234527 pursuant to s 35 of the Act, you engaged in conduct contrary to s 128 of the Act, by entering into a credit contract (the **Contract**) on 24 February 2015 with Stephen Golowicz (the **Customer**) without, pursuant to s 128, having made the inquiries and verification in accordance with section 130(2) of the Act, in particular, reg 28JA of the Regulations.

   The Contract was a credit contract within the meaning of s 4 of the National Credit Code (contained in Schedule 1 of the Act). The Contract was for an overdraft facility known as 'ANZ Assured' (**overdraft facility**) and was linked to the Customer's account number 269997229. The credit limit of the overdraft facility was $500.

   You sent to the Customer a pre-approved offer from ANZ to enter into the Contract on or about 29 January 2015. The Customer applied to enter into the Contract by either telephoning ANZ and speaking with an ANZ representative or by attending at an ANZ branch in person. The Contract was entered into on or about 24 February 2015. Prior to entering into the Contract with the Customer, you did not make any (or any adequate) inquiry as required by ss 128, 130(2) and reg 28JA.

Penalty under this notice

3. The penalty for the alleged offence under this notice is $8,500 for an individual or $42,500 for a body corporate.

   The applicable penalty in this notice is $42,500.

   This penalty can be paid by (**see attached invoice for payment options**).

4. If you pay the penalty stated in this notice within the time for payment mentioned below then (unless this notice is subsequently withdrawn and any penalty paid refunded):

   (a) any liability you have for the alleged contravention of the provision will be discharged;

   (b) no civil proceedings will be brought against you by the Commonwealth for the alleged contravention;

(c) you will not be taken to have admitted guilt in respect of the alleged contravention; and

(d) you will not be taken to have been found guilty of the alleged contravention.

Consequences of failure to pay penalty under this notice

5. If you do not pay the penalty specified in this notice within the time for payment mentioned below, civil proceedings maybe brought against you for the alleged contravention.

6. The maximum penalty that a court may impose for this offence is 2,000 penalty units for an individual and 10,000 penalty units for a body corporate.

Time for payment

7. The time for payment is:

(a) within 28 days after the day on which the notice is given to you; or

(b) if you apply for a further period of time in which to pay the penalty, and the application is granted — within the further period allowed; or

(c) if you apply for a further period of time in which to pay the penalty, and the application is refused or is taken to have been refused — within the later of:

(i) 7 days after:

(A) the day you receive the notice of refusal; or

(B) the application is taken to have been refused; and

(ii) 28 days after the day on which the infringement notice was given to you; or

(d) if you apply for permission to pay the penalty by instalments, and the permission is granted — in accordance with the permission; or

(e) if you apply for permission to pay the penalty by instalments, and the permission is refused or is taken to have been refused — within the later of:

(i) 7 days after:

(A) the day you receive the notice of refusal; or

(B) the application is taken to have been refused; and

(ii) 28 days after the day on which the infringement notice was given to you; or

(f) if you apply for the notice to be withdrawn, and the application is refused or is taken to have been refused — within the later of:

(i) 7 days after:

(A) the day you receive the notice of refusal; or

(B) the application is taken to have been refused; and

(ii) 28 days after the day on which the infringement notice was given to you.

Further penalty for continuing offence

8. If the alleged contravention of the civil penalty provision continues beyond 24 February 2015 a further penalty may be imposed even if the penalty imposed by this notice is paid.

Applying to have this notice withdrawn

9. Within 28 days after you receive this notice, you may apply to the **Credit Infringement Notice Officer** to have this notice withdrawn.

   (the Credit Infringement Notice Officer is the nominated person)

Applying for more time to pay the penalty under this notice

10. Within 28 days after you receive this notice, you may apply to the nominated person for a further period of up to 28 days in which to pay the penalty under this notice.

Applying to pay the penalty under this notice by instalments

11. Within 28 days after you receive this notice, you may apply to the nominated person for permission to pay the penalty under this notice by instalments.

Requirements for applications

12. An application to have this notice withdrawn, or for more time to pay the penalty under this notice, or for permission to pay the penalty under this notice by instalments:

    (a) must be in writing; and

    (b) must include the unique identification code set out at the top of this notice; and

    (c) must include your reasons for making the application; and

    (d) for an application for permission to pay the penalty under this notice by instalments — include the proposed amount and frequency of instalments; and

    (e) may be made by forwarding your application to:

    Credit Infringement Notice Officer

    Australian Securities and Investments Commission

    GPO Box 9827

    Melbourne VIC 3001

    or by facsimile: (03) 9280 3444

    or by email: CreditInfringementNotices@asic.gov.au

Signed:

……………………………………

David John McGuinness

To: Australia New Zealand Banking Group
ACN 005 357 522

Address: Australia New Zealand Banking Group
ANZ Centre
Level 5, 833 Collins Street
DOCKLANDS VIC 3008

Infringement Notice Unique Identification Code:	R2016000000 44822
Account Number:	66005357522
Issue Date:	05/02/2016

INVOICE

Infringement Notice Penalty **$42,500.00**

This invoice is issued for payment of the penalty under infringement notice R201600000044822

To stop further action being taken in relation to the alleged offence/ civil penalty contravention described in the infringement notice, ensure payment of the penalty is made within 28 days of receipt of the infringement notice.

For assistance, contact GeorginaThomas on (03) 9280 4107

This notice may not include all monies owed to ASIC.
Not Subject to GST, (Treasurer's Determination Exempt Taxes, Fees and Charges).

Payment Slip

Account Number: 66005357522

Recipient: Australia New Zealand Banking Group

Due this notice: $42,500.00

PAYMENT OPTIONS

POST billpay

Billpay Code: 8929
Ref: 669005357522335

Australia Post,
Present this payment slip. Pay by cash, cheque or EFTPOS.

Phone
Call 13 18 16 to pay by MasterCard or Visa

Online
Go to postbillpay.com.au to pay by MasterCard or Visa

Electronic Funds Transfer
ASIC's account details are:

BANK:	Reserve Bank of Australia
BSB:	093003
BANK ACCOUNT:	317118
ACCOUNT NAME:	ASIC Collectors rec.Acc.
REFERENCE:	6690053575223

B PAY

Biller Code: 17301
Ref: 6690053575223

Use these details for phone or internet banking. Call your financial institution to pay from your cheque, savings or credit card account. For info; www.bpay.com.au

Mail
Mail this payment slip and cheque (do not staple) to ASIC, Locked Bag 5000, Gippsland Mail Centre VIC 3841

Aus Post Barcode: *814 129 0006690053575223 35

M01290221

Infringement notice

section 331 of the Act
paragraph 40(a) of the Regulations

Date of issue: 5 February 2016

Unique identification code: R20160000044869

TO: Australia New Zealand Banking Group Limited (ACN 005 357 522) (**ANZ**):

1. I, David John McGuinness, give this infringement notice under regulation 39 of the *National Consumer Credit Protection Regulations 2010* (Cth) (the **Regulations**).

2. I have reasonable grounds to believe that you have contravened the *National Consumer Credit Protection Act 2009* (Cth) (the **Act**) as follows:

   During the period 10 November 2014 to 27 February 2015, as a holder of an Australian Credit Licence No 234527 pursuant to s 35 of the Act, you engaged in conduct contrary to s 128 of the Act, by entering into a credit contract (the **Contract**) on 27 February 2015 with Christopher David James Petersen (the **Customer**) without, pursuant to s 128, having made the inquiries and verification in accordance with section 130(2) of the Act, in particular, reg 28JA of the Regulations.

   The Contract was a credit contract within the meaning of s 4 of the National Credit Code (contained in Schedule 1 of the Act). The Contract was for an overdraft facility known as 'ANZ Assured' (**overdraft facility**) and was linked to the Customer's account number 506788237. The credit limit of the overdraft facility was $500.

   You sent to the Customer a pre-approved offer from ANZ to enter into the Contract on or about 29 January 2015. The Customer applied to enter into the Contract by either telephoning ANZ and speaking with an ANZ representative or by attending at an ANZ branch in person. The Contract was entered into on or about 27 February 2015. Prior to entering into the Contract with the Customer, you did not make any (or any adequate) inquiry as required by ss 128, 130(2) and reg 28JA.

Penalty under this notice

3. The penalty for the alleged offence under this notice is $8,500 for an individual or $42,500 for a body corporate.

   The applicable penalty in this notice is $42,500.

   This penalty can be paid by (**see attached invoice for payment options**).

4. If you pay the penalty stated in this notice within the time for payment mentioned below then (unless this notice is subsequently withdrawn and any penalty paid refunded):

   (a) any liability you have for the alleged contravention of the provision will be discharged;

   (b) no civil proceedings will be brought against you by the Commonwealth for the alleged contravention;

(c) you will not be taken to have admitted guilt in respect of the alleged contravention; and

(d) you will not be taken to have been found guilty of the alleged contravention.

Consequences of failure to pay penalty under this notice

5. If you do not pay the penalty specified in this notice within the time for payment mentioned below, civil proceedings maybe brought against you for the alleged contravention.

6. The maximum penalty that a court may impose for this offence is 2,000 penalty units for an individual and 10,000 penalty units for a body corporate.

Time for payment

7. The time for payment is:

   (a) within 28 days after the day on which the notice is given to you; or

   (b) if you apply for a further period of time in which to pay the penalty, and the application is granted — within the further period allowed; or

   (c) if you apply for a further period of time in which to pay the penalty, and the application is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of refusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you; or

   (d) if you apply for permission to pay the penalty by instalments, and the permission is granted — in accordance with the permission; or

   (e) if you apply for permission to pay the penalty by instalments, and the permission is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of refusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you; or

   (f) if you apply for the notice to be withdrawn, and the application is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of refusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you.

Further penalty for continuing offence

8. If the alleged contravention of the civil penalty provision continues beyond 27 February 2015 a further penalty may be imposed even if the penalty imposed by this notice is paid.

Applying to have this notice withdrawn

9. Within 28 days after you receive this notice, you may apply to the **Credit Infringement Notice Officer** to have this notice withdrawn.

   (the Credit Infringement Notice Officer is the nominated person)

Applying for more time to pay the penalty under this notice

10. Within 28 days after you receive this notice, you may apply to the nominated person for a further period of up to 28 days in which to pay the penalty under this notice.

Applying to pay the penalty under this notice by instalments

11. Within 28 days after you receive this notice, you may apply to the nominated person for permission to pay the penalty under this notice by instalments.

Requirements for applications

12. An application to have this notice withdrawn, or for more time to pay the penalty under this notice, or for permission to pay the penalty under this notice by instalments:

    (a) must be in writing; and

    (b) must include the unique identification code set out at the top of this notice; and

    (c) must include your reasons for making the application; and

    (d) for an application for permission to pay the penalty under this notice by instalments — include the proposed amount and frequency of instalments; and

    (e) may be made by forwarding your application to:

    Credit Infringement Notice Officer

    Australian Securities and Investments Commission

    GPO Box 9827

    Melbourne VIC 3001

    or by facsimile: (03) 9280 3444

    or by email: CreditInfringementNotices@asic.gov.au

Signed:

……………………………………………

David John McGuinness

To: Australia New Zealand Banking Group
ACN 005 357 522

Address: Australia New Zealand Banking Group
ANZ Centre
Level 5, 833 Collins Street
DOCKLANDS VIC 3008

Infringement Notice Unique Identification Code:	R2016000000 44869
Account Number:	66005357522
Issue Date:	05/02/2016

INVOICE

Infringement Notice Penalty **$42,500.00**

This invoice is issued for payment of the penalty under infringement notice R201600000044869

To stop further action being taken in relation to the alleged offence/ civil penalty contravention described in the infringement notice, ensure payment of the penalty is made within 28 days of receipt of the infringement notice.

For assistance, contact Georgina Thomas on (03) 9280 4107

This notice may not include all monies owed to ASIC.
Not Subject to GST, (Treasurer's Determination Exempt Taxes, Fees and Charges).

Payment Slip

Account Number: 66005357522

Recipient: Australia New Zealand Banking Group

Due this notice: $42,500.00

PAYMENT OPTIONS

POST billpay

Billpay Code: 8929
Ref: 669005357522335

Australia Post,
Present this payment slip. Pay by cash, cheque or EFTPOS.

Phone
Call 13 18 16 to pay by MasterCard or Visa

Online
Go to postbillpay.com.au to pay by MasterCard or Visa

Electronic Funds Transfer
ASIC's account details are:
BANK: Reserve Bank of Australia
BSB: 093003
BANK ACCOUNT: 317118
ACCOUNT NAME: ASIC Collectors rec.Acc.
REFERENCE: 6690053575223

B PAY

Biller Code: 17301
Ref: 6690053575223

Use these details for phone or internet banking. Call your financial institution to pay from your cheque, savings or credit card account. For info; www.bpay.com.au

Mail
Mail this payment slip and cheque (do not staple) to ASIC, Locked Bag 5000, Gippsland Mail Centre VIC 3841

Aus Post Barcode: *814 129 0006690053575223 35

M01290220

Infringement notice

section 331 of the Act
paragraph 40(a) of the Regulations

Date of issue: 5 February 2016

Unique identification code: R20160000044887

TO: Australia New Zealand Banking Group Limited (ACN 005 357 522) (**ANZ**):

1. I, David John McGuinness, give this infringement notice under regulation 39 of the *National Consumer Credit Protection Regulations 2010* (Cth) (the **Regulations**).

2. I have reasonable grounds to believe that you have contravened the *National Consumer Credit Protection Act 2009* (Cth) (the **Act**) as follows:

   During the period 10 November 2014 to 27 February 2015, as a holder of an Australian Credit Licence No 234527 pursuant to s 35 of the Act, you engaged in conduct contrary to s 128 of the Act, by entering into a credit contract (the **Contract**) on 6 February 2015 with Philip Arnold (the **Customer**) without, pursuant to s 128, having made the inquiries and verification in accordance with section 130(2) of the Act, in particular, reg 28JA of the Regulations.

   The Contract was a credit contract within the meaning of s 4 of the National Credit Code (contained in Schedule 1 of the Act). The Contract was for an overdraft facility known as 'ANZ Assured' (**overdraft facility**) and was linked to the Customer's account number 193696373. The credit limit of the overdraft facility was $500.

   You sent to the Customer a pre-approved offer from ANZ to enter into the Contract on or about 29 January 2015. The Customer applied to enter into the Contract via ANZ internet banking. The Contract was entered into on or about 6 February 2015. Prior to entering into the Contract with the Customer, you did not make any (or any adequate) inquiry as required by ss 128, 130(2) and reg 28JA.

Penalty under this notice

3. The penalty for the alleged offence under this notice is $8,500 for an individual or $42,500 for a body corporate.

   The applicable penalty in this notice is $42,500.

   This penalty can be paid by (**see attached invoice for payment options**).

4. If you pay the penalty stated in this notice within the time for payment mentioned below then (unless this notice is subsequently withdrawn and any penalty paid refunded):

   (a) any liability you have for the alleged contravention of the provision will be discharged;

   (b) no civil proceedings will be brought against you by the Commonwealth for the alleged contravention;

   (c) you will not be taken to have admitted guilt in respect of the alleged contravention; and

(c) you will not be taken to have admitted guilt in respect of the alleged contravention; and

(d) you will not be taken to have been found guilty of the alleged contravention.

Consequences of failure to pay penalty under this notice

5. If you do not pay the penalty specified in this notice within the time for payment mentioned below, civil proceedings maybe brought against you for the alleged contravention.

6. The maximum penalty that a court may impose for this offence is 2,000 penalty units for an individual and 10,000 penalty units for a body corporate.

Time for payment

7. The time for payment is:

   (a) within 28 days after the day on which the notice is given to you; or

   (b) if you apply for a further period of time in which to pay the penalty, and the application is granted — within the further period allowed; or

   (c) if you apply for a further period of time in which to pay the penalty, and the application is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of rcfusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you; or

   (d) if you apply for permission to pay the penalty by instalments, and the permission is granted — in accordance with the permission; or

   (e) if you apply for permission to pay the penalty by instalments, and the permission is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of refusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you; or

   (f) if you apply for the notice to be withdrawn, and the application is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of refusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you.

Further penalty for continuing offence

8. If the alleged contravention of the civil penalty provision continues beyond 6 February 2015 a further penalty may be imposed even if the penalty imposed by this notice is paid.

Applying to have this notice withdrawn

9. Within 28 days after you receive this notice, you may apply to the **Credit Infringement Notice Officer** to have this notice withdrawn.

   (the Credit Infringement Notice Officer is the nominated person)

Applying for more time to pay the penalty under this notice

10. Within 28 days after you receive this notice, you may apply to the nominated person for a further period of up to 28 days in which to pay the penalty under this notice.

Applying to pay the penalty under this notice by instalments

11. Within 28 days after you receive this notice, you may apply to the nominated person for permission to pay the penalty under this notice by instalments.

Requirements for applications

12. An application to have this notice withdrawn, or for more time to pay the penalty under this notice, or for permission to pay the penalty under this notice by instalments:

    (a) must be in writing; and

    (b) must include the unique identification code set out at the top of this notice; and

    (c) must include your reasons for making the application; and

    (d) for an application for permission to pay the penalty under this notice by instalments — include the proposed amount and frequency of instalments; and

    (e) may be made by forwarding your application to:

    Credit Infringement Notice Officer

    Australian Securities and Investments Commission

    GPO Box 9827

    Melbourne VIC 3001

    or by facsimile: (03) 9280 3444

    or by email: CreditInfringementNotices@asic.gov.au

Signed

………………………………………

David John McGuinness

To:	Australia New Zealand Banking Group ACN 005 357 522
Address:	Australia New Zealand Banking Group ANZ Centre Level 5, 833 Collins Street DOCKLANDS VIC 3008

Infringement Notice Unique Identification Code:	R2016000000 44887
Account Number:	66005357522
Issue Date:	05/02/2016

INVOICE

Infringement Notice Penalty **$42,500.00**

This invoice is issued for payment of the penalty under infringement notice R201600000044887

To stop further action being taken in relation to the alleged offence/ civil penalty contravention described in the infringement notice, ensure payment of the penalty is made within 28 days of receipt of the infringement notice.

For assistance, contact Georgina Thomas on (03) 9280 4107

This notice may not include all monies owed to ASIC.
Not Subject to GST, (Treasurer's Determination Exempt Taxes, Fees and Charges).

Payment Slip

Account Number: 66005357522

Recipient: Australia New Zealand Banking Group

Due this notice: $42,500.00

PAYMENT OPTIONS

POST billpay

Billpay Code: 8929
Ref: 669005357522335

Australia Post,
Present this payment slip. Pay by cash, cheque or EFTPOS.

Phone
Call 13 18 16 to pay by MasterCard or Visa

Online
Go to postbillpay.com.au to pay by MasterCard or Visa

Electronic Funds Transfer
ASIC's account details are:

BANK:	Reserve Bank of Australia
BSB:	093003
BANK ACCOUNT:	317118
ACCOUNT NAME:	ASIC Collectors rec.Acc.
REFERENCE:	6690053575223

B PAY

Biller Code: 17301
Ref: 6690053575223

Use these details for phone or internet banking. Call your financial institution to pay from your cheque, savings or credit card account. For info; www.bpay.com.au

Mail
Mail this payment slip and cheque (do not staple) to ASIC, Locked Bag 5000, Gippsland Mail Centre VIC 3841

Aus Post Barcode: *814 129 0006690053575223 35

ASIC
Australian Securities & Investments Commission

ASIC media releases are point-in-time statements. Please note the date of issue and use the internal search function on the site to check for other media releases on the same or related matters.

Tuesday 26 May 2015

15-128MR Sydney man pleads guilty to home loan fraud

Mr Shiv Prakash Sahay, a former credit representative of AHL Investments Pty Ltd trading as Aussie Home Loans, has pleaded guilty in the Downing Centre Local Court to three fraud-related charges brought by ASIC.

Mr Sahay, of Lidcombe in NSW, was charged with making false statements, making false documents and using false documents. These statements and documents were contained in loan applications submitted by Mr Sahay for his clients to Bankwest (a division of Commonwealth Bank of Australia) and Suncorp Metway Limited.

ASIC's investigation found that between 14 November 2011 and 6 August 2013, Mr Sahay, whilst a credit representative of Aussie Home Loans, made false statements in loan applications and created and used false bank statements for 17 of his clients to attempt to secure home loans totalling approximately $7 million.

Of the $7 million in loans for which Mr Sahay applied, $4.796 million were approved. Ask Consultancy Services Pty Ltd, a company controlled and owned by Mr Sahay, received over $5,500 in upfront commissions and then ongoing commissions as a result of Mr Sahay's offending.

ASIC Deputy Chairman Peter Kell said, 'The credit laws are designed to protect borrowers from loans they cannot afford. ASIC will act against dishonest mortgage brokers who flout the law for their own financial gain with little regard for the interests of their clients.

'ASIC is targeting loan fraud and we will continue to remove brokers and other credit representatives who engage in fraudulent activity from the lending industry,' Mr Kell said.

Mr Sahay next appears in court on 7 July 2015 for sentencing.

The Commonwealth Director of Public Prosecutions is prosecuting the matter.

Background

Mr Sahay, pleaded guilty to three charges related to:

- making 13 false statements, namely information contained in the application notes of loan applications to Bankwest and Suncorp, which carries a maximum penalty of five years imprisonment;
- making 23 false documents, namely bank statements, in support of those false statements, which carries a maximum penalty of ten years imprisonment; and
- using 26 false documents, namely bank statements, in support of those false statements, which carries a maximum penalty of ten years imprisonment.

On 1 February 2014, Mr Sahay was expelled from the Mortgage & Finance Association of Australia.

ASIC has been active in dealing with loan fraud which often involves mortgage brokers. Since becoming the national regulator of consumer credit in 2010, ASIC has achieved significant loan fraud outcomes including the banning of 31 individuals or companies (including 15 permanent bans). ASIC has also obtained convictions in six criminal actions, with four defendants currently before the Courts.

Last updated: 26/05/2015 12:00

ASIC
Australian Securities & Investments Commission

ASIC media releases are point-in-time statements. Please note the date of issue and use the internal search function on the site to check for other media releases on the same or related matters.

Tuesday 7 July 2015

15-176MR Sydney man sentenced on charges relating to $7 million home loan fraud

Mr Shiv Prakash Sahay, a former credit representative of AHL Investments Pty Ltd trading as Aussie Home Loans (Aussie) has been convicted and sentenced today in the Downing Centre Local Court on charges relating to a home loan fraud.

Mr Sahay, of Lidcome, NSW, was sentenced to 350 hours of community service work on three charges of making false statements, making false documents and using false documents in home loan applications submitted by Mr Sahay for his clients to Bankwest (a division of the Commonwealth Bank of Australia) and Suncorp Metway Limited.

ASIC Commissioner Peter Kell said, 'The reputation of the lending industry depends on mortgage brokers and other credit representatives acting honestly and in compliance with the credit laws. ASIC will vigorously pursue offenders involved in falsifying loan documents and other statements for their own financial benefit.'

ASIC continues to focus on misconduct involving loan fraud, which often involves mortgage brokers. Since becoming the national regulator of consumer credit in 2010, ASIC has achieved significant loan fraud outcomes, with criminal proceedings being launched against 11 people, resulting in seven convictions for various offences and four defendants currently before the Courts. Thirty-four individuals or companies have also been banned from providing credit services or precluded from holding a credit licence (including 18 permanent bans or cancellations).

The Commonwealth Director of Public Prosecutions prosecuted the matter.

Background

ASIC's investigation found that between 14 November 2011 and 6 August 2013, Mr Sahay, whilst a credit representative of Aussie, made false statements in loan applications and created and used false bank statements for 17 of his clients to attempt to secure home loans totaling approximately $7 million.

Of the $7 million in loans for which Mr Sahay applied, $4.796 million were approved. Ask Consultancy Services Pty Ltd, a company controlled and owned by Mr Sahay, received over $5,500 in upfront commissions and then ongoing commissions as a result of Mr Sahay's offending.

On 26 May 2015, Mr Sahay pleaded guilty to three charges of:

a) making 13 false statements in loan applications submitted by him for his clients to Bankwest and Suncorp; and

b) making 23 false documents, namely bank statements; and then using 26 false documents in loan applications submitted by him for his clients to Bankwest and Suncorp (refer 15-128MR).

Mr Sahay was expelled from the Mortgage & Finance Association of Australia on 1 February 2014.

Last updated: 07/07/2015 12:00

ASIC
Australian Securities & Investments Commission

ASIC media releases are point-in-time statements. Please note the date of issue and use the internal search function on the site to check for other media releases on the same or related matters.

Tuesday 6 October 2015

15-284MR ASIC bans convicted finance broker

ASIC has permanently banned Mr Shiv Prakash Sahay, of Lidcombe NSW, from the credit and financial services industries.

The bans follow an ASIC investigation which led to Mr Sahay being convicted on 7 July 2015 in Sydney Downing Centre Local Court on three charges of making false statements, making false documents and using false documents in home loan applications. He was sentenced to 350 hours of community service work. (refer: 15-176MR)

'ASIC's action against Mr Sahay shows how seriously we are about tackling loan fraud,' ASIC Deputy Chair Peter Kell said. 'We won't hesitate to take strong action to remove dishonest brokers, who falsify loan documents to the detriment of their clients, from the industry'.

Mr Sahay has the right to appeal to the Administrative Appeals Tribunal (AAT) for a review of ASIC's decision.

Background

On 26 May 2015, Mr Sahay pleaded guilty to three charges of:

a) making 13 false statements in loan applications submitted by him on behalf of his clients to Bankwest and Suncorp;

b) making 23 false documents in support of those false statements, mainly bank statements; and

c) using 26 false documents in loan applications submitted by him on behalf of his clients to Bankwest (a division of the Commonwealth Bank of Australia) and Suncorp Metway Limited. (refer: 15-128MR).

On 7 July 2015, Mr Sahay was convicted and sentenced to 350 hours of community service work for the above three charges. (refer: 15-176MR)

Since becoming the national regulator of consumer credit in 2010, ASIC has achieved significant loan fraud outcomes, with criminal proceedings being launched against 11 people, resulting in seven convictions for various offences and four defendants currently before the courts. 53 individuals or companies have also been banned from providing credit services or had their credit licences revoked (including 23 permanent bans and 13 cancellations or suspensions).

Editor's note:

On 22 October 2015, Mr Sahay made an application to the AAT for a review of ASIC's decision.

Last updated: 22/10/2015 12:00

ASIC
Australian Securities & Investments Commission

ASIC media releases are point-in-time statements. Please note the date of issue and use the internal search function on the site to check for other media releases on the same or related matters.

Thursday 11 August 2016

16-252MR AAT affirms permanent banning of financial adviser by ASIC

The Administrative Appeals Tribunal (AAT) has upheld ASIC's decision to permanently ban former credit representative, Shiv Sahay from providing financial services and engaging in credit activity. (refer: 15-284MR)

On 22 October 2015, Mr Sahay applied to the AAT for a review of ASIC's decision. On 9 August 2016, the AAT decided the permanent bans imposed by ASIC were appropriate in the circumstances.

According to the AAT decision, Mr Sahay's conduct 'involved deliberate and repeated action by him to provide false information to lending authorities including the creation of false documents to support the applications lodged by him' and 'was irresponsible and significantly inconsistent with the orderly operation of the financial market.'

In coming to the decision, the AAT took into consideration the need to protect the public from the conduct of Mr Sahay and the need to maintain the integrity of the financial services and credit industries to 'deter others from engaging in activity such as that being considered in this matter.'

Download the AAT decision

Last updated: 11/08/2016 11:50

ASIC
Australian Securities & Investments Commission

ASIC media releases are point-in-time statements. Please note the date of issue and use the internal search function on the site to check for other media releases on the same or related matters.

Tuesday 5 April 2016

16-108MR Former mortgage broker admits to charges relating to home loan fraud

Ms Emma Feduniw (also known as Emma Khalil) of Brisbane, Queensland, a former mortgage broker with AHL Investments Pty Ltd (trading as Aussie), has admitted through her solicitor to eight charges brought by ASIC. The charges related to the falsification of employment documents to secure approvals for home loans, submitted to Westpac.

ASIC's investigation found that between March 2013 and February 2014, Ms Feduniw submitted eight loan applications, totalling $2,720,400, containing false borrower employment letters. Of the eight loan applications, five were approved and disbursed, totalling $1,608,400. Ms Feduniw received commission on those five loans of $6,847.53.

The eight loan applications ranged in value from $250,000 to $480,000.

Ms Feduniw appeared before Beenleigh's Magistrates Court and through her solicitor admitted to providing documents knowing they were false or misleading.

ASIC Deputy Chairman Peter Kell said, 'The credit laws are designed to ensure borrowers do not take out loans they cannot afford. Actions by mortgage brokers to circumvent the laws, for their own financial benefit, erode trust and confidence in the mortgage broking industry and will not be tolerated'.

Ms Feduniw next appears in court on 3 June 2016 for sentencing.

The Commonwealth Director of Public Prosecutions (CDPP) is prosecuting the matter.

Background

Ms Feduniw was authorised to provide credit services as a credit representative to consumers from 1 July 2010 to 4 April 2014, when Aussie terminated her authorisation.

Ms Feduniw received her commission through Miga Loans Pty Ltd (ACN 106 962 467) a company controlled and owned by her.

Ms Feduniw was charged by ASIC under section 160D of the *National Consumer Credit Protection Act 2009* whilst she was engaging in credit activity on behalf of Aussie. Section 160D makes it an offence for a person engaging in credit activities to give false or misleading information or documents to another person. She appeared in Court and pleaded guilty to the charges on 1 April 2016.

Ms Feduniw faces a maximum penalty of two years imprisonment or a fine, for each charge.

Last updated: 05/04/2016 12:48

ASIC
Australian Securities & Investments Commission

ASIC media releases are point-in-time statements. Please note the date of issue and use the internal search function on the site to check for other media releases on the same or related matters.

Friday 29 July 2016

16-242MR Former Aussie Home Loans mortgage broker permanently banned for loan fraud

ASIC has permanently banned Ms Emma Feduniw, also known as Emma Khalil, of Brisbane QLD, from the credit and financial services industries.

The bans follow an ASIC investigation which led to Ms Feduniw, a former mortgage broker with AHL Investments Pty Ltd (trading as Aussie), being convicted on 3 June 2016 in Beenleigh Magistrate's Court on eight charges relating to home loan fraud. She was convicted and fined $8,500 (refer: 16-186MR).

ASIC's investigation found that Ms Feduniw provided documents in support of eight loan applications knowing that they contained false or misleading information about the applicant's employment.

'ASIC wants to ensure that dishonest brokers are removed from the industry,' ASIC Deputy Chair Peter Kell said. 'We will take all necessary steps to achieve this.'

Ms Feduniw has the right to appeal to the Administrative Appeals Tribunal (AAT) for a review of ASIC's decision.

Background

On 1 April 2016, Ms Feduniw pleaded guilty through her solicitor to eight charges under section 160D of the *National Consumer Credit Protection Act 2009* while she was engaging in credit activity on behalf of Aussie. Section 160D makes it an offence for a person engaging in credit activities to give false or misleading information or documents to another person. Ms Feduniw provided false employment documents to secure approvals for home loans, submitted to Westpac Banking Corporation (refer:16-108MR).

On 3 June 2016, Ms Feduniw was convicted and sentenced to a fine of $8,500 for the eight charges (refer: 16-186MR).

Since becoming the national regulator of consumer credit on 1 July 2010, ASIC has taken 79 actions involving loan fraud, including 60 actions to ban individuals and companies from providing or engaging in credit services or holding an Australian credit licence. ASIC has also commenced 13 criminal proceedings involving loan fraud.

Editor's note 1:

On 10 August 2016, Ms Feduniw filed an Application for Review of Decision in respect of her permanent banning from the credit and financial services industries. The appeal was heard on 8 May 2017 and the AAT affirmed ASIC's decisions. Ms Feduniw remains permanently banned from providing financial services and engaging in credit activities.

Last updated: 05/06/2017 04:44

ASIC
Australian Securities & Investments Commission

ASIC media releases are point-in-time statements. Please note the date of issue and use the internal search function on the site to check for other media releases on the same or related matters.

Wednesday 8 June 2016

16-186MR Former Aussie Home Loans mortgage broker convicted of loan fraud

Ms Emma Feduniw, also known as Emma Khalil, a former mortgage broker with AHL Investments Pty Ltd (trading as Aussie), has been convicted and sentenced today in the Beenleigh Magistrates Court on eight charges relating to home loan fraud.

Ms Feduniw, of Brisbane, Queensland, was convicted and fined $8,500 after admitting she provided documents in support of eight loan applications submitted to Westpac Banking Corporation (Westpac) knowing that they contained false or misleading information. The applications contained letters which purported to be from the applicant's employer. These letters were false and often the loan applicant had never worked for the particular employer.

In sentencing Ms Feduniw, Magistrate Thacker acknowledged that Ms Feduniw had cooperated with ASIC, admitted to the offences and entered a plea of guilty at the earliest possible opportunity. However, Magistrate Thacker rejected the submission that this was a victimless crime, stating: 'It's not a victimless crime when one looks at the necessity to protect the system from being impacted by fraud.'

ASIC Deputy Chair Peter Kell said, 'Mortgage brokers are entrusted by both borrowers and lenders to provide information that is accurate and truthful, to avoid borrowers taking on loans they can't afford. ASIC will continue to ensure that mortgage brokers who provide false documentation are held to account'.

The Commonwealth Director of Public Prosecutions (CDPP) prosecuted the matter.

Background

ASIC's investigation found that between March 2013 and February 2014, Ms Feduniw, while a mortgage broker of Aussie, submitted eight loan applications to Westpac totalling $2,720,400 that contained false borrower employment letters. Of the eight loan applications, five were approved and disbursed, totalling $1,608,400. Ms Feduniw received commission on those five loans of $6,847.53.

On 4 April 2014, Aussie terminated Ms Feduniw's authorisation to provide credit services as a credit representative of Aussie.

Ms Feduniw received her commission through Miga Loans Pty Ltd (ACN 106 962 467) a company controlled and owned by her.

On 1 April 2016, Ms Feduniw appeared in Beenleigh Magistrate's Court and pleaded guilty to eight charges under section 160D of the *National Consumer Credit Protection Act 2009* whilst she was engaging in credit activity on behalf of Aussie.

Section 160D makes it an offence for a person engaging in credit activities to give false or misleading information or documents to another person.

Ms Feduniw was fined $1,000 for each of seven of the charges and $1,500 for a charge where Ms Feduniw had escalated her involvement to forging the false document.

Since becoming the national regulator of consumer credit on 1 July 2010, ASIC has taken 79 actions involving loan fraud, including 60 actions to ban individuals and companies from providing or engaging in credit services or holding an Australian credit licence. ASIC has also commenced 13 criminal proceedings involving loan fraud.

Last updated: 08/06/2016 01:08

ASIC
Australian Securities & Investments Commission

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Thursday 7 July 2016

16-219MR Former AUSSIE mortgage broker admits to charges relating to the submission of false loan applications

Mr Madhvan Nair, a former mortgage broker with AHL Investments Pty Ltd (trading as Aussie), has admitted through his solicitor to eighteen charges brought by ASIC. The charges related to the submission, by Mr Nair, of loan applications and supporting documents which he knew contained false information, to secure approvals for home loans from Westpac, National Australia Bank, and ANZ.

ASIC's investigation found that between September 2012 and June 2014, Mr Nair submitted eighteen loan applications totalling $5,594,559 containing false borrower employment documents. Of the eighteen loan applications, twelve were approved and disbursed, totaling $3,721,684.

Mr Nair received commission on those twelve loans of $7,583.49. In addition Mr Nair received cash payments totalling $2,500 from two of the loan applicants upon approval of their loan applications. Mr Nair therefore received a financial benefit of $10,083.49 as a result of the approved loan applications.

The eighteen loan applications ranged in value from $10,000 to $490,875.

Mr Nair appeared before the Downing Centre Local Court and through his solicitor admitted to providing documents in support of loan applications that were false or misleading.

Mr Nair next appears in court on 30 August 2016 for sentencing

The Commonwealth Director of Public Prosecutions (CDPP) is prosecuting the matter.

Background

Mr Nair was authorised to provide credit services as a credit representative to consumers from 1 July 2010 to 7 July 2014, when Aussie terminated his authorisation.

Mr Nair received his commission through Smee & Pree Nair Enterprises Pty Ltd (ACN 091 014 756) a company controlled and owned by Mr Nair.

Mr Nair was charged by ASIC under section 160D (and the former section 33(2)) of the *National Consumer Credit Protection Act 2009* in relation to his conduct whilst he was engaging in credit activity on behalf of Aussie. Section 160D (formerly section 33(2)) makes it an offence for a person engaging in credit activities to give false or misleading information or documents to another person. He appeared in Court and pleaded guilty to the charges on 5 July 2016.

Mr Nair faces a maximum penalty of one year imprisonment or a fine of up to 60 penalty units (which in the case of sequence 1 equates to $6,600 and in the case of sequences 2 to 18 equates to $10,200), or both, for each charge.

Last updated: 12/07/2016 10:56

ASIC
Australian Securities & Investments Commission

ASIC media releases are point-in-time statements. Please note the date of issue and use the internal search function on the site to check for other media releases on the same or related matters.

Tuesday 6 September 2016

16-293MR Former Aussie mortgage broker convicted of submitting false or misleading documents

Mr Madhvan Nair, a former mortgage broker with AHL Investments Pty Ltd (trading as Aussie Home Loans), was convicted and sentenced in the Downing Centre Local Court last week on eighteen charges involving the submission of false or misleading information to banks.

Mr Nair was convicted after admitting to providing documents in support of eighteen loan applications to Westpac Banking Corporation (Westpac), Australia and New Zealand Banking Group (ANZ) and National Australia Bank (NAB) knowing that they contained false or misleading information.

The applications contained documents which purported to be from the applicant's employer. These documents were false and in most instances, the loan applicant had never worked for the particular employer.

For each and all eighteen charges, Mr Nair was convicted and released upon entering into a recognizance in the amount of $1,000 on the condition that he be of good behaviour for three years.

In sentencing Mr Nair, Magistrate Atkinson noted that it was a serious matter and that there are tough laws for good reason.

Magistrate Atkinson described the nature of the offending in submitting 18 separate loan applications containing false information or documents as very troubling. Noting Mr Nair had no prior convictions, his ill health, the relatively small financial benefit he received, his plea of guilty and high level of cooperation with ASIC, Magistrate Atkinson stated that had any of the factors been different, the defendant may have faced full-time imprisonment.

ASIC Deputy Chair Peter Kell said, 'ASIC wants to ensure that dishonest brokers are removed from the industry and we will take all necessary steps to achieve this.'

The Commonwealth Director of Public Prosecutions (CDPP) prosecuted the matter.

Background

ASIC's investigation found that between September 2012 and June 2014, Mr Nair submitted eighteen loan applications containing false borrower employment documents. Of the eighteen loan applications, twelve were approved and disbursed, totaling $3,256,684.

Mr Nair received commission on those twelve loans of $7,583.49. In addition, Mr Nair received cash payments totalling $2,500 from two of the loan applicants upon approval of their loan applications. Mr Nair received a total financial benefit of $10,083.49 as a result of the approved loan applications.

The eighteen loan applications ranged in value from $10,000 to $490,875.

Mr Nair received his commission through Smee & Pree Nair Enterprises Pty Ltd (ACN 091 014 756), a company controlled and owned by Mr Nair.

On 5 July 2016, Mr Nair appeared at the Downing Centre Local Court and pleaded guilty to seventeen charges under sections 160D and one charge under the former section 33(2) of the *National Consumer Credit Protection Act 2009*.

Section 160D (formerly section 33(2)) makes it an offence for a person engaging in credit activities to give information or documents to another person which is false in a material particular or materially misleading.

Mr Nair was sentenced on 30 August 2016.

Since becoming the national regulator of consumer credit on 1 July 2010, ASIC has taken 80 actions involving loan fraud, including 61 actions to ban individuals and companies from providing or engaging in credit services or holding an Australian credit licence. ASIC has also commenced 14 criminal proceedings involving loan fraud.

Last updated: 22/09/2016 02:05

ASIC

Australian Securities & Investments Commission

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Friday 27 January 2017

17-016MR Former Aussie Home Loans mortgage broker permanently banned by ASIC

ASIC has permanently banned Mr Madhvan Nair of Kellyville NSW, from the credit and financial services industries.

The bans follow an ASIC investigation which led to Mr Nair, a former mortgage broker with AHL Investments Pty Ltd (trading as Aussie), being convicted in Downing Centre Local Court on eighteen charges relating to home loan fraud. On each of the eighteen charges, Mr Nair was convicted and released upon entering in to a recognizance of $1,000 with the condition that he be of good behaviour for three years (refer: 16-293MR).

ASIC's investigation found that Mr Nair provided documents in support of eighteen loan applications knowing that they contained false or misleading information.

The applications contained letters which purported to be from the applicant's employer. These documents were false and in most instances, the loan applicant had never worked for the particular employer.

Mr Nair has the right to appeal to the Administrative Appeals Tribunal (AAT) for a review of ASIC's decision.

Background

On 5 July 2016, Mr Nair through his solicitor, pleaded guilty to seventeen charges under section 160D of the National Consumer Credit Protection Act 2009 (the Credit Act) and one charge under the former Section 33(2) of the Credit Act while he was engaging in credit activity on behalf of Aussie. Section 160D (and the former Section 33(2)) makes it an offence for a person engaging in credit activities to give false or misleading information or documents to another person.

Mr Nair provided false employment documents to secure approvals for home loans, submitted to Westpac Banking Corporation (Westpac), Australia and New Zealand Banking Group (ANZ) and National Australia Bank (NAB) (refer:16-219MR).

On each of the eighteen charges, Mr Nair was convicted and released upon entering into a recognizance of $1,000 on the condition that he be of good behaviour for three years (refer:16-293MR).

Since becoming the national regulator of consumer credit on 1 July 2010, ASIC has investigated in excess of 100 matters relating to loan fraud and has achieved many enforcement outcomes against the offenders. The outcomes range from undertakings by persons to voluntarily leave the industry, to bans and prosecutions.

To date, ASIC has banned, suspended or placed conditions of the licence of 80 individuals or companies from providing credit services (including 35 permanent bans). Through the Commonwealth Director of Public Prosecutions, ASIC has brought criminal prosecutions against 14 credit service providers; with 12 having been convicted of fraud or dishonesty offences relating to the provision of false and misleading information or documents to lenders in client loan applications.

Last updated: 27/01/2017 11:59

ASIC
Australian Securities & Investments Commission

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Thursday 20 October 2016

16-358MR ASIC permanently bans Aussie Home Loans mortgage broker

Mr Bernard Meehan, a former mortgage broker for AHL Investments Pty Ltd (trading as Aussie Home Loans), has been permanently banned from engaging in credit activities by ASIC.

ASIC's investigation found that Mr Meehan had submitted payslips, document checklists and loan serviceability forms in nine home loan applications to Westpac Banking Group (Westpac) over a twelve month period from January 2014 to January 2015, that were false or materially misleading. Among the false documents were payslips that had not been issued by the purported employer.

ASIC found that Mr Meehan's actions were wrong, inconsistent with a compliance mentality and showed a lacked of insight into what was required of a broker. Mr Meehan failed to adhere to proper procedures and did not accept wrongdoing or show appreciation of the fact that what he did involved failure to comply with credit legislation.

Aussie Home Loans reported the misconduct to ASIC.

ASIC's Deputy Chairman Peter Kell said, 'Gatekeepers, such as banks, aggregators and franchise groups have an important role to play in regulating the mortgage broking industry and act as a first line of defence to detect inappropriate practices and behaviour.'

Mr Meehan has the right to appeal to the Administrative Appeals Tribunal for a review of ASIC's decision.

Background

Since becoming the national regulator of consumer credit on 1 July 2010, ASIC has investigated in excess of 100 matters relating to loan fraud and has achieved many enforcement outcomes against the offenders.

The outcomes range from undertakings by persons to voluntarily leave the industry to bans and prosecutions. To date, ASIC has banned 74 individuals or companies from providing credit services (including 32 permanent bans).

Through the Commonwealth Director of Public Prosecutions, ASIC has also brought criminal prosecutions against 14 credit service providers; with 12 having been convicted of fraud or dishonesty offences relating to the provision of false and misleading information/documents to lenders in client loan applications.

Mr Meehan is the fourth Aussie Home Loans mortgage broker who has been permanently banned and/or convicted over the past 18 months for submitting false or misleading documents in loan applications. The other three mortgage brokers were:

- Mr Madhvan Nair – convicted on eighteen charges involving the submission of false or misleading information to Westpac, National Australia Bank, and ANZ, see 16-219MR and 16-293MR.
- Ms Emma Feduniw – convicted and permanently banned for providing false documents in eight loan applications to Westpac, see 16-108MR, 16-186MR and 16-242MR.
- Mr Shiv Prakash Sahay – convicted and permanently banned for providing false documents in loan applications for seventeen of his clients to Bankwest and Suncorp Metway Limited, see 15-176MR and 15-128MR.

Last updated: 20/10/2016 10:28

ASIC
Australian Securities & Investments Commission

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Wednesday 14 September 2016

16-308MR CBA pays $180,000 in penalties and will write off $2.5 million in loan balances

Commonwealth Bank of Australia (CBA) has paid four infringement notices totalling $180,000 in relation to breaches of responsible lending laws when providing personal overdraft facilities.

CBA reported this matter to ASIC following an ASIC surveillance. CBA conducted an internal review which identified a programming error in the automated serviceability calculator used to assess certain applications for personal overdrafts.

As a result of the error, between July 2011 and September 2015, CBA failed to take into consideration the declared housing and living expenses of some consumers.

Instead, CBA's serviceability calculator substituted $0 housing expenses, and living expenses based on a benchmark which in some instances was substantially less than the living expenses declared by the consumer. As a result, this led to an over-estimation of the consumer's capacity to service the overdraft facility.

CBA informed ASIC that between July 2011 and September 2015, as a result of the error, CBA approved:

- 9,577 consumers for overdrafts which would have otherwise been declined; and
- 1,152 consumers for higher overdraft limits than would have otherwise been provided.

Some consumers were approved for a personal overdraft, or an increased limit on their personal overdraft, even though their declared expenses were greater than their declared income.

ASIC was concerned that this conduct breached responsible lending laws and that affected consumers would have been unable to comply, or could only comply with substantial hardship, with their obligation to repay their personal overdraft on demand.

CBA has informed ASIC that it will write off a total of approximately $2.5 million in personal overdraft balances.

ASIC Deputy Chairman Peter Kell said, 'Credit licensees should continuously monitor their internal processes to ensure compliance with the law. This is especially the case with automated decision-making systems where ongoing monitoring is needed to ensure that information is correctly inputted into systems.'

Background

The responsible lending obligations that prohibit lenders from entering into credit contracts which are unsuitable for the consumer are found in the National Consumer Credit Protection Act 2009 (Cth). The laws aim to ensure that credit contracts are not unsuitable for consumers (see s133(1)), and consumers are likely able to afford the credit contract (see s133(2)).

ASIC issued four infringement notices in August 2016 totalling $180,000 for the breaches outlined above.

CBA self-reported the breaches to ASIC, and has co-operated with ASIC's investigation.

The payment of an infringement notice is not an admission of guilt in respect of the alleged contravention. ASIC can issue an infringement notice where it has reasonable grounds to believe a person has committed particular contraventions of the National Credit Act.

Download the infringement notices

Last updated: 22/09/2016 12:22

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ON THE RECORD

CBA ACKNOWLEDGES ASIC FINES FOR PERSONAL OVERDRAFTS

14 SEPTEMBER 2016

System error identified and fixed, ASIC notified and customers remediated.

Commonwealth Bank acknowledges the statement by the Australian Securities & Investments Commission announcing the fines relating to incorrectly assessing a small number of personal overdraft applications.

Commonwealth Bank identified a system error which meant the Bank did not consider all expense information during the serviceability assessment. Our review determined this affected approximately

11,000 customers, fewer than two per cent of our personal overdraft customers. Commonwealth Bank reported this matter at the time to ASIC and has nearly completed remediating affected customers.

“We sincerely apologise to our customers and we regret that this error occurred,” Clive van Horen, Executive General Manager, Retail Products and Strategy said.

“When we make a mistake that impacts our customers we will put it right to ensure our customers are not adversely affected.

“Once we identified this error, we informed the Australian Securities & Investments Commission and have been working with the regulator as we correct this issue for affected customers. We continue to review our systems and processes to ensure we are delivering the best possible customer experience,” Mr van Horen said.

Affected customers are being contacted to let them know of the error, as well as the need to remove or reduce their personal overdraft. We have also advised customers that any outstanding debt associated with this error is being written off, amounting to approximately $2.5m, and that their credit ratings have not been impacted as a result of this mistake.

Should customers have any questions they can contact the bank on 13 22 21.

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S01863990

Infringement notice

section 331 of the Act
paragraph 40(a) of the Regulations

Date of issue: 16/08/2016
Unique identification code: S01863990

TO: **Commonwealth Bank of Australia ACN 123 123 124**
Ground Floor Tower 1
201 Sussex Street
Sydney NSW 2000

1. I, David McGuinness, give this infringement notice under regulation 39 of the *National Consumer Credit Protection Regulations 2010.*

2. I have reasonable grounds to believe that you have contravened the following civil penalty provision:

   On 18 August 2015 at 07:56 AM at Nerang, Queensland, as a holder of Australian Credit Licence number 234945 pursuant to section 35 of the *National Consumer Credit Protection Act 2009* (the Act), you engaged in conduct contrary to subsection 133(1)(b) of the Act, namely increasing the credit limit of a credit contract (an overdraft facility) with a consumer from $2,000 to $4,000, when the contract was unsuitable for the consumer pursuant to subsection 133(2)(a) of the Act.

   The contract was unsuitable for the consumer pursuant to section 133(2)(a) of the Act in that at the time the credit limit was increased, it was likely that the consumer would be unable to comply with the consumer's obligations under the contract, or could only comply with substantial hardship.

   Due to a programming error in the serviceability calculation, you assessed the unsuitability of the contract without taking into account the consumer's declared housing expenses and living expenses. Instead you substituted $0 housing expenses, and living expenses based on a benchmark which was substantially less than that declared by the consumer. Had you assessed the unsuitability of the contract taking into account the consumer's declared expenses, the contract would have been assessed as unsuitable because the consumer's expenses were greater than the consumer's income.

Penalty under this notice

3. The penalty for the alleged offence under this notice is **$9,000.00** for an individual or **$45,000.00** for a body corporate.

   The applicable penalty in this notice is **$45,000.00.**

   This penalty can be paid by **(see attached invoice for payment options).**

4. If you pay the penalty stated in this notice within the time for payment mentioned below then (unless this notice is subsequently withdrawn and any penalty paid refunded):

   (a) any liability you have for the alleged contravention of the provision will be discharged; and

   (b) no civil proceedings will be brought against you by the Commonwealth for the alleged contravention; and;

   (c) you will not be taken to have admitted guilt in respect of the alleged contravention; and

   (d) you will not be taken to have been found guilty of the alleged contravention.

Consequences of failure to pay penalty under this notice

5. If you do not pay the penalty specified in this notice within the time for payment mentioned below, civil proceedings may be brought against you for the alleged contravention.

6. The maximum penalty that a court may impose for this offence is **2,000** penalty units for an individual and **10,000** penalty units for a body corporate.

Time for payment

7. The time for payment is:

   (a) within 28 days after the day on which the notice is given to you; or

   (b) if you apply for a further period of time in which to pay the penalty, and the application is granted — within the further period allowed; or

   (c) if you apply for a further period of time in which to pay the penalty, and the application is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of refusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you; or

   (d) if you apply for permission to pay the penalty by instalments, and the permission is granted — in accordance with the permission; or

   (e) if you apply for permission to pay the penalty by instalments, and the permission is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of refusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you; or

   (f) if you apply for the notice to be withdrawn, and the application is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

(A) the day you receive the notice of refusal; or

(B) the application is taken to have been refused; and

(ii) 28 days after the day on which the infringement notice was given to you.

Further penalty for continuing offence

8. If the alleged contravention of the civil penalty provision continues beyond 18 August 2015 a further penalty may be imposed even if the penalty imposed by this notice is paid.

Applying to have this notice withdrawn

9. Within 28 days after you receive this notice, you may apply to the **Credit Infringement Notice Officer** to have this notice withdrawn.

(the Credit Infringement Notice Officer is the nominated person)

Applying for more time to pay the penalty under this notice

10. Within 28 days after you receive this notice, you may apply to the nominated person for a further period of up to 28 days in which to pay the penalty under this notice.

Applying to pay the penalty under this notice by instalments

11. Within 28 days after you receive this notice, you may apply to the nominated person for permission to pay the penalty under this notice by instalments.

Requirements for applications

12. An application to have this notice withdrawn, or for more time to pay the penalty under this notice, or for permission to pay the penalty under this notice by instalments:

(a) must be in writing; and

(b) must include the unique identification code set out at the top of this notice; and

(c) must include your reasons for making the application; and

(d) for an application for permission to pay the penalty under this notice by instalments — include the proposed amount and frequency of instalments; and

(e) may be made by forwarding your application to:

Credit Infringement Notice Officer

Australian Securities and Investments Commission

GPO Box 9827

Melbourne VIC 3001

or by facsimile: (03) 9280 3444

or by email: CreditInfringementNotices@asic.gov.au

Signed

....

David McGuinness
Authorised ASIC officer issuing the notice

ASIC
Australian Securities & Investments Commission

To: Commonwealth Bank of Australia
ACN 123 123 124

Address: Commonwealth Bank of Australia
Ground Floor Tower 1
201 Sussex Street
SYDNEY NSW 2000

Level 5, 100 Market Street,
Sydney NSW 2000
GPO Box 9827, Sydney NSW 2001
DX 653 Sydney

Telephone: +61 2 9911 2000
Facsimile: +61 2 9911 2414
www.asic.gov.au

Infringement Notice Unique Identification Code:	S01863990
Account Number:	66123123124
Issue Date:	16/08/2016

INVOICE

Infringement Notice Penalty $45,000.00

This invoice is issued for payment of the penalty under infringement notice S01863990

To stop further action being taken in relation to the alleged offence/ civil penalty contravention described in the infringement notice, ensure payment of the penalty is made within 28 days of receipt of the infringement notice

For assistance, contact Helen Hasek on (02) 9911 5714

This notice may not include all monies owed to ASIC.
Not Subject to GST, (Treasurer's Determination Exempt Taxes, Fees and Charges).

Payment Slip

Account Number: 66123123124

Recipient: Commonwealth Bank of Australia

Due this notice: $45,000.00

PAYMENT OPTIONS

POST billpay

Billpay Code: 8929
Ref: 669123123124242

Australia Post,
Present this payment slip. Pay by cash, cheque or EFTPOS.

Phone
Call 13 18 16 to pay by MasterCard or Visa

Online
Go to postbillpay.com.au to pay by MasterCard or Visa

Electronic Funds Transfer
ASIC's account details are:

BANK:	Reserve Bank of Australia
BSB:	093003
BANK ACCOUNT:	317118
ACCOUNT NAME:	ASIC Collectors rec.Acc.
REFERENCE:	66912312312 42

B PAY

Biller Code: 17301
Ref: 66912312312 42

Use these details for phone or internet banking. Call your financial institution to pay from your cheque, savings or credit card account. For info; www.bpay.com.au

Mail
Mail this payment slip and cheque (do not staple) to ASIC, Locked Bag 5000, Gippsland Mail Centre VIC 3841

Aus Post Barcode: *814 129 0006691231231242 42

S01863989

Infringement notice

section 331 of the Act
paragraph 40(a) of the Regulations

Date of issue: 16/08/2016

Unique identification code: S01863989

TO: **Commonwealth Bank of Australia ACN 123 123 124**
Ground Floor Tower 1
201 Sussex Street
Sydney NSW 2000

1. I, David McGuinness, give this infringement notice under regulation 39 of the *National Consumer Credit Protection Regulations 2010.*

2. I have reasonable grounds to believe that you have contravened the following civil penalty provision:

   On 21 August 2015 at 4:06 PM at Kilsyth, Victoria, as a holder of Australian Credit Licence number 234945 pursuant to section 35 of the *National Consumer Credit Protection Act 2009* (the Act), you engaged in conduct contrary to subsection 133(1)(b) of the Act, namely increasing the credit limit of a credit contract (an overdraft facility) with a consumer from $800 to $1,500, when the contract was unsuitable for the consumer pursuant to subsection 133(2)(a) of the Act.

   The contract was unsuitable for the consumer pursuant to section 133(2)(a) of the Act in that at the time the credit limit was increased, it was likely that the consumer would be unable to comply with the consumer's obligations under the contract, or could only comply with substantial hardship.

   Due to a programming error in the serviceability calculation, you assessed the unsuitability of the contract without taking into account the consumer's declared housing expenses. Instead you substituted $0 housing expenses. Had you assessed the unsuitability of the contract taking into account the consumer's declared housing expenses, the contract would have been assessed as unsuitable because the consumer's expenses were greater than the consumer's income.

Penalty under this notice

3. The penalty for the alleged offence under this notice is **$9,000.00** for an individual or **$45,000.00** for a body corporate.

   The applicable penalty in this notice is **$45,000.00.**

   This penalty can be paid by **(see attached invoice for payment options).**

4. If you pay the penalty stated in this notice within the time for payment mentioned below then (unless this notice is subsequently withdrawn and any penalty paid refunded):

   (a) any liability you have for the alleged contravention of the provision will be discharged; and

   (b) no civil proceedings will be brought against you by the Commonwealth for the alleged contravention; and;

   (c) you will not be taken to have admitted guilt in respect of the alleged contravention; and

   (d) you will not be taken to have been found guilty of the alleged contravention.

Consequences of failure to pay penalty under this notice

5. If you do not pay the penalty specified in this notice within the time for payment mentioned below, civil proceedings may be brought against you for the alleged contravention.

6. The maximum penalty that a court may impose for this offence is **2,000** penalty units for an individual and **10,000** penalty units for a body corporate.

Time for payment

7. The time for payment is:

   (a) within 28 days after the day on which the notice is given to you; or

   (b) if you apply for a further period of time in which to pay the penalty, and the application is granted — within the further period allowed; or

   (c) if you apply for a further period of time in which to pay the penalty, and the application is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of refusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you; or

   (d) if you apply for permission to pay the penalty by instalments, and the permission is granted — in accordance with the permission; or

   (e) if you apply for permission to pay the penalty by instalments, and the permission is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of refusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you; or

   (f) if you apply for the notice to be withdrawn, and the application is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

(A) the day you receive the notice of refusal; or

(B) the application is taken to have been refused; and

(ii) 28 days after the day on which the infringement notice was given to you.

Further penalty for continuing offence

8. If the alleged contravention of the civil penalty provision continues beyond 21 August 2015 a further penalty may be imposed even if the penalty imposed by this notice is paid.

Applying to have this notice withdrawn

9. Within 28 days after you receive this notice, you may apply to the **Credit Infringement Notice Officer** to have this notice withdrawn.

(the Credit Infringement Notice Officer is the nominated person)

Applying for more time to pay the penalty under this notice

10. Within 28 days after you receive this notice, you may apply to the nominated person for a further period of up to 28 days in which to pay the penalty under this notice.

Applying to pay the penalty under this notice by instalments

11. Within 28 days after you receive this notice, you may apply to the nominated person for permission to pay the penalty under this notice by instalments.

Requirements for applications

12. An application to have this notice withdrawn, or for more time to pay the penalty under this notice, or for permission to pay the penalty under this notice by instalments:

(a) must be in writing; and

(b) must include the unique identification code set out at the top of this notice; and

(c) must include your reasons for making the application; and

(d) for an application for permission to pay the penalty under this notice by instalments — include the proposed amount and frequency of instalments; and

(e) may be made by forwarding your application to:

Credit Infringement Notice Officer

Australian Securities and Investments Commission

GPO Box 9827

Melbourne VIC 3001

or by facsimile: (03) 9280 3444

or by email: CreditInfringementNotices@asic.gov.au

Signed

....

David McGuinness

Authorised ASIC officer issuing the notice

ASIC
Australian Securities & Investments Commission

Level 5, 100 Market Street,
Sydney NSW 2000
GPO Box 9827, Sydney NSW 2001
DX 653 Sydney

Telephone: +61 2 9911 2000
Facsimile: +61 2 9911 2414
www.asic.gov.au

To: Commonwealth Bank of Australia
ACN 123 123 124

Address: Commonwealth Bank of Australia
Ground Floor Tower 1
201 Sussex Street
SYDNEY NSW 2000

Infringement Notice Unique Identification Code:	S01863989
Account Number:	66123123124
Issue Date:	16/08/2016

INVOICE

Infringement Notice Penalty $45,000.00

This invoice is issued for payment of the penalty under infringement notice S01863989

To stop further action being taken in relation to the alleged offence/ civil penalty contravention described in the infringement notice, ensure payment of the penalty is made within 28 days of receipt of the infringement notice

For assistance, contact Helen Hasek on (02) 9911 5714

This notice may not include all monies owed to ASIC.
Not Subject to GST, (Treasurer's Determination Exempt Taxes, Fees and Charges).

Payment Slip

Account Number: 66123123124

Recipient: Commonwealth Bank of Australia

Due this notice: $45,000.00

PAYMENT OPTIONS

POST billpay

Billpay Code: 8929
Ref: 669123123124242

Australia Post,
Present this payment slip. Pay by cash, cheque or EFTPOS.

Phone
Call 13 18 16 to pay by MasterCard or Visa

Online
Go to postbillpay.com.au to pay by MasterCard or Visa

Electronic Funds Transfer
ASIC's account details are:

BANK:	Reserve Bank of Australia
BSB:	093003
BANK ACCOUNT:	317118
ACCOUNT NAME:	ASIC Collectors rec.Acc.
REFERENCE:	6691231231242

B PAY

Biller Code: 17301
Ref: 6691231231242

Use these details for phone or internet banking. Call your financial institution to pay from your cheque, savings or credit card account. For info; www.bpay.com.au

Mail
Mail this payment slip and cheque (do not staple) to ASIC, Locked Bag 5000, Gippsland Mail Centre VIC 3841

Aus Post Barcode: *814 129 0006691231231242 42

S01863988

Infringement notice

section 331 of the Act
paragraph 40(a) of the Regulations

Date of issue: 16/08/16.
Unique identification code: S01863988

TO: **Commonwealth Bank of Australia ACN 123 123 124**
Ground Floor Tower 1
201 Sussex Street
Sydney NSW 2000

1. I, David McGuinness, give this infringement notice under regulation 39 of the *National Consumer Credit Protection Regulations 2010.*

2. I have reasonable grounds to believe that you have contravened the following civil penalty provision:

   On 17 September 2015 at 5:40 PM at Wynyard, New South Wales, as a holder of Australian Credit Licence number 234945 pursuant to section 35 of the *National Consumer Credit Protection Act 2009* (the Act), you engaged in conduct contrary to subsection 133(1)(a) of the Act, namely entering into a credit contract with a consumer for an overdraft facility with a credit limit of $1,500, when the contract was unsuitable for the consumer pursuant to subsection 133(2)(a) of the Act

   The contract was unsuitable for the consumer pursuant to section 133(2)(a) of the Act in that at the time the credit contract was entered into, it was likely that the consumer would be unable to comply with the consumer's obligations under the contract, or could only comply with substantial hardship.

   Due to a programming error in the serviceability calculation, you assessed the unsuitability of the contract without taking into account the consumer's declared housing expenses. Instead you substituted $0 housing expenses. Had you assessed the unsuitability of the contract taking into account the consumer's declared housing expenses, the contract would have been assessed as unsuitable because the consumer's expenses were greater than the consumer's income.

Penalty under this notice

3. The penalty for the alleged offence under this notice is **$9,000.00** for an individual or **$45,000.00** for a body corporate.

   The applicable penalty in this notice is **$45,000.00.**

   This penalty can be paid by **(see attached invoice for payment options)**.

4. If you pay the penalty stated in this notice within the time for payment mentioned below then (unless this notice is subsequently withdrawn and any penalty paid refunded):

   (a) any liability you have for the alleged contravention of the provision will be discharged; and

   (b) no civil proceedings will be brought against you by the Commonwealth for the alleged contravention; and;

   (c) you will not be taken to have admitted guilt in respect of the alleged contravention; and

   (d) you will not be taken to have been found guilty of the alleged contravention.

Consequences of failure to pay penalty under this notice

5. If you do not pay the penalty specified in this notice within the time for payment mentioned below, civil proceedings may be brought against you for the alleged contravention.

6. The maximum penalty that a court may impose for this offence is **2,000** penalty units for an individual and **10,000** penalty units for a body corporate.

Time for payment

7. The time for payment is:

   (a) within 28 days after the day on which the notice is given to you; or

   (b) if you apply for a further period of time in which to pay the penalty, and the application is granted — within the further period allowed; or

   (c) if you apply for a further period of time in which to pay the penalty, and the application is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of refusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you; or

   (d) if you apply for permission to pay the penalty by instalments, and the permission is granted — in accordance with the permission; or

   (e) if you apply for permission to pay the penalty by instalments, and the permission is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of refusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you; or

   (f) if you apply for the notice to be withdrawn, and the application is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

(A) the day you receive the notice of refusal; or

(B) the application is taken to have been refused; and

(ii) 28 days after the day on which the infringement notice was given to you.

Further penalty for continuing offence

8. If the alleged contravention of the civil penalty provision continues beyond 17 September 2015 a further penalty may be imposed even if the penalty imposed by this notice is paid.

Applying to have this notice withdrawn

9. Within 28 days after you receive this notice, you may apply to the **Credit Infringement Notice Officer** to have this notice withdrawn.

(the Credit Infringement Notice Officer is the nominated person)

Applying for more time to pay the penalty under this notice

10. Within 28 days after you receive this notice, you may apply to the nominated person for a further period of up to 28 days in which to pay the penalty under this notice.

Applying to pay the penalty under this notice by instalments

11. Within 28 days after you receive this notice, you may apply to the nominated person for permission to pay the penalty under this notice by instalments.

Requirements for applications

12. An application to have this notice withdrawn, or for more time to pay the penalty under this notice, or for permission to pay the penalty under this notice by instalments:

(a) must be in writing; and

(b) must include the unique identification code set out at the top of this notice; and

(c) must include your reasons for making the application; and

(d) for an application for permission to pay the penalty under this notice by instalments — include the proposed amount and frequency of instalments; and

(e) may be made by forwarding your application to:

Credit Infringement Notice Officer

Australian Securities and Investments Commission

GPO Box 9827

Melbourne VIC 3001

or by facsimile: (03) 9280 3444

or by email: CreditInfringementNotices@asic.gov.au

Signed

....

David McGuinness
Authorised ASIC officer issuing the notice

ASIC
Australian Securities & Investments Commission

Level 5, 100 Market Street,
Sydney NSW 2000
GPO Box 9827, Sydney NSW 2001
DX 653 Sydney

Telephone: +61 2 9911 2000
Facsimile: +61 2 9911 2414
www.asic.gov.au

To: Commonwealth Bank of Australia
ACN 123 123 124

Address: Commonwealth Bank of Australia
Ground Floor Tower 1
201 Sussex Street
SYDNEY NSW 2000

Infringement Notice Unique Identification Code: S01863988
Account Number: 66123123124
Issue Date: 16/08/2016

INVOICE

Infringement Notice Penalty $45,000.00

This invoice is issued for payment of the penalty under infringement notice S01863988

To stop further action being taken in relation to the alleged offence/ civil penalty contravention described in the infringement notice, ensure payment of the penalty is made within 28 days of receipt of the infringement notice

For assistance, contact Helen Hasek on (02) 9911 5714

This notice may not include all monies owed to ASIC.
Not Subject to GST, (Treasurer's Determination Exempt Taxes, Fees and Charges).

Payment Slip

Account Number: 66123123124

Recipient: Commonwealth Bank of Australia

Due this notice: $45,000.00

PAYMENT OPTIONS

POST billpay

Billpay Code: 8929
Ref: 669123123124242

Australia Post,
Present this payment slip. Pay by cash, cheque or EFTPOS.

Phone
Call 13 18 16 to pay by MasterCard or Visa

Online
Go to postbillpay.com.au to pay by MasterCard or Visa

Electronic Funds Transfer
ASIC's account details are:

BANK:	Reserve Bank of Australia
BSB:	093003
BANK ACCOUNT:	317118
ACCOUNT NAME:	ASIC Collectors rec.Acc.
REFERENCE:	6691231231242

B PAY

Biller Code: 17301
Ref: 6691231231242

Use these details for phone or internet banking. Call your financial institution to pay from your cheque, savings or credit card account. For info; www.bpay.com.au

Mail
Mail this payment slip and cheque (do not staple) to ASIC, Locked Bag 5000, Gippsland Mail Centre VIC 3841

Aus Post Barcode: *814 129 0006691231231242 42

S01863987

Infringement notice

section 331 of the Act
paragraph 40(a) of the Regulations

Date of issue: 16/08/16

Unique identification code: S01863987

TO: **Commonwealth Bank of Australia ACN 123 123 124**
Ground Floor Tower 1
201 Sussex Street
Sydney NSW 2000

1. I, David McGuinness, give this infringement notice under regulation 39 of the *National Consumer Credit Protection Regulations 2010.*

2. I have reasonable grounds to believe that you have contravened the following civil penalty provision:

   On 15 September 2015 at 4:15 PM at Morwell, Victoria, as a holder of Australian Credit Licence number 234945 pursuant to section 35 of the *National Consumer Credit Protection Act 2009* (the Act), you engaged in conduct contrary to subsection 133(1)(a) of the Act, namely entering into a credit contract with a consumer for an overdraft facility with a credit limit of $1,000, when the contract was unsuitable for the consumer pursuant to subsection 133(2)(a) of the Act.

   The contract was unsuitable for the consumer pursuant to section 133(2)(a) of the Act in that at the time the credit contract was entered into, it was likely that the consumer would be unable to comply with the consumer's obligations under the contract, or could only comply with substantial hardship.

   Due to a programming error in the serviceability calculation, you assessed the unsuitability of the contract without taking into account the consumer's declared housing expenses and living expenses. Instead you substituted $0 housing expenses, and living expenses based on a benchmark which was substantially less than that declared by the consumer. Had you assessed the unsuitability of the contract taking into account the consumer's declared expenses, the contract would have been assessed as unsuitable because the consumer's expenses were greater than the consumer's income.

Penalty under this notice

3. The penalty for the alleged offence under this notice is **$9,000.00** for an individual or **$45,000.00** for a body corporate.

   The applicable penalty in this notice is **$45,000.00.**

   This penalty can be paid by **(see attached invoice for payment options)**.

4. If you pay the penalty stated in this notice within the time for payment mentioned below then (unless this notice is subsequently withdrawn and any penalty paid refunded):

   (a) any liability you have for the alleged contravention of the provision will be discharged; and

   (b) no civil proceedings will be brought against you by the Commonwealth for the alleged contravention; and;

   (c) you will not be taken to have admitted guilt in respect of the alleged contravention; and

   (d) you will not be taken to have been found guilty of the alleged contravention.

Consequences of failure to pay penalty under this notice

5. If you do not pay the penalty specified in this notice within the time for payment mentioned below, civil proceedings may be brought against you for the alleged contravention.

6. The maximum penalty that a court may impose for this offence is **2,000** penalty units for an individual and **10,000** penalty units for a body corporate.

Time for payment

7. The time for payment is:

   (a) within 28 days after the day on which the notice is given to you; or

   (b) if you apply for a further period of time in which to pay the penalty, and the application is granted — within the further period allowed; or

   (c) if you apply for a further period of time in which to pay the penalty, and the application is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of refusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you; or

   (d) if you apply for permission to pay the penalty by instalments, and the permission is granted — in accordance with the permission; or

   (e) if you apply for permission to pay the penalty by instalments, and the permission is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

         (A) the day you receive the notice of refusal; or

         (B) the application is taken to have been refused; and

      (ii) 28 days after the day on which the infringement notice was given to you; or

   (f) if you apply for the notice to be withdrawn, and the application is refused or is taken to have been refused — within the later of:

      (i) 7 days after:

(A) the day you receive the notice of refusal; or

(B) the application is taken to have been refused; and

(ii) 28 days after the day on which the infringement notice was given to you.

Further penalty for continuing offence

8. If the alleged contravention of the civil penalty provision continues beyond 15 September 2015 a further penalty may be imposed even if the penalty imposed by this notice is paid.

Applying to have this notice withdrawn

9. Within 28 days after you receive this notice, you may apply to the **Credit Infringement Notice Officer** to have this notice withdrawn.

(the Credit Infringement Notice Officer is the nominated person)

Applying for more time to pay the penalty under this notice

10. Within 28 days after you receive this notice, you may apply to the nominated person for a further period of up to 28 days in which to pay the penalty under this notice.

Applying to pay the penalty under this notice by instalments

11. Within 28 days after you receive this notice, you may apply to the nominated person for permission to pay the penalty under this notice by instalments.

Requirements for applications

12. An application to have this notice withdrawn, or for more time to pay the penalty under this notice, or for permission to pay the penalty under this notice by instalments:

(a) must be in writing; and

(b) must include the unique identification code set out at the top of this notice; and

(c) must include your reasons for making the application; and

(d) for an application for permission to pay the penalty under this notice by instalments — include the proposed amount and frequency of instalments; and

(e) may be made by forwarding your application to:

Credit Infringement Notice Officer

Australian Securities and Investments Commission

GPO Box 9827

Melbourne VIC 3001

or by facsimile: (03) 9280 3444

or by email: CreditInfringementNotices@asic.gov.au

Signed

....

David McGuinness

Authorised ASIC officer issuing the notice

ASIC
Australian Securities & Investments Commission

To: Commonwealth Bank of Australia
ACN 123 123 124

Address: Commonwealth Bank of Australia
Ground Floor Tower 1
201 Sussex Street
SYDNEY NSW 2000

Level 5, 100 Market Street,
Sydney NSW 2000
GPO Box 9827, Sydney NSW 2001
DX 653 Sydney

Telephone: +61 2 9911 2000
Facsimile: +61 2 9911 2414
www.asic.gov.au

Infringement Notice Unique Identification Code:	S01863987
Account Number:	66123123124
Issue Date:	16/08/2016

INVOICE

Infringement Notice Penalty $45,000.00

This invoice is issued for payment of the penalty under infringement notice S01863987

To stop further action being taken in relation to the alleged offence/ civil penalty contravention described in the infringement notice, ensure payment of the penalty is made within 28 days of receipt of the infringement notice

For assistance, contact Helen Hasek on (02) 9911 5714

This notice may not include all monies owed to ASIC.
Not Subject to GST, (Treasurer's Determination Exempt Taxes, Fees and Charges).

Payment Slip

Account Number: 66123123124

Recipient: Commonwealth Bank of Australia

Due this notice: $45,000.00

PAYMENT OPTIONS

POST billpay

Billpay Code: 8929
Ref: 669123123124242

Australia Post,
Present this payment slip. Pay by cash, cheque or EFTPOS.

Phone
Call 13 18 16 to pay by MasterCard or Visa

Online
Go to postbillpay.com.au to pay by MasterCard or Visa

Electronic Funds Transfer
ASIC's account details are:

BANK:	Reserve Bank of Australia
BSB:	093003
BANK ACCOUNT:	317118
ACCOUNT NAME:	ASIC Collectors rec.Acc.

REFERENCE: 66912312312 42

B PAY

Biller Code: 17301
Ref: 6691231231242

Use these details for phone or internet banking. Call your financial institution to pay from your cheque, savings or credit card account.
For info; www.bpay.com.au

Mail
Mail this payment slip and cheque (do not staple) to ASIC,
Locked Bag 5000, Gippsland Mail Centre VIC 3841

Aus Post Barcode: *814 129 0006691231231242 42

ASIC
Australian Securities & Investments Commission

ASIC media releases are point-in-time statements. Please note the date of issue and use the internal search function on the site to check for other media releases on the same or related matters.

Friday 31 March 2017

17-093MR Citibank refunds $5 million in credit card international transaction fees, as ASIC warns consumers about international transaction fees

Citigroup Pty Limited (Citibank) has refunded approximately $5 million to around 230,000 customers, for failing to properly disclose that credit card international transaction fees apply to Australian dollar transactions where the merchant uses an entity based overseas to process its transactions.

In early 2016, Citibank began charging international transaction fees for Australian dollar transactions made with merchants located overseas or where the merchant uses a foreign bank or entity to process transactions. This applied to Citibank-branded and white-labelled credit cards, including Virgin Money, Bank of Queensland and Suncorp Bank cards. While Citibank amended its disclosure about the changes to the fees, it failed to properly disclose that Australian dollar transactions processed by an entity outside Australia attracted the fees.

This may have led customers to believe that international transaction fees would be charged only when a transaction was made in a foreign currency or with an overseas merchant. For Citibank-issued credit cards, Australian dollar transactions with an Australian website where the merchant uses a foreign bank or entity to process transactions – attract international transaction fees.

Citibank has identified impacted customers of Citibank-branded and Citibank partner-branded credit cards, and has refunded customers with the amount of the fee charged plus interest. Citibank has also updated its disclosure to clearly state that Australian dollar transactions – where the merchant uses a foreign bank or entity to process transactions – will also attract international transaction fees.

Citibank will also refund over $48,000 to 30,174 Virgin Money credit card customers for charging an incorrect percentage amount of the international transaction fee. This error resulted in customers being overcharged by 0.1% of the transaction value.

This follows similar concerns with Westpac's credit cards, which resulted in 820,000 customers being refunded approximately $20 million in September 2016.

ASIC Deputy Chairman Peter Kell said, 'Financial product issuers must take care to provide clear disclosure to help consumers understand all circumstances where fees will be charged.'

ASIC's warning to consumers

ASIC continues to warn consumers to be mindful when making credit card transactions, because transactions in Australian dollars with overseas merchants, or processed by an entity outside Australia (that is, the merchant's financial institution or payment provider) can attract foreign transaction fees.

This is particularly important in an on-line shopping environment because foreign transaction fees may apply where a merchant's website has an Australian address (domain name) or where a foreign merchant advertises and invoices prices in Australian dollars.

Consumers should check with the merchant whether the transaction they make is with an overseas-based merchant or processed overseas. Consumers with queries or concerns about the charging of credit card foreign transaction fees should contact their credit card issuer.

ASIC has published guidance for consumers about the charging of international transaction fees by credit card issuers on its MoneySmart website.

Background

A foreign transaction fee is a fee charged by many credit card providers for transactions - including purchases and cash advances:

- that are converted from a foreign currency to the Australian dollar; or
- that are made in Australian dollars with merchants and financial institutions located overseas; or
- that are made in Australian dollars (or other currencies) that are processed outside Australia.

A foreign transaction fee is generally calculated as a percentage of the Australian dollar value of the transaction (typically up to 3.5%). Credit card schemes (such as Visa, MasterCard and American Express) have different rules about foreign transaction fees and the percentage fees will vary depending on the card scheme.

In September 2016, Westpac refunded approximately $20 million to around 820,000 customers for not clearly disclosing the types of credit card transactions that attract foreign transaction fees (see 16-298MR).

Not all cards impose foreign transaction fees. For consumers who make frequent overseas purchases, it is worth shopping around for a card that offers no foreign transaction fees.

Last updated: 19/06/2017 09:25

ASIC
Australian Securities & Investments Commission

ASIC media releases are point-in-time statements. Please note the date of issue and use the internal search function on the site to check for other media releases on the same or related matters.

Thursday 8 September 2016

16-298MR Westpac refunds $20 million in credit card foreign transaction fees, as ASIC warns consumers on foreign transaction fees for Australian dollar transactions

Westpac Banking Corporation (Westpac) has recently refunded approximately $20 million to around 820,000 customers for not clearly disclosing the types of credit card transactions that attract foreign transaction fees.

Following a customer complaint, Westpac notified ASIC that customers may have been incorrectly charged foreign transaction fees for Australian dollar transactions processed by overseas merchants. Because Westpac's terms and conditions did not clearly state that foreign transaction fees would be charged for such Australian dollar transactions, Westpac commenced a process to identify impacted customers and provide refunds with interest.

Westpac has updated its disclosure to clarify that Australian dollar transactions – when they are processed by overseas merchants – will also attract a foreign transaction fee.

ASIC Deputy Chairman Peter Kell said, 'It is essential for consumers to know when fees will be charged, so that they can make an informed decision when using financial products and services.'

ASIC acknowledges the cooperative approach taken by Westpac in its handling of this matter, and its appropriate reporting of the matter to ASIC.

ASIC warning to consumers

ASIC is also issuing a warning to consumers about unanticipated credit card foreign transaction fees.

It may come as a surprise to consumers that transactions made in Australian dollars with overseas merchants, or processed by a business outside Australia, can attract a foreign transaction fee. This may even occur where the merchant’s website has an Australian address (domain name) or where a foreign business advertises and invoices prices in Australian dollars.

'It may not always be clear to the consumer that the merchant or entity is located outside Australia, particularly in an online environment where the website uses an Australian domain name,' said ASIC Deputy Chairman Peter Kell. 'We urge consumers to check whether the transaction they make is with an overseas-based merchant or processed outside Australia, especially when they shop online.

'Equally, credit card issuers need to ensure that the disclosure of such fees is clear so customers understand the fees that they are charged when using their cards.'

'Not all cards impose foreign transaction fees. For consumers who make frequent overseas purchases, it is worth shopping around for a card that offers no foreign transaction fees,' he said.

ASIC is working with other industry participants on this issue, including by requiring improved disclosure by a number of credit card issuers.

Overseas merchants who display prices to Australian consumers in Australian dollars will usually give consumers the choice to pay in the applicable foreign currency or in the Australian dollar equivalent, as converted by the merchant at their own exchange rate (using a process known as 'dynamic currency conversion'). As consumers may be unable to avoid paying international transaction fees for Australian dollar transactions with overseas merchants, consumers may wish to pay in the applicable foreign currency if they expect the exchange rate to be applied by their card issuer to be more competitive than the exchange rate used by the merchant.

Customers with queries or concerns about the charging of credit card foreign transaction fees should contact their credit card issuer. ASIC has published specific information and guidance for consumers about the charging of international transaction fees by credit card issuers on its MoneySmart website.

Background

A foreign transaction fee (also known as an international transaction fee) is a fee charged by many credit card providers for transactions - including purchases and cash advances:

- that are converted from a foreign currency to the Australian dollar; or
- that are made in Australian dollars with merchants and financial institutions located overseas; or
- that are made in Australian dollars (or other currencies) that are processed outside Australia.

A foreign transaction fee is generally calculated as a percentage of the Australian dollar value of the transaction (typically up to 3.5%). Credit card schemes (such as Visa, MasterCard and American Express) have different rules about foreign transaction fees and the percentage fees will vary depending on the card scheme.

Debit cards may also attract a foreign transaction fee, and consumers are encouraged to check the terms and conditions to find out whether this fee will be imposed by debit card issuers.

From March 2014, Westpac's credit card terms and conditions did not clearly state that a 'foreign transaction fee' would be charged for transactions:

- for 'card-not-present' transactions in Australian dollars with merchants located overseas;
- in Australian dollars with financial institutions located overseas; or
- in Australian dollars (or any other currency) that is processed by an entity outside Australia (together referred to as Overseas Transactions in Australian Dollars).

This may have led customers to believe that a foreign transaction fee would be charged only when a transaction was made in a foreign currency that required a conversion into Australian dollars at the time of the transaction.

Affected customers have been provided compensation, including:

- a refund of the foreign transaction fee charged on the transaction;
- where any credit card interest was charged on the foreign transaction fee amount, a refund of the interest component; and
- an additional interest payment on the refund amount from the date the foreign transaction fee was charged until the date of refund.

Last updated: 22/09/2016 02:04

ASIC
Australian Securities & Investments Commission

ASIC media releases are point-in-time statements. Please note the date of issue and use the internal search function on the site to check for other media releases on the same or related matters.

Monday 3 April 2017

17-095MR ASIC announces further measures to promote responsible lending in the home loan sector

ASIC today announced a targeted industry surveillance to examine whether lenders and mortgage brokers are inappropriately recommending more expensive interest-only loans. With many lenders, including major lenders, charging higher interest rates for interest-only loans compared with principal-and-interest loans, lenders and brokers must ensure that consumers are not provided with unsuitable interest-only loans.

Building on earlier work on home lending standards, ASIC is also announcing that eight major lenders will provide remediation to consumers who suffer financial difficulty as a result of shortcomings in past lending practices.

Interest-only loans

ASIC will shortly commence a surveillance to identify lenders and mortgage brokers who are recommending high numbers of more expensive interest-only loans. Data will be gathered using ASIC's compulsory information-gathering powers from large banks, other banks, mutual banks and non-bank lenders.

In an environment where many interest-only loans are now clearly more expensive than principal-and-interest loans, lenders and mortgage brokers must carefully consider the implications of providing borrowers with interest-only loans. While interest-only loans may be a reasonable option for some borrowers, for the vast majority of owner-occupiers in particular, an interest-only loan will not make sense.

Past lending practices

In 2015, ASIC conducted a review of how lenders provide interest-only home loans. ASIC found that lenders were not properly inquiring into a consumer's actual living expenses when assessing their capacity to make repayments. ASIC's review led to industry-wide improvements by lenders: see 15-220MR *Lenders to improve standards following interest-only loan review*.

As part of today's announcement, eight lenders examined by ASIC have improved their practices for enquiring about expenses to determine the consumer's financial situation and capacity to make repayments. Rather than obtaining a single monthly living expense figure and then relying on a benchmark figure to assess suitability, borrowers' actual figures for different categories of living expenses (e.g. food, transport, insurance, entertainment) will now be obtained. This will provide lenders with a better understanding of consumers' expenses.

In addition to typical hardship processes, lenders will individually review cases where consumers suffer financial difficulty in repaying their home loans, and determine whether they have been impacted by shortcomings in past lending practices. Where appropriate, consumers will be provided with tailored remediation, which may include refunds of fees or interest.

As interest rates are currently at record lows, and were falling in the lead up to 2015 and during 2016, ASIC does not expect lenders to identify high numbers of consumers who are now experiencing financial difficulty due to past lending decisions. Nevertheless, these additional actions will ensure that consumers are not disadvantaged.

To ensure that these remediation programs are operating effectively, ASIC is requiring lenders to audit their processes.

ASIC Deputy Chairman Peter Kell said, 'Home loans are the biggest financial commitment most people will ever make. In assessing whether borrowers can meet loan repayments without substantial hardship in the short and longer term, it is important that lenders can collect and rely on information which provides an accurate view of the consumer's financial situation. This is especially the case when interest rates are at record low levels'.

'Lenders and mortgage brokers must also ensure that consumers are being provided with the home loan product that meets their needs. Lenders and mortgage brokers need to think twice before recommending that a consumer obtain a more expensive interest-only loan'.

Background

In 2015, ASIC reviewed interest-only loans provided by 11 home lenders, and issued REP 445 Review of interest-only home loans (Refer: REP 445) in 2015, which made a number of recommendations for home lenders to comply with their responsible lending obligations (Refer:15-297MR).

In REP 445, ASIC gave guidance on how lenders can make proper inquiries into a borrower's actual expenses.

ASIC's monitoring of lenders' home lending practices continues. ASIC will carry out further reviews to ensure that industry standards are improved where necessary. ASIC will also take enforcement action as appropriate.

Any consumer with concerns about their ability to make home loan repayments should contact their lender in the first instance. Consumers can also access free external dispute resolution, through either the Financial Ombudsman Service (FOS) or Credit and Investments Ombudsman (CIO).

The eight lenders are:

- Australia and New Zealand Banking Group Limited
- Bendigo and Adelaide Bank Limited
- Commonwealth Bank of Australia
- Firstmac Limited
- ING Bank (Australia) Limited
- Macquarie Bank Limited
- National Australia Bank Limited
- Pepper Group Limited.

ASIC has also provided guidance to industry in Regulatory Guide 209 Credit licensing: Responsible lending conduct (Refer: RG 209).

Responsible lending is a key priority for ASIC in its regulation of the consumer credit industry. The changes made by the eight reviewed lenders continue a number of developments and outcomes involving responsible lending:

- Treasury releases ASIC's Review of Mortgage Broker Remuneration.
- ASIC filed civil penalty proceedings against Westpac in the Federal Court on 1 March 2017 for alleged breaches of the National Consumer Credit Protection Act 2009 (refer: 17-048MR).
- Cairns-based car yard lender, Channic Pty Ltd, and broker, Cash Brokers Pty Ltd, breached consumer credit laws (refer: 16-335MR). Part of the court's judgement was that the broker did not meet all of the necessary responsible lending obligations before providing credit assistance because he did not consider the borrower's insurance expenses, which was required under the credit contract and represented a significant portion of the borrower's income.

- ANZ paid a $212,500 penalty for breaching responsible lending laws when offering overdrafts (refer: 16-063MR).
- Payday lender Nimble to refund $1.5 million following ASIC probe (Refer: 16-089MR).
- BMW Finance pays $391,000 penalty for breaching responsible lending and repossession laws (refer: 16-019MR).
- Westpac pays $1 million following ASIC's concerns about credit card limit increase practices (refer: 16-009MR).
- Bank of Queensland Limited improved its lending practices following ASIC's concerns about the way it assessed applications for home loans (Refer: 15-125MR).
- The Cash Store Pty Ltd and Assistive Finance Australia Pty Ltd failed to comply with their responsible lending obligations. The Federal Court awarded record civil penalties (refer: 15-032MR).
- Wide Bay Australia Ltd (now Auswide Bank Ltd) made changes to their responsible lending policy as a result of ASIC's intervention (refer: 15-013MR).

Last updated: 22/06/2017 01:56

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Wednesday 20 January 2016

16-009MR Westpac pays $1 million following ASIC's concerns about credit card limit increase practices

In response to ASIC's concerns, Westpac has improved its lending practices when providing credit card limit increases to customers. Westpac has also committed to a remediation program that includes proactive customer refunds, and a contribution of $1 million over four years to support financial counselling and literacy.

ASIC was concerned that Westpac failed to make reasonable inquiries about some consumers' income and employment status before increasing their credit card limit. In particular, ASIC was concerned that Westpac, in relying largely on its automated processes, was not making reasonable inquiries of individual cardholders, which is not consistent with the responsible lending obligations under by the *National Consumer Credit Protection Act 2009* (the National Credit Act).

Westpac has committed to a number of steps to address ASIC’s concerns including:

- Changing its credit limit increase processes to ensure that, at a minimum, reasonable inquiries are made about a customer's income and employment status to ascertain their financial situation before the limit is increased.
- A remediation program involving a review of credit limit increases previously provided where a cardholder experiences financial difficulty, with consumer refunds paid where appropriate.
- Engaging an independent external expert to provide assurance of the effectiveness of the remediation program.

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

Michael Saadat, Senior Executive Leader of Deposit Takers, Credit and Insurers said, ‘Credit card issuers, like all consumer credit providers, have to meet obligations under responsible lending laws.'

‘ASIC maintains an ongoing focus on compliance with these laws. Where we see non-compliance, we will take action, including taking steps to ensure affected consumers are appropriately remediated.’

ASIC acknowledges the co-operation of Westpac in resolving this issue, including suspending its sending of credit limit increase invitations until ASIC's concerns were resolved and Westpac's processes improved.

Westpac credit card customers who have any questions should contact, depending on the brand:

- Westpac 1300 363 503
- St.George 1300 369 877
- BankSA 1300 365 502
- Bank of Melbourne 1300 656 698

Background

ASIC has been engaging closely with credit card issuers following the introduction of the National Credit Act. In 2014, ASIC conducted a review focussing on credit card providers' invitations to customers to increase credit card limits. ASIC's concerns with Westpac's processes were identified through the course of this review.

ASIC has provided guidance to industry in Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209). RG 209 was last updated in November 2014, and reflects the Federal Court decision in *ASIC v The Cash Store (in liquidation)* [2014] FCA 926.

The action taken with respect to Westpac follows a number of developments and outcomes involving responsible lending:

- Bank of Queensland Limited improved its lending practices following ASIC's concerns about the way it assessed applications for home loans (refer: 15-125MR).
- The Cash Store Pty Ltd and Assistive Finance Australia Pty Ltd failed to comply with their responsible lending obligations. The Federal Court awarded record civil penalties (refer: 15-032MR).
- Wide Bay Australia Ltd (now Auswide Bank Ltd) made changes to their responsible lending policy as a result of ASIC's intervention (refer: 15-013MR).
- ASIC released its report into interest-only home loans to help credit licensees improve their lending practices by increasing their awareness of obligations (REP 445).

Last updated: 23/03/2016 03:05

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ASIC media releases are point-in-time statements. Please note the date of issue and use the internal search function on the site to check for other media releases on the same or related matters.

Wednesday 7 February 2018

18-031MR Update - Westpac remediates credit card customers more than $11 million

Westpac has provided around $11.3 million in remediation to around 3,400 credit card customers after ASIC raised concerns about its credit card limit increase practices.

In 2016, ASIC announced that Westpac had agreed to improve its lending practices when providing credit card limit increases to customers to ensure that reasonable inquiries are made about customers' income and employment status (refer: 16-009MR).

As part of Westpac's commitment, it reviewed credit limit increases previously provided to affected cardholders where they subsequently experienced financial difficulty. Following this review, Westpac provided remediation to around 3,400 customers, which included refunds of around $3 million for fees and interest, and around $8.3 million in credit card balances waived.

Customers with questions about Westpac's refunds and remediation can contact, depending on the brand:

- Westpac 1300 363 503
- St.George 1300 369 877
- BankSA 1300 365 502
- Bank of Melbourne 1300 656 698

Westpac engaged an independent expert to provide assurance over the remediation program and has made the first two payments (of the $1 million total contribution) to support financial counselling and financial literacy, with further payments to follow in 2018 and 2019.

Background

In 2014 ASIC conducted a review focussing on credit card providers' invitations to customers to increase credit card limits. ASIC’s concerns with Westpac’s processes were identified through the course of this review.

The Government has introduced reforms into Parliament that will prohibit credit card providers from sending credit card limit increase invitations regardless of whether the consumer has provided their consent.

The Government’s reforms will also require credit card providers to assess whether a credit card limit might be unsuitable based on the consumer’s ability to repay the proposed credit limit within a period prescribed by ASIC, rather than the consumer’s ability to meet the minimum repayment.

Consumers who are experiencing difficulty in meeting their credit card repayments should speak to their lender. ASIC's MoneySmart website also has information for consumers about managing debt, as well as a credit card calculator to help them work out the fastest way to pay off their credit card.

Last updated: 16/02/2018 04:28

Westpac completes credit card credit limit increase remediation program

07 February, 2018

Westpac today confirmed it has completed a remediation program for credit card customers affected by a former credit limit increase process issue. The matter was reported by the Australian Securities & Investments Commission (ASIC) and the press in January 2016 and impacted customers were also informed at this time.

The issue related to whether employment status and income had been directly reconfirmed in the credit card credit limit increase application process. Following an industry wide review in 2014 and feedback from ASIC, Westpac reviewed and amended its application forms and processes in March 2015.

Westpac subsequently commenced a program to review customers who may have been affected by the credit limit increase process. It completed this by February 2017 and kept ASIC informed, including sharing the independent assurance report over the remediation.

As part of the program, 3,401 customer accounts were remediated. This included refunds and limit reductions, with $11.3 million in total refunded directly to customers.

Westpac is committed to lending responsibly. If we get something wrong, we will acknowledge it and will put it right for our customers.

Conditions, fees and charges apply. These may change or we may introduce new ones in the future. Full details are available on request. Lending criteria apply to approval of credit products. This information does not take your personal objectives, circumstances or needs into account. Consider its appropriateness to these factors before acting on it. Read the disclosure documents for your selected product or service, including the Terms and Conditions or

Product Disclosure Statement, before deciding. Unless otherwise specified, the products and services described on this website are available only in Australia from Westpac Banking Corporation ABN 33 007 457 141 AFSL and Australian credit licence 233714.

ASIC

Australian Securities & Investments Commission

REPORT 499

Financial advice: Fees for no service

October 2016

About this report

In 2015, ASIC commenced a project to review the extent of failure to deliver ongoing advice services to financial advice customers who were paying fees to receive those services.

The project covers Australian financial services (AFS) licensees that are product issuers or provide personal advice to retail clients, and that are part of AMP Limited, Australia and New Zealand Banking Group Limited, Commonwealth Bank of Australia, Macquarie Group Limited, National Australia Bank Limited and Westpac Banking Corporation.

This report outlines the findings and outcomes to date.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

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Executive summary

1 In April 2015, we announced—as part of ASIC's Wealth Management Project—that we were investigating multiple instances of Australian financial services (AFS) licensees charging customers fees for annual financial advice reviews where the reviews were not provided. Most of these fees had been charged as part of a customer's ongoing service agreement with their financial adviser or the licensee.

Note: See Media Release 15-081MR *ASIC update on Wealth Management Project—Investigation into charging of advice fees without providing advice* (16 April 2015).

2 ASIC has commenced several enforcement investigations in relation to this conduct.

3 We consider that, regardless of any enforcement investigation, AFS licensees should compensate affected customers through review and remediation.

4 Our work has therefore also involved:

(a) ensuring that customers affected by any known failures would be identified and compensated by AFS licensees in an efficient, honest and fair manner;

(b) monitoring wider reviews, instigated by AFS licensees at ASIC's request, to determine whether the licensees had further ongoing advice service failures; and

(c) monitoring the changes made by AFS licensees to their systems and processes to prevent such failures from recurring in the future.

Note: We use the term 'customer' or 'client' in this report to mean 'retail client'.

5 Under our Wealth Management Project, we are focusing on the conduct of six of Australia's largest banking and financial services institutions:

(a) AMP Limited (AMP);

(b) Australia and New Zealand Banking Group Limited (ANZ);

(c) Commonwealth Bank of Australia (CBA);

(d) Macquarie Group Limited (Macquarie);

(e) National Australia Bank Limited (NAB); and

(f) Westpac Banking Corporation (Westpac).

6 The project covered by this report focuses more specifically on AFS licensees that are part of these banking and financial services institutions, where these licensees:

(a) are authorised to provide personal advice to retail clients; or

(b) are product issuers that have identified a systemic failure in relation to the charging of ongoing advice fees to customers.

Note: We use the term 'advice licensees' in this report to refer to AFS licensees that provide personal advice to retail clients. 'Personal advice' is defined in s766B(3) of the *Corporations Act 2001* (Corporations Act): see also 'Key terms'.

7 AMP, ANZ, CBA and NAB have all identified systemic issues in relation to the charging of ongoing advice fees. Westpac has also identified a systemic issue but in relation to one adviser only. Macquarie has not identified any systemic failures in this area (likely reflecting its different business model) and is therefore excluded from our discussion of compensation for already identified failures in Section B. However, Macquarie is included in our description in Section C of the related checks and reviews that each of the institutions has performed, with the results to be reported on.

8 This report discusses the systemic failure by advice licensees to discharge their obligations to ensure that ongoing advice services were provided to customers who paid fees to receive these services, and the failure of advisers to provide such services. It also discusses the systemic failure of product issuers to stop charging ongoing advice fees to customers who did not have a financial adviser.

9 We discuss the actions taken by the AFS licensees to compensate customers affected by these failures (see Section B), the progress and outcomes to date of the further reviews instigated by the licensees at ASIC's request (see Section C), and the steps AFS licensees are taking to fix their systems and processes to prevent recurrence of these failures (see Section D). The report also sets out our observations from this project (see Section E).

10 In the course of this project, we have successfully obtained a range of positive and improved compensation outcomes for affected customers. These relate to:

(a) the number of customers identified for refunds and compensation;

(b) the fairness and amount of compensation paid to affected customers; and

(c) the scope of the further reviews conducted by the advice licensees, which have resulted in additional customers being identified for refunds and compensation.

11 We are also requiring licensees to prevent these failures from continuing and to significantly reduce the likelihood that similar failures will occur in the future.

12 To date, we have no evidence of fee-for-service failures of a similar scale occurring in advice licensees outside of the banking and financial services institutions covered by this report. However, we strongly encourage other advice licensees to review their operations to ensure they do not have similar issues.

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Nature of ongoing advice service failures

13 We initiated this project in response to information we obtained, including through breach notifications from some AFS licensees, suggesting that customers were being charged fees for ongoing advice but were not receiving that advice.

14 In this report, we confirm that these systemic failures have affected 21 AFS licensees that were part of the banking and financial services institutions in ASIC's Wealth Management Project. These licensees included both advice licensees and the issuers of financial products such as superannuation.

15 The systemic failures—referred to in this report as 'fee-for-service failures'—related to instances where customers were being charged a fee to receive an ongoing advice service, but had not been provided with this service because:

(a) the customer did not have an adviser allocated to them; or

(b) the adviser allocated to the customer failed to deliver on their obligation to provide the ongoing advice service, and the advice licensee failed to ensure that the service was provided.

Positive impact of FOFA reforms

16 Most of the systemic failures identified in the project covered in this report occurred before the Future of Financial Advice (FOFA) reforms, which became mandatory on 1 July 2013.

17 ASIC supported the introduction of the FOFA reforms, which have helped to address systemic problems in the financial advice industry, including conflicted remuneration and the lack of transparency of advice services and advice fees.

18 The changes made under the FOFA reforms—in particular, the requirement that customers opt in to receiving ongoing advice services, and the introduction of fee disclosure statements—contributed to some AFS licensees identifying the fee-for-service failures. This is discussed in Section A.

19 In addition, these provisions, and the system changes they have required, substantially reduce the likelihood that the type of systemic failures described in this report will recur.

Compensation

20 As at 31 August 2016, compensation arising from the fee-for-service failures that were reported to ASIC was approximately $23.7 million in total. This was paid, or agreed to be paid, to over 27,000 customers. We report on these outcomes in Section B.

Note: As at 31 August 2016, some of these AFS licensees were still in the process of communicating with and compensating affected customers.

21 We expect these compensation figures to increase substantially in the coming months as the process to identify and compensate affected customers continues. Our current estimate is that compensation may increase by approximately $154 million plus interest to over 176,000 further customers, meaning that total compensation for related failures could be over $178 million.

22 We stress that these figures are estimates based on information reported to ASIC by the AFS licensees in October 2016. We will report on the actual compensation figures at a later date.

Further reviews

23 Because of the extent of the specific failures identified by the advice licensees, we requested that each of the six banking and financial services institutions conduct further large-scale reviews of their advice licensees to determine whether they had any additional fee-for-service failures.

24 While most of these large-scale reviews—generally covering periods of seven years across multiple advice licensees—have yet to be completed, some have resulted in further failures being identified and compensation of approximately $250,000 being paid to a small number of additional customers. We report on these outcomes in Section C.

Systems changes to prevent future failures

25 We asked the advice licensees and product issuers that had identified fee-for-service failures to describe the changes they were making to their systems and processes to prevent such failures from recurring in the future, or to enable early detection of any failures that did occur.

26 In Section D, we report on the changes that some of the advice licensees and product issuers have made to their systems to ensure that ongoing advice services are provided to customers who are paying fees to receive these services. We also give details of the further work to be done. We are following up with the banking and financial services institutions in relation to the adequacy of their systems changes.

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Our observations

27 In Section E, we record our observations to date from our work on this fee-for-service project.

28 Some of the advice licensees and product issuers that identified fee-for-service failures demonstrated a proactive approach in identifying affected customers—presenting ASIC with an acceptable process for customer review and remediation—and showed a commitment to paying refunds and compensation within a reasonable timeframe.

29 However, we also identified, from the licensees we reviewed in our project, the issues outlined in Table 1. We continue to address these issues with the licensees.

Table 1: Our concerns about fee-for-service failures and review and remediation

Culture and remuneration	During the period of time covered by this project, the financial advice industry still had a culture of reliance on automatic periodic payments, such as sales commissions and adviser service fees. Some advice licensees prioritised advice revenue and fee generation over ensuring that they delivered the required services. Cultural factors in the banking and financial services institutions covered by this report may have contributed to the systemic failures we observed.
Record keeping and monitoring	Some licensees and advisers failed to keep adequate records or to capture sufficient data electronically to enable monitoring and analysis. Some licensees did not develop and enforce effective monitoring and checking procedures to prevent systemic failures.
Review and remediation	On some occasions advice licensees proposed review and remediation processes that were legalistic and did not prioritise the interests of customers.

Regulatory Guide 256

30 In September 2016, ASIC published Regulatory Guide 256 *Client review and remediation conducted by advice licensees* (RG 256). This guidance was based on our observations and experience gained from reviewing past review and remediation conducted by advice licensees, including this fee-for-service project.

31 RG 256 should be used by advice licensees when considering:

(a) when to initiate the process of review and remediation;

(b) the scope of review and remediation;

(c) designing and implementing a comprehensive and effective process for review and remediation;

(d) communicating effectively with customers; and

(e) ensuring that customers have access to the external review of decisions.

Future reporting

32 We intend to provide a public update, in the first half of 2017, on the progress and outcomes of the advice licensees' review and remediation activities: see Section F.

33 We will also make a public statement where we take enforcement action.

A Background

Key points

The financial advice industry relies heavily on receiving periodic payments from customers, usually by automatic deductions from their financial products, to remunerate advisers and advice licensees. Under the arrangements made with customers, there may or may not be an obligation to provide a specific advice service in return for these payments.

Our review of the AFS licensees in our project demonstrated that:

- there were systemic failures by advice licensees to provide ongoing advice services to customers who were paying a fee to receive such services; and
- there have been systemic failures relating to the charging of ongoing advice fees to customers who did not have an adviser.

This work forms part of ASIC's Wealth Management Project, which focuses on the conduct of Australia's largest banking and financial services institutions, and reports on systemic failures by that industry sector.

Exploring the problem

34 The problems covered in this report arise in two situations:

(a) a customer who has a financial adviser pays fees to receive ongoing advice from that adviser, but the adviser does not provide the advice; or

(b) a customer who does not have a financial adviser (because, for example, the adviser departed the advice licensee or retired) is charged a fee for ongoing advice, which the customer does not receive.

35 To provide context for how these problems have emerged, this section describes the prevalent methods of remuneration in the financial advice industry.

36 For many years, three key features of the financial advice industry in Australia have been:

(a) the prevalence of adviser remuneration structures based on periodic payments from customers, usually by automatic deductions from their financial products, to remunerate advisers and advice licensees—these periodic payments also include sales commissions paid by product issuers to advice licensees and advisers;

(b) in the case of commissions, the absence of a clear agreement between advisers and customers about the specific services to be provided in return for these automatic payments; and

(c) the prevalence of large numbers of 'passive' customers who do not receive regular advice from their adviser or the advice licensee.

37 Automatic payments may comprise initial and trail commissions paid by financial product issuers to advice licensees and their representatives (advisers), based on the amount of the customer's investment or insurance premium. In aggregate, these commissions increase the product costs or insurance premiums paid by customers. There is generally no specific advice service obligation tied to these commissions, which continue to be paid to advice licensees and advisers whether or not they give customers ongoing advice.

38 Periodic payments may also be in the form of adviser fees that customers authorise to be automatically deducted from their financial products and to be paid by product issuers to advice licensees and their representatives.

39 In Report 407 *Review of the financial advice industry's implementation of the FOFA reforms* (REP 407), released in September 2014, ASIC reported on the prevalence in the industry of 'passive' customers. We defined these as customers who have not received advice or services in the previous 12 months. REP 407 found low levels of ongoing advice service delivery to customers, particularly by advice licensees associated with large banks. The report stated at paragraphs 53–54 that:

> On average, licensees in the sample indicated that about 60% of their clients were 'active' clients, having received some advice or service in the previous 12 months, while 40% of the clients were 'passive' clients.
>
> However, there were wide variations between the different size categories of licensee. Some large licensees, including several bank-owned licensees, reported that between 60% and 80% of their clients had received no advice or service in the past year.

40 Customers who did not enter into an agreement to receive a specific advice service in return for the commissions they funded, or the adviser fees they paid, are not covered by this report. This is because there is no obligation on the advice licensee or adviser to provide an advice service to these customers.

41 Many customers, however, paid periodic advice fees for ongoing advice services that they did not receive. We focus on these customers in this report.

Positive impact of FOFA

Introduction of fee disclosure statements

42 Following the introduction of the FOFA reforms, which became mandatory on 1 July 2013, the Corporations Act was amended to require AFS licensees and their representatives who have ongoing fee arrangements with retail

clients (fee recipients) to comply with the fee disclosure statement obligations. These obligations are designed to help customers ascertain whether they are receiving a service commensurate with the ongoing fees that they are paying.

43 An ongoing fee arrangement exists when an advice licensee or its representative gives personal advice to a retail client and the client enters into an arrangement with the licensee or representative, the terms of which provide for the payment of a fee during a period of more than 12 months.

> Note: An ongoing fee (including a commission) paid by a third party to an AFS licensee or its representative will generally not constitute an ongoing fee for the purposes of the Corporations Act, unless the fee is paid with the clear consent of, or at the direction of, the customer.

44 For the purposes of the definition of 'ongoing fee arrangement', a fee is any fee (however described or structured) that is paid under the terms of the ongoing fee arrangement between the AFS licensee or representative and the customer.

45 A fee disclosure statement is a statement in writing that includes information relating to the previous 12-month period of an ongoing fee arrangement.

46 Based on our discussions with advice licensees, we understand that the introduction of fee disclosure statements was a key factor that enabled licensees and customers to gain a better understanding of the advice services being charged for and provided, and that this contributed to a number of the systemic failures in relation to ongoing fees and services being identified by advice licensees. We expect that fee disclosure statements will also help to reduce the likelihood of related systemic failures in the future.

Opt-in (renewal notices)

47 Following the introduction of the FOFA reforms, in an ongoing fee arrangement for financial advice, the fee recipient must provide the customer with a renewal notice for the arrangement every two years. The notice must include a statement that:

(a) the customer may renew the arrangement by giving the current fee recipient notice in writing;

(b) the arrangement will terminate, and no further advice will be provided or fee charged, if the customer does not renew the arrangement;

(c) if the customer does not renew the arrangement before the end of the renewal period, the fee recipient will assume the customer has chosen not to renew the arrangement; and

(d) the renewal period is a period of 60 days beginning on the day on which the renewal notice and fee disclosure statement is given to the customer.

48 This reform significantly reduces the likelihood that customers will continue to pay fees for ongoing advice services if they do not wish to receive those services or pay those fees.

Scope and methodology of our review

49 Our project had the following main objectives:

(a) *compensation*—to ensure that customers who were affected by known fee-for-service failures were identified and compensated by the AFS licensees;

(b) *further review*—to ensure that advice licensees conducted reviews for the period from 1 July 2008 to 30 June 2015 (or a different relevant seven-year period) and that other licensees where systemic failures had not been identified would be included in this review. The purpose of these reviews was to identify whether other licensees had fee-for-service failures and whether there were further customers requiring refunds and compensation; and

(c) *systems changes*—to inquire about and assess the adequacy of changes licensees have made to their processes and systems to reduce the likelihood of similar fee-for-service failures occurring in the future.

50 As noted at paragraph 2, we have also commenced several enforcement investigations in relation to this conduct.

51 The project focused on AFS licensees that are part of the banking and financial services institutions covered by the Wealth Management Project, where these licensees:

(a) are authorised to provide personal advice to retail clients (i.e. advice licensees); or

(b) are product issuers that have identified:

(i) a failure to provide ongoing advice services to customers; or

(ii) the incorrect charging of ongoing advice fees to customers.

52 For the ‘further review’ part of this project (see Section C), we wrote to each of the six institutions, requesting that they undertake a review of the provision of ongoing advice services to customers by their advice licensees between 1 July 2008 and 30 June 2015.

53 We held meetings with the institutions so that we could understand, negotiate and provide guidance on:

(a) the steps that they should take to assess which customers were affected by known fee-for-service failures;

(b) communications with customers;

(c) processes for further reviews to investigate other potential fee-for-service failures; and

(d) compensation methodologies.

54 We have required regular reporting from the institutions on the progress of their customer review and remediation. This report provides the key outcomes to date.

B Compensation

Key points

Between 1 August 2013 and 31 December 2015, we received 22 significant breach notifications about fee-for-service failures, from 21 AFS licensees representing five of the banking and financial services institutions covered by ASIC's Wealth Management Project.

Our focus has been on overseeing the licensees' processes to identify affected customers and to compensate them in an efficient, honest and fair manner.

As at 31 August 2016, these review and remediation activities have resulted in approximately $23.7 million in compensation being paid, or agreed to be paid, to over 27,000 customers.

We expect the amount of compensation to substantially increase as the process to identify and remediate affected customers continues.

Nature of ongoing advice service failures

55 Between 1 August 2013 and 31 December 2015, we received 22 significant breach notifications about fee-for-service failures from 21 AFS licensees representing five of the banking and financial services institutions covered by ASIC's Wealth Management Project.

56 The majority of the fee-for-service failures identified by the institutions fell into the following categories:

(a) failure of the advice licensee or adviser to provide an advice service to a customer who had an adviser allocated to them and who was paying fees to receive such a service; and

(b) charging ongoing advice fees to customers who did not have an adviser allocated to them. The reasons for this happening included:

(i) that the adviser had departed from the licensee;

(ii) that the customer had requested that the advice service be discontinued;

(iii) that the advice fees were charged from a no-advice service package; or

(iv) other reasons why the advice fee was not 'turned off' by the licensee, such as information technology (IT) or communications failures.

Processes to identify affected customers

57 After determining that there were systemic fee-for-service failures, the AFS licensees designed and implemented processes to identify the customers affected.

58 Most of the AFS licensees in our project have engaged external consultancy firms as part of their work to identify and compensate affected customers, or to provide some level of assurance in relation to those activities.

59 In general, the banking and financial services institutions and their external advisers have used the following high-level processes to identify potentially affected customers.

Data analysis to determine who paid the fees

60 The licensees analysed their revenue data systems to try to identify all customers who had paid ongoing advice fees.

61 Generally, this method was used by the advice licensees because they did not have complete or accurate information about the customers to whom they promised to provide ongoing advice services. The revenue data allows the advice licensees to identify the customers who have made payments, and therefore are likely to have been entitled to advice services.

62 In some cases, this process involved the advice licensees making assumptions—for example, an assumption that every client who paid an annual advice fee of 1% of their assets was likely to be an ongoing advice customer because this was the fee usually charged by the licensee's advisers.

63 We consider that the scope of customers identified by this analysis should extend (if applicable) to at least seven years before the date that the advice licensee identified the systemic failure. A minimum seven-year period is consistent with an AFS licensee's record-keeping obligations and the guidance in RG 256.

Assessment of advice provision

64 To determine whether advice had been provided to customers who had an allocated adviser, advice licensees often needed to conduct a 'manual' or case-by-case review of customers' hard copy or electronic files. This was because the licensees often did not have adequate data or systems to more efficiently determine whether advice was provided to large groups of customers.

65 In many cases, this identification work is ongoing. Several advice licensees are still trying to determine how many customers, and which customers,

were affected by the fee-for-service failures and will require refunds and compensation.

66 In some cases, advice licensees are taking a pragmatic and customer-focused approach to refunds, where the cost and time for the licensee to assess whether ongoing advice was provided to certain groups of customers is likely to outweigh the value of the fees and interest to be refunded to them. In such cases, some advice licensees are paying refunds without going through the full file review process.

Our observations

67 The ability of AFS licensees to efficiently identify affected customers has been affected by factors including:

(a) the nature of the failure and the extent to which affected customers could be identified through the analysis of data and systems, or whether manual checking of customer files was required;

(b) the quality and availability of the licensees' systems, records and data;

(c) the magnitude of the failure—for example, the time period of the failure and the number of potentially affected customers; and

(d) the extent to which the licensees have prioritised and adequately resourced their review and remediation programs.

68 The AFS licensees could generally identify affected customers most efficiently where they could rely on existing data systems rather than manual processes, provided that:

(a) the complete data was available and accessible to the licensees;

(b) record keeping was of a reasonable quality;

(c) the nature of the failure was limited to a specific problem;

(d) the process proposed by the licensee to define and identify affected customers was, in ASIC's view, acceptable; and

(e) the program was adequately resourced and prioritised by the licensee.

Compensation methodologies

69 ASIC's view, which we communicated to the AFS licensees, is that compensation processes for customers affected by the fee-for-service failures identified in this report should comprise the following elements:

(a) a refund of the fees that were incorrectly charged (fee refund);

(b) a payment to compensate for the interest or earnings that would have been earned on the amount of the fee refund if it had not been incorrectly deducted; and

(c) clear communications with affected customers explaining:

   (i) why a refund and compensation was required, and their right to complain or seek a review including through the licensee's dispute resolution system (which includes internal dispute resolution (IDR) and membership of the Financial Ombudsman Service, an external dispute resolution (EDR) scheme); and

   (ii) the basis for their compensation amount and the method of calculation (e.g. interest rate or lost earnings).

Calculating interest or earnings

70 In relation to the interest or earnings calculation, affected customers were generally compensated in one of the following three ways, depending on the quality of the AFS licensee's customer data.

(1) Where data was available and of adequate quality

71 Most licensees advised ASIC that, for the majority of affected customers, they had been able to accurately calculate the interest or earnings that their customers would have earned if the systemic failure had not occurred.

72 This was possible through data analysis of the source of the fees. For example, AFS licensees were able to track the performance of the investment accounts or funds that the fees were deducted from, and to include an equivalent amount in their compensation payments.

(2) Where data was limited

73 In some instances, the advice licensees had some data about the affected customers that would enable them to calculate an approximate compensation amount in a relatively short period of time, but they had inadequate data to enable them to both perform precise individual calculations of loss and compensate customers reasonably promptly.

74 In these cases, the advice licensees calculated the approximate interest or earnings that customers would have received if the systemic failures had not occurred.

75 For example, an advice licensee that had data about the risk profile of its affected customers (e.g. conservative, balanced, growth) based its compensation amounts on the benchmark returns from those asset classes.

76 All customers, if they are unhappy about the compensation they are offered, can seek a review or lodge a complaint through the AFS licensee's IDR process and the Financial Ombudsman Service.

(3) Where no data was available

77 In some instances, the advice licensees had no data about groups of customers to enable them to apply the approach in either (1) or (2), or to do so in a reasonable period of time.

78 A common example was where advice fees were deducted from financial products issued by third parties that were unrelated to the customer's financial institution or advice licensee, and the institution or licensee did not keep relevant data and was unable to obtain such data from the third party as part of its review and remediation assessment.

79 Another example was where advice licensees provided advice services through their authorised representatives and:

(a) the licensees did not retain copies of customers' files; and

(b) the authorised representatives took the client files with them when they departed from the licensee.

Note: To change this conduct in the future, we have amended Class Order [CO 14/923] *Record-keeping obligations for Australian financial services licensees when giving personal advice* to clarify that, when an advice licensee or one of its representatives provides personal advice, the licensee must ensure not only that client records are kept, but also that the licensee continues to have access to these records during the period in which they are required to be retained.

80 In these instances, some licensees have applied a proxy interest rate that is consistent with the principles outlined in paragraph 83. In other cases we are having discussions with licensees to ensure they apply a fair and reasonable compensation methodology: see paragraph 86.

Note: For an example of how an AFS licensee has applied a proxy interest rate in the absence of adequate data to calculate accurate compensation, see Example 8 in RG 256.

Estimating interest or earnings

81 Our clear preference is for the licensees to apply the approach outlined in paragraph 71. This means that customers are compensated in a timely way with an amount that accurately reflects the interest or earnings they lost as a result of the systemic failure.

82 However, we consider that, for the purposes of this project, where customer records are incomplete, it is sometimes acceptable and provides a better outcome for customers if the AFS licensee promptly compensates customers with an approximation of the interest or earnings forgone, as outlined in paragraph 74. In these instances, it is critical that customers are given information about how they may seek a review of the compensation amount.

83 Where licensees have little or no data to calculate compensation, as described in paragraph 77, they should use a fair and reasonable rate to calculate the lost

returns or interest, by applying the following principles which are set out in RG 256:

(a) the rate should be reasonably high—to ensure that clients will not be disadvantaged by an advice licensee's inability to determine the actual investment returns or interest, and to remove any incentive for licensees to use a proxy to calculate foregone returns or interest instead of working out the actual investment returns or interest that a client would have received;

(b) the rate should be relatively stable (compared, for example, to market-linked returns); and

(c) the rate should be objectively set by an independent body.

84 An example of a rate that meets these criteria is the Reserve Bank of Australia cash rate plus a margin of 6% per year.

85 Some of the licensees that do not have adequate data to perform accurate compensation calculations agreed to implement the principles described in paragraph 77, and this is reflected in the compensation payments made to their customers.

86 In other instances, where licensees failed to keep adequate client records and data, we continue to discuss with licensees the interest rates to be applied to provide a fair and reasonable outcome for customers.

Summary of compensation outcomes and projections

87 Table 2 shows, by banking or financial services institution, the compensation that had been reported to ASIC as paid or agreed to be paid by 31 August 2016. It also shows the future expected compensation.

88 These summary figures are further broken down by AFS licensee in Table 3 and Table 4.

Table 2: Compensation outcomes as at 31 August 2016, and future projections

Group	Compensation paid or agreed to be paid	Estimated future compensation	Total (estimate)
AMP	$2,120,000	$2.4m (see Note 1)	$4.6m
ANZ	$16,202,860	$33.5m	$49.7m
CBA	$575,587	$105.1m plus interest	$105.7m plus interest

Group	Compensation paid or agreed to be paid	Estimated future compensation	Total (estimate)
NAB	$3,523,500	$13.4m plus interest	$16.9m plus interest
Westpac	$1,244,659	Not yet available	$1.2m
Totals	**$23,666,606**	**$154.4m plus interest**	**$178.0m plus interest**

Source: Data is based on estimates provided to ASIC by the institutions and will change as the reviews to determine customer impact continue. For further details, see Table 3–Table 4.

Note 1: AMP's estimate is for compensation where the customer did not have an adviser allocated to them, but does not include a future projection for remediation where the adviser allocated to the customer failed to deliver on their obligation to provide the ongoing advice service and where the AFS licensee failed to ensure that the service was provided.

Compensation progress to date

89 Table 3 shows, by AFS licensee, the compensation paid, or agreed to be paid, to customers as a result of the identified fee-for-service failures, as at 31 August 2016. It shows that approximately $23.7 million has been paid, or agreed to be paid, to over 27,000 customers.

90 Some of the licensees in Table 3 have not yet completed their review and remediation activities. Their estimates of further compensation to be paid are shown in Table 4. We will report publicly on their progress and the outcomes at a later date: see Section F.

Table 3: Compensation progress reported to ASIC as at 31 August 2016

Group	AFS licensee	Customers offered compensation	Compensation amount offered
AMP	AMP Financial Planning Pty Limited, Charter Financial Planning Limited, Hillross Financial Services Limited (see Note 1)	8,178	$2,120,000
ANZ	Australia and New Zealand Banking Group Limited (see Note 2)	4,872	$14,507,451
ANZ	OnePath Custodians Pty Limited	2,389	$1,362,590
ANZ	OnePath Funds Management Limited	129	$145,356
ANZ	OnePath Life Limited	127	$187,463
CBA	Commonwealth Financial Planning Limited	165	$321,797
CBA	Commonwealth Private Limited (see Note 3)	17	$253,652
CBA	Commonwealth Securities Limited (see Note 3)	2	$138
NAB	MLC Investments Limited	96	$49,173
NAB	MLC Limited (see Note 4)	7	$887
NAB	MLC Nominees Pty Limited (see Note 4)	7,597	$1,982,274
NAB	National Australia Bank Limited	2,659	$1,118,747
NAB	Navigator Australia Limited	235	$120,743
NAB	NULIS Nominees (Australia) Pty Limited	529	$251,676
Westpac	Westpac Banking Corporation (see Note 5)	177	$1,244,659
Totals		**27,179**	**$23,666,606**

Note 1: As described at paragraph 126, before this project began, 14 AMP-owned advice licensees had paid further compensation of $193,519 to 196 customers for fee-for-service failures. The compensation for the three licensees shown in this table is not complete: see Table 4 for AMP's estimate of further compensation to be paid.

Note 2: Compensation is not complete: see Table 4 for ANZ's estimate of further compensation to be paid.

Note 3: The table shows compensation paid by Commonwealth Private Limited and Commonwealth Securities Limited arising from the further reviews described in Section C.

Note 4: On 3 October 2016, NAB divested 80% of its shareholding in the MLC Limited Life Insurance business. On 1 July 2016, trusteeship of superannuation assets previously governed by MLC Nominees Pty Limited transferred to NULIS Nominees (Australia) Limited (NULIS) effective 1 July 2016. However, accountability for remediation activity (including compensation) of the above events reported by MLC Limited and MLC Nominees Pty Ltd remains within the NAB Group. See the 'Key terms' for further information.

Note 5: Westpac's failure relates to an individual adviser who was identified by the licensee before our project started. The compensation amount shown relates to fee refunds only; some customers were also offered further compensation for other failures by the adviser, such as inappropriate advice.

Source: ASIC, AFS licensees.

91 Table 4 shows the further compensation estimates provided by the AFS licensees for customers that had not yet been compensated as at October 2016.

92 We note that these estimates are subject to confirmation by the advice licensees. We will provide an update on the licensees' progress and the outcomes at a later date: see Section F.

Table 4: Estimated further compensation, as reported to ASIC in October 2016

Group	AFS licensee	Affected customers	Compensation estimate
AMP	AMP Financial Planning Pty Limited, Charter Financial Planning Limited, Hillross Financial Services Limited (see Note 1)	9,800 (estimate)	$2.4m
ANZ	Australia and New Zealand Banking Group Limited	5,128 (estimate)	$33.5m
CBA	BW Financial Advice Limited	3,000 (estimate)	$4m plus interest
CBA	Commonwealth Financial Planning Limited	40,000 (estimate)	$100m plus interest
CBA	Count Financial Limited	5,000 (estimate)	$1.1m plus interest
NAB	Apogee Financial Planning Limited	554	$156,000 plus interest
NAB	Godfrey Pembroke Limited	1,708	$220,000 plus interest
NAB	GWM Adviser Services Limited	1,909	$490,000 plus interest
NAB	Meritum Financial Group Pty Limited	307	$81,000 plus interest
NAB	MLC Nominees Pty Limited (see Note 2 and Note 3)	108,867	$12.4m plus interest
Totals (of estimates reported to ASIC)		**176,273**	**$154.4m plus interest**

Note 1: AMP's estimate is for compensation where the customer did not have an adviser allocated to them, but does not include a future projection for remediation where the adviser allocated to the customer failed to deliver on their obligation to provide the ongoing advice service and where the licensee failed to ensure that the service was provided.

Note 2: MLC Nominees Pty Limited's failure relates to the deduction of fees for general advice from members of an employer superannuation plan, where there was no financial adviser attached to the plan and members did not receive the general advice services they paid for.

Note 3: On 1 July 2016 trusteeship of superannuation assets previously governed by MLC Nominees Pty Limited transferred to NULIS Nominees (Australia) Limited. However, accountability for remediation activity (including compensation) of the above event reported by MLC Nominees Pty Ltd remains within the NAB Group. See the 'Key terms' for further information.

Source: ASIC, AFS licensees.

C Further reviews

Key points

Apart from the processes to identify and compensate customers affected by the known fee-for-service failures described in Section B, the banking and financial services institutions agreed to conduct further reviews to determine whether they had additional related failures.

Some of these large-scale reviews have been completed, while most still need to be conducted and/or finalised.

As a result of these further reviews, some advice licensees have identified the need for additional customer compensation.

Background

Purpose of review

93 Since the project started, we have written to each of the six banking and financial services institutions covered by the Wealth Management Project, requesting that they conduct further reviews of their advice licensees to determine whether ongoing advice services were being provided to customers who were paying fees for such services, or whether there had been any systemic failure to do so.

94 We requested these further reviews because of the extent of the identified failures for the majority of the banking and financial services institutions, as outlined in Section B. We wanted to gain some assurance that advice licensees did not have further fee-for-service failures.

95 We consider it likely that, where this process identifies further systemic failures, advice licensees will need to compensate customers through review and remediation.

Scope of further reviews

96 We requested that the scope of these reviews should cover:

(a) AFS licensees that are part of the group and that are authorised to give personal advice to retail clients;

(b) the seven-year period preceding our request; and

(c) where sample testing of customer files was used, a sufficient sample to provide meaningful results.

97 Table 5 describes the scope of each review by the banking and financial services institutions.

Table 5: Scope of further reviews

Group	Covers all advice licensees?	Seven-year period reviewed?	Sample test methodology	Expected completion
AMP	No (see paragraph 127)	Yes	Risk-based (see paragraph 127)	September 2017
ANZ	No (see paragraph 132)	Yes	Risk-based (see paragraph 132)	To be confirmed
CBA	Yes	Varied (see paragraphs 104, 110, 135, 140, 144)	Random	2016
Macquarie	No (see paragraph 153)	Yes	Risk-based	To be confirmed
NAB	Yes	Yes	Random and risk-based as appropriate	31 December 2017
Westpac	Yes	Yes	Risk-based	To be confirmed

Source: ASIC, AFS licensees.

Methodology

98 The sampling approach generally took one of two forms:

(a) *random sampling*—where the advice licensee reviewed a sample of randomly selected customer files to attempt to form conclusions about the whole population of ongoing advice customers; or

(b) *risk-based sampling*—where the advice licensee split its population of ongoing advice customers or advisers into two or more groups for the purposes of sample testing, review and remediation. This enabled the licensee to form conclusions about the level of risk or failures in different groups.

99 We were not prescriptive about whether advice licensees should take a random or risk-based approach to sampling. However, we scrutinised the methodologies they applied, or proposed to apply, to ensure that the results would be able to identify, with an acceptable degree of confidence, whether or not there was a similar systemic failure.

100 Most advice licensees obtained external advice or assistance in relation to sampling methodologies.

101 The ability of all of the advice licensees to test the provision of ongoing advice services during the seven-year period was affected by the quality of their data, record keeping and data analytics capabilities. Individual

customer files, either in hard copy or digital format, usually needed to be reviewed manually.

Compensation outcomes

102 As a result of the completed further reviews, two CBA licensees have reported to ASIC that they have paid, or agreed to pay, compensation of approximately $253,790 to 19 customers, as at 31 August 2016.

103 Reviews by all of the banking and financial institutions are continuing, as described below, and the findings may lead to further customer compensation. We will report further on the outcome of these reviews—and, in particular, whether they indicate a systemic failure—at a later date.

Reviews completed

CBA

CFPL 'Pathways' division

104 The majority of Commonwealth Financial Planning Limited's (CFPL) advisers are employees of CBA. However, CFPL also has financial advisers who are self-employed authorised representatives of CFPL, operating within a business unit called 'Pathways'.

105 For this review, CFPL reviewed its Pathways division separately to the review of its employed advisers.

106 The review of Pathways advisers covered the period from 1 July 2008 to 30 June 2014.

107 For each of the six years reviewed, the failure rate was under 5% of customer files and, for three of these years, under 1%. CFPL has reported to ASIC that 34 customers require fee refunds plus interest.

108 We are assessing the implication of these results and discussing with CFPL whether further steps should be taken to identify whether other customers outside of the sample tested should be reviewed.

109 For the identified failures, we are discussing with CFPL the processes and methodology to provide affected customers with refunds and compensation.

Commonwealth Private Limited

Review

110 This advice licensee's review of the provision of ongoing advice services for customers was split into:

(a) a review of the 2014–15 financial year; and

(b) a review of the period from 1 July 2008 to 30 June 2014.

111 For 2014–15, the licensee reviewed the files of all customers who had an ongoing service agreement. This entailed over 1,000 file reviews.

112 The 2014–15 review found that:

(a) by 30 June 2015, 40 customers had not received an annual review for the 2014–15 financial year. These late annual reviews were subsequently provided by 31 December 2015; and

(b) 10 customers did not receive an annual review for 2014–15 and, as a result, received refunds and compensation.

113 For the period from 1 July 2008 to 30 June 2014, the licensee reviewed the files of more than 200 customers, and checked over 850 annual reviews.

Note: Most of the 200 plus customers did not have ongoing service agreements for each year in the six-year period.

114 The review found that seven customers did not receive their annual review at least once during the six-year period. There were 16 instances of an annual review not being provided (across the seven customers) in that period.

115 The licensee is conducting a further review of its retail ongoing advice customers for the 1 July 2008 to 30 June 2014 period who were not included in the samples above to determine if additional customers should be compensated.

Remediation

116 The licensee advised ASIC that, for customers who did not receive a formal annual review for 2014–15 by 30 June 2015, annual reviews were subsequently completed by 31 December 2015.

117 For the 10 customers who did not receive an annual review for 2014–15, the licensee compensated these clients with refunds and interest totalling $93,924.

118 For customers who were found not to have received annual reviews in the period from 1 July 2008 to 30 June 2014, the licensee refunded the annual fees they paid, plus interest. This resulted in payments of $159,728.

119 Interest added to the refunds was calculated at 6% per year. The licensee advised ASIC that 6% per year exceeded the actual interest rate on the

accounts that the fees were drawn from, at all times during the six-year period, so customers would not be disadvantaged by the use of this rate.

Commonwealth Securities Limited

Review

120 This advice licensee's review identified that 10 advisers had an ongoing service agreement with some of their customers during the period from 1 July 2008 to 30 June 2015.

121 The licensee reviewed the customer files of these advisers, entailing approximately half of the customers who had ongoing service agreements. This sample review checked the service delivery in every financial year from 1 July 2008 to 30 June 2015, or for the life of the agreement if that was shorter.

122 The licensee reported to ASIC that:

(a) from 1 July 2008 to 30 June 2013, it identified no instances of failure to provide an ongoing service; and

(b) from 1 July 2013 to 30 June 2015, one adviser had ongoing service agreements with two customers where a fee was charged but the required service was not provided.

Remediation

123 The licensee paid compensation of $138 to two customers for the failures.

Reviews not yet completed

AMP advice licensees

Initial review

124 AMP initially conducted a review covering 14 advice licensees for the period from 1 July 2010 to 30 June 2015. AMP chose 1 July 2010 as the start date because this was when AMP licensees introduced fee-for-service arrangements for investment products, instead of commissions.

125 The licensees included in the initial review were:

(a) AMP Financial Planning Limited;

(b) Charter Financial Planning Limited;

(c) Forsythes Financial Services Pty Limited;

(d) Genesys Wealth Advisers Limited;

(e) Hillross Financial Services Limited;

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(f) Ipac Securities Limited;

(g) King Financial Services Pty Limited;

(h) PPS Lifestyle Solutions Pty Limited;

(i) Prosperitus Pty Limited;

(j) SMSF Advice Pty Limited;

(k) Strategic Planning Partners Pty Limited;

(l) TFS Financial Planning Pty Limited;

(m) Total Super Solutions Pty Limited; and

(n) Tynan McKenzie Pty Limited.

126 The initial review of data from previous audits and complaints identified, across the 14 licensees, 196 instances of failure to provide customers with an ongoing advice service they had paid for. Affected customers had already been paid, before our project commenced, compensation of $193,519 for these failures.

Note: This figure is not included in Table 2 or Table 4 in Section B because it relates to compensation paid prior to our project.

Wider review

127 In May 2016, AMP agreed to conduct a wider review for the period from 1 July 2008 to 30 June 2015, using a methodology that would:

(a) include the 15 AMP-owned advice licensees that charged ongoing service fees in the relevant period;

(b) exclude the two advice licensees that did not charge ongoing service fees in the relevant period;

(c) initially focus on identifying and reviewing advice practices considered by AMP to have a higher risk of non-compliance; and

(d) entail a subsequent review of practices perceived to be lower risk.

128 AMP has commenced this review, which it expects to complete by September 2017.

ANZ advice licensees

Initial review

129 ANZ initially conducted a small risk-based review, covering the following licensees for the period from 1 July 2013 to 30 June 2015:

(a) Financial Services Partners Pty Limited;

(b) Millennium3 Financial Services Pty Limited; and

(c) RI Advice Group Pty Limited.

130 ANZ reviewed 50 files across the three licensees. The files were selected by ANZ based on the perceived risks, using factors such as the size of an authorised representative's practice and whether it had recently been acquired by ANZ or the licensee.

131 ANZ reported that it had not identified, from this initial review, any failure to provide ongoing advice services to customers. However, the review did identify instances of incorrect fee disclosure in fee disclosure statements.

Wider review

132 In June 2016, ANZ proposed a methodology that would:

(a) include the three advice licensees covered in the initial review;

(b) initially focus on identifying advisers considered by ANZ to have a higher risk of non-compliance;

(c) entail reviewing higher-risk advisers by selecting a sample of their customers, based on the size of their customer book; and

(d) entail reviewing lower-risk advisers by selecting a sample of customers from these advisers.

133 ANZ has commenced this wider review.

CBA

BW Financial Advice Limited

134 This advice licensee is still in the process of identifying customers affected by the known systemic failure described in Section B and referred to in Table 4. The licensee found that this known failure affected customers during a four-year period between 2 November 2010 and 30 June 2014.

135 We requested that the licensee conduct further reviews for the other three years in the July 2008 to 30 June 2015 period, to determine whether customers received the ongoing services they paid for during those years.

136 For two of those years (1 July 2008 to 31 October 2010), the licensee advised that it did not offer an ongoing advice package, and that a review of a random sample of 59 customer files for that period found no instances of advisers entering an ongoing fee or service arrangement with customers.

137 To review the delivery of ongoing advice in the remaining year during the period (i.e. 1 July 2014 to 30 June 2015), the licensee is testing service delivery and will report on the results to ASIC.

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Commonwealth Financial Planning Limited

138 This advice licensee is still in the process of identifying customers affected by the known systemic failure described in Section B and referred to in Table 4. This failure relates to an ongoing service package that was available to new customers until 30 June 2013 and which some existing customers continued to pay for after that date.

139 The licensee is currently conducting further reviews to determine whether customers received the ongoing services they paid for in a new ongoing service package that was introduced in July 2013.

Count Financial Limited

140 This advice licensee reviewed a sample of 385 files for customers who had ongoing service agreements in the period from 1 January 2009 to 30 June 2015, and in some cases contacted advisers and customers for further information.

141 The licensee reported to ASIC that it found evidence of ongoing service delivery in 98% of the sample, leaving the failure rate at 2%.

142 We are currently reviewing further information obtained from the licensee to validate these results and to consider the potential implications for the licensee's wider population of customers.

143 For customers where a failure has been identified, we are discussing with the licensee its process to communicate with and compensate the customers.

Financial Wisdom Limited

144 This advice licensee reviewed a sample of 224 files for customers with ongoing service agreements in the period from 1 January 2009 to 30 June 2015 and, in a similar process to Count Financial Limited, in some cases contacted advisers and customers for further information.

145 The licensee reported to ASIC that it found substantial evidence of service delivery in 98% of files, leaving the failure rate at 2% of the sample.

146 As with Count Financial Limited (see paragraph 142), we are currently reviewing further information obtained from the licensee to validate these results and to consider the potential implications for the licensee's wider population of customers.

147 For customers where a failure has been identified, we are also discussing with the licensee its process to communicate with and compensate the customers.

NAB

148 NAB is reviewing customer files for the period from 1 July 2008 to 30 June 2015 across its advice licensees, and has engaged an external consultant for advice on an appropriate and statistically valid sampling methodology.

149 By 31 August 2016, NAB's external consultant had reviewed a sample of 59 files for the period from 1 July 2013 to 30 June 2015 for the National Australia Bank Limited AFS licensee (NAB Financial Planning). The review excluded customers who were already being reviewed and compensated in connection with the fee-for-service failures described in Section B.

150 The consultant's initial findings were that:

(a) 54 files (92%) contained evidence that suggested the customer received 'services or an offer of service as per their service agreement'; and

(b) five files (8%) contained no evidence of service delivery.

151 NAB is currently investigating whether this failure rate may indicate a wider systemic failure, and is taking steps to compensate customers where a service delivery failure has been confirmed.

152 NAB has recently advised ASIC that it may not be able to complete reviews of its other advice licensees until 31 December 2017. We are discussing the adequacy of this proposed timeframe with NAB.

Macquarie

Scope of review

153 Macquarie's review covered one advice licensee—Macquarie Equities Limited.

154 The review excluded two other advice licensees:

(a) Macquarie Bank Limited told us that in limited instances it provides advice to retail clients, which are predominantly superannuation funds with less than $10 million in assets. It advised that these clients are recorded in the same systems as Macquarie Equities Limited clients, so the review of complaints for such clients would be captured as part of the Macquarie Equities Limited analysis described below.

(b) Risk Advice Specialists Pty Limited predominantly provided insurance services and ceased to hold its AFS licence in October 2015. Insurance services are not generally paid for through ongoing advice fees.

155 Macquarie Equities Limited's business model differs from the other financial institutions covered by this report, as it generally has a greater focus on equities (direct shares) advice and transactions.

156 The review of Macquarie Equities Limited comprised the following key elements:

(a) review of advice templates;

(b) review of relevant customer complaints;

(c) review of advice fee documentation; and

(d) sample testing of client files.

157 The timeframes for the review were:

(a) advice fee data from relevant commission systems—from 1 July 2013 to 31 July 2015; and

(b) complaint and client file review data since 2004.

Findings

158 Macquarie found the following from its review:

(a) *Complaints data*: 18 complaints were identified since May 2005 where customers alleged that a fee was charged but no service was provided, or raised concerns about the level of service provided. Macquarie reported that approximately half of these cases resulted in compensation, while the remaining complaints were not upheld.

(b) *Customer file reviews*: a customer file was reviewed from each of 32 advisers who were high fee earners. Macquarie reported that the review did not find any instances where ongoing advice services had not been provided to customers.

159 We are currently obtaining further information and clarification from Macquarie about the scope of its review and whether it is sufficient to address ASIC’s requirements.

Westpac

160 In January 2016, we wrote to Westpac to request that it review all advice licensees in the Westpac group to determine whether there were systemic issues relating to the incorrect charging of advice fees in the period from 2008.

161 We wrote to Westpac later than the other banking and financial services institutions because of a separate investigation that ASIC is conducting in relation to a Westpac adviser who was reported to ASIC (as referred to in Table 3, note 5).

162 Westpac agreed to review the period from 1 July 2008 to 31 December 2015 covering the following licensees:

(a) Magnitude Group Pty Limited;

(b) Securitor Financial Group Limited; and

(c) Westpac Banking Corporation.

163 We are currently discussing with Westpac an appropriate methodology for its review.

D Systems changes

Key points

We asked the AFS licensees that had found fee-for-service failures to describe any changes being made to their systems and processes.

Some of the licensees gave details of the changes they had made to their supervision and monitoring systems, which they expected to help prevent similar failures from happening in the future, or to enable early detection of failures if they did occur. Some consider their existing systems are adequate, and some are still in the course of considering or implementing changes.

Background

164 We asked the AFS licensees that had identified fee-for-service failures for information about the changes being made to:

(a) resolve the cause of the failures;

(b) reduce the likelihood of similar failures recurring in the future; and

(c) increase the likelihood that such failures would be detected if they did occur.

165 This section summarises the licensees' responses to date. We have not yet assessed the operating effectiveness of these recent changes.

166 Some of the advice licensees that had not identified systemic fee-for-service failures outlined the reasons why they considered their current systems to be adequate.

167 We have provided comments to several AFS licensees in relation to areas where we consider improvements could be made. We will report publicly on further changes at a later date.

168 This section does not describe changes made to systems which were made before our project commenced, but which may also have reduced the likelihood of fee-for-service failures occurring in the future. Some of these changes were prompted by the introduction of the FOFA reforms, which we also expect will reduce the likelihood of similar systemic failures in the future: see paragraphs 42–48.

Licensees that have implemented changes

AMP

169 AMP advised us of changes it has made to its systems to help prevent a recurrence of the identified fee-for-service failures, including:

(a) monthly reporting to monitor whether ongoing advice fees have been switched off following instructions from customers to do so;

(b) processes to ensure that instructions to switch off advice fees are provided to all relevant product divisions; and

(c) a new process where AMP will contact external product providers to request that advice fees are switched off and to monitor that this occurs, rather than relying on customers to contact these product issuers.

170 AMP advised us of further work being implemented over the next four months, including:

(a) assigning a 'process owner' to ensure that fees are switched off in accordance with instructions received from customers;

(b) establishing clearer roles and responsibilities within AMP in relation to switching off advice fees; and

(c) investigating whether automated systems processes, rather than manual processes, can be developed to ensure that relevant advice fees are switched off.

ANZ

171 Since identifying the systemic failure in 2013, ANZ Financial Planning has advised us that it has made changes to its controls and practices for delivering the Prime Access service. These are summarised below.

System controls

172 ANZ advised ASIC that:

(a) all advisers are now required to create records of providing documented annual reviews to customers, which are stored on ANZ's systems;

(b) automated alerts are sent to advisers to prompt them to complete ongoing service obligations when they are due;

(c) daily reports are provided to advisers and managers identifying customers with outstanding documented annual reviews, requiring action;

(d) compliance checks and monitoring have increased their focus on whether ongoing services have been delivered;

(e) in preparing fee disclosure statements, there is a requirement for documentary evidence that an annual review has been completed (if this is stated in the fee disclosure statement); and

(f) a new team has been established with end-to-end responsibility for ensuring that Prime Access services are delivered—with responsibilities including monitoring and oversight of the delivery of services, assessing whether systems and processes are functioning effectively and are fit for purpose, and regular and effective reporting provided to management.

173 ANZ advised that, in some instances, fees and membership for Prime Access services had been switched off—for example, where the customer could not be contacted, had moved permanently overseas, was unwilling to participate in the documented annual review process, or had repeatedly not attended scheduled meetings.

Remuneration

174 ANZ has revised its remuneration scheme by introducing ongoing service delivery measures that must be satisfied for planners to be eligible for performance bonuses, including that there are no overdue annual review meetings for Prime Access customers in each quarter, and that at least 95% of all Prime Access obligations have been met within a 12-month fee disclosure period.

Management oversight and governance

175 ANZ told us that it has introduced detailed regular reporting to senior management on the delivery of Prime Access services, with failures to be documented and remediated.

Training

176 ANZ advised us that it has provided training and communications to advisers, managers and support staff on:

(a) their obligations in delivering ongoing services under Prime Access;

(b) the changes to processes and reporting; and

(c) remuneration scheme changes.

Review and assurance

177 ANZ informed us that, since identifying the Prime Access fee-for-service failures, its testing has identified the need for improvements to controls and practices, as described above. ANZ states that it is continuing to develop ways to improve the delivery of the Prime Access service.

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CBA

Commonwealth Private Limited

178 This advice licensee advised ASIC that it has made changes to its:

(a) monitoring and workflow system used by advisers and managers; and

(b) supervision and monitoring policies and procedures.

179 The licensee advised ASIC that it had made a number of changes to its annual review monitoring tool that had been introduced in 2013, including:

(a) automatic reminders to be sent to advisers and their managers 30 and 60 days before the annual review is due;

(b) increased monitoring and testing of whether annual reviews are completed on time;

(c) notification of identified failures to management; and

(d) reporting of compliance testing results to the licensee's Compliance Review Committee.

180 However, we considered that the tool was failing to operate effectively because it did not prevent the fee-for-service failures that subsequently occurred, or it failed to detect them after they had occurred.

181 The licensee has now informed ASIC that it has made further improvements to its existing systems and processes by:

(a) improving recording of customer interactions related to annual reviews;

(b) implementing adviser training; and

(c) reporting to management about the effectiveness of these changes.

NAB

MLC Limited, MLC Nominees Pty Limited, MLC Investments Limited, NULIS Nominees (Australia) Limited, Navigator Australia Limited

182 NAB commissioned an external compliance consultant to assess the design and implementation of the process to review and remediate these licensees, and the sustainability of NAB's risk controls. The consultant's report has been provided to ASIC.

183 The consultant recommended that NAB should introduce an automated process to switch off advice fees when a customer requests that the services of their adviser be discontinued.

184 In the meantime, a quality assurance process and other manual (non-automated) controls have been implemented, which the consultant stated

were a reasonably strong short-term solution that would significantly reduce the risk of customers affected by a failure being missed.

185 The consultant noted that, because the temporary control was manual, it would be subject to potential human error; however, if a failure did recur, a control had been put in place to enable early detection and this was likely to be effective.

186 The consultant recommended that:

(a) NAB should implement the automated controls; and

(b) when the automated controls were introduced, NAB should perform a check to establish whether any customers affected since 30 November 2015 had not been remediated, and if not, to remediate such customers.

187 NAB has committed to implementing these recommendations.

NAB Financial Planning

188 NAB has made some changes to its risk controls within its National Australia Bank Limited AFS licensee (NAB Financial Planning), including that:

(a) a monthly report is to be produced, identifying incorrectly applied ongoing advice fees; and

(b) a new staff position has been created to monitor that customers transferring from an advice service to a no-advice service will have their advice fees switched off.

Institutions not described in this section

189 This section does not refer to changes made by:

(a) Macquarie—because, as described at paragraph 7, Macquarie had not identified a fee-for-service failure at the date of this report; and

(b) Westpac—because, at the time of writing this report, Westpac had only reported a fee-for-service failure in relation to one of its financial advisers. Westpac's further reviews to determine whether there are additional fee-for-service failures are not complete, as described in Section C.

E Our observations

Key points

In this section, we record our observations on:

- the fee-for-service failures of AFS licensees covered by this project; and
- steps taken by licensees to identify and compensate customers in an efficient, honest and fair manner.

We identified that some licensees showed a commitment to identifying and compensating customers in a timely way.

However, following our review, we were also concerned that:

- some licensees prioritised advice revenue and fee generation over ensuring that they delivered the required services;
- some licensees did not have adequate systems, data, policies and procedures in relation to the provision of ongoing advice services;
- some licensees adopted an overly legalistic, rather than customer-focused, approach to customer compensation;
- without ASIC's intervention, some customer remediation programs proposed by the licensees may have led to poor customer compensation outcomes; and
- cultural factors contributed to the issues identified in this report.

We describe the reasons for these observations in more detail below.

190 Our analysis of the fee-for-service failures and our work with the AFS licensees to ensure customers affected by those failures are identified and compensated has led us to make certain observations about:

(a) remuneration practices;

(b) record keeping and monitoring of advisers;

(c) approach to review and remediation of customers; and

(d) the way in which the culture of the licensees may have contributed to the fee-for-service failures and the impact of these failures on customers.

Remuneration

Prioritisation of revenue over service

191 ASIC considers that the fee-for-service failures show that AFS licensees and advisers prioritised revenue and fee generation over the delivery of advice and services paid for by their customers. For example, we are concerned that:

(a) licensees did not have systems in place to ensure that services were being provided in return for the fees being charged. By contrast, the licensees had much more effective systems for recording incoming revenue;

(b) advisers were allowed to have many more ongoing advice customers on their books than they would have been able to monitor or advise on an annual basis. For example, some advisers had many hundreds of customers—often having 'inherited' these customers, and the stream of fee revenue, from other advisers who had departed from the licensee; and

(c) some licensees charged fees for services that, arguably, had limited value for customers. For example, the customers of one licensee paid ongoing fees for services that included 'Retention of client records by your adviser … Retaining this information may reduce the cost of providing additional advice and service in the future'. However, all AFS licensees already have legal obligations to keep client records for seven years.

192 These observations indicate that advice licensees did not adequately monitor and supervise their representatives, or have had adequate business systems and practices.

Fee maximisation

193 Section A describes how a prevalent form of adviser remuneration in the financial advice industry is based on automatic deductions and payments—traditionally for sales commissions, but also for other payments such as adviser service fees based on the value of customers' assets. There is generally no specific service connected to the payment of commissions and, in many cases, the licensees have found that they and their advisers did not provide specific services that fee-paying customers were entitled to.

194 The FOFA reforms in 2013 banned certain commissions for new advice, and required increased transparency around fees charged and services provided through fee disclosure statements and opt-in renewal notices. However, we are concerned that the industry (including licensees and advisers) may still have a culture of reliance on ongoing trail revenue (through commissions and fees) for a portion of their income, without necessarily providing advice to customers in return.

195 We saw instances of fee arrangements where, in the licensees' view, there was no obligation to provide advice to customers in return for the fees they paid.

196 For example, some advice licensees considered that their ongoing service obligation was satisfied if an adviser offered or *attempted* to offer an annual review (e.g. by making three unanswered phone calls), even if this review was not provided. We are concerned that, regardless of whether there is a

legal basis to support such an approach, this may indicate business practices that support revenue and fee generation over service delivery to customers. As discussed below, we consider that this indicates there are cultural factors within the advice licensees and the institutions that need to be addressed.

Record keeping and monitoring

Data, systems and record keeping

197 We are concerned that advice licensees and advisers failed to keep adequate records or data to enable monitoring and analysis of ongoing service provision. During this project, we note the continued reliance by some licensees on hard copy customer files (which were often incomplete) to demonstrate service delivery.

198 The impacts of advice licensees' record-keeping systems and practices on this project included:

(a) significant difficulties and delays in licensees identifying affected customers;

(b) an absence of customer files, meaning that licensees were unable to determine whether customers received the services they paid for; and

(c) the inability of licensees to accurately calculate the refunds and compensation owing to customers, meaning that proxy interest or earnings rates needed to be applied to compensation payments.

199 Having proper information and data systems is fundamental to running a financial services business, supervising and monitoring representatives and ensuring that customers receive the services they pay for.

Note: As noted earlier, we have amended [CO 14/923] to clarify advice licensees' record-keeping obligations.

Policies and procedures

200 We are concerned that advice licensees failed to develop and enforce policies and procedures to ensure that:

(a) ongoing advice services were provided to customers who paid for them;

(b) fees would not be charged for ongoing advice services that were not provided; and

(c) fees would be switched off, and customers compensated, if customers continued in successive years to pay ongoing advice fees without receiving advice.

Review and remediation

201 Some advice licensees and product issuers that identified fee-for-service failures showed a commitment to identifying affected customers and paying refunds and compensation in a timely and acceptable way.

202 Positive aspects of these licensees' approaches to review and remediation included:

(a) a proactive approach in identifying affected customers; and

(b) a commitment to developing an acceptable and customer-focused methodology for paying refunds and compensation, and implementing the process within a reasonable timeframe after it was agreed with ASIC.

203 However, we also found that on some occasions licensees initially proposed review and remediation processes that were legalistic and not focused on customers' interests. Examples of such proposals are:

(a) an opt-in approach for customer remediation;

(b) review and compensation of customers over a six-year period instead of seven years; and

(c) a narrow or legalistic approach to defining affected customers.

204 Following our intervention, the licensees generally revised their review and compensation processes to meet our expectations. We are still discussing aspects of some review and remediation processes with the licensees. We note that the need for us to intervene and review all remediation processes carefully and insist on changes has caused delays to customer compensation.

Cultural indicators

205 Culture is a set of shared values or assumptions. Values are what an organisation chooses to prioritise, and these shared values can shape and influence people's attitudes and behaviours towards, for example, treatment of customers and compliance.

206 ASIC is concerned about culture because it is a key driver of conduct within the financial services licensees that we regulate, and the financial services industry more broadly.

207 Where there are systemic failures in an organisation, the culture of that organisation is very likely to have been a contributing factor.

208 The information we have gathered for this project to date suggests that cultural factors in the specific banking and financial services institutions and advice licensees covered by this report—in particular, those where multiple

advisers and a large number of customers were involved—contributed to the systemic failures we observed. These systemic failures had direct impacts on outcomes for customers, including:

(a) financial advisers failing to provide ongoing advice services to customers who paid ongoing service fees; and

(b) relevant licensees' staff and management failing to put in place systems (e.g. for data, compliance and record keeping) to ensure such services were provided to customers who paid these fees.

209 Of particular concern is that many of the banking and financial services institutions covered by this review publicly state that their core values include being customer focused, 'doing what is right' for customers, and acting with integrity.

210 We encourage the institutions reviewed in this report to consider how their culture may have supported these systemic failures, and why their stated commitment to providing excellent service to customers is not translating into good outcomes for customers in the many instances we identified in this report.

Next steps

211 In an organisation, values and cultural leadership must come from the top. The role of the board, senior executives and management is critical in setting the right culture.

212 During this project, we have been in regular contact with senior executives of the banks and financial services institutions in relation to the issues identified in this report.

213 In addition, a copy of this report will be provided to the boards of each of the banks and financial services institutions that were covered by the review, including for the attention of the boards' risk committees. We will also meet with these institutions to discuss the findings and implications of this report.

F Future reporting

Key points

Advice licensees are expected to complete their customer review and remediation for each of the systemic failures described in Section B by 30 June 2017 or earlier.

The further reviews described in Section C will be completed after that.

We will report publicly on compensation outcomes.

214 As described in Section B, some of the review and remediation processes initiated by the advice licensees are large scale and complex, and substantial work remains to be completed by the licensees.

215 We expect that compensation may increase substantially in the coming months as the process to identify and compensate affected customers continues.

216 As described in Section C, most of the advice licensees have yet to complete their further reviews.

217 We will continue to monitor the advice licensees' implementation of both the review and remediation processes, and the further reviews instigated at ASIC's request. This will include regular progress reporting by the licensees to ASIC.

218 We intend to provide a public update, via media release, on the progress and outcomes of these review and remediation activities in the first half of 2017.

Key terms

Term	Meaning in this document
advice	Personal advice given to retail clients
advice licensee	An AFS licensee that provides personal advice to retail clients
adviser	A natural person providing personal advice to retail clients on behalf of an AFS licensee who is either: • an authorised representative of a licensee; or • an employee representative of a licensee
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act Note: This is a definition contained in s761A.
AMP	AMP Limited
ANZ	Australia and New Zealand Banking Group Limited
ASIC	Australian Securities and Investments Commission
authorised representative	A person authorised by an AFS licensee, in accordance with s916A or 916B of the Corporations Act, to provide a financial service or services on behalf of the licensee Note: This is a definition contained in s761A.
CBA	Commonwealth Bank of Australia
CFPL	Commonwealth Financial Planning Limited
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
customer (or client)	Retail client
fee disclosure statement	A document required by s962G to be given in accordance with Div 3 of Pt 7.7A of the Corporations Act. Specifically, it is a statement in writing provided by a fee recipient to their client about the previous 12 months of their ongoing fee arrangement, including information about the amount of fees paid by the client, the services received by the client, and the services that the client was entitled to receive

Term	Meaning in this document
fee-for-service failure	The systemic failure to deliver ongoing advice services to customers who are paying fees to receive these services, or the incorrect charging of ongoing advice fees to customers who do not have an adviser allocated to them
fee recipient	A fee recipient is: • the AFS licensee or its representative who enters into the ongoing fee arrangement with the client; or • if the rights of the person who entered into the ongoing fee arrangement have been assigned, the person who currently holds those rights Note: See s962C of the Corporations Act for the exact definition.
financial advice	Financial product advice
financial adviser	See 'adviser'
financial product	Generally, a facility through which, or through the acquisition of which, a person does one or more of the following: • makes a financial investment (see s763B); • manages financial risk (see s763C); • makes non-cash payments (see s763D) Note: See Div 3 of Pt 7.1 of the Corporations Act for the exact definition.
financial product advice	A recommendation or a statement of opinion, or a report of either of these things, that: • is intended to influence a person or persons in making a decision about a particular financial product or class of financial product, or an interest in a particular financial product or class of financial product; or • could reasonably be regarded as being intended to have such an influence. This does not include anything in an exempt document Note: This is a definition contained in s766B of the Corporations Act.
FOFA	Future of Financial Advice
Macquarie	Macquarie Group Limited

Term	Meaning in this document
NAB	National Australia Bank Group of Companies Note: On 3 October 2016, National Australia Bank Limited divested 80% of its shareholding in the MLC Limited Life Insurance business. Accordingly, MLC Limited ceased to form part of the NAB Group of companies. Ahead of the sale, superannuation members from the registrable superannuation entities (RSE) governed by MLC Nominees Pty Limited were transferred into a new RSE governed by NULIS Nominees (Australia) Limited. At this time, MLC Limited ceased its role as administrator of the former RSE. Regardless of these changes, NAB retains accountability for remediation of events reported by MLC Limited and MLC Nominees Pty Limited that are included in this report.
ongoing fee arrangement	An ongoing fee arrangement exists when an AFS licensee or its representative gives personal advice to a retail client and the retail client enters into an arrangement with the AFS licensee or representative, the terms of which provide for the payment of a fee during a period of more than 12 months
ongoing service agreement	An agreement between a customer and an AFS licensee or its representative, where the AFS licensee or its representative agrees to provide ongoing advice services to the customer
personal advice	Financial product advice that is given or directed to a person in circumstances where the provider of the advice has considered one or more of the person's objectives, financial situation and needs, or a reasonable person might expect the provider to have done so Note: See s766B(3) of the Corporations Act for the exact definition.
retail client	A client as defined in s761G of the Corporations Act and Div 2 of Pt 7.1 of the Corporations Regulations 2001
RG 256 (for example)	An ASIC regulatory guide (in this example numbered 256)
s913B (for example)	A section of the Corporations Act (in this example numbered 913B)
Westpac	Westpac Banking Corporation

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Related information

Headnotes

advice licensee, AFS licensee, annual review, banking and financial services institutions, client files, compensation, fee disclosure statement, ongoing advice fees, ongoing advice service, ongoing service agreement, remediation, review

Legislative instruments

[CO 14/923] *Record-keeping obligations for Australian financial services licensees when giving personal advice*

Regulatory guides

RG 256 *Client review and remediation conducted by advice licensees*

Legislation

Corporations Act, s766B(3)

Consultation papers and reports

CP 247 *Client review and remediation projects and update to record-keeping requirements*

REP 407 *Review of the financial advice industry's implementation of the FOFA reforms*

Media releases

15-081MR *ASIC update on Wealth Management Project—Investigation into charging of advice fees without providing advice*

15-101MR *ASIC to give guidance on review and remediation in the financial advice industry*

15-388MR *ASIC releases draft guidance on review and remediation projects and proposed changes to record-keeping requirements for advice licensees*

16-188MR *ASIC bans former ANZ financial adviser*

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Friday 15 December 2017

17-438MR Update on financial advice institutions fees-for-no-service refund programs

AMP, ANZ, CBA, NAB and Westpac have now paid or offered customers $215.9 million of an estimated $219.5 million in refunds and interest for failing to provide general or personal advice to customers while charging them ongoing advice fees.

This is an additional $155 million in payments and offers since the ASIC's last public update on the fees-for-no-service project, which provided compensation figures as at 21 April 2017.

The table provides compensation payments and estimates for fees for no service failures that were reported to ASIC as at 31 October 2017. The institutions' total estimates have changed over the past six months as they investigated the compensation required and in some cases identified new failures.

Group	Compensation paid or offered	Estimated future compensation (excludes interest)	Total estimate
AMP	$4,715,188	Not yet available	$4,715,188
ANZ	$49,178,004	$712,785	$49,890,789
CBA	$117,671,810	$1,517,690	$119,189,500
NAB	$5,413,535	$1,289,404	$6,702,939
Westpac	$3,113,159	Not yet available (1)	$3,113,159
Total (personal advice failures)	**$180,091,696**	**$3,519,879**	**$183,611,575**
NULIS Nominees (Australia) Ltd (2) (no changes)	$35,900,408	Nil	$35,900,408
Total (personal and general advice failures)	**$215,992,104**	**$3,519,879**	**$219,511,983**

Source: Data reported by the institutions to ASIC as at 31 October 2017.

Next steps

ASIC will continue to monitor the institutions' compensation programs and supervise the institutions' further reviews to determine whether any additional instances of fees being charged without advice being provided are identified. We will provide another public update in mid-2018.

Background

In October 2016 the Australian Securities and Investments Commission (ASIC) released Report 499 *Financial advice: fees for no service* (REP 499). The report described systemic failures of the advice divisions of the largest banks and AMP, as well as some of their product issuers, to ensure that ongoing advice services were provided to customers who paid fees to receive these services, the failure of advisers to provide such services, and the failure of product issuers to switch off advice fees of customers who did not have a financial adviser.

At the time of the publication of the report compensation arising from the fee-for-service failures reported to ASIC was approximately $23.7 million, which had been paid, or agreed to be paid, to more than 27,000 customers.

Since REP 499 a further $192 million has been paid or offered to over 276,000 customers.

MoneySmart

Customers who are paying ongoing advice fees for services they do not need can ask for those fees to be switched off. Customers who have paid fees for services they did not receive may be entitled to refunds and compensation, and should lodge a complaint through the bank or licensee's internal dispute resolution system or the Financial Ombudsman Service.

ASIC's MoneySmart website explains how customers can check they are getting the financial advice they paid for. It also has a financial advice toolkit to help customers navigate the financial advice process and understand what they should expect from an adviser, and useful information about how to make a complaint.

Table notes

(1) At the time of publication Westpac had not determined the size of future compensation.

(2) The table shows compensation paid by NAB's superannuation trustee, NULIS Nominees (Australia) Limited (NULIS), for two breaches involving failures in relation to the provision of general advice services to superannuation members who paid general advice fees (other fees referred to in this release relate to personal advice).

As announced by ASIC on 2 February 2017 ASIC imposed additional licence conditions on NULIS following this and another breach: ASIC media release 17-022MR.

The failure was by MLC Nominees Pty Ltd and MLC Limited. While on 1 July 2016 the superannuation assets governed by MLC Nominees were transferred by successor fund transfer to NULIS, and on 3 October 2016 NAB divested 80% of its shareholding in the MLC Limited Life Insurance business, accountability for this remediation activity (including compensation) remains within the NAB Group.

Last updated: 22/12/2017 12:37

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Friday 19 May 2017

17-145MR Compensation update: major financial advisory institutions continue refund programs for fees-for-no-service

AMP, ANZ, CBA, NAB and Westpac have so far repaid more than $60 million of an expected $200 million-plus total in refunds and interest for failing to provide general or personal financial advice to customers while charging them ongoing advice fees.

These institutions' total compensation estimates for these advice delivery failures now stand at more than $204 million, plus interest. As foreshadowed in ASIC's Report 499 *Financial advice: fees for no service* (REP499), ASIC can now provide an update on compensation outcomes to date.

Background

In October 2016 the Australian Securities and Investments Commission (ASIC) released REP499. The report covered advice divisions of the big four banks and AMP and described systemic failures to ensure that ongoing advice services were provided to customers who paid fees to receive these services, and the failure of advisers to provide such services. The report also discussed the systemic failure of product issuers to stop charging ongoing advice fees to customers who did not have a financial adviser.

At the time of the publication of the report compensation arising from the fee-for-service failures reported to ASIC was approximately $23.7 million, which had been paid, or agreed to be paid, to more than 27,000 customers.

Since REP 499 a further $37 million has been paid or offered to more than 18,000 customers. In addition, the institutions' estimates of total required compensation for general and personal advice failures have increased by approximately 15% to more than $204 million, plus interest.

The table provides, at an institution level, compensation payments and estimates that were reported to ASIC as at 21 April 2017. Since that date compensation figures have continued to increase.

Group	Compensation paid or offered	Estimated future compensation (excludes interest)	Total (estimate, excludes interest)
AMP	$3,816,327	$603,387	$4,419,714

ANZ	$43,818,571	$8,613,001	$52,431,572
CBA	$5,850,827	$99,786,760	$105,637,587
NAB	$4,641,539	$385,844	$5,027,383
Westpac	$2,670,479	Not yet available	$2,670,479
Total (personal advice failures)	**$60,797,743**	**$109,388,992**	**$170,186,735**
NULIS Nominees (Australia) Ltd (1)	Nil	$34,720,614	$34,720,614
Total (personal and general advice failures)	**$60,797,743**	**$144,109,606**	**$204,907,349**

Source: Data is based on estimates provided to ASIC by the institutions and will change as the reviews to determine customer impact continue.

(1) For details, see the section on NAB below.

Key compensation developments

AMP

- AMP's total compensation estimate decreased from $4.6 million to $4.4 million as AMP reviewed customer files and data to determine compensation required, and revised its previous estimates.

ANZ

- The total compensation estimate has increased from $49.7 million to $52.4 million due to the expansion of existing compensation programs and the identification of further failures by authorised representatives of two ANZ-owned advice businesses:
    - Financial Services Partners Pty Ltd; and
    - RI Advice Group Pty Ltd.
- The largest component of ANZ's compensation program relates to fees customers were charged for the Prime Access service, where ANZ could not find evidence of a statement of advice or record of advice for each annual review period.
- In addition, ANZ found that further compensation of approximately $7.5 million is required to be paid to ANZ Prime Access customers for ANZ's failure to rebate commissions in line with its agreement with customers. This compensation has not been included in the figures in this media release because it does not relate to a failure to provide advice for which customers were charged, but is noted for completeness and transparency.

CBA

- There has been no substantial change in CBA's compensation estimate, which remains at approximately $105 million, plus interest, the majority of which relates to Commonwealth Financial Planning Ltd (CFPL). The compensation estimate for CFPL results from a customer-focused methodology whereby, as well as providing refunds where the adviser failed to contact the client to provide an annual review, CFPL will provide fee refunds to customers where:
  - the adviser offered the customer an annual review and the customer declined, or -
  - the adviser tried to contact the customer to offer a review, but was unable to contact the customer.
- Some of the other licensees or banks covered by the ASIC fees-for-no-service project have not, at this stage, adopted a similar customer-focused approach to the situation in which a service was offered but not delivered. ASIC continues to discuss the approach to this situation with these banks and licensees.

NAB

- Since the publication of REP 499, by 21 April 2017, NAB reported to ASIC the further erroneous deduction of adviser service fees for personal advice from more than 3,000 customers of the following licensees:
  - Apogee Financial Planning Ltd: $11,978, from 11 customers;
  - GWM Adviser Services Ltd: $179,446, from 290 customers;
  - MLC Investments Ltd: $9,755, from six customers;
  - National Australia Bank Ltd: $2,777, from seven customers; and
  - NULIS: $173,120, from 3,310 customers.
- In addition, the table shows the expected compensation of approximately $34.7 million by NAB's superannuation trustee, NULIS Nominees (Australia) Limited (NULIS), for two breaches involving failures in relation to the provision of general advice services to superannuation members who paid general advice fees (other fees referred to in this release relate to personal advice). As announced by ASIC on 2 February 2017 ASIC has imposed additional licence conditions on NULIS following these and another breach: ASIC MR 17-022. The failure was by MLC Nominees Pty Ltd (and MLC Limited for the first of the two breaches). Whilst on 1 July 2016 the superannuation assets governed by MLC Nominees were transferred by successor fund transfer to NULIS, and on 3 October 2016 NAB divested 80% of its shareholding in the MLC Limited Life Insurance business, accountability for this remediation activity (including compensation) remains within the NAB Group. The estimate of customer accounts affected has increased from approximately 108,867 to 220,460 since REP 499, reflecting the second of two breaches.

Westpac

- REP 499 noted that Westpac had identified a systemic fees-for-no-service issue in relation to one adviser only, with compensation of $1.2 million paid in relation to those failures.
- Following further ASIC enquiries, Westpac subsequently clarified that it has paid further compensation of approximately $1.4 million to 161 customers of that adviser and 14 further advisers, in respect for fee-for-no-service failures in the period 1 July 2008 to 31 December 2015.

Next steps

ASIC will continue to monitor these compensation programs and will provide another public update by the end of 2017. In addition ASIC will continue to supervise the institutions' further reviews to determine whether any additional instances are identified of fees being charged without advice being provided.

MoneySmart

Customers who are paying ongoing advice fees for services they do not need can ask for those fees to be switched off. Customers who have paid fees for services they did not receive may be entitled to refunds and compensation, and should lodge a complaint through the bank or licensee's internal dispute resolution system or the Financial Ombudsman Service.

ASIC's MoneySmart website has a financial advice toolkit to help customers navigate the financial advice process and understand what they should expect from an adviser. It also has useful information about how to make a complaint.

Last updated: 19/05/2017 01:25

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Thursday 16 April 2015

15-081MR ASIC update on Wealth Management Project - Investigation into charging of advice fees without providing advice

ASIC today provided an update on its Wealth Management Project which is focusing on the conduct of the largest financial advice firms.

ASIC is investigating multiple instances of licensees charging clients for financial advice, including annual advice reviews, where the advice was not provided. Most of the fees have been charged as part of a client's service agreement with their financial adviser.

Deputy Chairman, Peter Kell said: 'ASIC will consider all regulatory options, including enforcement action, where we find evidence of breaches of the law relating to fees being charged where no advice service has been provided. We will look to ensure that advice licensees follow a proper process of customer remediation and reimbursement of fees where such breaches have occurred.'

The ASIC Wealth Management Project was established in October last year with the objective of lifting standards in major financial advice providers. Under this project ASIC is carrying a number of investigations and is conducting a range of proactive risk-based surveillances with particular focus on compliance in large financial institutions.

ASIC's investigations are continuing.

Background

ASIC set up the specialist Wealth Management Project in October 2014 (refer: Senate Estimates: Opening statement - February 2015)

Last updated: 23/03/2016 03:09

ASIC

Australian Securities & Investments Commission

REPORT 515

Financial advice: Review of how large institutions oversee their advisers

March 2017

About this report

In July 2015, ASIC commenced a project to review how effectively Australia's largest banking and financial services institutions oversee their financial advisers.

This project focused on:

- how these institutions identified and dealt with non-compliant conduct by advisers between 1 January 2009 and 30 June 2015;
- the development and implementation by the institutions of a framework for the large-scale review and remediation of customers who received non-compliant advice between 1 January 2009 and 30 June 2015; and
- a review of Australian financial services (AFS) licensees, selected from within the institutions, to test their current processes for monitoring and supervising their advisers.

This report outlines ASIC's observations and findings from this project, and provides an update on the actions of the largest advice institutions to address customer loss or detriment. The report will assist the financial advice industry as a whole to raise its standards and reduce the risk of current customers receiving non-compliant advice in the future.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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Contents

Executive summary

1 This project—which forms part of ASIC's broader Wealth Management Project—focuses on five of Australia's largest banking and financial services institutions (institutions):

(a) AMP Limited (AMP);

(b) Australia and New Zealand Banking Group Limited (ANZ);

(c) Commonwealth Bank of Australia (CBA);

(d) National Australia Bank Limited (NAB); and

(e) Westpac Banking Corporation (Westpac).

2 More specifically, we considered the conduct of Australian financial services (AFS) licensees that were solely controlled or owned by the above institutions for all or part of the period between 1 January 2009 and 30 June 2015, where these licensees provided personal advice to retail clients. A list of the 35 advice licensees that fell within the scope of this project is set out in Appendix 1.

Note: In this report, we use the terms:

- 'advice licensee' to refer to 'AFS licensees that provide personal advice to retail clients';
- 'advice' or 'personal advice' to refer to 'personal advice provided to retail clients': see s766B(3) of the *Corporations Act 2001* (Corporations Act) for the exact definition of 'personal advice'; and
- 'customer' or 'client' to refer to 'retail client', as defined in s761G of the Corporations Act and Div 2 of Pt 7.1 of the Corporations Regulations 2001.

See also the list of 'Key terms' in this report.

3 As set out in ASIC's Corporate Plan 2016–17 to 2019–20, ASIC's aim in the sectors it regulates is to promote investor and consumer trust and confidence and market integrity. For the financial advice industry this can be achieved if financial advisers:

(a) act professionally, avoid conflicts of interest and treat customers fairly;

(b) deliver strategic financial advice that is aligned with customer needs and preferences; and

(c) ensure that customers are fully compensated when loss or detriment results from poor conduct.

4 We recognise that a key driver to realising this aim is the impact that organisational culture and collective industry norms and practices have on the behaviour and conduct of the firms that we regulate and the individuals who work within these firms.

5 We commenced this project because of information ASIC received about non-compliant advice, as well as public concerns about wider problems in

large advice firms. This included information disclosed by some of the institutions in early 2015. Similar information was provided to the Senate Economics References Committee Inquiry into the Scrutiny of Financial Advice. A range of reviews and enforcement actions by ASIC in the financial advice industry, in recent years, had also highlighted systemic concerns.

6 Before the start of this project, it was apparent that some of the institutions had identified potentially significant past advice failings which they were seeking to address through customer remediation. The institutions also notified ASIC of a number of advisers they suspected of past non-compliant conduct.

7 Since 1 July 2013, significant law reform has taken place to improve standards in the financial advice industry, including the Future of Financial Advice (FOFA) reforms and the introduction of ASIC's financial advisers register. More reforms are being introduced, including improvements to professional standards for advisers. These reforms will help to improve customer outcomes in the future. However, we also consider it important that past misconduct is effectively addressed.

8 The aims of this project were therefore:

(a) to ensure that past non-compliant conduct by advisers was identified by the institutions, and for ASIC to determine which of these advisers should be considered for regulatory and enforcement actions;

(b) to ensure that a framework for large-scale customer review and remediation would be developed and implemented by each of the institutions to remediate customers who received non-compliant advice between 1 January 2009 and 30 June 2015; and

(c) to review the current monitoring and supervision processes used by advice licensees, to determine whether changes were required to ensure that, in the future, these processes would effectively identify advisers who provided non-compliant advice. We will continue to work with licensees where we see areas for improvement.

Note: See 'Key terms' for definitions of 'non-compliant conduct' and 'non-compliant advice'.

9 To improve trust and confidence in the financial advice industry, we considered it imperative that the institutions' work on addressing non-compliant advice was undertaken transparently and effectively. In addition, we wanted to ensure that insights gained from past experience were applied by the institutions. ASIC is working actively with the institutions, and other industry participants, to rectify past problems and identify areas for improvement.

10 This report outlines our observations and findings from the project to date. Except in relation to the development of the review and remediation frameworks, this report does not name specific institutions or licensees because the information on which it relies:

(a) was provided by the institutions in response to our compulsory information-gathering powers which require us to maintain confidentiality; and

(b) may be used to seek an enforcement outcome against the institutions or, depending on the conduct, an adviser.

Note: This report does not cover separate actions and outcomes in relation to individual financial advice firms—such as ASIC's earlier actions against CBA (see paragraphs 116–119)—and it does not cover the actions and remediation we are seeking through our work on advice fees charged where no services were provided: see Report 499 *Financial advice: Fees for no service* (REP 499).

11 When we have public enforcement outcomes, our public reporting names the affected institutions and advisers. Further details can be found on ASIC's website.

Phase 1: Identifying and dealing with non-compliant conduct by advisers

12 The project was conducted in three phases. In Phase 1, we directed the institutions to identify and provide information about their advisers whose past conduct had been identified as non-compliant. The purpose of gathering this information was to:

(a) determine how the institutions identified and dealt with non-compliant conduct by advisers; and

(b) allow ASIC to consider whether to take action against those advisers.

13 In response to our direction, the institutions identified serious compliance concerns about 149 advisers, and provided this information to ASIC by 16 December 2015. At that time, ASIC had already banned 14 of these SCC advisers and had ongoing investigation or surveillance activities in relation to a further 38 of these advisers.

Note: In this report, we use the term 'SCC adviser' to refer to an adviser whose conduct has given rise to serious compliance concerns. For our definition of 'serious compliance concerns', see paragraph 108.

14 Over the course of the project, 36 additional SCC advisers were brought to our attention. This resulted in a total of 185 SCC advisers to be considered for further regulatory or enforcement action. As at 31 December 2016, we had banned 26 of these SCC advisers and had ongoing investigation or surveillance activities in relation to 75 SCC advisers.

Note: For details about how we selected the SCC advisers for further regulatory or enforcement action, see paragraphs 149–159.

15 We reviewed the breach reports and other notifications provided to ASIC by the institutions since 1 January 2009. From the information held on our registers, and information provided to us by the institutions, it was apparent that reporting practices varied, with some of the institutions notifying ASIC more often. However, nearly half of the SCC advisers were not notified to ASIC until the licensees identified and reported their SCC advisers to us in response to our direction.

16 We observed that, where breach reports were lodged relating to the SCC advisers, there was often a considerable delay between the institution first becoming aware of the suspected non-compliant conduct and the breach report being lodged with ASIC.

17 Failure or delay in notifying us of reportable breaches, or suspected serious non-compliant conduct, may impede our ability to take appropriate enforcement or other regulatory action. Importantly, it may also result in an increased risk of customer loss or detriment as a result of advice being provided by non-compliant advisers who have been allowed to continue to work in the industry.

18 We accept that not every instance of adviser non-compliance will trigger the need to lodge a breach report with ASIC, and we will not take formal enforcement or other regulatory action in relation to every breach report. This is because we have limited resources and must therefore prioritise taking action on matters that will address the most significant risks and have the greatest impact. However, even if breach reports do not lead to ASIC taking action, they help us to better understand the trends and potential risks in the financial advice industry and to improve our identification of matters where we need to take action.

19 ASIC has clearly and publicly signalled to the financial advice industry the importance of breach reporting, and we are receiving more breach reports from advice licensees. The launch of ASIC's financial advisers register on 31 March 2015 underlines the role that breach reporting can play in helping to address poor adviser conduct. The register assists ASIC to more readily identify where advisers whose conduct has been the subject of a breach report are now working, or whether they have left the industry.

20 For further information about our review of advisers whose conduct has been identified as non-compliant, including a full definition of 'serious compliance concerns', see Section B.

Phase 2: Customer review and remediation

21 In Phase 2, we engaged with each of the institutions to oversee the development and implementation of a framework for large-scale customer review and remediation.

22 The purpose of this engagement was to ensure that the institutions identified and remediated—in a comprehensive, fair, timely and transparent manner—customers who had suffered loss or detriment as a result of receiving non-compliant advice between 1 January 2009 and 30 June 2015. These are large-scale, complex remediation processes, and if this purpose is to be met, the institutions need to ensure they invest adequate resources into developing their frameworks.

23 The institutions recognise the importance of this work, and the development of their review and remediation frameworks has been undertaken on a consultative basis. We worked with each of the institutions to ensure that the review and remediation framework they put in place would be consistent with the principles that were developed through Consultation Paper 247 *Client review and remediation programs and update to record-keeping requirements* (CP 247) and are set out in our recently published guidance in Regulatory Guide 256 *Client review and remediation conducted by advice licensees* (RG 256).

24 In particular, the completed review and remediation framework should:

(a) provide a streamlined review and remediation process for each of the institutions;

(b) operate efficiently, honestly and fairly—in line with advice licensees' obligations—by addressing the key principles set out in our guidance; and

(c) provide customers with confidence in the fairness of remediation outcomes.

25 In the past, the institutions have relied on traditional monitoring and supervision tools, such as customer complaints data or adviser audit outcomes, to identify which advisers pose a higher risk of non-compliant conduct (high-risk advisers).

26 More recently, as part of their review and remediation processes, the institutions have been using new technologies and data analytics to develop key risk indicators (KRIs) to assist in identifying high-risk advisers and affected customers. This will contribute to more effective monitoring and supervision.

27 When developing these KRIs, the institutions faced challenges because of the limitations on data collection and retention. Some of the reasons observed for these limitations included that:

(a) older data was less reliable, unavailable or non-existent;

(b) paper-based record keeping made information more difficult to access;

(c) incompatible legacy systems, resulting from technology upgrades and business mergers, made data extraction difficult; and

(d) different data-recording methods were used within the institutions and across their different licensees.

28 Nevertheless, we think that the development and use of KRIs, and enhanced records and data management, appropriate to the licensee's business, can assist in identifying high-risk advisers and affected customers.

29 As at 23 February 2017, some institutions were yet to finalise all of the documentation relating to their review and remediation framework. Phase 2 of the project is therefore ongoing. Table 3 sets out the key elements that we encouraged institutions to include in their review and remediation framework, and the progress made by each institution towards incorporating these elements.

30 To ensure that its review and remediation framework will satisfy the objective of Phase 2, each of the institutions has agreed to appoint an external expert to provide assurance on the design and operational effectiveness of its framework.

Compensation

31 The compensation arising from the non-compliant conduct identified within the scope of this project—reported to ASIC as paid at 31 December 2016—was approximately $30 million in total. This was paid across the institutions to approximately 1,347 customers who had suffered loss or detriment as a result of non-compliant conduct by 97 currently identified high-risk advisers whose conduct occurred between 1 January 2009 and 30 June 2015.

32 The compensation amount can be broken down into:

(a) $5,928,821 paid in response to customer complaints;

(b) $22,765,365 paid under previous or existing remediation processes; and

(c) $1,572,086 paid under the frameworks for large-scale review and remediation developed as part of this project.

Note 1: The above figures are rounded to the nearest dollar.

Note 2: We will provide ongoing updates by publicly reporting on the progress made by the institutions on remediating customers who have suffered loss or detriment as a result of receiving non-compliant advice between 1 January 2009 and 30 June 2015, until the completion of that work.

Note 3: For further details on the compensation paid by the institutions, see Table 5.

33 The compensation figures set out in this report do not include compensation amounts paid in relation to:

(a) CBA's other large-scale remediation programs, as noted in:

(i) Media Release (15-083MR) *Update on licence conditions on two Commonwealth Bank financial planning businesses: ASIC releases initial report into advice compensation program* (23 April 2015);

(ii) Media Release (16-415MR) *Update on licence conditions of two CBA financial advice businesses: ASIC releases compliance report from KordaMentha Forensic* (5 December 2016); and

(iii) CBA's Open Advice Review program; or

(b) fees-for-no-service issues, as noted in REP 499.

34 For further information on the review and remediation of customers, see Section C.

Phase 3: Monitoring and supervision of advisers

35 For Phase 3, we selected 10 advice licensees (Phase 3 licensees) from the 35 advice licensees in this project. We undertook a review of two key aspects of the Phase 3 licensees' monitoring and supervision processes.

36 Our review focused on:

(a) the adequacy of the licensees' background and reference-checking processes when appointing new advisers; and

(b) the effectiveness of the licensees' adviser audit processes.

37 We also observed how the advice licensees have increasingly been using data analytics to develop their KRIs as part of monitoring and supervising their advisers.

Background and reference-checking

38 We reviewed the background and reference-checking processes used by the Phase 3 licensees. We found that all of these licensees currently undertake some form of background and reference checking when recruiting new advisers—however, these processes were inadequate and often failed to identify which advisers had a history of non-compliant conduct.

39 In particular, we were concerned about the following issues:

(a) *Contacting referees*: We found that, in some instances, recruiting licensees sought references from former colleagues of an adviser. These former colleagues were not appropriately independent and would not have had access to the compliance records of their advice licensee. When conducting background and reference checks, it is important that the recruiting licensee contacts an appropriately qualified and authorised person, within the former licensee, who has access to the adviser's compliance history.

(b) *Adviser audit reports*: We found that recruiting licensees rarely received effective responses to a request for an adviser's previous audit reports. We were concerned that, when recruiting licensees did receive an audit report that flagged potential non-compliant conduct by an adviser, there were instances where those licensees failed to make further inquiries about the conduct identified.

Policy for providing references

40 We found that the limited effectiveness of advice licensees' background and reference-checking processes could sometimes be attributed to a former licensee's reluctance to provide relevant information to a recruiting licensee about a former adviser's compliance history. As a result, we found that some advisers were employed without this information becoming known to the recruiting licensee.

41 The Australian Bankers' Association (ABA)—together with its members, which include the institutions—is also concerned about the background and reference-checking processes in the financial services industry. The ABA has recently released its *Reference checking and information sharing protocol* (ABA protocol), which seeks to set out a standard for background and reference checking.

42 The ABA protocol is a positive initiative and helps to highlight the importance of reference checking. However, we note that the obligation to disclose information remains subject to exceptions. We will continue to liaise with the ABA on this important initiative as we wish to support effective reference checking in the financial advice industry.

43 We also note that the operation of the ABA protocol is limited to those AFS licensees that subscribe to it. The ABA states that current subscribers to its protocol appoint approximately 38% of the financial advisers recorded on ASIC's financial advisers register. We encourage advice licensees that are not ABA members to contact the ABA to subscribe to the protocol.

44 Appendix 2 sets out a checklist of issues that all advice licensees should consider when conducting background and reference checks before appointing a new adviser. In future surveillances, where we see advice licensees failing to adequately conduct or provide background and reference checks, we will seek to publicly highlight this conduct.

45 For further information on background and reference checking, see paragraphs 223–245.

Effectiveness of the adviser audit process

46 Each of the Phase 3 licensees uses regularly scheduled adviser audits (referred to in this report as business-as-usual audits) as part of its broader audit process for monitoring adviser compliance with financial services laws and the licensee's business rules: see Table 8 for further details about business-as-usual adviser audits.

47 Outcomes from the adviser audits are used by the Phase 3 licensees for a number of purposes, including determining the subsequent level of monitoring and supervision required for each adviser. An adequate adviser audit process is therefore an integral part of effective monitoring and supervision. For further discussion, see paragraphs 219–221.

48 To assess the effectiveness of the adviser audit processes of the Phase 3 licensees, we selected and reviewed a total of 160 customer files (sample files). We assessed each of the sample files, together with the licensees' audit outcomes for those files, to determine whether the licensees' auditors had correctly identified whether advisers had demonstrated compliance with the best interests duty and related obligations. As part of the next steps following this project, we will be undertaking further work with the licensees in this area to assist them in improving the way they monitor and supervise their advisers.

Note: 'Best interests duty and related obligations' refers to the obligations set out in Div 2 of Pt 7.7A of the Corporation Act. See also 'Key terms'.

49 From our assessment, we found that:

(a) the audit process was *effective* in 18% of the sample files—that is, the findings by the licensees' auditors aligned with our own file review. We observed an effective audit process only on files where no areas of non-compliance were identified by either the licensees' auditors or our advice reviewers;

Note: We did not observe an effective audit process for any of the sample files where our reviewers identified areas of non-compliance. In these cases, the licensees' auditors did not correctly identify all of the compliance concerns found by ASIC.

(b) the audit process was *partially effective* in 57% of the sample files—that is, some areas of non-compliance were identified by the licensees' auditors, but our advice reviewers found additional areas of non-compliance; and

(c) the audit process was *ineffective* in 25% of the sample files—that is, no areas of non-compliance were identified by the licensees' auditors, but our advice reviewers found that there were areas of non-compliance.

50 It is important to note that, where we observed non-compliance with the best interests duty and related obligations in the 160 sample files, this did not indicate a serious compliance concern requiring formal enforcement or other

regulatory action in relation to the advisers. Non-compliant advice does not necessarily indicate that financial remediation or similar action is required.

51 Our project did not draw conclusions on customer detriment. However, where we assessed that an adviser had failed to demonstrate compliance with the best interests duty and related obligations, we will meet with the advice licensee to discuss our findings.

52 Where we found the adviser audit process to be ineffective, or partially effective, we formed the view that some form of corrective action (often referred to as 'consequence management') should have occurred in 127 out of 131 cases. We observed that the licensees' auditors recorded that corrective action was only required in 80 out of these 131 cases.

53 In our review, we identified a number of potential issues that may have affected the effectiveness of the business-as-usual adviser audits undertaken by the Phase 3 licensees. In particular, we were concerned about:

(a) the adequacy of the file audit questionnaire;

(b) amendments made to the customer file to resolve identified non-compliance following recommendations made by the auditor as part of the adviser audit; and

(c) the adequacy of audit record keeping.

54 In Appendix 3, we provide a checklist which sets out the relevant factors for all advice licensees and compliance consultants to consider when auditing advisers to determine whether they have demonstrated compliance with the best interests duty and related obligations when providing personal advice. The checklist covers compliance with these legal obligations, as well as providing additional commentary on giving good quality advice. Each advice licensee should tailor the application of this checklist to the unique nature, scale and complexity of its advice business.

55 For further information on the adviser audit process, see Section D.

Use of data analytics in monitoring and supervision

56 Data collection, the use of data analytics, and effective record keeping underpin all aspects of this project. In particular, they form the basis of targeted and effective KRIs to improve the monitoring and supervision of advisers and the identification of high-risk advisers.

57 From our engagement with the institutions, we observed that significant resources have been allocated to the development and improvement of data systems and data analytic tools. These changes range from the centralisation of their licensees' data records, through to their transition from paper-based to digital record keeping.

Note: See 'Key terms' for the meaning of 'data analytics'.

58 In this project, we observed that the development of data analytics and KRI tools is more advanced in some institutions than others, and all of the institutions are continuing to work in this area. For example, some of the institutions currently use KRIs, supported by data analytics, to identify potentially non-compliant advice—which is then further tested by reviewing a sample of the relevant customer files. This analysis is in addition to the business-as-usual adviser audits conducted by those institutions.

59 All of the institutions expect to use the technical capabilities and infrastructure being developed as part of their review and remediation frameworks to make continual improvements to their data analytics and KRI tools.

60 We expect that these changes will have a substantial positive impact on the ability of the institutions to monitor and supervise their advisers:

(a) improved data collection will result in more data being available that can be organised into a wider range of searchable categories. This will allow for better oversight by enabling a variety of complex KRIs to be applied;

(b) more effective record keeping will improve the way auditors are able to access and review advisers' customer files; and

(c) better access to business records will allow the institutions to interact in a more timely way with their regulators, including ASIC.

61 These changes align with ASIC's recently amended Class Order [CO 14/923] *Record-keeping obligations for Australian financial services licensees when giving personal advice*. The enhanced obligation for advisers to keep appropriate records and, most importantly, to make these records available to their licensee at all times, will enable advice licensees to improve their monitoring and supervision of advisers.

62 In Appendix 4, we set out our checklist and guidance for consideration by all advice licensees in the financial advice industry when developing and implementing their KRIs for monitoring and supervising advisers in their retail advice businesses. We expect that using these KRIs will help licensees to identify potentially high-risk advisers and non-compliant advice.

63 For further information on KRIs, see paragraphs 189–197 and 285–292.

Observations on cultural indicators

64 ASIC is concerned about culture because it is a key driver of conduct within the AFS licensees that we regulate. It is an issue that we have highlighted for the financial services industry in general, and not just for large banking and financial services institutions.

65 Culture is a set of shared values or assumptions. Values are what an organisation chooses to prioritise, and these shared values can shape and influence people's behaviour and attitudes towards, for example, the treatment of customers and compliance.

66 In this project, we considered how the culture of an institution can influence the effectiveness of its processes for monitoring and supervising its advisers. In particular, we considered a number of key indicators of culture in the institutions to determine whether the interests of customers were being prioritised. These indicators include:

(a) the way that an institution deals with advisers whose conduct has been identified as non-compliant;

(b) how an institution remediates customers who have been adversely affected by receiving non-compliant advice; and

(c) how effectively an institution's monitoring and supervision processes identify adviser non-compliance.

67 Where there are systemic failures in an organisation, the culture of that organisation is very likely to have been a contributing factor. The information we gathered for this report suggests to us that cultural factors in the institutions contributed to the failures we observed.

68 All of the institutions publicly state that their core values include being customer focused, 'doing what is right' for customers, and acting with integrity.

69 Our concern is that, despite these stated values, many of the institutions we reviewed did not ensure that their internal processes consistently supported the value of 'doing what is right' for the customer. Many of the failings we identified led, or had the potential to lead, to poor outcomes for customers. For example, we observed:

(a) *inadequate information sharing*: when advice licensees became aware of serious non-compliance by an adviser, they often failed to protect future customers by adequately notifying ASIC or the recruiting licensee;

(b) *inadequate background and reference-checking processes*: when recruiting advice licensees failed to make comprehensive background-checking inquiries, advisers with a poor compliance record were able to circulate undetected within the financial services industry, increasing the risk that new customers would receive non-compliant advice; and

(c) *inadequate audit processes:* when customers had potentially received non-compliant advice, the audit process failed to properly assess whether the adviser had demonstrated compliance with the best interests duty and other related obligations, so that affected customers were not always identified or properly remediated, where necessary, and advisers providing non-compliant advice remained undetected.

70 In the course of ASIC’s broader engagement with the institutions, it is apparent that they are now more engaged with the issue of culture. We have observed an increasing use of technology to improve staff oversight and the identification of issues that may lead to, or indicate the presence of, poor culture. The institutions have also recognised that background and reference-checking processes need to be improved. While we have noticed that progress is being made, there is still room for significant ongoing cultural change to occur at all levels within the institutions.

71 We recognise that there is no single measure or action that will raise standards and improve culture across the financial advice industry. Rather, it is the combination of broad industry reforms as well as the work within advice firms that will improve consumer trust and confidence. We encourage the institutions to consider how improvements in areas such as remuneration structures, professional standards, reference checking and record keeping can be used in practical ways to improve and strengthen a customer-focused culture.

Regulatory reform

72 Our project findings highlight the importance of both recent law reforms and current reform processes that are designed to address poor conduct and structural problems in the financial advice industry. Most of the reforms are phased in over a period of time, as they generally require very significant industry change. However, as a ‘package’, these reforms will raise standards and reduce misconduct in the industry.

73 Some of the key recent, current and future law reforms relevant to the findings in this report are set out below. Reforms that ASIC has supported include measures to address conflicts of interest in adviser remuneration, efforts to raise professional standards, and the Government’s current proposals to strengthen breach reporting.

Recently implemented reforms

Future of Financial Advice

74 The FOFA reforms were passed by Parliament and commenced on 1 July 2013.

75 The FOFA reforms are an important step in moving the financial advice industry away from a commission-driven distribution network to a professional services industry. These reforms were designed to improve trust and confidence in the industry by introducing the best interests duty and related obligations, a ban on conflicted forms of remuneration, fee disclosure statements and opt-in requirements for ongoing service.

76 The FOFA reforms have also extended the scope of the conduct obligations. The legislation now imposes obligations on employed advisers, and not just the advice licensee or its authorised representatives.

77 This report covers advice given both before and after FOFA. In Phase 3, we focused on testing the effectiveness of key aspects of advice licensees' monitoring and supervision processes after the FOFA reforms were implemented.

Financial advisers register

78 On 24 October 2014, the Government announced that it was delivering on its commitment to establish an enhanced, industry-wide public register of financial advisers. The financial advisers register, administered by ASIC, provides key information on all individuals who have, since 31 March 2015, provided personal advice to retail clients on relevant financial products (i.e. all financial products other than basic banking products, general insurance products or consumer credit insurance, or a combination of any of these products). The register is intended to improve transparency for consumers, allow ASIC to track and monitor financial advisers, and assist advice licensees to improve recruitment practices and manage risks.

79 We successfully launched the financial advisers register on 31 March 2015. The key information on the register includes:

(a) the adviser's name, registration number, status and experience;

(b) the name of each AFS licensee who authorises the adviser;

(c) if an adviser is authorised by an authorised representative, their details;

(d) the recent advising history of the adviser;

(e) what product areas the adviser can provide advice on;

(f) any bans, disqualifications or enforceable undertakings entered into by the adviser; and

(g) the adviser's qualifications and training courses and any memberships of professional bodies.

Note: The *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* inserts additional information to be included on the financial advisers register from 1 January 2019.

80 The financial advisers register is proving to be a useful tool. As at 31 December 2016, over 25,300 advisers were recorded on the register, and more than 1.5 million searches of the register had been undertaken since it was launched. ASIC sees the financial advisers register as a positive step towards a more transparent advice industry.

81 Further reforms introduced by the Government on professional, ethical and education standards (see paragraphs 82–86) will lead to enhancements to the register.

Current reform proposals

Professional, ethical and education standards

82 We have observed in this project that advisers have often failed to demonstrate compliance with the best interests duty and related obligations. Inadequate education standards for advisers may be one of the causes of this non-compliance. ASIC has long advocated for stronger education standards for advisers.

83 On 15 March 2017, the *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* commenced. The legislation seeks to raise the professional, ethical and education standards of financial advisers. We consider that the enhanced professional standards framework for financial advisers will assist in improving the quality of advice.

84 Key elements of the reforms include requirements for advisers to hold a bachelor's degree or higher, pass an exam that will provide a common benchmark across the industry, undertake continuing professional development, and subscribe to a code of ethics. The Government will also establish an independent industry-funded body, recognised in legislation, to develop the new standards.

85 There is a transitional period which means that most of the new provisions relating to professional standards have staggered commencement dates from 1 January 2019. Existing advisers will have until 1 January 2021 to pass the exam, and until 1 January 2024 to reach degree-equivalent status.

86 ASIC strongly supports these reforms.

Future reform

87 In October 2016, the Government announced that it would set up the ASIC Enforcement Review Taskforce to assess the suitability of the existing regulatory tools available to ASIC to perform its functions adequately. The terms of reference allow for a thorough but targeted examination of the adequacy of ASIC's enforcement regime—including in relation to industry codes of conduct—to deter misconduct and foster consumer confidence in the financial system.

88 We strongly support the review and, in our submission to the taskforce, we have argued that the regulatory tools available to us should be strengthened.

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89 The review will include (relevant to this project) an examination of the legislation dealing with corporations, financial services, credit, and insurance to assess the adequacy of:

(a) the frameworks for notifying ASIC of breaches of the law;

(b) our powers in relation to the licensing of financial services providers and credit providers;

(c) our coercive powers to direct licensees to take, or refrain from taking, particular action; and

(d) our power, where appropriate, to ban offenders from being corporate officers following the commission of, or involvement in, serious contraventions.

Breach reporting

90 The terms of reference for the ASIC Enforcement Review provide for a review into the adequacy of the framework for notifying ASIC of breaches of the law, including:

(a) the triggers for the obligation to notify ASIC of a breach;

(b) the time period in which notifications must be made; and

(c) whether the obligation to notify breaches should be expanded to take into account the conduct of other regulated parties. The obligation to lodge breach reports is currently confined to auditors, liquidators, and licensees.

91 We support a review into the breach reporting framework, and have publicly highlighted the importance of improvements to these provisions. We have highlighted deficiencies in the approach to breach reporting within this project.

Directions power

92 In this project, the development of a framework for large-scale customer review and remediation has been undertaken by each of the institutions voluntarily.

93 We support the taskforce’s examination of providing ASIC with a power to direct AFS licensees and credit licensees, among other things, to conduct customer review and remediation, or to undergo an independent compliance review. This will allow more effective regulation of our stakeholders, and promote investor and consumer trust and confidence.

Power to ban an individual from managing a financial services business

94 In this project, we observed instances where an adviser’s past conduct has given rise to serious compliance concerns and the adviser has since become a director of an AFS licensee, or of a corporate authorised representative, although they are no longer providing financial advice.

95 Our current licensing powers allow us to suspend or cancel a licence, or ban an individual from providing financial services. Our powers do not extend to banning individuals from having an integral role in managing a financial services business. We support the review into the adequacy of our power to ban an individual because this would allow ASIC to more effectively target those who set the compliance culture within a business.

Next steps

96 We will continue to carry out our review of SCC advisers. We will publicly report on our regulatory outcomes arising from this review.

97 We will continue to meet with the institutions until the design and operational effectiveness of their review and remediation frameworks have been assured by their external experts.

98 We will report further as each institution's framework is finalised and implemented. Following implementation, we will continue to monitor the external expert's assurance of any customer review and remediation undertaken. We will provide updates on that further work, including the number of customers remediated and the amount of monetary compensation paid.

99 Further to our Phase 3 review, we will meet with each of the institutions to discuss their adviser audit outcomes and the findings of our file reviews, and to highlight our concerns about the licensees' background and reference-checking processes. If necessary, we will consider enforcement or other appropriate regulatory action.

A Background

Key points

This project forms part of ASIC's Wealth Management Project and was undertaken to review how Australia's largest banking and financial services institutions oversee their financial advisers.

The project focused on 35 advice licensees that were solely owned or controlled by AMP, ANZ, CBA, NAB or Westpac.

The project was undertaken in three phases:

- identifying and dealing with non-compliant conduct by advisers between 1 January 2009 and 30 June 2015;
- the review and remediation of customers affected by non-compliant advice received between 1 January 2009 and 30 June 2015; and
- our review of some of the key aspects of the institutions' current processes for monitoring and supervising their advisers.

Purpose of this project

100 This project was undertaken as part of ASIC's Wealth Management Project. The Wealth Management Project was established in October 2014 with the aim of raising standards within the major providers of financial advice to retail customers and, in doing so, promote investor and consumer trust and confidence in the financial advice industry.

101 In July 2015, we commenced this review of how large institutions oversee their financial advisers, following public discussion about past non-compliant advice provided by the institutions. We focused on five of Australia's largest banking and financial services institutions, as set out in paragraph 1.

102 To achieve the aims of this project, as set out in paragraph 8, we focused on three key areas:

(a) *Phase 1*—reviewing how each of the institutions identified and dealt with non-compliant conduct by advisers between 1 January 2009 and 30 June 2015, and determining which of these advisers should be considered for regulatory or enforcement action by ASIC;

(b) *Phase 2*—overseeing the development and implementation by each of the institutions of a framework for the large-scale review and remediation of customers affected by non-compliant advice received between 1 January 2009 and 30 June 2015; and

(c) *Phase 3*—conducting a review of 10 advice licensees selected from within the institutions (Phase 3 licensees) to test the current processes used by these licensees for monitoring and supervising their advisers. We considered:

(i) the adequacy of the licensees' background and reference-checking processes when appointing new advisers; and

(ii) the effectiveness of the licensees' processes to audit the advice provided by their existing advisers.

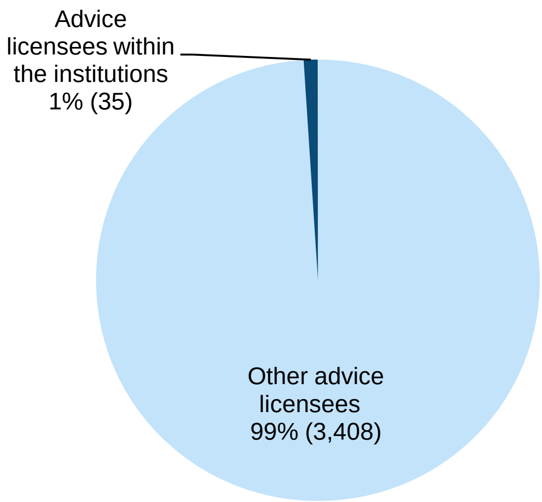
Scope of our review

103 This project focused on the 35 advice licensees that were solely controlled or owned by the institutions for all or part of the period between 1 January 2009 and 30 June 2015.

Note: A list of these 35 advice licensees is set out in Appendix 1.

104 As shown in Figure 1 and Figure 2, when the project commenced on 1 July 2015, the 35 advice licensees in this project represented 1% of the 3,443 advice licensees authorised to provide personal advice in the Australian financial advice industry. However, at that time, these 35 advice licensees authorised around 40% (8,888) of Australia's approximate 22,500 financial advisers.

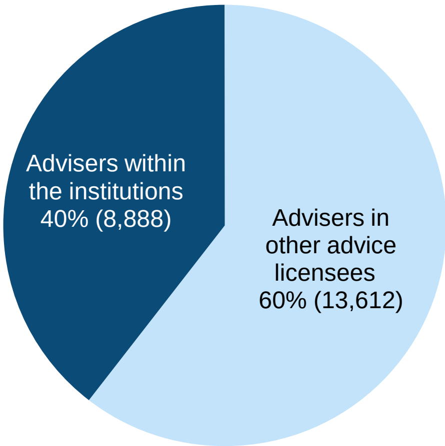
Figure 1: Distribution of advice licensees (as at 1 July 2015)



Note: See Table 14 in Appendix 5 for the data shown in this figure (accessible version).

Source: Institutions, ASIC

Figure 2: Distribution of advisers (as at 1 July 2015)



Note: See Table 15 in Appendix 5 for the data shown in this figure (accessible version).

Source: Institutions, ASIC

Macquarie Group

105 Although Macquarie Group Limited is part of the larger Wealth Management Project, it has not been included in this project. This is because ASIC accepted an enforceable undertaking from Macquarie Equities Limited (MEL)—a subsidiary of Macquarie Group—in January 2013, the effect of which was for MEL to undertake work that was largely consistent with the aims of this project. As at December 2016, total compensation of approximately $20.86 million (plus interest) had been paid out by MEL under the consequential remediation program.

Note: Further detail about ASIC's engagement with MEL can be found in Media Release (13-010MR) *ASIC accepts enforceable undertaking from Macquarie Equities Limited* (29 January 2013), Media Release (14-201MR) *Macquarie Equities' financial advice remediation* (15 August 2014) and Media Release (15-022MR) *Macquarie Equities Limited enforceable undertaking and next steps* (13 February 2015).

Our approach

106 Each phase of this project is described below, including details about our objectives and how we went about gathering information.

Phase 1: Identifying and dealing with non-compliant conduct by advisers

107 Using our compulsory notice powers, we directed each of the 35 licensees to identify and inform us about existing and former advisers whose conduct had given rise to compliance concerns within the relevant periods detailed below: see paragraphs 109–110.

108 We defined the following two categories of compliance concern to assist the institutions in assessing non-compliant conduct by advisers:

(a) *Serious compliance concerns:* This is where an advice licensee believes, and has some credible information in support of the concerns identified, that an adviser—in the course of providing financial services (as defined in s766A of the Corporations Act)—may have engaged in the following:

  (i) dishonest, illegal, deceptive, and/or fraudulent misconduct;

  (ii) any misconduct that, if proven, would be likely to result in the instant dismissal or immediate termination of the adviser;

  (iii) deliberate non-compliance with financial services laws; or

  (iv) gross incompetence or gross negligence.

(b) *Other compliance concerns:* This is where an advice licensee has reason to believe, and has some credible information in support of the concerns identified, that an adviser—in the course of providing financial services (as defined in s766A of the Corporations Act)—may have been involved in misconduct (other than a serious compliance concern), including but not limited to:

  (i) a breach by act or omission of the licensee's internal business rules or standards, such as where an adviser has recommended non-approved products, entered into personal agreements or arrangements with customers, demonstrated poor record keeping, or acted outside the scope of their authorisation or competence;

  (ii) an adverse finding from audits conducted by, or for, the licensee; or

  (iii) conduct resulting in actual or potential financial loss to customers as a result of the advice received.

109 The relevant period for identifying non-compliant conduct giving rise to 'serious compliance concerns' was between 1 January 2009 and 30 June 2015. This period was chosen to align with the advice licensees' record-keeping obligations and with the scope of the institutions' customer review and remediation work undertaken as part of Phase 2.

Note: The relevant period for identifying serious compliance concerns for two of CBA's advice licensees—Commonwealth Financial Planning Limited (CFPL) and Financial Wisdom Limited (FWL)—differed from the other advice licensees because of previous customer review and remediation conducted by CFPL and FWL (see paragraphs 116–119). The relevant period for CFPL and FWL was between 1 July 2012 and 13 August 2015.

110 The relevant period for identifying non-compliant conduct giving rise to 'other compliance concerns' was between 1 July 2013 and 30 June 2015. We sought information from this period to assist in understanding the licensees' current monitoring and supervision processes.

111 A summary and analysis of the information gathered in Phase 1 is set out in Section B.

Phase 2: Customer review and remediation

112 In Phase 2, we asked the institutions to develop a framework for large-scale customer review and remediation to ensure that customers affected by non-compliant advice, received between 1 January 2009 and 30 June 2015, would be identified and remediated. Commencing in July 2015, we held meetings with the institutions approximately every three to four weeks throughout the project.

113 We asked the institutions to consider the following elements when developing their review and remediation frameworks, to ensure that these would be structured fairly and efficiently:

(a) all advisers who should form part of the review and remediation are properly identified;

(b) all customers who should form part of the review and remediation are properly identified;

(c) communication with customers is fair and transparent;

(d) the adviser audit process, which determines whether the adviser has demonstrated compliance with the relevant financial services laws, is fair and effective;

(e) the compensation calculation methodologies are consistent with the principles of the Financial Ombudsman Service (FOS);

(f) a variation to the FOS terms of reference is agreed with FOS, so that customers may access FOS for claims extending back to 1 January 2009 and up to a monetary limit of $1 million;

(g) affected customers are reimbursed for the cost of seeking an independent opinion on the result of an advice review or compensation offer;

(h) an external expert is engaged to provide assurance on the design and operational effectiveness of the review and remediation framework; and

(i) ASIC has oversight of the external expert's terms of engagement and will receive a report on the completed assurance.

Note: For details about the progress that each of the institutions has made towards incorporating these elements, see Table 3.

114 These elements are consistent with RG 256, which was being developed at the same time as this project was being carried out.

Note: The principles set out in RG 256 should be considered by all advice licensees; however, these principles may be:

- scaled up or down, as appropriate for the size of review and remediation to be undertaken; or
- otherwise adapted to suit advice licensees of different sizes and with different internal structures.

115 A summary and analysis of the information gathered in Phase 2 is set out in Section C.

CBA's previous review and remediation

116 The scope of Phase 2 was different for CBA licensees because of previous regulatory outcomes in relation to CFPL and FWL. ASIC accepted an enforceable undertaking from CFPL in 2011; and additional AFS licence conditions were imposed, by agreement, on CFPL and FWL during 2014.

117 The effect of the work undertaken by CFPL and FWL was similar to the large-scale review and remediation framework that we requested the institutions develop within this project, including having external expert assurance. Before this project, CBA applied the insight gained from its work with CFPL and FWL to develop a large-scale review and remediation framework for use, as needed, within other licensees in the CBA Group.

Note: Further details about ASIC's engagement with CFPL and FWL can be found in Media Release (11-229MR) *ASIC accepts enforceable undertaking from Commonwealth Financial Planning* (26 October 2011) and 15-083MR.

118 At the commencement of this project, therefore, CBA had already developed and implemented a large-scale review and remediation framework, and CFPL and FWL had undertaken work to identify and remediate customers who had experienced loss or detriment as a result of receiving non-compliant advice.

119 Our work with CBA has since focused on assessing, and receiving external expert assurance on, the adequacy of the work undertaken by CBA's other licensees (apart from CFPL and FWL) to identify high-risk advisers, and to identify and remediate potentially affected customers.

Phase 3: Monitoring and supervision of advisers

Scope of review

120 In Phase 3 of the project, we conducted a review of selected advice licensees (Phase 3 licensees) to test the current processes they used for monitoring and supervising their advisers.

121 We considered the extent to which the Phase 3 licensees relied on background and reference checking when recruiting new advisers, and assessed how they used the audit process to identify advisers providing non-compliant advice. We also observed how the advice licensees used data analytics to develop their KRIs as part of monitoring and supervising their advisers.

122 Our review covered the period between 1 July 2013 and 31 March 2016 so that we could review the advice licensees' current policies and procedures implemented in light of the FOFA reforms.

123 To select the Phase 3 licensees, we selected two advice licensees from each institution.

124 Advice licensees generally operate:

(a) an employee representative model—where the advisers are predominantly employees of the licensee; or

(b) an authorised representative model—where the advisers are predominantly self-employed and appointed as authorised representatives.

125 For each institution, we selected:

(a) from those licensees operating an employee representative model, the licensee with the largest number of advisers; and

(b) from those licensees operating an authorised representative model, the licensee with the largest number of advisers.

A total of 10 advice licensees were selected.

Note: For details of the 10 Phase 3 licensees, see Appendix 1.

126 We used our compulsory notice powers to obtain information and documentation from the Phase 3 licensees addressing the following key areas:

(a) background and reference checking of advisers;

(b) the adviser audit process; and

(c) the use of data analytics to develop KRIs.

127 For our review of the adviser audit process, we selected four advisers from each of the 10 Phase 3 licensees—a total of 40 advisers (sample advisers); and four customer files from each sample adviser—a total of 160 customer files (sample files): see paragraphs 134–137 for more details.

128 A summary and analysis of the information gathered in Phase 3 is set out in Section D.

Background and reference checking

129 We have had concerns for more than a decade about the effectiveness of background and reference-checking processes used industry wide by advice licensees when recruiting new advisers.

130 In October 2007, we announced the launch of Standards Australia’s Handbook HB 322-2007 *Reference checking in the financial services industry* (reference-checking handbook), which was developed by ASIC and a panel of industry representatives to provide guidance on appropriate reference-checking processes. We subsequently reported in 2011 (Report 251 *Review of financial advice industry practice* (REP 251)) and in 2013

(Report 362 *Review of financial advice industry practice: Phase* 2 (REP 362)) on continuing deficiencies we had observed in advice licensees' background and reference-checking processes.

131 To test whether the background and reference-checking processes used by the advice licensees had improved since 2013, we used our compulsory notice powers to direct the Phase 3 licensees to provide information about their current processes—including:

(a) for background and reference checking in general:

(i) the information that is sought from the former licensee about the adviser; and

(ii) the information that is provided about an adviser when responding to a request from a recruiting licensee; and

(b) details about the background and reference checks undertaken when the 40 sample advisers were appointed.

Effectiveness of the adviser audit process

132 An effective adviser audit process is fundamental to the success of an advice licensee's monitoring and supervision processes. For further discussion, see paragraphs 219–221.

133 To form a view on the effectiveness of the Phase 3 licensees' adviser audit processes, we independently reviewed a number of the customer files (including Statements of Advice) that had been reviewed by the licensees as part of their business-as-usual adviser audits. We compared our assessment of the customer files and advice with the findings of the licensees' adviser audits.

Selecting advisers

134 We found that the Phase 3 licensees conducted a number of different types of adviser audits as part of their monitoring and supervision processes. For our review, we focused solely on the business-as-usual adviser audits that formed part of the licensees' business-as-usual supervision of advisers.

135 We selected four sample advisers from each of the 10 Phase 3 licensees using the following criteria:

(a) one adviser about whom compliance concerns had been identified while working at their previous institution, and before being appointed by their current licensee;

(b) one adviser who had the licensee's highest number of customers in 2014–15; and

(c) two advisers, chosen at random, who did not have any relevant history of non-compliant conduct known to ASIC.

Note: The advisers who were selected at paragraph 135(a) had been identified by the institutions as an SCC adviser or an OCC adviser as part of this project. In this report, we use the terms 'SCC adviser' or 'OCC adviser' to mean an adviser whose conduct has given rise to 'serious compliance concerns' or 'other compliance concerns', respectively.

Selecting customer files

136 Using our compulsory notice powers, we directed the Phase 3 licensees to:

(a) provide the detailed compliance findings for each of the customer files prepared as part of the most recent business-as-usual audit for each of the sample advisers; and

(b) undertake an adviser audit capturing the five most recently completed Statements of Advice (or records of advice) provided by each of the sample advisers, and provide the findings to ASIC—including whether the adviser had demonstrated compliance with the best interests duty and related obligations in providing the advice to the customer.

137 From these findings, we selected four customer files for each sample adviser—two from the business-as-usual audit in paragraph 136(a), and two from the ASIC-directed audit in paragraph 136(b). In total, 160 customer files were selected for our independent review.

Requesting customer files

138 Using our compulsory notice powers, we directed the Phase 3 licensees to provide the following documentation for each of the 160 sample files:

(a) the customer file;

(b) the adviser audit results and all of the working papers created by the advice licensee as a result of the adviser audit;

(c) any recommendations made for corrective action or consequence management, and/or customer remediation; and

(d) the advice licensee's policies and procedures applicable at the time of the adviser audit.

Conducting file reviews

139 We conducted independent reviews of the 160 sample files, and supporting documentation (see paragraph 138), on the basis of whether advisers had demonstrated compliance with the best interests duty and related obligations when providing the advice.

140 We engaged an external consultant to review some of the sample files. The external consultant reviewed 90 files, and ASIC analysts reviewed the remaining 70 files.

Note: Each file review carried out by the external consultant, or by ASIC, was subject to a peer review to check for consistency of approach.

141 The assessments of the sample files were compared with each licensee's adviser audits to determine whether the licensee's auditor had correctly

identified whether advisers had demonstrated compliance with the best interests duty and related obligations.

142 The results of our findings were grouped into three categories:

(a) If the auditor correctly identified all areas of non-compliance (if any) in a sample file, we considered the audit to be *effective*.

(b) If the auditor identified some areas of non-compliance but our advice review found additional areas of non-compliance, we considered the audit to be *partially effective*.

(c) If the auditor identified no areas of non-compliance but our advice review found there were areas of non-compliance, we considered the audit to be *ineffective*.

143 We also assessed the adequacy of the recommendations made by each auditor for:

(a) consequence management of the adviser; and

(b) remediation of the customer.

B Phase 1: Identifying and dealing with non-compliant conduct by advisers

Key points

We directed that each institution identify the advisers about whom they had compliance concerns. The institutions identified serious compliance concerns about 149 advisers.

As at 31 December 2016, ASIC had banned 26 SCC advisers and we had ongoing investigation or surveillance activities in relation to 75 SCC advisers.

We found that many of the SCC advisers had not previously been reported by the institutions to ASIC by a breach report or other notification.

We found that there were inadequacies in the approach taken by the institutions to the background and reference checking of advisers.

What we did

144 Using our compulsory notice powers, we directed the institutions to identify their existing and former advisers whose conduct had been found to be non-compliant during the relevant periods: see paragraphs 107–111.

145 We asked each institution to provide information on the advisers about whom they had identified serious compliance concerns (SCC advisers) or other compliance concerns (OCC advisers).

Note: 'Serious compliance concerns' and 'other compliance concerns' are defined in paragraph 108. See also 'Key terms'.

146 We gathered information about:

(a) the nature and seriousness of the compliance concerns and the length of time that had passed since the suspected non-compliant conduct occurred;

(b) how the institution identified the compliance concerns;

(c) actions the institution took to deal with the adviser;

(d) how the institution remediated the customers affected by the non-compliant conduct;

(e) whether ASIC had previously been notified of the non-compliant conduct; and

(f) whether background and reference checks on the adviser were undertaken before their appointment to the institution.

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147 We assessed the information received to determine whether we should take regulatory or enforcement action in relation to the SCC advisers. All SCC and OCC adviser information has also been recorded on ASIC's confidential internal databases.

148 It should be noted that, outside of this project, we have taken—and continue to take—enforcement action against other financial advisers who have engaged in misconduct. Public reporting on these actions is available on ASIC's website.

Serious compliance concerns

149 By 16 December 2015, the institutions had informed us about 149 SCC advisers. At that time, we had ongoing investigation or surveillance activities in relation to 38 of these advisers.

150 We assessed the information provided by the institutions to consider whether further enforcement or other regulatory action should be taken in relation to any of the remaining SCC advisers. A two-stage approach was used.

Identification of SCC advisers for further action

151 In the first stage, for each of the remaining 111 SCC advisers, we considered:

(a) whether the adviser was already subject to a banning order;

(b) whether the adviser was currently providing personal advice; and

(c) the nature and seriousness of the compliance concern and the length of time that had passed since the suspected non-compliant conduct occurred.

152 Table 1 sets out a summary of our findings.

153 ASIC does not commence an investigation into every matter that is brought to our attention. To ensure that we direct our finite resources appropriately, we consider a range of factors, including the risk to customers, when deciding whether to investigate and possibly take enforcement action: see Information Sheet 151 *ASIC's approach to enforcement* (INFO 151) for more detail.

Table 1: Number of SCC advisers not being considered for further enforcement or other regulatory action by ASIC as at 16 December 2015

Reasons for not taking further action	Number of SCC advisers
The adviser is already subject to a banning order	14
The adviser is not currently providing personal advice	38
The nature and seriousness of the compliance concern, and the length of time that has passed since the suspected non-compliant conduct occurred, does not warrant further action	19
Total number of SCC advisers not being considered for further action	71

Source: Institutions, ASIC

154 There were 40 SCC advisers who remained within the scope of our ongoing review to determine whether enforcement or other regulatory action would be appropriate.

Note: This is in addition to the 38 advisers in relation to whom we already had an ongoing investigation or surveillance at the time of the original notification by the institutions: see paragraph 149.

155 We implemented processes to alert us if any of the 38 advisers who were not currently providing personal advice re-entered the industry. If this occurred, we would reassess whether action by ASIC was appropriate: see paragraph 157(a).

Review of SCC advisers

156 In the second stage, we undertook or commenced a review in relation to the 40 SCC advisers identified in stage one as advisers to be considered for further enforcement or other regulatory action. The reviews used:

(a) additional information provided by the institutions (requested under our compulsory notice powers);

(b) information available from searching ASIC's internal confidential databases; and

(c) up-to-date information sought from the adviser's current licensee.

Additional SCC advisers

157 As at 31 December 2016, 43 advisers were added as SCC advisers to our review to be considered for further enforcement or other regulatory action. These advisers were drawn to our attention because:

(a) SCC advisers, who had previously been assessed as requiring no further action, returned to the financial advice industry;

(b) further information was received, resulting in ASIC reclassifying some OCC advisers as SCC advisers; and

(c) new relevant information was received from an institution, resulting in the addition of new SCC advisers.

Note: As more information is received, it is possible that this figure of 83 may increase.

158 As at 31 December 2016, the total number of SCC advisers identified had increased to 185. At that time, 26 had been the subject of a banning order and we had ongoing investigation or surveillance activities in relation to 75 of these advisers.

159 As these activities progress, more advisers are likely to be subject to banning actions. We will publicly report on these outcomes.

Other compliance concerns

160 We consider that the conduct of the advisers classified by the institutions as giving rise to 'other compliance concerns' was not serious enough to warrant enforcement or other regulatory action by ASIC.

161 We have also requested that the institutions notify us of any new relevant information that becomes available about OCC advisers. We will assess any additional information on a case-by-case basis. As noted in paragraph 157(b), where appropriate, these individuals may be reclassified as SCC advisers. If this occurs, we will reassess whether we should take action.

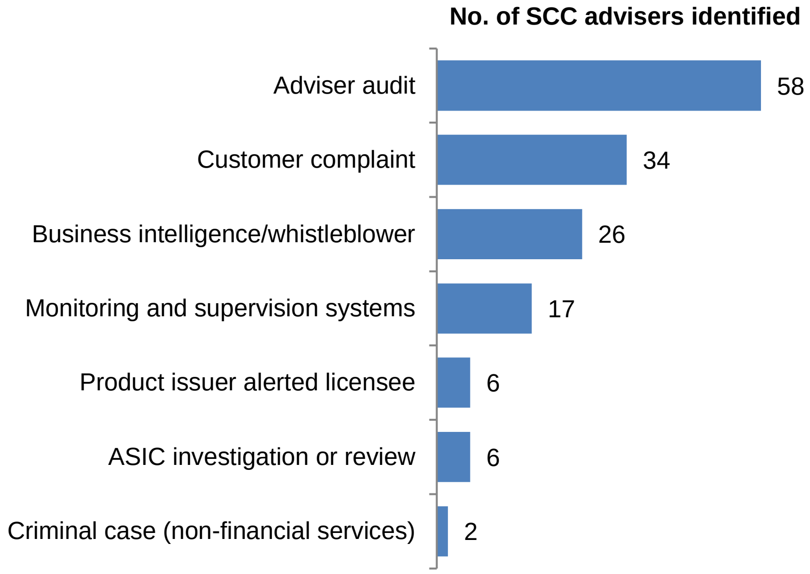
162 We have recorded the information about the OCC advisers in our internal confidential databases. If further information is received about these advisers, it will be assessed, together with our existing data, to determine whether further action is appropriate.

What we found

Identification of SCC advisers

163 The institutions used various methods to identify the 149 SCC advisers. As set out in Figure 3, the primary method of identification relied on information from adviser audits. This demonstrates the reliance institutions place on the adviser audit process as part of the overall monitoring and supervision of advisers. See Section D for further discussion.

Figure 3: Methods used by the institutions to identify SCC advisers



Note 1: The data shown in this figure has been compiled and interpreted by ASIC from the information received from the institutions.

Note 2: See Table 16 in Appendix 5 for the accessible version of this figure.

Source: Institutions, ASIC

Notification of non-compliance to ASIC

164 We found that, until the advice licensees notified ASIC of their SCC advisers as part of this project, 73 of the 149 SCC advisers had not been the subject of a breach report or other notification to ASIC by the reporting licensees.

Breach reporting

165 Before notifying ASIC of the 149 SCC advisers, the institutions had lodged breach reports in relation to the conduct of 42 of these advisers. However, these breach reports were often provided to us a substantial period after the institution became aware of the matters giving rise to the serious compliance concerns.

166 Breach reports are an important part of ASIC's regulatory framework and a valuable source of information. Not every instance of adviser non-compliance will trigger the need to lodge a breach report with ASIC. However, when adviser non-compliance is identified, and results in a significant breach or likely breach of the licensee's obligations, it must be reported to ASIC in a timely manner.

167 Breach reporting is time sensitive, and a breach report must be lodged with ASIC as soon as practicable, and no later than 10 business days, after the licensee becomes aware of a breach, or likely breach, that is significant: s912D of the Corporations Act and Regulatory Guide 78 *Breach reporting by AFS licensees* (RG 78).

168 We are aware that there is an industry-wide approach which considers that the time period for breach reporting commences only after the decision-makers delegated to decide whether a breach should be reported have determined that the breach or likely breach is *significant* to the licensee.

169 This approach has led to considerable delays in reporting to ASIC. For example, in one instance, an institution acknowledged that 179 days had passed from when it first became aware of the suspected non-compliance to formally assessing the breach as significant, and subsequently lodging a breach report with ASIC.

170 There appeared to be considerable delays in many other cases between the date the non-compliant conduct occurred and the date the breach report was lodged with ASIC. However, because many of the breach reports did not indicate when the institution first became aware of the breach, it has not been possible to accurately determine the extent of the delay.

171 While this approach may not necessarily contravene the breach reporting requirements, this lack of timeliness can affect the value of the breach report to ASIC. The delay in reporting non-compliant conduct to ASIC may also result in an increased risk of customer loss or detriment.

172 We are currently involved in the Treasury's taskforce to review ASIC's enforcement regime. The terms of reference for this taskforce include the adequacy of the frameworks for notifying ASIC of breaches of law: see paragraphs 90–91. As we have submitted to the taskforce, we believe that the regulatory tools available to us should be strengthened, particularly in relation to the breach reporting regime.

Other notifications to ASIC

173 In addition to the 42 SCC advisers who have been the subject of a breach report, 34 SCC advisers were notified to ASIC by the licensees in some other way—including, for example, through reports of misconduct. The remaining 73 SCC advisers were not notified to ASIC until the licensees identified and reported their SCC advisers to us in response to our direction.

174 We expect that, if an advice licensee identifies serious compliance concerns about an adviser, the advice licensee will voluntarily notify ASIC even if the obligation to lodge a breach report does not arise.

Background and reference checking

175 For some of the SCC advisers, we found that there were inadequacies in the approach taken by the institutions to background and reference checking. A detailed discussion of these findings is set out in Section D.

Next steps

176 We will continue our review of the SCC advisers. As our reviews progress, more advisers are likely to be subject to banning actions or other enforcement action. We will report publicly on these outcomes.

C Phase 2: Customer review and remediation

Key points

We engaged with each of the institutions to oversee the development and implementation of a customer review and remediation framework. This engagement required that each institution:

- identify non-compliant advice provided by its advisers in the period between 1 January 2009 and 30 June 2015, and remediate affected customers; and
- appoint an external expert to provide assurance on the design and operational effectiveness of the framework.

We found that:

- the identification of high-risk advisers to be included in the scope of the review and remediation framework represented a significant challenge for the institutions; and
- as a result of our feedback, the institutions have improved their customer communication strategies, advice review templates, and compensation calculation methodologies.

What we did

Developing a review and remediation framework

177 Each of the institutions acknowledged that, in the past, they have had difficulties in identifying all of their high-risk advisers and remediating affected customers. Each of the institutions agreed that, to address these concerns, it was appropriate to develop and implement a framework for large-scale customer review and remediation.

178 Our objective in Phase 2 was to ensure that the institutions identified and remediated—in a comprehensive, timely, fair and transparent manner—customers who had suffered loss or detriment as a result of receiving non-compliant advice between 1 January 2009 and 30 June 2015.

179 To achieve this objective, we have worked with the institutions to ensure that they each develop a review and remediation framework that would be consistent with the principles in RG 256 and, in particular, that this framework would:

(a) provide a streamlined review and remediation process for the advice licensees within each institution;

(b) operate efficiently, honestly and fairly—in line with advice licensees' obligations—by addressing the key principles set out in our guidance; and

(c) provide customers with confidence in the fairness of remediation outcomes.

180 While developing their review and remediation frameworks, the institutions produced supporting documents for our consideration. These included:

(a) methodologies for identifying the advisers who provided non-compliant advice;

(b) methodologies for identifying the customers affected by the non-compliant advice;

(c) policies and guidance on customer communications;

(d) advice review templates and guidance;

(e) compensation calculation methodologies;

(f) policies and guidance on the governance processes for the review and remediation; and

(g) the terms of engagement for an external expert to provide assurance on the framework.

Note: We advised the institutions that the advisers who should be considered for the purposes of paragraph 180(a) should not be limited to their identified SCC or OCC advisers.

181 Since July 2015, ASIC has held regular meetings with each of the institutions to oversee the development and implementation of their review and remediation framework. As part of these meetings, we provided feedback on the documents that were provided throughout the project.

182 As part of developing their review and remediation framework, we encouraged each of the institutions to:

(a) establish a variation of the FOS terms of reference to allow customers within the scope of the remediation to lodge a claim with FOS relating to advice extending back to 1 January 2009 and up to a monetary limit of $1 million;

(b) offer financial assistance to all customers who wished to seek their own professional opinion about the advice licensee's remediation decision; and

(c) appoint an external expert to provide assurance on the design and operational effectiveness of the review and remediation framework.

Note: For further details about each of the elements considered by the institutions as part of their large-scale review and remediation frameworks, see Table 3.

183 For the reasons set out in paragraphs 116–119, the approach taken by CBA has differed from the other institutions. Rather than developing a new review and remediation framework in response to this project, CBA has engaged with us to demonstrate that its existing processes, developed to address previously identified issues, satisfy ASIC's expectations.

Key elements of review and remediation frameworks and progress made

184 As at 23 February 2017, some institutions are yet to finalise all of their framework documentation. Our work on this phase of the project is therefore ongoing. An overview of the current status of each institution's review and remediation framework is set out in Table 2.

Table 2: Status of each institution's review and remediation framework as at 23 February 2017

Institution	Current progress made
AMP	AMP commenced implementation of its large-scale review and remediation framework in relation to its identified high-risk advisers in September 2016. AMP is continuing to develop KRIs to identify other high-risk advisers.
ANZ	ANZ implemented its large-scale review and remediation framework in July 2016. At this time, ANZ's external expert provided assurance that, at a high level, the design of this framework was appropriate. ANZ is currently reviewing 16 SCC advisers under this framework. Following the publication of RG 256, initial feedback received from ASIC and the findings from ANZ's pilot program, ANZ has developed a revised framework. This framework remains subject to assurance of its design effectiveness by ANZ's external expert, and approval by ASIC. ANZ is continuing to develop KRIs to identify any high-risk advisers not identified by its previous monitoring and supervision processes.
CBA	CBA has a process in place for the large-scale review and remediation of customers. This work was developed in response to business-initiated programs and other regulatory outcomes. Three of the advice licenses within CBA are seeking external expert assurance that the work to identify high-risk advisers and remediate affected customers is adequate: see paragraphs 116–119 for the advice licensees not included in the current work. CBA has advised that its large-scale review and remediation framework is being reviewed to ensure that it is consistent with the principles set out in RG 256. ASIC will review this work as it is completed.
NAB	NAB announced the commencement of a remediation program in February 2015. NAB implemented its revised large-scale review and remediation framework (Customer Response Initiative (CRI)), approved by ASIC, on 21 October 2015: see Media Release (15-306MR) *National Australia Bank to implement a large-scale financial advice remediation program* (21 October 2015). At that time, the CRI focused on identifying and remediating customers of its currently identified high-risk advisers. NAB has developed KRIs to identify other high-risk advisers.
Westpac	Westpac has undertaken significant work to identify and remediate customers affected by non-compliant advice provided by its identified high-risk advisers. This work, which commenced before we engaged with Westpac as part of this project in July 2015, is ongoing. Westpac is seeking external expert assurance of the work that it has already undertaken, including whether previous assessments of customer remediation are consistent with ASIC's expectations in RG 256. As a result of this project, Westpac has developed a customer review and remediation framework, and we have provided feedback on this framework. Westpac has developed KRIs to identify other high-risk advisers.

Source: Institutions, ASIC

185 In Table 3, we set out further detail about what we consider to be the key elements of a large-scale review and remediation framework, and the progress made by each institution towards incorporating these elements.

186 The review and remediation frameworks set out in Table 3 relate to the identification of non-compliant advice and the assessment of remediation in circumstances where the customer may not have complained about the advice, or may have had no reason to believe that they received non-compliant advice.

187 If a customer has made a complaint to the institution about the advice they received, we expect that this will have been dealt with by the institution in accordance with its processes for internal dispute resolution (IDR) and external dispute resolution (EDR).

188 Following the implementation of the large-scale review and remediation frameworks, we expect there to be a high degree of consistency in customer remediation outcomes, whether this occurs through IDR and EDR, or through large-scale customer review and remediation.

Table 3: Key elements of the institutions' review and remediation frameworks and progress made as at 23 February 2017

Element	AMP	ANZ	CBA	NAB	Westpac
Key risk indicators to assist in identifying high-risk advisers not identified by previous monitoring and supervision processes	Nearing finalisation	Being developed	Design and implementation finalised and currently being externally assured	Design finalised and externally assured	Nearing finalisation
Key risk indicators to assist in identifying affected customers	Design finalised and externally assured	Finalised and currently being externally assured	Design and implementation finalised and currently being externally assured	Design finalised and externally assured	Nearing finalisation
Customer communications: • template letters; • call scripts; and • brochures	Design finalised and externally assured	Nearing finalisation	Developed as part of its previous review and remediation processes Due to be updated in response to RG 256 and then to be reviewed by ASIC	Design finalised and externally assured	Nearing finalisation
Advice review template and guidance	Design finalised and externally assured	Nearing finalisation	As above	Design finalised and externally assured	Nearing finalisation
Compensation calculation methodology	Design finalised and externally assured	Nearing finalisation	As above	Design finalised and externally assured	Nearing finalisation
Variation of FOS terms of reference to ensure customer access to: • an increased monetary limit to $1 million; and • an extended time period—back to at least 1 January 2009	Agreed	Agreed	Not applicable	Agreed	Agreed (subject to formal documentation being finalised with FOS)

Element	AMP	ANZ	CBA	NAB	Westpac
Reimbursement of *all* customers wishing to seek an independent opinion about remediation	Will reimburse customers seeking independent advice from qualified professionals—up to a set maximum amount of $5,000 plus GST	Not agreed. ANZ will indemnify vulnerable customers, or customers suffering loss as a result of adviser fraud, for their reasonable costs of obtaining independent advice about their remediation outcome. ANZ has advised us it will assess other customers on a case-by-case basis, and will provide assistance where it considers this to be appropriate. This support could take the form of costs indemnity or other assistance. ANZ will provide support in excess of $5,000, where appropriate	Not agreed. As part of its current review and remediation framework, CBA considers on a case-by-case basis whether to contribute to the cost of the customer obtaining independent advice. CBA has advised us that it will take into account factors such as customer vulnerability and understanding (e.g. customers from non-English speaking backgrounds) Note: These details recorded for CBA are independent of the requirements agreed with ASIC by advice licensees within the CBA Group under an enforceable undertaking or AFS licence conditions: see 11-229MR and 15-083MR.	Will reimburse customers seeking independent advice from qualified professionals—up to a set maximum amount of $5,000 plus GST	Not agreed. Vulnerable customers who require assistance to understand and make an informed assessment about the circumstances relating to their remediation will be reimbursed by Westpac for the reasonable cost of an appropriate and independent interpreter and/or support person, determined on a case-by-case basis
Engagement of an external expert to provide assurance	Expert appointed	Expert appointed	Expert appointed	Expert appointed	Expert appointed

Note 1: Although ASIC's discussions with the institutions are finalised or nearing finalisation for many elements of the review and remediation frameworks, the design and operational effectiveness remain subject to assurance provided by an external expert.

Note 2: Once finalised, the institutions' review and remediation frameworks will be subject to continuing improvement for a number of reasons, including the insights gained from the implementation of their frameworks, feedback from the external expert, changes in technology and improvements in data analytics, feedback from both customers and ASIC, and changes in industry practices that may give rise to new areas of risk.

Source: Institutions, ASIC

What we found

Identifying high-risk advisers and affected customers

189 Identifying high-risk advisers and customers affected by non-compliant advice who fall within the scope of a review and remediation has been a significant challenge for the institutions.

190 In the past, KRIs commonly used to identify high-risk advisers and affected customers for remediation arose predominantly from customer complaints and adviser audit outcomes. More recently—and as part of the institutions' work to develop their review and remediation frameworks for this project—the institutions have recognised the importance of using data analytics to develop new KRIs to improve the identification of high-risk advisers and affected customers.

> Note: The development and application of data analytics within the monitoring and supervision process is discussed in Section D.

191 The use of data analytics to develop KRIs for identifying high-risk advisers and affected customers is an essential part of the institutions' review and remediation frameworks. However, the development of KRIs using data analytics has presented challenges for the institutions because:

(a) older data was found to be less reliable, unavailable, or non-existent;

(b) paper-based record keeping made information more difficult to access;

(c) incompatible legacy systems, as a result of technology upgrades and business mergers, made data extraction difficult; and

(d) different data-recording methods were used within the institutions and across their different licensees, resulting in different naming conventions and data that were not easily comparable.

192 These difficulties have influenced the volume and quality of digital data available to the institutions for assessment. Limited digital data reduces the range of KRIs that can be applied effectively.

193 We have also observed situations in which advice licensees had difficulty in accessing copies of records that they still controlled legally, but not physically. This was generally because the adviser who had provided the advice under review had moved to a new licensee and the adviser refused or failed to provide the relevant records.

> Note: ASIC has recently amended Class Order [CO 14/923] *Record-keeping obligations for Australian financial services licensees when giving personal advice* to require that advice licensees must have access to records for the period of time that the records are required to be kept, even if a person other than the licensee holds the records; and to make explicit that authorised representatives who are advisers must keep records, and give the records to their authorising licensee, if the licensee requests the records for the purposes of complying with financial services laws. See also Media Release (16-362MR) *ASIC clarifies record-keeping obligations for financial services licensees* (27 October 2016).

194 The institutions have told us that one of the challenges they face in developing effective KRIs is choosing which KRIs to apply and how to set appropriate tolerance levels at which a KRI will be triggered.

195 Appropriate tolerance levels seek to strike a balance between limiting 'false positive' results and maintaining KRI effectiveness. We observed that, to set appropriate tolerance levels, the institutions engaged with subject-matter experts and considered their own data and industry averages.

196 Appendix 4 sets out a list of the KRIs that we have observed from this project, which has been compiled, in part, through consultation with the institutions. Not all of the listed KRIs will be used by each institution as part of its review and remediation framework for a number of reasons, including:

(a) because there is limited availability of data, as set out in paragraph 191; and

(b) because the KRI is not an effective indicator for a particular licensee's adviser or customer population.

197 For each institution's review and remediation framework, we have required that an external expert test and report on the KRIs that will be used and, in particular, to confirm that the KRIs will be reasonably effective in identifying high-risk advisers.

Customer communication

198 In the past, we have found that advice licensees' communication with their customers about remediation has not been clear, and this often resulted in low rates of customer engagement. To understand the current position, we have reviewed, or will review, the institutions' proposed customer communication policies and template documents.

199 We encouraged each of the institutions to develop customer communication strategies that:

(a) are transparent and clearly identify why the customer is being written to and what action, if any, the customer should take; and

(b) allow customers adequate time and opportunity to consider and respond to communications.

200 During this phase of the project, we consistently found that there was room for improvement in the quality of the communication with customers. Common improvements that we required to be made included:

(a) being clear about the purpose of the communication—including that the customer has, or may have, received non-compliant advice;

(b) setting out clearly the steps the customer can take to assist the progress of their remediation assessment; and

(c) clarifying that the institution will assess the advice the customer received, whether or not the customer chooses to be involved in the process.

201 To assist with customer engagement, some institutions have also developed a customer information brochure to be sent with the initial customer communication. We are encouraging each institution to develop this as part of their finalised customer communication documents.

202 Table 4 sets out some observations we made about poor customer communication, and why that communication was not effective.

Table 4: Examples of poor customer communication

Poor customer communication	Reasons why communication was poor
We informed you that we have evaluated the advice provided by Adviser A and believe your circumstances should be reviewed to ensure the advice is meeting your objectives.	The licensee does not make clear that the correspondence is only being sent because it has identified the risk that the customer may have received non-compliant advice.
Even though you have declined our offer to review the appropriateness of the advice previously provided to you, we would like to encourage you to take up the offer of a review with one of our advisers.	In addition to the reason set out in the row above, this communication does not set out the process for the review and remediation that the licensee is conducting, and presents the review of advice as a bonus that the licensee is offering to the customer.

Note: The examples in this table have been de-identified but are drawn from actual observations within this project.

Source: Institutions, ASIC

Advice review templates and guidance

203 An effective review and remediation process relies on the institutions fairly and correctly assessing whether the customer has received non-compliant advice that caused loss or detriment to the customer. Institutions use an advice review template to assist in the assessment process and record the findings.

204 The advice review templates we have seen to date have generally been appropriately focused on compliance with the relevant financial services laws.

205 The effectiveness of the templates relies on each institution ensuring that the staff who use them are appropriately qualified and trained, and are allocated sufficient resources.

206 We expect that the institutions' external experts will select a sample of advice to test, and consequently assure and report on, the effectiveness of the advice review process.

Compensation calculation methodologies

207 We required each institution to develop and apply guidance and policies to calculate the amount of customer loss, consistent with the compensation principles of the institution's EDR scheme—in each case the Financial Ombudsman Service (FOS).

208 In some cases, we observed different approaches between the institutions in their proposed interpretation of the FOS compensation principles and, in particular, the level of guidance provided to assess customer loss. For example, the FOS Terms of Reference provide for compensation of direct financial loss. We had some concerns that the proposed guidance to calculate customer loss sought to interpret what is meant by direct financial loss too narrowly, potentially limiting the extent of legitimate claims.

209 We also observed a tendency for guidance to be developed with reference to case studies which interpreted the FOS principles in narrow factual scenarios. We encouraged the institutions to provide additional case studies and guidance to support the application and interpretation of the FOS principles.

210 In developing their compensation calculation methodologies, where the institutions had little or no data to accurately calculate compensation (e.g. if it could not be determined what alternative investment strategy a customer would have implemented if compliant advice had been provided), we encouraged the use of a proxy interest rate, equivalent to the Reserve Bank of Australia (RBA) cash rate plus a margin of 6% per year.

Note: For an example of how an AFS licensee has applied a proxy interest rate in the absence of adequate data to calculate accurate compensation, see Example 8 in RG 256.

Compensation

211 As reported to ASIC, at 31 December 2016 a total of approximately $30 million had been paid across the institutions to approximately 1,347 customers who had suffered loss or detriment as a result of non-compliant conduct by 97 currently identified high-risk advisers whose conduct occurred between 1 January 2009 and 30 June 2015.

Note: In this context, the compensation is not limited solely to customer loss or detriment arising out of non-compliant advice.

212 The figures set out in this report do not include the compensation amounts paid in relation to fees-for-no-service issues, as noted in REP 499, or the compensation paid under CBA's other large-scale remediation programs—

totalling approximately $80 million—as noted in 15-083MR, 16-415MR and CBA's Open Advice Review Program.

213 The total compensation amount can be broken down into:

(a) $5,928,821 paid in response to customer complaints;

(b) $22,765,365 paid under previous or existing remediation processes; and

(c) $1,572,086 paid under the frameworks for large-scale review and remediation developed as part of this project.

Note: The above figures are rounded to the nearest dollar.

214 Table 5 sets out the compensation paid by the institutions to customers as at 31 December 2016.

Table 5: Compensation paid to customers as at 31 December 2016

Compensation type	AMP	ANZ	CBA	NAB	Westpac
Compensation paid under the review and remediation framework developed as part of this project	$1,105,909 (341 customers) (8 advisers)	$53,363 (2 customers) (1 adviser)	N/A	$3,400 (2 customers) (2 advisers)	$409,414 (11 customers) (4 advisers)
Compensation paid under previous or existing remediation processes	$5,095,248 (24 customers) (4 advisers)	$6,677,105 (182 customers) (11 advisers)	$4,158,167 (207 customers) (10 advisers)	$757,952 (59 customers) (2 advisers)	$6,076,893 (221 customers) (12 advisers)
Compensation paid under complaints process	$1,063,430 (64 customers) (14 advisers)	$1,169,643 (116 customers) (21 advisers)	$1,072,974 (26 customers) (11 advisers)	$1,523,207 (56 customers) (24 advisers)	$1,099,567 (38 customers) (14 advisers)
Total compensation paid including under remediation and complaints	$7,264,587 (429 customers) (19 advisers)	$7,900,111 (300 customers) (22 advisers)	$5,231,141 (233 customers) (16 advisers)	$2,284,559 (115 customers) (24 advisers)	$7,585,874 (270 customers) (16 advisers)

Note 1: The data in this table has been compiled and interpreted by ASIC from the information received from the institutions. It relates to the currently identified high-risk advisers whose non-compliant conduct occurred between 1 January 2009 and 30 June 2015.

Note 2: The compensation figures are rounded to the nearest dollar.

Note 3: An adviser or a customer can appear under more than one compensation type.

Note 4: As part of its pilot work under the review and remediation framework developed as part of this project, NAB focused on an adviser whose non-compliant conduct commenced before 1 January 2009. Under its CRI, NAB has paid $3,385,154 as compensation to affected customers (as at 31 October 2015). These figures do not appear in this table.

Note 5: The figures recorded for CBA do not include compensation amounts paid under its previous large-scale remediation programs: see paragraph 211.

Source: Institutions, ASIC

Next steps

215 We are continuing our discussions with the institutions about the outstanding elements of their review and remediation frameworks, including the external expert assurance of the design effectiveness of their frameworks. We will publicly report on this as each institution's review and remediation framework is implemented.

216 Following implementation, the external experts will periodically report to ASIC on their work to assure operational effectiveness of the review and remediation frameworks.

217 We will provide updates on the institutions' remediation of customers who have suffered loss or detriment as a result of receiving non-compliant advice between 1 January 2009 and 30 June 2015.

D Phase 3: Monitoring and supervision of advisers

Key points

We found that the advice licensees' background and reference-checking processes when appointing advisers were inadequate, and that this allowed the circulation of non-compliant advisers within the financial advice industry.

We also assessed whether the Phase 3 licensees' business-as-usual audits were effective and, in particular, whether their auditors had correctly identified whether advisers had demonstrated compliance with the best interests duty and related obligations.

From our assessment, we found that the licensees' audit processes were:

- *effective* in 18% of the sample files;
- *partially effective* in 57% of the sample files; and
- *ineffective* in 25% of the sample files.

Where we assessed that the business-as-usual adviser audit was ineffective or partially effective, we found that there were 48 cases where some form of corrective action should have been recommended by the licensee's auditor but none had been recommended.

We found that the effectiveness of the audit process was affected by:

- the inadequacy of the file audit questionnaire;
- the inadequacy of the auditor's assessment of a customer file to review whether advisers had demonstrated compliance with the best interests duty and related obligations;
- recommendations that the customer file be updated during the adviser audit process; and
- inadequacies in audit record keeping.

We observed that the institutions have been developing increasingly sophisticated KRIs to identify high-risk advisers as part of their monitoring and supervision processes.

Background to Phase 3

218 The Corporations Act requires advice licensees to implement adequate monitoring and supervision processes to provide financial services efficiently, honestly and fairly, and to ensure their representatives provide financial services that comply with the financial services laws.

Note: For further detail on these obligations, see s912A of the Corporations Act and Section C of Regulatory Guide 104 *Licencing: Meeting the general obligations* (RG 104).

219 In Phase 3 of the project, we reviewed the way that 10 advice licensees selected from within the institutions (Phase 3 licensees) monitor and supervise their advisers and the quality of advice provided.

220 Effective monitoring and supervision of advisers requires a wide-reaching framework with many elements. These elements may include the use of data analytics, effective records management, business-as-usual audits, impromptu audits, appropriate background and reference checking, pre-vetting of advice, and qualified and competent compliance staff.

221 For this report, we chose to focus on two elements that we consider to be integral to an effective monitoring and supervision framework:

(a) *background and reference-checking processes*: reference checking when recruiting advisers is a longstanding area of concern for ASIC, and we have observed that advisers whose past conduct has been identified as non-compliant sometimes circulate undetected within the financial advice industry. Following our previous reporting and guidance on this issue (see paragraphs 129–131), we wanted to observe whether there have been appropriate changes to processes to address these deficiencies; and

(b) *the effectiveness of the adviser audit process:* in Phase 1, the institutions notified us that the adviser audit process was central to their identification of 58 of the SCC advisers: see paragraph 163.We therefore wanted to assess the licensees' current adviser audit processes to determine whether these were effective in assessing whether an adviser had demonstrated compliance with the best interests duty and related obligations when providing advice. For this report, we focused on business-as-usual audits conducted during 2016 because of:

(i) the availability of better quality data and records to allow for a comprehensive customer file to be produced; and

Note: Paragraph 27 sets out some of the reasons observed, as part of this project, for limitations on data collection and retention.

(ii) the standardisation of the way that these more recent audits are conducted as a result of updated policies reflecting the FOFA reforms.

222 As a result of the information evaluated in Phase 2 and Phase 3, we have made some observations about the way institutions are using data analytics, as part of their monitoring and supervision processes, to develop KRIs for identifying high-risk advisers.

Background and reference-checking processes

223 This project is not the first time that ASIC has examined industry policies and practices in relation to the processes for background and reference checking of advisers. For further details, see paragraphs 129–131.

What we did

224 We used our compulsory notice powers to direct the Phase 3 licensees to provide information about their background and reference-checking processes. In particular, we sought the following information:

(a) whether recruiting licensees sought information from former licensees before appointing a new adviser, and if so, details of the information sought; and

(b) whether the former licensees provided information to the recruiting licensees in response to requests for background or reference checks for a former adviser, and if so, the details of the information provided.

What we found

225 Our review showed that all of the institutions were aware of Standards Australia's reference-checking handbook, and followed parts of it. However, none of the Phase 3 licensees followed every aspect of it. We observed that, most often, the deficiencies related to the extent to which the former licensees followed the handbook guidance on the provision of information to a recruiting licensee.

Note: For further details about Standards Australia's Handbook HB 322-2007, see paragraph 130.

Factual background information

226 We found that the Phase 3 licensees generally contacted an adviser's former licensee before appointing the adviser, and that requests for factual information, such as verification of the adviser's employment, were responded to adequately.

227 While we acknowledge it is necessary to verify relevant factual information, it is also important to seek information about the adviser's compliance history from an appropriate person.

Compliance history (including audit reports)

228 We found that the Phase 3 licensees often requested details, from the former licensee, of an adviser's compliance history together with the adviser's previous audit reports.

229 We found, however, that there was widespread failure by former licensees to respond adequately to such requests for information or to provide the relevant audit reports.

230 Even where the recruiting licensee did receive information that raised potential concerns about the adviser's past non-compliant conduct, we observed instances where the recruiting licensee failed to make appropriate further inquiries and appointed the adviser regardless.

Who should be asked to provide information?

231 The recruiting licensee should ensure that it obtains an adviser's compliance history from an appropriately qualified and authorised person within the former licensee.

232 We found that, in some instances, references were sought from former colleagues of an adviser. Former colleagues are often not appropriately independent and are unlikely to have had access to the advice licensee's compliance records for the adviser.

Case study 1: Appropriateness of referee

Scenario

Adviser B's employment with Old Bank is terminated for serious misconduct.

Adviser B applies to be an adviser at New Bank. On their application, the adviser does not disclose that their employment had been terminated.

Adviser B provides New Bank with details of two referees. Both are former colleagues, one of whom no longer works for Old Bank. Neither has supervised Adviser B in any capacity.

Neither reference provided to New Bank discloses the genuine reason for Adviser B's departure from Old Bank.

Adviser B is appointed by New Bank.

Commentary

We expect that a recruiting licensee will take reasonable steps to ensure that compliance information is sought from staff members of the former licensee who are appropriately informed and authorised to provide it.

If references are provided in a personal capacity by former colleagues (rather than on behalf of the former licensee), this should be made clear to the recruiting licensee so that the need to seek further information is apparent.

Note: This case study has been de-identified but is based on an actual example observed within this project.

Policy for providing references

233 We found that only two of the Phase 3 licensees had a written policy about providing background and reference material in relation to their former advisers. The remaining eight licensees did not have a written policy about responding to a background and reference-checking request, although they had generally accepted practices. The findings below refer to both of these situations as 'policies'.

Case study 2: Completing a background reference check

Scenario

Adviser C resigns after receiving a warning letter from Old Bank raising certain compliance concerns about advice the adviser has provided.

Two weeks later, Old Bank determines, internally, that it would have terminated Adviser C's employment if they had not resigned.

Adviser C seeks employment as a financial adviser with New Bank. New Bank has a policy of conducting background and reference checks with the compliance manager of an applicant adviser's most recent AFS licensee.

New Bank contacts Old Bank to seek a compliance reference for its proposed appointment of Adviser C. Old Bank has a policy of not providing a written reference if there are known adviser compliance failings. Old Bank therefore declines to provide a written reference to New Bank. The compliance staff at Old Bank, however, offer to provide a verbal reference. New Bank does not accept this offer.

As a result, New Bank appoints Adviser C without having any knowledge of their poor compliance record.

Commentary

We expect that licensees will take reasonable steps to conduct background and reference checks when recruiting advisers. This did not occur in this case.

Note: This case study has been de-identified but is based on an actual example observed within this project.

234 As set out in paragraph 229, we found that most of the Phase 3 licensees did not provide information to a recruiting licensee about an adviser's compliance history. We were told that this was because of concerns about:

(a) a potential breach of the privacy legislation;

(b) a perception that a defamation action may be pursued by the adviser; and

(c) procedural fairness in circumstances where the adviser had resigned before investigations into their suspected non-compliant conduct had been completed, and the adviser had therefore not had an opportunity to respond.

235 Table 6 summarises the policies on providing information about an adviser's background for the Phase 3 licensees (grouped by institution).

Table 6: Summary of policies for providing information about former advisers

Institutions	Policy on responding to requests for background checks
A (employee and authorised representative model)	A will only provide the details that are specifically asked for and that the adviser has specifically consented to having released.
B (employee and authorised representative model)	B will provide background-checking information, provided that the adviser gives written consent allowing the information to be released.
C (employee representative model)	C (employee representative model) does not provide responses to background checks because of privacy and confidentiality considerations. If the *adviser* requests the release of limited information (e.g. confirmation of employment, length of service and nature of the role), this can be provided.
C (authorised representative model)	C (authorised representative model) will provide background-checking information.
D (employee and authorised representative model)	D will generally only provide the details that are specifically requested and that the adviser has specifically consented to having released. However, if the adviser has not given their consent, D may still consider, on a case-by-case basis, whether some information can be disclosed.
E (employee and authorised representative model)	E will provide background-checking details; however, if there are any compliance issues, only a verbal response may be provided.

Note: Institutions A, B, D and E had the same policies on providing background and reference checks for both their employee representative models and the authorised representative models. Only Institution C had any material differences between the employee representative model and the authorised representative model.

Source: Institutions, ASIC

236 The policies set out in Table 6 result in limited information sharing between the former licensee and the recruiting licensee. We found that ineffective background and reference checking has resulted in non-compliant conduct by advisers not being identified to recruiting licensees. This is attributable to the practices and procedures of both the recruiting licensee and the former licensee—together with legal and procedural fairness concerns: see paragraph 234.

Case study 3: Information sharing between licensees

Scenario

Adviser D has applied for a position as adviser with New Bank.

New Bank has a policy of conducting compliance reference checks with an applicant adviser's most recent licensee (although not necessarily with the compliance manager). New Bank contacts Old Bank to request a compliance reference check for Adviser D.

New Bank's request is made using the consent, direction and release forms from Appendices B and C of the reference-checking handbook (Standards Australia, HB 322-2007), appropriately signed by Adviser D. The forms direct Old Bank (and give Adviser D's consent to the extent that it is required) to share information about Adviser D's compliance history, and to release Old Bank from legal responsibility for any loss, damage or claim arising from sharing this information.

It is Old Bank's policy not to provide a response in writing if there are known compliance concerns about an adviser. Despite the direction and release, Old Bank refuses to answer the specified questions, stating that it is unable to provide the information sought, with no further explanation provided.

Commentary

We expect that licensees will respond to a request for a background reference check, particularly when the adviser has consented to the disclosure.

Note: This case study has been de-identified but is based on an actual example observed within this project.

Improving industry standard of background and reference checking

237 The ABA has recognised that there have been inadequacies in the background and reference-checking processes within the financial advice industry.

238 The ABA has recently released its protocol on reference checking and sharing information about an adviser's compliance, risk management and quality of advice.

239 We consider that the ABA protocol has the potential to address some of the failings we observed relating to background and reference checking. We will continue to liaise with the ABA on this important initiative, as we strongly support efforts to improve the background and reference checking of advisers.

240 The effectiveness of the protocol will be affected by:

(a) the extent that AFS licensees subscribe (at present, the ABA reports that subscribing licensees appoint approximately 38% of the advisers recorded on ASIC's financial advisers register); and

(b) the exceptions, in the protocol, to the obligation to provide information, including:

  (i) any legal obligations or considerations that prevent the sharing or disclosure of information; and

  (ii) operational reasons (e.g. the AFS licensee does not have the required records).

241 In relation to the first issue, the protocol states that any AFS licensee with financial advisers operating under its licence may subscribe to the protocol, and must then adhere to its obligations. This includes licensees that are not ABA members. The ABA has published a list of all current subscribers to the protocol. We expect that this ongoing public reporting will encourage non-ABA licensees to contact the ABA to become subscribing licensees.

242 In relation to paragraph 240(b), because of the potentially broad nature of the protocol's exceptions, we consider that it is currently difficult to assess how effective it will be in practical terms. For example, we found in this project that the institutions often did not share their existing concerns about an adviser because they were concerned about the risk of adviser claims of defamation, misrepresentation, or breach of privacy or confidentiality. Each of these concerns may continue to fall within the exception relating to legal obligations or considerations. ASIC will continue to highlight this issue during the implementation of the protocol to understand the impact of the exceptions.

243 The ABA has informed ASIC that, to assess any impact the exemptions to the protocol may have, the current subscribing members have agreed to participate in a review of the protocol and its underlying processes. ABA will make enhancements to the protocol based on the outcomes of that review, which is due to take place during June 2017.

244 We consider that initiatives limiting the opportunity for an adviser whose past conduct has been identified as non-compliant to move undetected through the financial advice industry are fundamental in promoting customer trust and confidence in the industry and improving customer outcomes.

245 Appendix 2 sets out a checklist of issues for advice licensees to consider when conducting background checks on advisers. One of the key steps that we consider will improve background and reference checking is for the recruiting licensee to require an adviser to provide their consent for the release of the adviser's compliance history from the former licensee. In turn, the former licensee should rely on the adviser's consent to respond meaningfully.

Effectiveness of adviser audit process

What we did

Selecting the sample files

246 To test the effectiveness of the adviser audit process, we selected 160 customer files (sample files) from the Phase 3 licensees, where these files had been subject to the licensee's business-as-usual audit. The files related to advice given by 40 advisers (sample advisers).

Note: For further detail about how these 160 sample files were selected, see paragraphs 123–127 and 134–137.

247 To observe whether there would be a difference in outcome between files audited during the previous 12 months as part of the licensees' business-as-usual audit and files audited at our direction, we directed the licensees to audit the five most recently completed Statements of Advice (or records of advice) provided by each of the sample advisers.

248 We then selected four customer files for each sample adviser—half from the business-as-usual audit and the remaining half from the ASIC-directed audit.

249 The sample files were drawn from a range of high-rated and low-rated outcomes in the licensees' adviser audits. As a result, we expected to observe how each licensee applied its adviser audit process to different advice compliance issues, including non-compliant advice.

Note: The 160 sample files represent a very small subset of the total advice provided by the Phase 3 licensees. Our findings are therefore limited by the scope of the work we have undertaken.

Reviewing the sample files

250 We observed a wide variety of adviser audit processes—sometimes even between licensees within the same institution. To draw conclusions about the effectiveness of each adviser audit process, we assessed the sample files to determine, in each case, whether the adviser had demonstrated compliance with the best interests duty and related obligations in giving advice.

251 We did this by first applying our usual file review processes. We then compared our assessment against the licensee's adviser audit outcomes for each sample file to determine whether the licensees had identified the same compliance concerns that we found during our file review process.

252 The sample files were:

(a) reviewed by ASIC analysts or our external consultant; and

(b) subject to quality checks.

Note: The external consultant is an independent subject matter expert engaged as an agent of ASIC. For further detail, see paragraph 140.

253 We reviewed the files against the obligations in the Corporations Act, including the obligations in Div 2 of Pt 7.7A; however, for the purposes of assessing the effectiveness of the licensees' adviser audit process, we treated the files as fully compliant if the adviser had demonstrated compliance with s961B, 961G and 961J.

254 Table 7 sets out a summary of these obligations.

Table 7: Summary of the requirements in s961B, 961G and 961J of the Corporations Act

Statutory provision	Summary of requirements
Best interests duty: s961B(1)	An advice provider must act in the best interests of the customer in relation to the advice they provide to the customer.
Safe harbour for complying with the best interests duty: s961B(2)	Section 961B(2) provides a 'safe harbour' that advice providers may rely on to prove they have complied with the best interests duty. If an advice provider shows they have taken the steps in s961B(2), they have met their obligation to act in the best interests of the customer.
Providing appropriate advice: s961G	Advice providers must only provide advice if it is reasonable to conclude that the advice is appropriate for the customer, assuming the best interests duty has been complied with.
Prioritising the interests of the customer: s961J	When providing customers with advice, advice providers must place the interests of the customers ahead of any interests they have or those of their related parties.

Note: An 'advice provider' is generally the adviser who provides the personal advice. This is the person to whom the obligations in Div 2 of Pt 7.7A of the Corporations Act apply: see also the key term definition of 'advice provider' in Regulatory Guide 175 *Licensing: Financial product advisers—Conduct and disclosure* (RG 175).

Source: ASIC

Evaluation of the licensees' adviser audits for the sample files

255 The licensees' adviser audits in relation to the sample files were evaluated against ASIC's assessment of compliance, as set out in paragraph 253.

256 The results of our findings were grouped into three categories:

(a) If the licensee's adviser audit correctly identified all areas of non-compliance (if any) in a sample file, we considered the audit to be *effective*.

(b) If the licensee's adviser audit identified some areas of non-compliance but our advice review found additional areas of non-compliance, we considered the adviser audit to be *partially effective*; and

(c) If the licensee's adviser audit identified no areas of non-compliance but our advice review found there were areas of non-compliance, we considered the audit to be *ineffective*.

257 If the licensee's adviser audit for a sample file identified non-compliance, we expected to see appropriate recommendations by the licensee's auditor to address the non-compliance by carrying out:

(a) adviser consequence management—for example, requiring the adviser to:

(i) undertake additional training;

(ii) improve their record-keeping practices;

(iii) submit all draft advice to the licensee for approval before being authorised to provide the advice to a customer (pre-vet); and/or

(iv) undergo closer scrutiny under the licensee's monitoring and supervision systems; and

(b) *customer remediation*, where appropriate—for example, requiring corrective disclosure, offering the customer access to a free advice appointment, rectifying errors that occurred when the advice was implemented, and/or paying monetary compensation.

What we found

Use of adviser audit

258 We found that the Phase 3 licensees used the adviser audit process to:

(a) test adviser compliance with financial services laws and the licensee's business rules;

(b) risk assess advisers for future monitoring and supervision (i.e. if the adviser audit outcome was poor, a licensee would apply an increased level of monitoring and supervision until the compliance concerns were resolved); and

(c) give feedback to advisers on areas needing improvement, where these were identified (often referred to as 'coaching').

Frequency of adviser audit

259 We observed that the Phase 3 licensees conducted business-as-usual adviser audits at regular intervals. The frequency of the audits, and the number of files reviewed, depended on a number of factors. Table 8 summarises the frequency and the file selection process for business-as-usual adviser audits conducted by the Phase 3 licensees (grouped by institution).

Table 8: Summary of business-as-usual adviser audit processes for Phase 3 licensees

Institution	Frequency of audit	No. of files reviewed per audit	How customer files were selected for business-as-usual audit
A	Dependent on previous audit results—can occur every 3, 6 or 12 months	Minimum of 3 files	Files were selected from 4 advice categories: retirement income, personal insurance, superannuation, and investment strategies. However, where the adviser was authorised to provide advice on complex strategies, additional customer files were selected.
B	Dependent on adviser's previous compliance rating—can occur every 3, 6 or 12 months	5 files	Files were selected from new customers (from the previous 12 months), taking into account the types of advice provided by the adviser. The areas the audit focused on were influenced by the adviser's profile.

Institution	Frequency of audit	No. of files reviewed per audit	How customer files were selected for business-as-usual audit
C	Dependent on the licensee and on the adviser's previous compliance rating—can occur every 3 or 12 months	2–6 files (with a minimum of 6 annually)	File selection was random and/or files were selected from areas of complex advice. File selection also depended on the adviser's compliance history and the individual licensee's processes.
D	Dependent on adviser's previous compliance rating and advice profile—can occur every 6 or 12 months	5–8 files	File selection was based primarily on the adviser's past compliance and complaints history, adviser profile, and responses to a pre-review questionnaire.
E	Dependent on adviser's previous compliance rating and advice profile—can occur every 3, 6, 9, 12 or 24 months	Minimum of 4 files	File selection was based on the use of KRIs to identify high-risk strategies (e.g. gearing, managed discretionary account products, structured products, self-managed superannuation funds (SMSFs) or limited recourse borrowing arrangements, and superannuation switching).

Source: Institutions, ASIC

Differences in approach to audit

260 The Phase 3 licensees differed in their approach to the audit of customer files. The main differences we observed from the sample files were:

(a) variations in the audit questionnaires and accompanying guidance about:

(i) whether sufficient evidence was held on the file to support making a finding;

(ii) the required level of compliance with financial services laws;

(iii) the required level of compliance with the licensee's internal policies and business rules; and

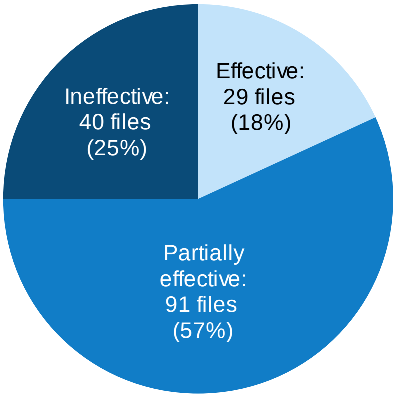
(iv) other legal compliance matters, such as compliance with privacy legislation; and

(b) different methodologies used to award audit ratings to the individual advisers based on the findings of the audit.

Adviser audit outcomes

261 Our evaluation of the Phase 3 licensees' adviser audit processes showed that there were deficiencies in the effectiveness of these processes. Figure 4 shows the relative distribution of the effectiveness of the audit process for the sample files. For further details of how our evaluation was carried out, see paragraphs 250–256 and Figure 5.

Figure 4: Effectiveness of adviser audit process for sample files



Note: See Table 17 in Appendix 5 for the data shown in this figure (accessible version).

Source: Institutions, ASIC

262 From our assessment, we found that:

(a) the audit process was *effective* in 18% of the sample files—that is, the findings by the licensees' auditors aligned with our own file review. We observed an effective audit process only on files where no areas of non-compliance were identified by either the licensees' auditors or our advice reviewers;

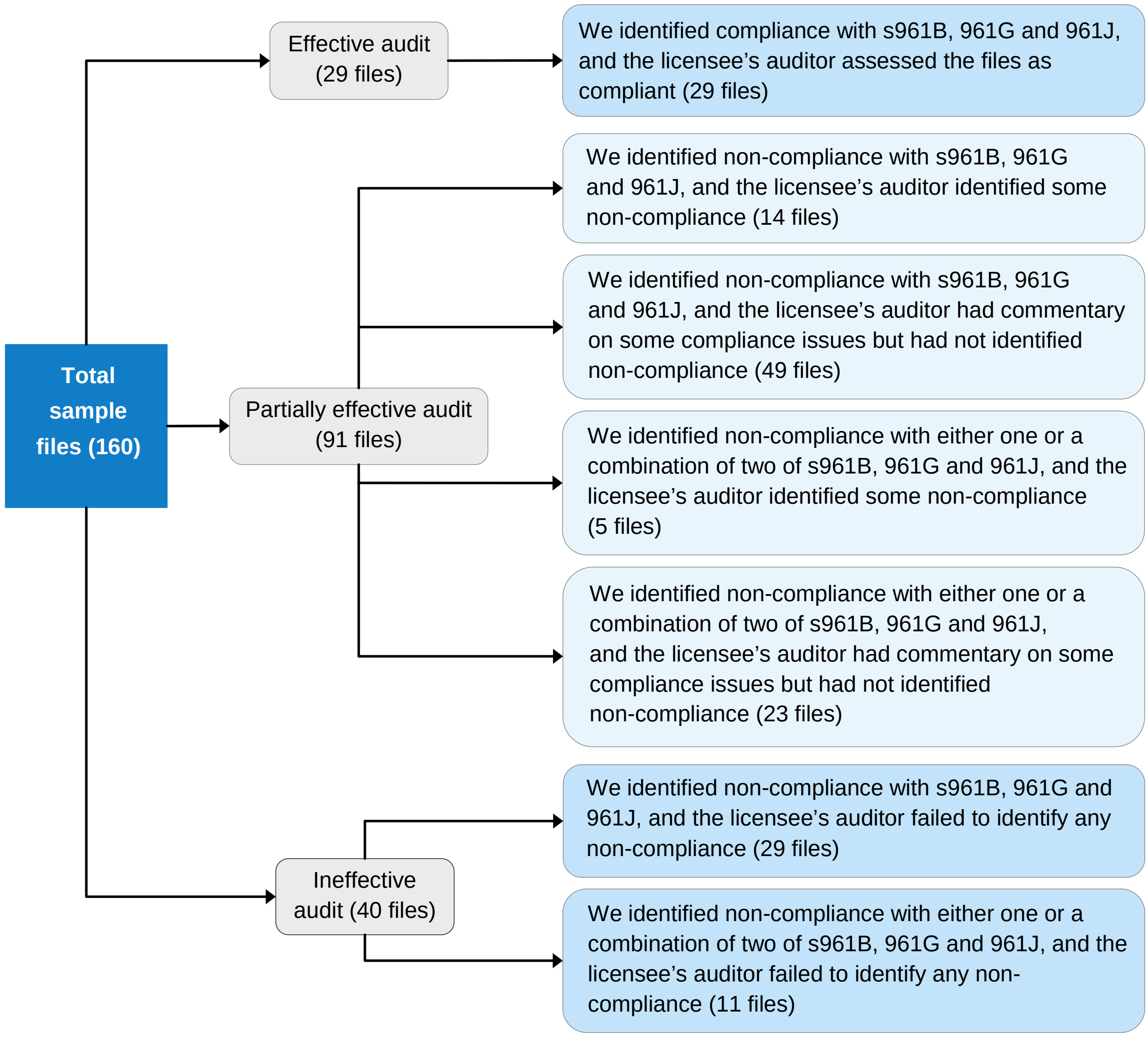
Note: We did not observe an effective audit process for any of the sample files where our reviewers found compliance concerns. In these cases, the licensees did not correctly identify all of the compliance concerns found.

(b) the audit process was *partially effective* in 57% of the sample files—that is, some areas of non-compliance were identified by the licensees' auditors, but our advice reviewers found additional areas of non-compliance; and

(c) the audit process was *ineffective* in 25% of the sample files—that is, no areas of non-compliance were identified by the licensees' auditors, but our advice reviewers found that there were some areas of non-compliance.

263 Figure 5 sets out a summary of the findings from our evaluation of how effective the licensees' adviser audits were in identifying adviser compliance with the best interests duty and other statutory obligations.

Figure 5: Our assessment of the adviser audit process for sample files



Note 1: Table 7 sets out a summary of s961B, 961G and 961J.

Note 2: See Table 18 in Appendix 5 for the data shown in this figure (accessible version).

Source: Institutions, ASIC

Incidental findings to the adviser audit process

264 To assess the effectiveness of the adviser audit process, it was necessary to review the underlying customer files. The basis on which we assessed the advice is set out in paragraphs 246–254.

265 Our file review process was carried out by reviewing the entire customer file. Consistent with record-keeping obligations, we expect all the relevant information to be contained in the file. When assessing compliance, we expect to see positive evidence that shows:

(a) why or how the advice was in the customer's best interests;

(b) that the advice is likely to satisfy the customer's relevant circumstances and is likely to be appropriate for the customer; and

(c) how the customer's interests have been prioritised over those of the adviser or related parties.

266 We expected that some of the advice reviewed would be non-compliant because our sampling exercise included selecting files for which the licensees' auditors had identified adviser compliance failings.

267 Our findings revealed that, in a significant number of the sample files, the adviser failed to demonstrate compliance with the best interests duty and related obligations. However, in these cases, we found that:

(a) none of the adviser non-compliance fell within the definition of a 'serious compliance concern';

(b) some of the adviser non-compliance did fall within the definition of 'other compliance concerns'; and

(c) regardless of how the adviser was selected—that is, whether the adviser had demonstrated past compliance concerns or whether they were selected randomly—there was no observable variance in either the rate of occurrence, or type, of the non-compliance.

268 Our proposed next steps in relation to these findings are set out at paragraph 293.

Factors affecting the adviser audit process

269 As part of the Phase 3 review, we identified a number of deficiencies that affected the quality of the adviser audits undertaken by the Phase 3 licensees. We found that:

(a) the adviser audit questionnaire often did not directly align with the best interests duty and related obligations;

(b) the licensees' auditors often failed to identify adviser non-compliance with the best interests duty and related obligations;

(c) recommendations were made to amend customer files during the adviser audit process; and

(d) audit record keeping was often inadequate.

Inadequacy of the file audit questionnaire

270 We observed deficiencies in the file audit questionnaires used by the Phase 3 licensees in the audit process. We found that the questionnaire often did not directly align with the best interests duty and related obligations, making it more difficult for the licensees' auditors to assess compliance. For example:

(a) the majority of the licensees' questionnaires did not directly provide for the assessment of the appropriateness of advice under s961G; and

(b) in some cases, the questionnaire addressed whether there was disclosure of conflicts of interest, but did not adequately address whether the customer's interests had been prioritised in line with s961J.

271 We expect the audit questionnaire to align with the best interests duty and related obligations. An effective adviser audit also requires auditors to use their professional judgement in recording why an adviser passes or fails each step. Appendix 3 sets out some template questions on the matters we would expect an audit questionnaire to include.

Failure of auditor to identify non-compliance

272 We observed that the auditor often failed to identify advisers who had not:

(a) demonstrated compliance with the best interests duty (or satisfied the safe harbour steps), including;
    (i) identifying the scope of the advice;
    (ii) identifying the customer's relevant circumstances; and
    (iii) investigating and considering the customer's existing financial products—including a 'like-for-like' comparison of the fees and features of existing and new products;

(b) provided advice that was appropriate for the customer; and

(c) prioritised the customer's interests over those of the adviser or related parties.

273 We also observed that auditors commonly assessed advisers as demonstrating compliance with the best interests duty and related obligations, despite the customer file containing incomplete documentation.

274 The failure of auditors to identify non-compliant advice may be a competence issue which extends beyond the inadequacy (in some cases) of the file audit questionnaire. However, this seems unlikely to be the only reason. This is because we found that:

(a) when non-compliant advice was identified by ASIC in business-as-usual audits, the licensee's auditor failed, in 37% of cases, to identify any of the non-compliance that we observed. This improved in the ASIC-directed audits, with the auditor failing to identify any of the compliance issues that we observed in 23% of cases; and

(b) when non-compliant advice was identified by ASIC in business-as-usual audits, and assessed as requiring a remediation response, the licensee's auditor recommended consequence management or customer remediation in 58% of cases. This increased to 67% of cases in the ASIC-directed audits.

Note: See paragraph 247 for more information about the ASIC-directed audits.

275 Other causes that may explain the failure of auditors to identify non-compliant advice include the level of resourcing available to conduct the adviser audits, and the adequacy of auditor training.

Amending customer files during the audit process

276 We found that, where deficiencies in the file documentation were identified within the adviser audit process, the auditor would sometimes recommend that the adviser amend the customer file to make it compliant. In our view, this practice is undesirable because it is inconsistent with the obligation for the adviser to maintain records to demonstrate that they have complied with the best interests duty and related obligations.

277 File notes should be made at the same time as the events that they record. In some cases, we observed a time delay of up to 12 months between the advice being provided to the customer and the recommendation from the auditor to update the file. Often, amendments to the customer file were made without any customer engagement.

278 Where record-keeping deficiencies are identified—and, in particular, where these relate to instructions provided by, or information given to, the customer—any amendments to the customer file should occur in consultation with the customer. Table 9 sets out some of the file amendment recommendations that we observed.

Note: In appropriate cases, we will take action when customer records have been altered: see Media Release (16-239MR) *ASIC bans North Queensland financial adviser* (26 July 2016).

Table 9: Observed recommendations made to amend customer files during the audit process

	Customer File A	Customer File B
Observed audit findings	The SOA referred to the customer's existing superannuation fund but there was no demonstration of a like-for-like comparison with the recommended superannuation product, including the difference in premium payable and any benefits lost or gained.	The adviser failed to properly record meetings with the customer, including establishing the customer's individual circumstances and goals, and how advice would assist the customer.
Remedial action recommended by auditor	The auditor recommended that: • the adviser should research the maximum benefit and premium of the former product through the superannuation fund website and PDS; • the research should identify the limit of suitable cover within the former product; • the file should be updated to show the new like-for-like research; and • copies of relevant documents and file notes of discussions should be retained.	The auditor recommended that the adviser should prepare file notes, using the current date, to record the adviser's recollection of: • discussions with the customer, including the customer's circumstances, goals and reasons for seeking personal insurance advice; and • explanations about why specific features, benefits and sum amounts were agreed on.

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	Customer File A	Customer File B
Course of action ASIC would expect	We expect that this non-compliance would be recorded on the audit record and affect the audit rating. To remediate the situation, we agree that research should be undertaken. After the necessary research has been completed, we expect that (when appropriate): • corrective disclosure should be made to the customer; • a determination should be made about whether the existing advice has complied with the best interests duty and related obligations, and if not, the affected customer should receive further remediation; • the licensee should monitor that the adviser has undertaken these steps appropriately; • a determination should be made about what, if any, adviser consequence management is required; and • the licensee should ensure that any systemic issues identified by the auditor, if relevant, are captured as part of the audit process.	We expect that this non-compliance would be recorded on the audit record and affect the audit rating. To remediate the situation, we agree that appropriate records should be created using the current date. When creating such a record, we expect that: • the customer should be consulted to verify the accuracy of the adviser's recollection; • where there is disagreement about what was discussed, the customer's recollection of events should be favoured; • if the customer provides alternative facts, a determination should be made about whether the existing advice complies with the best interests duty and related obligations, and whether an affected customer should be remediated; • the licensee should monitor that the adviser has undertaken these steps appropriately; • a determination should be made about what, if any, adviser consequence management is required; and • the licensee should ensure that any systemic issues identified by the auditor, if relevant, are captured as part of the audit process.

Source: Institutions, ASIC

Inadequacy of audit record keeping

279 As part of our review, we asked the institutions whether they retained a full copy of the customer file at the time it was audited (point-in-time copy).

280 We consider retaining a point-in-time copy of the customer file to be an important part of an advice licensee's audit process because the file forms the source documentation for any subsequent audit of the licensee's control testing environment. If a point-in-time copy of the customer file is not retained, we consider that the licensee's ability to test the effectiveness of the adviser audit process itself is likely to be impeded.

281 We found that eight of the 10 Phase 3 licensees did not have a practice of retaining a point-in-time copy of the customer file that was subject to an audit. One explanation offered was that retaining point-in-time copies of customer files would be too costly and time consuming.

Note: The ability to test the adequacy of risk management processes, including the adviser audit, forms part of the 'three lines of defence' risk management model which all of the institutions told us they used. The 'three lines of defence' model is discussed in Report 298 *Adequacy of risk management systems of responsible entities* (REP 298).

Recommendations to address non-compliance

282 We observed that, in some instances, where non-compliant advice was identified by the auditor, the Phase 3 licensees have undertaken:

(a) *adviser consequence management*—for example:

(i) requiring the adviser to undertake additional training and improve their record-keeping practices;

(ii) returning the adviser to pre-vet status; and/or

(iii) placing the adviser under closer scrutiny within the licensee's monitoring and supervision systems by requiring more frequent adviser audits in the future; and

(b) *customer remediation*, where appropriate—for example, requiring corrective disclosure, offering the customer access to a free advice appointment, rectifying errors that occurred when the advice was implemented, and/or paying monetary compensation.

283 The recommendations made for adviser consequence management or customer remediation were often inadequate to address the compliance issues that we identified. Of the 131 audit outcomes that we assessed as being ineffective or partially effective, we found that there were 48 cases where corrective action should have been recommended by the licensee's auditor but none had been recommended. We have set out in paragraph 293 what we will do to address these issues with the licensees.

284 We also observed that, for a significant number of the sample files where we assessed the advice as non-compliant, the licensee's auditor made no recommendations for consequence management of the adviser or customer remediation. This occurred in two ways:

(a) the licensee's auditor did not identify non-compliance and therefore no recommendations were made for adviser consequence management or customer remediation; or

(b) the licensee's auditor identified non-compliance but made no recommendation for adviser consequence management or customer remediation.

Further observations about KRIs and data analytics

What we did

285 We used our compulsory notice powers to direct the institutions to provide information about the use of data analytics within their monitoring and supervision processes.

286 As part of Phase 2, we also received information from the institutions about the development of data analytics and the use of KRIs to identify high-risk advisers for the purposes of remediation.

What we found

287 We believe that the use of data analytics to develop KRIs is a useful and efficient method to improve the identification of high-risk advisers and non-compliant advice.

288 We found that the main KRIs used by the institutions, as part of their monitoring and supervision processes, included:

(a) the use of adviser audit ratings as a measure of the risk the advisers expose their licensee to—the ratings are then used to assess whether more frequent audits need to be undertaken;

(b) the occurrence of potentially systemic issues identified by the adviser audit process—so that institutions can review similar customer files to determine whether the non-compliance is widespread and customer remediation is necessary; and

(c) the frequency and monetary value of customer complaints.

289 We observed the increasing trend to use data analytics in the development of KRIs for identifying high-risk advisers, although it was apparent that some of the institutions had more advanced processes than others for using data analytics to monitor their advisers.

290 We asked the institutions to ensure that the development of data analytics to identify high-risk advisers within their remediation work would also form the basis of the continuing development of their KRIs for monitoring and supervision.

291 ASIC has worked with the institutions to establish a number of KRIs as part of their monitoring and supervision processes. In Appendix 4, we include a list of possible KRIs for advice licensees to consider when developing and implementing their KRIs to identify potentially high-risk advisers and non-compliant advice.

292 We expect that KRIs developed using data analytics will be subject to continuous review and improvement as new industry and product risks emerge.

Next steps

293 We will meet with each of the institutions to discuss the findings of our customer file reviews, and our concerns about the institutions' adviser audit processes. We will consider enforcement or other appropriate regulatory action against the Phase 3 licensees, and will make a public statement where we take enforcement action.

Appendix 1: Advice licensees within the scope of this project

294 Table 10 sets out a list of the advice licensees that were part of this project. These licensees were solely owned or controlled by the institutions for all or part of the period between 1 January 2009 and 30 June 2015.

Note 1: This list includes only licensees that provided personal advice during the relevant period for this project.

Note 2: The 10 licensees that we also selected as our Phase 3 licensees are identified in the table: see also paragraph 35.

Table 10: Advice licensees we reviewed in this project

Institution	Licensee
AMP	AMP Direct Pty Ltd
	AMP Financial Planning Pty Limited (also a Phase 3 licensee)
	Charter Financial Planning Limited
	Forsythes Financial Services Pty Ltd
	Genesys Wealth Advisers Limited
	Hillross Financial Services Limited
	IPAC Securities Limited (also a Phase 3 licensee)
	King Financial Services Pty Ltd
	PPS Lifestyle Solutions Pty Ltd
	Prosperitus Pty Ltd
	Quadrant Securities Pty Ltd
	SMSF Advice Pty Limited
	Strategic Planning Partners Pty Ltd
	TFS Financial Planning Pty Ltd
	Total Super Solutions Pty Ltd
	Tynan Mackenzie Pty Ltd
ANZ	Australia and New Zealand Banking Group Limited (also a Phase 3 licensee)
	Financial Services Partners Pty Limited
	Millennium 3 Financial Services Pty Ltd (also a Phase 3 licensee)
	RI Advice Group Pty Ltd

Institution	Licensee
CBA	Commonwealth Financial Planning Limited (also a Phase 3 licensee)
	Financial Wisdom Limited
	BW Financial Advice Limited
	Count Financial Limited (also a Phase 3 licensee)
	Commonwealth Private Limited
	Commonwealth Securities Limited
NAB	GWM Adviser Services Limited (also a Phase 3 licensee)
	Apogee Financial Planning Limited
	Godfrey Pembroke Limited
	Meritum Financial Group Pty Ltd
	JB Were Limited
	National Australia Bank Limited (also a Phase 3 licensee)
Westpac	Westpac Banking Corporation (also a Phase 3 licensee)
	Securitor Financial Group Ltd (also a Phase 3 licensee)
	Magnitude Group Pty Ltd

Appendix 2: Checklist—Background checking of advisers

295 Table 11 sets out a checklist of issues for advice licensees to consider when conducting background checks on advisers.

Table 11: Issues for advice licensees to consider when conducting background checks on advisers

Issue	Considerations
Regulatory status and history	Licensees should check whether the adviser is listed on: • ASIC's financial advisers register; • ASIC's banned and disqualified register, or enforceable undertakings register; • the professional registers on ASIC Connect; and • the Australian Prudential Regulation Authority's (APRA) disqualification register. Note: Advisers who were banned or disqualified, or who entered into an enforceable undertaking, before 31 March 2015—and who have not re-entered the advice industry—will appear on our banned and disqualified register or enforceable undertakings register, but will not be listed on ASIC's financial advisers register.
Other background checks	Licensees should carry out the following checks: • criminal history (in Australia or overseas if the adviser has been resident overseas); • bankruptcy; • directorship and significant shareholdings history (for companies in external administration); • 100 point identification; and • Anti-Money Laundering, Counter Terrorism Financing Rules and Global Official List (Sanctions). Note: See page 12 of Standards Australia's Handbook HB 322-2007 (PDF 1 MB).
Disclosure, verification and consent from the adviser	The appointment application form should request: • a copy of the adviser's curriculum vitae, showing their qualifications, professional memberships and work history; • information about the adviser's compliance history; Note: See Appendix D of Standards Australia's Handbook HB 322-2007 (PDF 1 MB). • information about complaints made against the adviser; • information about the adviser's conflicts of interest; • information about any high-risk positions the adviser has held (including appointment by a customer as an attorney under power of attorney, an executor of estate, a trustee, a guarantor or an authorised signatory on a customer account); • information about any related businesses the adviser carries on (e.g. providing credit, accounting or real estate services); • a list of the adviser's directorships and significant shareholdings (past and current); • a character questionnaire; • confirmation about whether the adviser has been known by any other name (e.g. alias or by marriage); • acknowledgments and declarations of the truth and accuracy of the information provided; and • the adviser's consent for background checks to be conducted, and direction to the adviser's recent former licensees requiring them to provide the necessary information to the recruiting licensee. Note: See Appendices B and C of Standards Australia's Handbook HB 322-2007 (PDF 1 MB).

Issue	Considerations
Compliance history	Licensees should request: • the findings of the adviser's most recent audit reports; and • references from designated compliance managers—or an appropriately qualified and authorised person within the adviser's recent former licensees—who can provide objective, relevant and factual compliance information about the adviser. Note: See Part B and Appendix C of Standards Australia's Handbook HB 322-2007 (PDF 1 MB).
Qualifications and training	Licensees should verify whether the adviser: • has appropriate qualifications; and Note: The minimum level of training and competence required to provide personal advice is set out in Regulatory Guide 146 *Training of financial product advisers* (RG 146) and, in some cases, more specialised training may be required by licensees. The *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* commenced on 15 March 2017. This seeks to raise the professional, ethical and education standards of financial advisers. There is a transitional period which means that most of the new provisions relating to professional standards have staggered commencement dates from 1 January 2019. • has undertaken appropriate continuing professional development.
Online media	Licensees should carry out a general internet search—for example, by reviewing the adviser's website(s) and any mention of them in published media, social media and on professional networking sites.
Assessment of information	The officer responsible for auditing should assess the adviser's recent audit reports. The officer responsible for training should assess the adviser's qualifications and training. An appropriate compliance officer should carry out an overall assessment of all the collated information, including responses and feedback from specialist teams and any outsourced checking or verification service providers. Issues or concerns should be escalated to appropriate designated decision makers (e.g. a compliance committee or compliance manager).
Process management	Senior management should commit to an effective process of conducting and responding to background checks. Licensees should: • have in place written policies and procedures on conducting and responding to background checks; • use an appointment form and checklist; and • retain an organised and accessible record of checks conducted, information and documents received, and assessments undertaken. The extent of process management will vary depending on the nature, size and complexity of the licensee.

Appendix 3: Checklist—Reviewing personal advice as part of an adviser audit

296 Table 12 sets out a checklist of issues that all advice licensees and compliance consultants should consider when reviewing personal advice as part of an adviser audit to determine whether the adviser has demonstrated compliance with the best interests duty and related obligations.

297 The checklist covers the existing obligations in the Corporations Act, as well as additional considerations for giving good quality advice. It is based on our guidance in Regulatory Guide 175 *Licensing: Financial product advisers—Conduct and disclosure* (RG 175) and Regulatory Guide 244 *Giving information, general advice and scaled advice* (RG 244).

298 This is not a complete checklist of issues to consider when reviewing personal advice. A licensee may want, or need, to include additional questions and considerations, or tailor these matters according to the nature of its particular advice business. A licensee will also need to assess, in its audit process, an adviser's compliance with other legal obligations, in addition to the best interests duty and related obligations.

Other resources

299 In addition to the checklist in Table 12, ASIC has extensive regulatory guides and information for advice licensees to refer to when reviewing customer files and advice:

(a) Information Sheet 182 *Super switching advice—Complying with your obligations* (INFO 182);

(b) Information Sheet 205 *Advice on self-managed superannuation funds: Disclosure of risks* (INFO 205);

(c) Information Sheet 206 *Advice on self-managed superannuation funds: Disclosure of costs* (INFO 206);

(d) Regulatory Guide 90 *Example Statement of Advice: Scaled advice for a new client* (RG 90);

(e) Regulatory Guide 175 *Licensing: Financial product advisers—Conduct and disclosure* (RG 175);

(f) Regulatory Guide 244 *Giving information, general advice and scaled advice* (RG 244);

(g) Report 337 *SMSFs: Improving the quality of advice given to investors* (REP 337)—in particular, Section C; and

(h) Report 413 *Review of retail life insurance advice*—in particular, Section D and the appendix 'Life insurance advice checklist' (REP 413).

Table 12: Issues to consider when reviewing personal advice as part of an adviser audit

Key issue	Audit questions	Considerations
Acting in the best interests of the customer: s961B(1)	Has the adviser acted in the best interests of the customer? Why/Why not? Did the customer file pass or fail this step?	Advisers must act in the best interests of their customers. As a result, a reasonable adviser would believe that the customer is likely to be in a better position if they follow the advice, than at the time the advice is provided. See RG 175.224–RG 175.231, including Examples 1–6, for further information. Advice provided by an adviser who has complied with the best interests duty is likely to leave the customer in a better position if they follow the advice. 'Better position' depends on the circumstances and includes: • the position the customer would be in if they did not follow the advice; • the facts at the time the advice is provided; • the subject matter of the advice sought by the customer (both explicit and implicit)—that is, whether the scope of the advice is consistent with the customer's relevant circumstances and the subject matter of the advice sought (and why/why not); • whether the advice balances the need for strategic advice and/or financial product advice; • where relevant, the product features that the customer particularly values—provided that the customer understands the cost of, and is prepared to pay for, those features; and • whether the benefits the customer receives as a result of the advice are more than trivial (and why/why not). If an advice model produces a 'one-size-fits-all' outcome (i.e. the processes do not allow each customer's relevant circumstances to be taken into account, or result in advice that does not reflect the customer's relevant circumstances), it will be difficult to demonstrate that the best interests duty is being complied with. When assessing whether the best interests duty has been complied with, advice reviewers should assess: • which aspects of the advice were in the customer's best interests; • which aspects of the advice were not in the customer's best interests; • whether a reasonable adviser assessing the advice, at the time it was given, would believe that the customer would be likely to be in a better position if the customer followed the advice; • whether the advice took into account and reflected the customer's relevant circumstances; • whether the scope of advice was consistent with the customer's relevant circumstances and the subject matter of the advice sought; and • whether the advice balanced the need for strategic advice and/or financial product advice. Deficient switching advice (see below) may lead to the customer file and advice failing s961B(1).

<table>
<tr><th>Key issue</th><th>Audit questions</th><th>Considerations</th></tr>
<tr><td>Identifying the customer’s objectives: s961B(2)(a)

Note: This is a safe harbour step.</td><td>Did the adviser identify the objectives of the customer that were disclosed to the adviser by the customer through instructions?

Why/Why not?

Did the customer file pass or fail this step?</td><td>Personal advice should ensure that a customer’s objectives are specific, measurable and prioritised: see RG 175.218(c). These objectives may include, but are not limited to:
• cash flow management and budgeting;
• debt reduction or repayment;
• building savings and wealth;
• superannuation advice;
• planning for retirement;
• personal insurance advice; and
• investment of a lump sum.

The reasons or objectives that prompted the customer to seek advice should be clear and recorded in the customer’s own words. Both the customer file and Statement of Advice (SOA) should clearly explain why the customer is seeking advice and the outcomes the customer wants to achieve.

If a customer file and SOA are based on pre-determined or leading instructions, and questions from a ‘fact find’, this does not allow each customer’s relevant circumstances to be taken into account and is likely to result in advice that does not reflect the customer’s relevant circumstances.</td></tr>
<tr><td>Identifying the customer’s financial situation and needs: s961B(2)(a)

Note: This is a safe harbour step.</td><td>Did the adviser identify the financial situation and needs of the customer that were disclosed to the adviser by the customer through instructions?

Why/Why not?

Did the customer file pass or fail this step?</td><td>The adviser should identify, discuss and document all relevant aspects of the customer’s financial situation and needs, such as:
• their financial position (i.e. income, expenses, assets and liabilities);
• their personal circumstances (i.e. age, relationship status and family situation);
• their health status;
• any foreseen changes to their personal or financial position (i.e. inheritance, home renovations, divorce, new baby, sale of business, retirement, redundancy, job or career changes);
• any existing insurance arrangements (including insurance held within their superannuation fund); and
• their insurance needs and the relative priority of those needs.

The customer’s financial situation and needs should be recorded in the customer file (e.g. in a fact find or file note summarising the conversation) and summarised concisely in the SOA to the extent that this information provides the basis of the advice given. Some of this information will merely provide context and background to the advice and does not need to be in the SOA.</td></tr>
</table>

Key issue	Audit questions	Considerations
Identifying the subject matter and scope of the advice sought by the customer: s961B(2)(b)(i) Note: This is a safe harbour step.	Did the adviser identify the subject matter of the advice sought by the customer and, where relevant, change the scope of the advice accordingly? Why/Why not? Did the customer file pass or fail this step?	A customer file and SOA should together demonstrate: • why the customer is seeking advice; • the subject matter and scope of the advice being provided; and • why the subject matter and scope are suitable for the customer and consistent with the customer's objectives, financial situation and needs. A customer file should also demonstrate that the subject matter of the advice sought was identified through a two-way process between the customer and the adviser. The scope of advice must not be reduced by the adviser to exclude critical issues that are relevant to the subject matter of the advice sought. Where the customer seeks to limit the scope of the advice, the adviser should decline to provide the advice if their ability to act in the customer's best interests is affected by the customer's instructions. Where the subject matter of the advice is limited in scope at the request of the customer, the adviser should carefully record this in the customer file, including the customer's reasons for the request. This should also be detailed in the SOA.
Identifying the customer's relevant circumstances: s961B(2)(b)(ii) Note: This is a safe harbour step.	Depending on why the customer is seeking advice, the adviser should exercise their judgement in identifying the customer's relevant circumstances, based on the information disclosed. Has this occurred? Why/Why not? Did the customer file pass or fail this step?	As part of identifying the customer's circumstances that are reasonably considered relevant to the subject matter of the advice sought, an adviser may need to make inquiries that are additional to those they would normally make. This is particularly important if the advice is relatively complex or if it is reasonably apparent that the customer has a low level of financial literacy. If the subject matter of the advice is revised as part of this process, this should be clear in the customer file and in the SOA, including why the revised subject matter is suitable and in the customer's best interests. The customer's relevant circumstances would normally encompass any matter that the customer indicates is important.

Key issue	Audit questions	Considerations
Making inquiries where information is incomplete or inaccurate: s961B(2)(c) Note: This is a safe harbour step.	If it was reasonably apparent that information about the customer's relevant circumstances was incomplete or inaccurate, did the adviser make reasonable inquiries to obtain complete and accurate information? Why/Why not? Did the customer file pass or fail this step?	Where there is incomplete or inaccurate information (including inconsistent information) about the customer's relevant circumstances, the adviser should clearly demonstrate what steps they took to obtain or clarify information. Advisers should use their knowledge, skill and judgement to identify incomplete or inaccurate information that is required to provide the advice sought by the customer on that subject matter. In some cases, where the information is incomplete or inaccurate, the adviser should consider whether they should decline to provide advice.
Assessing the adviser's expertise: s961B(2)(d) Note: This is a safe harbour step.	Does the adviser have the expertise required to provide the advice sought by the customer on that subject matter? Why/Why not? Did the customer file pass or fail this step?	Advice reviewers should make an objective assessment about the competence and experience of the adviser. This includes consideration of the adviser's authorisations, education, experience and memberships as recorded on ASIC's financial advisers register. If the adviser is not trained or authorised to provide the advice sought by the customer on that subject matter, they should decline to provide the advice.

<table>
<tr><th>Key issue</th><th>Audit questions</th><th>Considerations</th></tr>
<tr>
<td>Recommending a financial product: s961B(2)(e)

Note: This is a safe harbour step.</td>
<td>Where a financial product is recommended, did the adviser conduct a reasonable investigation and assessment of the financial products that might meet the objectives and needs of the customer that would reasonably be considered as relevant to the advice on that subject matter?

Why/Why not?

Did the customer file pass or fail this step?</td>
<td>Before recommending that a customer acquire a financial product, we expect advisers to formulate the strategy that they are basing their advice on. In some cases, it is unlikely that a product recommendation would be in the customer’s best interests, given the subject matter of the advice sought. For example:
• a customer experiencing financial difficulty may need advice on how to manage their cash flow and reduce debt. If the customer is unwilling or unable to pay for this advice, consideration should be given to referring the customer to a financial counsellor; or
• a customer whose existing superannuation and insurance products meet their needs and objectives may need advice to make no changes and continue what they are already doing.

An adviser should consider the customer’s existing financial products and whether the customer’s needs and objectives can be met by retaining (or modifying) their existing financial products.

An adviser must conduct a reasonable investigation into products that will meet the customer’s needs and objectives. The level of inquiries will vary according to the complexity of the advice, including the financial products and strategies recommended. Complex financial products and strategies necessitate more extensive inquiries.

Advisers can refer to investigations conducted by their AFS licensee or various service providers (e.g. research houses) to assist their own inquiries. However, product research does not take into account the customer’s unique personal circumstances, objectives, and needs. The adviser is ultimately responsible for ensuring that the product is suitable for the customer, given their relevant circumstances.

Note: Not all research is the same. For further information, see Regulatory Guide 79 Research report providers: Improving the quality of investment research (RG 79).

In summary, a customer file should demonstrate:
• whether it was reasonable to recommend a financial product, taking into account the reasons why the customer sought advice;
• consideration of strategic advice that may form the basis of the financial product recommendations;
• consideration and investigation of financial products, taking into account:
– the customer’s existing financial products;
– financial products that might meet the customer’s needs and objectives (including the recommended financial products);
– a clear rationale about why the recommended financial products meet the customer’s needs and objectives when compared with other products considered (including the customer’s existing products); and
– any research used by the adviser.</td>
</tr>
</table>

Key issue	Audit questions	Considerations
Making a recommendation to replace a financial product: s961B(2)(e) Note: This is a safe harbour step.	Where an adviser recommends that a financial product is replaced, did the adviser conduct a reasonable investigation and assessment of the financial products that might meet the objectives and needs of the customer that would reasonably be considered relevant to the advice on that subject matter? Why/Why not? Did the adviser consider and investigate the customer's existing products? Why/Why not? Did the customer file pass or fail this step?	Advice that recommends replacing one financial product with another (switching advice) must be in the customer's best interests. Advisers should carefully consider important risks to the customer. This is particularly important where an adviser recommends a switch of superannuation and/or insurance products, because this can have significant risks of lost benefits for a customer. In addition, a superannuation fund often contains insurance cover that should always be considered and investigated when providing switching advice. Once an adviser has established it is reasonable to recommend a financial product, before recommending a replacement product, the adviser must consider and investigate: • the customer's existing products; • the new financial products that the customer could potentially acquire or invest in; and • the new recommended products. Switching advice should: • be clear, concise and effective; • be easily understandable and enable the customer to make an informed decision; and • compare 'like-for-like' fees and features of existing and new products. When giving switching advice, an adviser must consider the advantages and disadvantages, including the costs and risks, of both the existing and new products. This obligation also applies if an adviser recommends that the customer redirects their superannuation contributions into a new superannuation fund, including an SMSF, or other product. Advice may leave the customer in a better position if there are overall cost savings for the customer that override the loss of any benefits. The overall cost savings must take into account all the circumstances, including the cost of the replacement product and the adviser's fees. Switching advice will generally not be in the customer's best interest if the adviser knows (or should have known) that: • the overall benefits likely to result from the replacement product would be lower than under the existing product, unless outweighed by overall cost savings; or • the cost of the replacement product is higher than the existing product, unless the replacement product better satisfies the customer's needs. Deficient switching advice may lead to the adviser failing the obligation to act in the customer's best interests (s961B(1)), satisfy the safe harbour step in s961B(2)(e), or provide appropriate advice (s961G).

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Key issue	Audit questions	Considerations
All judgements are based on the customer's relevant circumstances: s961B(2)(f) Note: This is a safe harbour step.	Has the adviser based all judgements made, in advising the customer, on the customer's relevant circumstances? Why/Why not? Did the customer file pass or fail this step?	An adviser must base all judgements made, in advising the customer, on the customer's relevant circumstances. This includes: • whether the scope of advice is suitable; • the extent of inquiries made into the customer's relevant circumstances (i.e. whether the adviser has identified and inquired about all of the customer's relevant circumstances); • the strategies and financial products investigated and assessed, including existing products; • the strategies and financial products recommended, including why the recommended strategies and products meet the customer's relevant circumstances, and are suitable and in the customer's best interests; • where relevant, how the customer should acquire financial products—for example: – whether personal insurance should be held through the customer's superannuation benefits (and why/why not); and – whether the customer's superannuation should be in an SMSF, industry fund or retail investor directed portfolio service (IDPS) platform (and why/why not); and • whether complying with the best interests duty means that the advice required is not product specific. We consider that, to satisfy s961B(2)(f), a reasonable adviser would believe the customer is likely to be in a better position if the customer follows the advice. In some cases, complying with the best interests duty will require an adviser to give the customer advice that is not product specific and does not result in replacing a financial product or acquiring a new financial product (e.g. a customer seeking to understand when they are able to retire).
Other reasonable steps: s961B(2)(g) Note: This is a safe harbour step.	Has the adviser taken any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the customer, given the customer's relevant circumstances? Why/Why not? Did the file pass or fail this step?	Advisers *may* need to undertake further steps, if they have not already done so—for example: • explain clearly to the customer the advice that is, and is not, being provided (see Section E of RG 244); • when recommending financial products, provide strategic recommendations that benefit the customer; and • offer to provide advice (or refer the customer to someone who can provide advice) on any other key issues identified by the adviser. Advisers must use their judgement in considering whether there are any other steps that need to be taken to ensure they comply with the best interests duty. *Example:* A customer seeks advice on obtaining life insurance only to cover new debt. In the course of providing this advice, the adviser determines that the customer is the single income earner for the customer's family and has no income protection cover. In this case, the adviser should bring this issue to the attention of the customer and offer to provide advice on this issue to the customer.

Key issue	Audit questions	Considerations
Providing appropriate personal advice: s961G	Would it be reasonable to conclude that the advice is appropriate to the customer? Why/Why not? Did the customer file pass or fail this step?	A customer file and SOA should together demonstrate that the customer is likely to be in a better position if they follow the advice. When assessing whether the duty to provide appropriate advice has been complied with, advice reviewers should consider the following: • What were the customer's objectives? • Was each objective satisfied by the advice? Why/why not? • Which aspects of the advice were appropriate? • Which aspects of the advice were not appropriate? • Was the customer likely to be in a better position if they followed the advice (see RG 175.224–RG 175.231)? Deficient switching advice may lead to the adviser failing s961G.
Resulting advice based on incomplete or inaccurate information: s961H	Was the information about the customer's relevant circumstances, on which the advice was based, incomplete or inaccurate? If yes, was the customer given a warning that the advice was based on incomplete or inaccurate information? Why/Why not? Did the customer file pass or fail this step?	Advisers must make reasonable inquiries to obtain complete and accurate information about the customer's relevant circumstances. Personal advice may be provided if an adviser makes reasonable inquiries into the customer's relevant circumstances, even if the customer has not, in fact, provided all the information that the adviser has sought. If it is reasonably apparent, after reasonable inquiries have been made, that information about the customer's relevant circumstances, on which the advice is based, is incomplete or inaccurate, an adviser must warn the customer that: • the advice is, or may be, based on incomplete or inaccurate information relating to the customer's relevant circumstances; and • because of this, the customer should consider the appropriateness of the advice, taking into account their relevant circumstances, before acting on the advice.
Prioritising the customer's interests: s961J	Where there is a known, or reasonably apparent, conflict between the interests of the adviser and the customer, did the adviser prioritise the interests of the customer when giving the advice? Why/Why not? Did the customer file pass or fail this step?	Does the advice, product and/or service create additional revenue or some other form of benefit for the adviser, their advice licensee or another related party? • If yes, can additional benefits for the customer be demonstrated? • If yes, what are these additional benefits and how do they prioritise the interests of the customer? • Would a reasonable adviser without a conflict of interest have provided this advice? Why/why not? This information should be clear in the customer file. Any potential or actual conflicts of interest should be clearly set out in the SOA. Where appropriate, advisers should recommend solutions relevant to the customer's situation that are not product specific (e.g. advice on debt reduction, estate planning, and Centrelink benefits).

Source: ASIC

Appendix 4: Checklist—Key risk indicators for monitoring and supervising advisers

300 Table 13 sets out some key risk indicators (KRIs) that we have observed from this project. Advice licensees can consider using these, as appropriate, for monitoring and supervising advisers in their retail advice businesses. Each licensee should tailor the application of this checklist to the unique nature, scale and complexity of its business. We expect that using these KRIs will help licensees to identify potentially high-risk advisers and non-compliant advice.

301 Before adopting these KRIs, advice licensees should consider:

(a) *identifying the available data*—for example, data may be available from the software and systems used for compliance, revenue and remuneration, financial products, and financial planning;

(b) *determining which data sources will provide reliable data*—when appropriate, this will involve testing. Characteristics of reliable data include consistency and scalability;

(c) *choosing appropriate KRIs* for the nature, scale and complexity of the licensee's particular advice business;

(d) *ensuring appropriate testing is undertaken* when setting thresholds for the KRIs, to minimise the incidence of 'false positive results', while still ensuring the KRI is effective. Consideration should be given to:

   (i) the nature, scale and complexity of the advice business;

   (ii) engagement with senior staff and subject matter experts to set and approve risk thresholds; and

   (iii) research into industry tolerances and risk thresholds; and

(e) *monitoring and testing KRIs* and relevant thresholds on a regular basis to ensure they remain effective and achieve their stated purpose.

Table 13: KRIs for advice licensees to consider when monitoring and supervising advisers

Indicator category	Key risk indicators
Product or advice type	High ratio of records of advice to Statements of Advice provided to customers
	High level of 'execution only' services or evident lack of advice documents
	Variations, spikes and changes in remuneration or revenue of advisers. This may be assessed on a product basis or on an adviser basis
	High level of insurance commission clawbacks and lapse rates
	High level of product replacement
	High level of funds withdrawal from financial products or platforms
	High level of higher-risk or complex strategies and/or products (e.g. gearing, direct share advice, structured products and SMSFs)
	Recommendation of similar advice strategies to all customers (i.e. a 'one-size-fits-all' advice or business model)
	Trend of recommending insurance premium payments to be paid from superannuation when cash flow is raised as a concern by customers

Indicator category	Key risk indicators
Adviser profile	Adverse complaints history in terms of both the number and value of complaints Adverse adviser audit outcomes High level of recorded incidents, issues and events, and breaches Note: The institutions use a variety of terms, similar to and including those in the product or advice category above, to describe and record matters of adviser non-compliance. These matters may result in a breach report to ASIC. Poor training history (e.g. training not completed by due dates or failure rates) Identified personal or behavioural concerns (e.g. gambling habits, financial stress or acute health concerns) Identified conflicts of interest Customer signature irregularities Customer file integrity issues (e.g. unexplained additions, omissions or variations to a customer file) Advisers working in the same office as an identified high-risk adviser
Customer profile	High percentage of advice to elderly or vulnerable customers High percentage of customers in retirement who hold gearing products that may be unsuitable for their circumstances (e.g. customers approaching or in retirement, vulnerable customers, or customers with insufficient cash flow) High percentage of customers approaching retirement, or in retirement, who have an aggressive or assertive risk profile Adviser charging excessive fees relative to the amount being invested by the customer Adverse customer survey results
Other	Adverse results of an ASIC surveillance Adverse results revealed by searching the ASIC registers Any judgements against the adviser, or tribunal or banning decisions Negative or concerning feedback from the business, para-planners and compliance teams Whistleblowing reports Industry-wide risks

Appendix 5: Accessible versions of figures

302 This appendix is for people with visual or other impairments. It provides the underlying data for any figures included in this report.

Table 14: Distribution of advice licensees as at 1 July 2015

Category of advice licensee	Percentage of all advice licensees in industry	Number of advice licensees out of industry total of 3,443
Advice licensees within the institutions	1%	35
Other advice licensees	99%	3,408

Note: This is the data contained in Figure 1.

Table 15: Distribution of advisers as at 1 July 2015

Category of advisers	Percentage of all financial advisers in industry	Number of financial advisers out of industry total of 22,500
Advisers within the institutions	40%	8,888
Advisers in other advice licensees	60%	13,612

Note: This is the data contained in Figure 2.

Table 16: Methods used by the institutions to identify SCC advisers

Method used to identify SCC advisers	Number of SCC advisers identified
Adviser audit	58
Customer complaint	34
Business intelligence or whistleblower	26
Monitoring and supervision systems	17
Product issuer alerted licensee	6
ASIC investigation or review	6
Criminal case (non-financial services)	2

Note: This is the data contained in Figure 3.

Table 17: Effectiveness of adviser audit process for sample files

Outcomes of adviser audit	Number of files	Percentage of total files reviewed
Effective audit process	29	18%
Partially effective audit process	91	57%
Ineffective audit process	40	25%
Total files	160	100%

Note: This is the data contained in Figure 4.

Table 18: Adviser audit outcomes for sample files

Type of audit outcome	Breakdown of findings	Number of sample files
Effective audit	We identified compliance with s961B, 961G and 961J, and the licensee's auditor assessed the files as compliant	29
Partially effective audit	We identified non-compliance with s961B, 961G and 961J, and the licensee's auditor identified some non-compliance	14
Partially effective audit	We identified non-compliance with s961B, 961G and 961J, and the licensee's auditor had commentary on some compliance issues but had not identified non-compliance	49
Partially effective audit	We identified non-compliance with either one or a combination of two of s961B, 961G and 961J, and the licensee's auditor identified some non-compliance	5
Partially effective audit	We identified non-compliance with either one or a combination of two of s961B, 961G and 961J, and the licensee's auditor had commentary on some compliance issues but had not identified non-compliance	23
Ineffective audit	We identified non-compliance with s961B, 961G and 961J, and the licensee's auditor failed to identify any non-compliance	29
Ineffective audit	We identified non-compliance with either one or a combination of two of s961B, 961G and 961J, and the licensee's auditor failed to identify any non-compliance	11
Total files	Not applicable	160

Note: This is the data contained in Figure 5.

Key terms

Term	Meaning in this document
ABA	Australian Bankers' Association
ABA protocol	*Reference checking and information sharing protocol*, issued by the Australian Bankers' Association
advice	Personal advice given to retail clients
advice licensee	An AFS licensee that provides personal advice to retail clients
adviser	A natural person providing personal advice to retail clients on behalf of an AFS licensee who is either: • an authorised representative of an AFS licensee; or • an employee representative of an AFS licensee Note: This is the person to whom the obligations in Div 2 of Pt 7.7A of the Corporations Act apply: see key term definition of 'advice provider' in RG 175.
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act Note: This is a definition contained in s761A.
AMP	AMP Limited
ANZ	Australia and New Zealand Banking Group Limited
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
authorised representative	A person authorised by an AFS licensee, in accordance with s916A or 916B of the Corporations Act, to provide a financial service or services on behalf of the licensee Note: This is a definition contained in s761A.
authorised representative model	Business model used by an advice licensee where the licensee's advisers are predominantly self-employed and appointed as authorised representatives of the licensee
best interests duty	The duty to act in the best interests of the client when giving personal advice to a client as set out in s961B(1) of the Corporations Act
best interests duty and related obligations	The obligations in Div 2 of Pt 7.7A of the Corporations Act

Term	Meaning in this document
business-as-usual audits	Regularly scheduled adviser audits conducted by the Phase 3 licensees as part of their broader audit processes for monitoring adviser compliance with financial services laws and the licensee's business rules Note: See Table 8 for further details about this type of audit.
CBA	Commonwealth Bank of Australia
CFPL	Commonwealth Financial Planning Limited
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
CPL	Commonwealth Private Limited
customer (or client)	Retail client
customer's relevant circumstances	The objectives, financial situation and needs of a customer that would reasonably be considered relevant to the subject matter of advice sought by the customer
data analytics	The analysis of raw data to identify key trends using automated computer processes and statistics
employee representative	A person employed by an AFS licensee, or by a representative of the licensee, to provide a financial service or services on behalf of the licensee
employee representative model	Business model used by an advice licensee where the licensee's advisers are predominantly employees of the licensee
financial advice	Financial product advice
financial adviser	See 'adviser'
financial product	Generally a facility through which, or through the acquisition of which, a person does one or more of the following: • makes a financial investment (see s763B); • manages financial risk (see s763C); • makes non-cash payments (see s763D) Note: See Div 3 of Pt 7.1 of the Corporations Act for the exact definition.
financial product advice	A recommendation or a statement of opinion, or a report of either of these things, that: • is intended to influence a person or persons in making a decision about a particular financial product or class of financial product, or an interest in a particular financial product or class of financial product; or • could reasonably be regarded as being intended to have such an influence. This does not include anything in an exempt document Note: This is a definition contained in s766B of the Corporations Act.

Term	Meaning in this document
financial service	Has the meaning given in s766A of the Corporations Act
FOFA	Future of Financial Advice
GST	Goods and services tax
high-risk adviser	An adviser who poses a higher risk of non-compliant conduct
institutions	Five of Australia's largest banking and financial services institutions, including AMP, ANZ, CBA, NAB and Westpac
key risk indicators (KRIs)	A set of factors that can indicate whether an adviser may be a high-risk adviser
Macquarie Group (or Macquarie)	Macquarie Group Limited
NAB	National Australia Bank Limited
non-compliant advice	Personal advice provided to a retail client by an adviser who has not demonstrated compliance with the relevant provisions of Ch 7 of the Corporations Act, including the best interests duty and related obligations, in providing the advice Note: Further guidance on these provisions is set out in RG 175.
non-compliant (financial) adviser	An adviser whose conduct has been identified as non-compliant
non-compliant conduct (or non-compliance)	Conduct of an adviser that fails to comply with the obligations imposed by: • relevant Commonwealth, state or territory legislation; • the requirements of regulatory bodies; or • a licensee's internal business rules or standards. Non-compliant conduct may include providing non-compliant advice. In Phase 1, non-compliant conduct refers to serious compliance concerns or other compliance concerns
OCC adviser	An adviser whose conduct has given rise to other compliance concerns
other compliance concerns	Where an advice licensee has reason to believe, and has some credible information in support of the concerns identified, that an adviser—in the course of providing financial services (as defined in s766A of the Corporations Act)—may have been involved in misconduct (other than a serious compliance concern), including but not limited to: • a breach by act or omission of the licensee's internal business rules or standards, such as where an adviser has recommended non-approved products, entered into personal agreements or arrangements with customers, demonstrated poor record keeping, or acted outside the scope of their authorisation or competence; • an adverse finding from audits conducted by, or for, the licensee; or • conduct resulting in actual or potential financial loss to customers as a result of the advice received

Term	Meaning in this document
personal advice	Financial product advice that is given or directed to a person who is a retail client in circumstances where the provider of the advice has considered one or more of the person's objectives, financial situation and needs, or a reasonable person might expect the provider to have done so Note: See s766B(3) of the Corporations Act for the exact definition.
Phase 3 licensees	The 10 advice licensees that were selected for Phase 3 of this project: see paragraph 125
retail client	A client as defined in s761G of the Corporations Act and Div 2 of Pt 7.1 of the Corporations Regulations 2001
RG 256 (for example)	An ASIC Regulatory Guide (in this example numbered 256)
s912A (for example)	A section of the Corporations Act (in this example numbered 912A)
sample advisers	The 40 advisers that we selected from the Phase 3 licensees
sample files	The 160 customer files that we selected from the files that had been reviewed by the Phase 3 licensees—either as part of their business-as-usual adviser audit, or as part of an ASIC-directed audit—for each of the sample advisers: see paragraph 137
SCC adviser	An adviser whose conduct has given rise to serious compliance concerns
serious compliance concerns	Where an advice licensee believes, and has some credible information in support of the concerns identified, that an adviser—in the course of providing financial services (as defined in s766A of the Corporations Act)—may have engaged in the following: • dishonest, illegal, deceptive, and/or fraudulent misconduct; • any misconduct that, if proven, would be likely to result in the instant dismissal or immediate termination of the adviser; • deliberate non-compliance with financial services laws; or • gross incompetence or gross negligence.
SMSF	Self-managed superannuation fund
SOA	Statement of Advice
switching advice	Advice that recommends that a customer replaces one financial product with another
Westpac	Westpac Banking Corporation

Related information

Headnotes

advice licensee, advice review checklist, adviser audit process, AFS licensee, background and reference checking, banking and financial services institutions, best interests duty, breach reporting, client compensation, customer files, customer review and remediation, data analytics, external expert assurance, financial advisers, key risk indicators, KRIs, monitoring and supervision processes, non-compliance, non-compliant advice, other compliance concerns, serious compliance concerns

Instruments

[CO 14/923] *Record-keeping obligations for Australian financial services licensees when giving personal advice*

Regulatory guides

RG 78 *Breach reporting by AFS licensees*

RG 79 *Research report providers: Improving the quality of investment research*

RG 90 *Example Statement of Advice: Scaled advice for a new client*

RG 104 *Licensing: Meeting the general obligations*

RG 146 *Licensing: Training of financial product advisers*

RG 175 *Licensing: Financial product advisers—conduct and disclosure*

RG 244 *Giving information, general advice and scaled advice*

RG 256 *Client review and remediation conducted by advice licensees*

Information sheets

INFO 151 *ASIC's approach to enforcement*

INFO 182 *Super switching advice—Complying with your obligations*

INFO 205 *Advice on self-managed superannuation funds: Disclosure of risks*

INFO 206 *Advice on self-managed superannuation funds: Disclosure of costs*

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Legislation

Corporations Act, Div 2 of Pt 7.7A; s761A, 761G, 763B, 763C, 763D, 766A, 766B(3), 912A, 912D, 913B, 916A, 916B, 922C, 961B, 961G, 961H, 961J

Corporations Regulations, Div 2 of Pt 7.1

Corporations Amendment (Professional Standards of Financial Advisers) Act 2017

Consultation papers and reports

CP 247 *Client review and remediation programs and update to record-keeping requirements*

REP 251 *Review of financial advice industry practice*

REP 298 *Adequacy of risk management systems of responsible entities*

REP 337 *SMSFs: Improving the quality of advice given to investors*

REP 362 *Review of financial advice industry practice: Phase* 2

REP 413 *Review of retail life insurance advice*

REP 499 *Financial advice: Fees for no service*

Media and other releases

11-229MR *ASIC accepts enforceable undertaking from Commonwealth Financial Planning*

13-010MR *ASIC accepts enforceable undertaking from Macquarie Equities Limited*

14-201MR *Macquarie Equities' financial advice remediation*

15-022MR *Macquarie Equities Limited enforceable undertaking and next steps*

15-083MR *Update on licence conditions on two Commonwealth Bank financial planning businesses: ASIC releases initial report into advice compensation program*

15-306MR *National Australia Bank to implement a large-scale financial advice remediation program*

16-239MR *ASIC bans North Queensland financial adviser*

16-362MR *ASIC clarifies record-keeping obligations for financial services licensees*

16-415MR *Update on licence conditions of two CBA financial advice businesses: ASIC releases compliance report from KordaMentha Forensic*

Other publications

ASIC's Corporate Plan 2016–17 to 2019–20

Australian Bankers' Association, Reference checking and information sharing protocol (ABA protocol)

Commonwealth Bank, Open Advice Review program

Financial Ombudsman Service, Terms of reference

Standards Australia's Handbook HB 322-2007, Reference checking in the financial services industry (reference-checking handbook)

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Friday 17 March 2017

17-068MR ASIC reports on how large financial advice firms have dealt with poor advisers

ASIC has today released the findings of its review of how Australia's largest financial advice firms have dealt with past poor advice and non-compliant advisers, including how these firms have dealt with affected customers.

The review—which forms part of ASIC's broader Wealth Management Project—was focussed on the conduct of the financial advice arms of AMP, ANZ, CBA, NAB and Westpac. It arose out of serious concerns about past adviser misconduct, and had the broad objective of lifting standards in major financial advice providers.

The review looked at:

- how the firms identified and dealt with non-compliant conduct by their advisers between 1 January 2009 and 30 June 2015
- the development and implementation by the firms of large-scale review and remediation frameworks to remediate customers impacted by non-compliant advice, and
- the processes used to monitor and supervise the firms' advisers, focussing on background and reference-checking, the adviser audit process and use of data analytics.

ASIC Report 515 *Financial advice: Review of how large institutions oversee their advisers* (REP 515) covers the key findings of this review and also provides an update on ASIC's actions against the advisers who have been identified as raising serious compliance concerns, as well as the institutions' progress in developing review and remediation programs.

As of 31 December 2016, ASIC had banned 26 advisers identified in this review who demonstrated serious compliance concerns, and has ongoing investigations or surveillance activities in relation to many others.

A total of approximately $30 million has been paid to 1,347 customers who suffered loss or detriment as a result of non-compliant conduct by advisers during the period of this review. (This amount is in addition to the compensation being paid by the institutions as part of the 'fee for no service' compensation payments set out in Report 499 *Financial advice: Fees for no service* (REP 499)).

ASIC Deputy Chairman Peter Kell said, 'ASIC's report sets out the significant work that has been done by the major financial advice institutions to implement large-scale review and remediation programs to identify and remediate customers impacted by poor advice given in the past. ASIC is working closely with these institutions as they deal with customers who have been affected by the past non-compliant advice. The programs all have third-party oversight and assurance.'

'ASIC acknowledges the work undertaken by the financial advice institutions to improve their practices, and broader compliance approach, since the period of conduct under review, supported by recent legislative and regulatory reforms.

'However, there is further work to be done to assist in re-building consumer trust and confidence in the financial advice industry,' he said.

ASIC identified a number of areas of concern where further improvements need to be made, including:

- failure to notify ASIC about serious non-compliance concerns regarding adviser conduct
- significant delays between the institution first becoming aware of the misconduct and reporting it to ASIC
- inadequate background and reference-checking processes, and
- inadequate audit processes to assess whether the advice complied with the 'best interest' duty and other obligations.

Mr Kell said, 'Failure or delay in notifying ASIC of suspected serious non-compliant conduct significantly affects our ability to take appropriate enforcement or other regulatory action. More importantly, it may also result in an increased risk of customer detriment as so-called 'bad apple' advisers continue to work in the industry.'

'Strengthening breach reporting requirements will be an important issue in the current review of ASIC's enforcement powers announced by Government in October 2016,' he said.

ASIC acknowledged the Australian Bankers' Association's recently announced Reference Checking and Information Sharing Protocol. 'There will be considerable focus on the operation of this protocol, and we encourage the industry to take a rigorous approach to ensure it is effective so that we see rapid improvements in the checking and provision of adviser references,' said Mr Kell.

ASIC also welcomes the development of data analytics and key risk indicator tools by all of the advice institutions to improve the early identification of potentially non-compliant advice.

ASIC has developed a number of checklists for all advice licensees and compliance consultants to consider when:

- conducting background and reference checks before appointing a new adviser (refer Appendix 2 of REP 515)
- auditing advisers to assess their compliance with the best interests duty and related obligations when providing personal advice (refer Appendix 3 of REP 515), and
- developing and implementing Key Risk Indicators to identify high-risk advisers (refer Appendix 4 of REP 515).

'It is critical that customers are able to get financial advice they can trust. ASIC expects internal processes to support core values of putting the customer first and where there are failings, for advice firms to act quickly to provide a response in the interests of their customers. This is a message for both large and small advice firms,' Mr Kell said.

ASIC's MoneySmart website has a new financial advice toolkit to help clients navigate the financial advice process and understand what service they should expect from an adviser. It also has useful information about what to do if you want to make a complaint about your adviser.

Download

REP 515 *Financial advice: Review of how large institutions oversee their advisers* and checklists

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Tuesday 20 February 2018

18-049MR Update on Advice Compliance Report: Additional $21.4 million compensation paid to customers

Australia's five largest banking and financial services institutions have now paid a further $21.4 million in compensation to customers who suffered loss or detriment as a result of non-compliant conduct by financial advisers.

This compensation relates to advice identified in the ASIC March 2017 Report 515 *Financial advice: Review of how large institutions oversee their advisers* (REP 515). REP 515 outlined ASIC's observations and findings from its Advice Compliance Project. This additional compensation brings the overall compensation total for matters covered by REP 515 to $51.4 million.

REP 515 reviewed advice compliance at AMP, ANZ, CBA, NAB and Westpac. In addition to reviewing the effectiveness of adviser oversight, the project reported on work being undertaken by these institutions to identify and compensate customers affected by non-compliant advice provided between 1 January 2009 and 30 June 2015.

As reported in REP 515, at 31 December 2016, approximately $30 million had been paid (or offered to be paid) by the institutions to approximately 1,347 customers who had suffered loss as a result of advice failings by 97 high risk advisers identified at that time.

The institutions have since made an additional $21.4 million in payments to more than 1,687 customers. The table below updates the figures that were reported in REP 515 and is current to 31 December 2017. ASIC expects further compensation to be paid, but the amount of compensation and number of potentially affected customers is not known at this stage.

Compensation payment update

Compensation type	AMP	ANZ	CBA	NAB	Westpac

Compensation type	AMP	ANZ	CBA	NAB	Westpac
Compensation paid under the review and remediation framework developed as part of this project	$8,481,742 (1192 customers) (11 advisers)	$3,036,164 (245 customers) (9 advisers)	N/A	$1,431,482 (103 customers) (9 advisers)	$4,510,890 (137 customers) (11 advisers)
Compensation paid under previous or existing remediation processes	$5,047,871 (17 customers) (4 advisers)	$6,677,105 (182 customers) (11 advisers)	$6,575,952 (501 customers) (12 advisers)	$815,694 (82 customers) (3 advisers)	$6,862,021 (250 customers) (13 advisers)
Compensation paid under complaints process	$1,193,034 (57 customers) (15 advisers)	$1,530,804 (127 customers) (23 advisers)	$1,091,748 (27 customers) (11 advisers)	$2,512,570 (70 customers) (25 advisers)	$1,632,802 (44 customers) (14 advisers)
Total compensation paid including under remediation and complaints	$14,722,648 (1266 customers) (24 advisers)	$11,244,073 (554 customers) (29 advisers)	$7,667,700 (528 customers) (17 advisers)	$4,759,746 (255 customers) (26 advisers)	$13,005,713 (431 customers) (17 advisers)

Note 1: The data in this table has been compiled and interpreted by ASIC from the information received from the institutions. It relates to the currently identified high-risk advisers whose non-compliant conduct occurred between 1 January 2009 and 30 June 2015. It is current up to 31 December 2017 and differs from REP 515 in that it only includes amounts actually paid to clients.

Note 2: The compensation figures are rounded to the nearest dollar.

Note 3: An adviser or a customer can appear under more than one compensation type.

Note 4: As part of its pilot work under the review and remediation framework developed as part of this project, NAB focused on an adviser whose non-compliant conduct commenced before 1 January 2009. NAB has paid $11,633,831 as compensation to affected customers (as at 31 December 2017). These figures do not appear in this table.

Note 5: The figures recorded for CBA do not include compensation amounts paid under its other large-scale remediation programs as noted in 15-083MR, 16-415MR and CBA's Open Advice Review Program.

Note 6: The figures recorded in this table do not include the compensation amounts paid in relation to fees-for-no-service issues, as noted in REP 499 and 17-438MR.

Source: Institutions, ASIC

Remediation program progress update

All institutions are reviewing the advice received by customers of their identified high risk advisers.

ASIC continues to oversee the implementation and expert assurance of the remediation work undertaken by the institutions. The institutions are also undertaking, and seeking expert assurance of, work to identify any high-risk advisers not identified by their previous monitoring and supervision processes.

ASIC committed to providing regular reports on the progress of the remediation being made to customers who suffered a loss or detriment.

In addition, ASIC has ongoing investigation or surveillance activities in relation to more than 50 individual advisers within the scope of the work in REP 515. ASIC will publicly report on the outcomes from these activities as they progress.

As at 31 January 2018, ASIC has publicly reported upon regulatory outcomes achieved in relation to 42 advisers who fall within the scope of the work in REP 515.

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Friday 13 April 2018

18-102MR ASIC accepts enforceable undertaking from Commonwealth Bank subsidiaries for Fees For No Service conduct

ASIC has accepted an enforceable undertaking (EU) from Commonwealth Financial Planning Limited (CFPL) and BW Financial Advice Limited (BWFA), both wholly owned subsidiaries of the Commonwealth Bank of Australia (CBA). ASIC found that CFPL and BWFA failed to provide, or failed to locate evidence regarding the provision of, annual reviews to approximately 31,500 'Ongoing Service' customers in the period from July 2007 to June 2015 (for CFPL) and from November 2010 to June 2015 (for BWFA).

The EU requires, among other things:

a. CFPL and BWFA to pay a community benefit payment of $3 million in total;
b. CFPL to provide an attestation from senior management setting out the material changes that have been made to CFPL's compliance systems and processes in response to the misconduct; and
c. CFPL to provide further attestations from senior management, supported by an expert report, that:
    - CFPL's compliance systems and processes are now reasonably adequate to track CFPL's contractual obligations to its Ongoing Service clients; and
    - CFPL has taken reasonable steps to identify and remediate its Ongoing Service customers to whom CFPL did not provide annual reviews in the period from July 2015 to January 2018.

As BWFA ceased trading in October 2016, CFPL is the focus of the compliance improvements required under the EU.

ASIC Deputy Chair Peter Kell said, 'Our report into Fees For No Service in October 2016 identified the major financial institutions' systemic failures in this area, and called for fair compensation to be paid to customers who did not receive the advice reviews that they were promised and paid for.

'This enforceable undertaking follows on from the earlier enforceable undertaking accepted by ASIC in relation to ANZ's fees for no service conduct. These failures show that all too often the financial institutions prioritised revenue and fee generation over the delivery of advice and services paid for by their customers.'

In addition to the EU, CFPL and BWFA have also agreed to compensate approximately 31,500 affected customers in the period from July 2007 to June 2015 (for CFPL) and from November 2010 to June 2015 (for BWFA). The compensation program is nearing completion and as at 28 February 2018, CFPL and BWFA have paid or offered to pay approximately $88 million (plus interest) to these customers (with the total compensation estimated at $88.6 million (plus interest)).

Background

The EU follows an ASIC investigation into CFPL and BWFA in relation to their fees for no service conduct concerning various Ongoing Service packages which were offered to CFPL and BWFA financial planning customers for an annual fee. A key component of those packages from about 2004 (for CFPL) and from 2010 (for BWFA) was the provision of an annual review of the customer's financial plan.

As a result of the investigation, ASIC was concerned that:

a. CFPL and BWFA either did not provide, or have not identified evidence regarding the provision of, annual reviews to approximately 31,500 Ongoing Service customers who had paid for those reviews;
b. CFPL and BWFA did not have adequate systems and processes in place for tracking their Ongoing Service customers and ensuring that annual reviews were provided to them;
c. senior management were aware from at least mid-2012 that a relatively small number of CFPL Ongoing Service customers who were not assigned to an active adviser may not have received an annual review, and that there was a potential risk of a broader 'fees for no service' issue in relation to other Ongoing Service customers, but CFPL did not notify ASIC of the issue until July 2014; and
d. CFPL and BWFA failed to comply with section 912A(1)(a) of the Corporations Act which provides that a financial services licensee must do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly, and a condition of their respective Australian financial services licence.

Both CFPL and BWFA have acknowledged in the EU that ASIC's concerns were reasonably held.

View the enforceable undertaking here.

The EU has been accepted by ASIC as part of ASIC's Wealth Management Project to address systemic failures by financial institutions and advisers, over a number of years, to provide ongoing advice services to customers who paid fees to receive those services (commonly referred to by ASIC as Fees for No Service conduct). A report on ASIC's work in this area was released in October 2016 (Report 499), and updated in May 2017 (17-145MR) and December 2017 (17-438MR).

ASIC's media release in relation to the ANZ fees for no service enforceable undertaking referred to above is available here (18-092MR).

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Friday 15 December 2017

17-438MR Update on financial advice institutions fees-for-no-service refund programs

AMP, ANZ, CBA, NAB and Westpac have now paid or offered customers $215.9 million of an estimated $219.5 million in refunds and interest for failing to provide general or personal advice to customers while charging them ongoing advice fees.

This is an additional $155 million in payments and offers since the ASIC's last public update on the fees-for-no-service project, which provided compensation figures as at 21 April 2017.

The table provides compensation payments and estimates for fees for no service failures that were reported to ASIC as at 31 October 2017. The institutions' total estimates have changed over the past six months as they investigated the compensation required and in some cases identified new failures.

Group	Compensation paid or offered	Estimated future compensation (excludes interest)	Total estimate
AMP	$4,715,188	Not yet available	$4,715,188
ANZ	$49,178,004	$712,785	$49,890,789
CBA	$117,671,810	$1,517,690	$119,189,500
NAB	$5,413,535	$1,289,404	$6,702,939
Westpac	$3,113,159	Not yet available (1)	$3,113,159
Total (personal advice failures)	**$180,091,696**	**$3,519,879**	**$183,611,575**
NULIS Nominees (Australia) Ltd (2) (no changes)	$35,900,408	Nil	$35,900,408
Total (personal and general advice failures)	**$215,992,104**	**$3,519,879**	**$219,511,983**

Source: Data reported by the institutions to ASIC as at 31 October 2017.

Next steps

ASIC will continue to monitor the institutions' compensation programs and supervise the institutions' further reviews to determine whether any additional instances of fees being charged without advice being provided are identified. We will provide another public update in mid-2018.

Background

In October 2016 the Australian Securities and Investments Commission (ASIC) released Report 499 *Financial advice: fees for no service* (REP 499). The report described systemic failures of the advice divisions of the largest banks and AMP, as well as some of their product issuers, to ensure that ongoing advice services were provided to customers who paid fees to receive these services, the failure of advisers to provide such services, and the failure of product issuers to switch off advice fees of customers who did not have a financial adviser.

At the time of the publication of the report compensation arising from the fee-for-service failures reported to ASIC was approximately $23.7 million, which had been paid, or agreed to be paid, to more than 27,000 customers.

Since REP 499 a further $192 million has been paid or offered to over 276,000 customers.

MoneySmart

Customers who are paying ongoing advice fees for services they do not need can ask for those fees to be switched off. Customers who have paid fees for services they did not receive may be entitled to refunds and compensation, and should lodge a complaint through the bank or licensee's internal dispute resolution system or the Financial Ombudsman Service.

ASIC's MoneySmart website explains how customers can check they are getting the financial advice they paid for. It also has a financial advice toolkit to help customers navigate the financial advice process and understand what they should expect from an adviser, and useful information about how to make a complaint.

Table notes

(1) At the time of publication Westpac had not determined the size of future compensation.

(2) The table shows compensation paid by NAB's superannuation trustee, NULIS Nominees (Australia) Limited (NULIS), for two breaches involving failures in relation to the provision of general advice services to superannuation members who paid general advice fees (other fees referred to in this release relate to personal advice).

As announced by ASIC on 2 February 2017 ASIC imposed additional licence conditions on NULIS following this and another breach: ASIC media release 17-022MR.

The failure was by MLC Nominees Pty Ltd and MLC Limited. While on 1 July 2016 the superannuation assets governed by MLC Nominees were transferred by successor fund transfer to NULIS, and on 3 October 2016 NAB divested 80% of its shareholding in the MLC Limited Life Insurance business, accountability for this remediation activity (including compensation) remains within the NAB Group.

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Friday 19 May 2017

17-145MR Compensation update: major financial advisory institutions continue refund programs for fees-for-no-service

AMP, ANZ, CBA, NAB and Westpac have so far repaid more than $60 million of an expected $200 million-plus total in refunds and interest for failing to provide general or personal financial advice to customers while charging them ongoing advice fees.

These institutions' total compensation estimates for these advice delivery failures now stand at more than $204 million, plus interest. As foreshadowed in ASIC's Report 499 *Financial advice: fees for no service* (REP499), ASIC can now provide an update on compensation outcomes to date.

Background

In October 2016 the Australian Securities and Investments Commission (ASIC) released REP499. The report covered advice divisions of the big four banks and AMP and described systemic failures to ensure that ongoing advice services were provided to customers who paid fees to receive these services, and the failure of advisers to provide such services. The report also discussed the systemic failure of product issuers to stop charging ongoing advice fees to customers who did not have a financial adviser.

At the time of the publication of the report compensation arising from the fee-for-service failures reported to ASIC was approximately $23.7 million, which had been paid, or agreed to be paid, to more than 27,000 customers.

Since REP 499 a further $37 million has been paid or offered to more than 18,000 customers. In addition, the institutions' estimates of total required compensation for general and personal advice failures have increased by approximately 15% to more than $204 million, plus interest.

The table provides, at an institution level, compensation payments and estimates that were reported to ASIC as at 21 April 2017. Since that date compensation figures have continued to increase.

Group	Compensation paid or offered	Estimated future compensation (excludes interest)	Total (estimate, excludes interest)
AMP	$3,816,327	$603,387	$4,419,714

ANZ	$43,818,571	$8,613,001	$52,431,572
CBA	$5,850,827	$99,786,760	$105,637,587
NAB	$4,641,539	$385,844	$5,027,383
Westpac	$2,670,479	Not yet available	$2,670,479
Total (personal advice failures)	**$60,797,743**	**$109,388,992**	**$170,186,735**
NULIS Nominees (Australia) Ltd (1)	Nil	$34,720,614	$34,720,614
Total (personal and general advice failures)	**$60,797,743**	**$144,109,606**	**$204,907,349**

Source: Data is based on estimates provided to ASIC by the institutions and will change as the reviews to determine customer impact continue.

(1) For details, see the section on NAB below.

Key compensation developments

AMP

- AMP's total compensation estimate decreased from $4.6 million to $4.4 million as AMP reviewed customer files and data to determine compensation required, and revised its previous estimates.

ANZ

- The total compensation estimate has increased from $49.7 million to $52.4 million due to the expansion of existing compensation programs and the identification of further failures by authorised representatives of two ANZ-owned advice businesses:
    - Financial Services Partners Pty Ltd; and
    - RI Advice Group Pty Ltd.
- The largest component of ANZ's compensation program relates to fees customers were charged for the Prime Access service, where ANZ could not find evidence of a statement of advice or record of advice for each annual review period.
- In addition, ANZ found that further compensation of approximately $7.5 million is required to be paid to ANZ Prime Access customers for ANZ's failure to rebate commissions in line with its agreement with customers. This compensation has not been included in the figures in this media release because it does not relate to a failure to provide advice for which customers were charged, but is noted for completeness and transparency.

CBA

- There has been no substantial change in CBA's compensation estimate, which remains at approximately $105 million, plus interest, the majority of which relates to Commonwealth Financial Planning Ltd (CFPL). The compensation estimate for CFPL results from a customer-focused methodology whereby, as well as providing refunds where the adviser failed to contact the client to provide an annual review, CFPL will provide fee refunds to customers where:
  - the adviser offered the customer an annual review and the customer declined, or -
  - the adviser tried to contact the customer to offer a review, but was unable to contact the customer.
- Some of the other licensees or banks covered by the ASIC fees-for-no-service project have not, at this stage, adopted a similar customer-focused approach to the situation in which a service was offered but not delivered. ASIC continues to discuss the approach to this situation with these banks and licensees.

NAB

- Since the publication of REP 499, by 21 April 2017, NAB reported to ASIC the further erroneous deduction of adviser service fees for personal advice from more than 3,000 customers of the following licensees:
  - Apogee Financial Planning Ltd: $11,978, from 11 customers;
  - GWM Adviser Services Ltd: $179,446, from 290 customers;
  - MLC Investments Ltd: $9,755, from six customers;
  - National Australia Bank Ltd: $2,777, from seven customers; and
  - NULIS: $173,120, from 3,310 customers.
- In addition, the table shows the expected compensation of approximately $34.7 million by NAB's superannuation trustee, NULIS Nominees (Australia) Limited (NULIS), for two breaches involving failures in relation to the provision of general advice services to superannuation members who paid general advice fees (other fees referred to in this release relate to personal advice). As announced by ASIC on 2 February 2017 ASIC has imposed additional licence conditions on NULIS following these and another breach: ASIC MR 17-022. The failure was by MLC Nominees Pty Ltd (and MLC Limited for the first of the two breaches). Whilst on 1 July 2016 the superannuation assets governed by MLC Nominees were transferred by successor fund transfer to NULIS, and on 3 October 2016 NAB divested 80% of its shareholding in the MLC Limited Life Insurance business, accountability for this remediation activity (including compensation) remains within the NAB Group. The estimate of customer accounts affected has increased from approximately 108,867 to 220,460 since REP 499, reflecting the second of two breaches.

Westpac

- REP 499 noted that Westpac had identified a systemic fees-for-no-service issue in relation to one adviser only, with compensation of $1.2 million paid in relation to those failures.
- Following further ASIC enquiries, Westpac subsequently clarified that it has paid further compensation of approximately $1.4 million to 161 customers of that adviser and 14 further advisers, in respect for fee-for-no-service failures in the period 1 July 2008 to 31 December 2015.

Next steps

ASIC will continue to monitor these compensation programs and will provide another public update by the end of 2017. In addition ASIC will continue to supervise the institutions' further reviews to determine whether any additional instances are identified of fees being charged without advice being provided.

MoneySmart

Customers who are paying ongoing advice fees for services they do not need can ask for those fees to be switched off. Customers who have paid fees for services they did not receive may be entitled to refunds and compensation, and should lodge a complaint through the bank or licensee's internal dispute resolution system or the Financial Ombudsman Service.

ASIC's MoneySmart website has a financial advice toolkit to help customers navigate the financial advice process and understand what they should expect from an adviser. It also has useful information about how to make a complaint.

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Thursday 16 April 2015

15-081MR ASIC update on Wealth Management Project - Investigation into charging of advice fees without providing advice

ASIC today provided an update on its Wealth Management Project which is focusing on the conduct of the largest financial advice firms.

ASIC is investigating multiple instances of licensees charging clients for financial advice, including annual advice reviews, where the advice was not provided. Most of the fees have been charged as part of a client's service agreement with their financial adviser.

Deputy Chairman, Peter Kell said: 'ASIC will consider all regulatory options, including enforcement action, where we find evidence of breaches of the law relating to fees being charged where no advice service has been provided. We will look to ensure that advice licensees follow a proper process of customer remediation and reimbursement of fees where such breaches have occurred.'

The ASIC Wealth Management Project was established in October last year with the objective of lifting standards in major financial advice providers. Under this project ASIC is carrying a number of investigations and is conducting a range of proactive risk-based surveillances with particular focus on compliance in large financial institutions.

ASIC's investigations are continuing.

Background

ASIC set up the specialist Wealth Management Project in October 2014 (refer: Senate Estimates: Opening statement - February 2015)

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Friday 17 March 2017

17-068MR ASIC reports on how large financial advice firms have dealt with poor advisers

ASIC has today released the findings of its review of how Australia's largest financial advice firms have dealt with past poor advice and non-compliant advisers, including how these firms have dealt with affected customers.

The review—which forms part of ASIC's broader Wealth Management Project—was focussed on the conduct of the financial advice arms of AMP, ANZ, CBA, NAB and Westpac. It arose out of serious concerns about past adviser misconduct, and had the broad objective of lifting standards in major financial advice providers.

The review looked at:

- how the firms identified and dealt with non-compliant conduct by their advisers between 1 January 2009 and 30 June 2015
- the development and implementation by the firms of large-scale review and remediation frameworks to remediate customers impacted by non-compliant advice, and
- the processes used to monitor and supervise the firms' advisers, focussing on background and reference-checking, the adviser audit process and use of data analytics.

ASIC Report 515 *Financial advice: Review of how large institutions oversee their advisers* (REP 515) covers the key findings of this review and also provides an update on ASIC's actions against the advisers who have been identified as raising serious compliance concerns, as well as the institutions' progress in developing review and remediation programs.

As of 31 December 2016, ASIC had banned 26 advisers identified in this review who demonstrated serious compliance concerns, and has ongoing investigations or surveillance activities in relation to many others.

A total of approximately $30 million has been paid to 1,347 customers who suffered loss or detriment as a result of non-compliant conduct by advisers during the period of this review. (This amount is in addition to the compensation being paid by the institutions as part of the 'fee for no service' compensation payments set out in Report 499 *Financial advice: Fees for no service* (REP 499)).

ASIC Deputy Chairman Peter Kell said, 'ASIC's report sets out the significant work that has been done by the major financial advice institutions to implement large-scale review and remediation programs to identify and remediate customers impacted by poor advice given in the past. ASIC is working closely with these institutions as they deal with customers who have been affected by the past non-compliant advice. The programs all have third-party oversight and assurance.'

'ASIC acknowledges the work undertaken by the financial advice institutions to improve their practices, and broader compliance approach, since the period of conduct under review, supported by recent legislative and regulatory reforms.

'However, there is further work to be done to assist in re-building consumer trust and confidence in the financial advice industry,' he said.

ASIC identified a number of areas of concern where further improvements need to be made, including:

- failure to notify ASIC about serious non-compliance concerns regarding adviser conduct
- significant delays between the institution first becoming aware of the misconduct and reporting it to ASIC
- inadequate background and reference-checking processes, and
- inadequate audit processes to assess whether the advice complied with the 'best interest' duty and other obligations.

Mr Kell said, 'Failure or delay in notifying ASIC of suspected serious non-compliant conduct significantly affects our ability to take appropriate enforcement or other regulatory action. More importantly, it may also result in an increased risk of customer detriment as so-called 'bad apple' advisers continue to work in the industry.'

'Strengthening breach reporting requirements will be an important issue in the current review of ASIC's enforcement powers announced by Government in October 2016,' he said.

ASIC acknowledged the Australian Bankers' Association's recently announced Reference Checking and Information Sharing Protocol. 'There will be considerable focus on the operation of this protocol, and we encourage the industry to take a rigorous approach to ensure it is effective so that we see rapid improvements in the checking and provision of adviser references,' said Mr Kell.

ASIC also welcomes the development of data analytics and key risk indicator tools by all of the advice institutions to improve the early identification of potentially non-compliant advice.

ASIC has developed a number of checklists for all advice licensees and compliance consultants to consider when:

- conducting background and reference checks before appointing a new adviser (refer Appendix 2 of REP 515)
- auditing advisers to assess their compliance with the best interests duty and related obligations when providing personal advice (refer Appendix 3 of REP 515), and
- developing and implementing Key Risk Indicators to identify high-risk advisers (refer Appendix 4 of REP 515).

'It is critical that customers are able to get financial advice they can trust. ASIC expects internal processes to support core values of putting the customer first and where there are failings, for advice firms to act quickly to provide a response in the interests of their customers. This is a message for both large and small advice firms,' Mr Kell said.

ASIC's MoneySmart website has a new financial advice toolkit to help clients navigate the financial advice process and understand what service they should expect from an adviser. It also has useful information about what to do if you want to make a complaint about your adviser.

Download

REP 515 *Financial advice: Review of how large institutions oversee their advisers* and checklists

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Tuesday 20 February 2018

18-049MR Update on Advice Compliance Report: Additional $21.4 million compensation paid to customers

Australia's five largest banking and financial services institutions have now paid a further $21.4 million in compensation to customers who suffered loss or detriment as a result of non-compliant conduct by financial advisers.

This compensation relates to advice identified in the ASIC March 2017 Report 515 *Financial advice: Review of how large institutions oversee their advisers* (REP 515). REP 515 outlined ASIC's observations and findings from its Advice Compliance Project. This additional compensation brings the overall compensation total for matters covered by REP 515 to $51.4 million.

REP 515 reviewed advice compliance at AMP, ANZ, CBA, NAB and Westpac. In addition to reviewing the effectiveness of adviser oversight, the project reported on work being undertaken by these institutions to identify and compensate customers affected by non-compliant advice provided between 1 January 2009 and 30 June 2015.

As reported in REP 515, at 31 December 2016, approximately $30 million had been paid (or offered to be paid) by the institutions to approximately 1,347 customers who had suffered loss as a result of advice failings by 97 high risk advisers identified at that time.

The institutions have since made an additional $21.4 million in payments to more than 1,687 customers. The table below updates the figures that were reported in REP 515 and is current to 31 December 2017. ASIC expects further compensation to be paid, but the amount of compensation and number of potentially affected customers is not known at this stage.

Compensation payment update

Compensation type	AMP	ANZ	CBA	NAB	Westpac

Compensation type	AMP	ANZ	CBA	NAB	Westpac
Compensation paid under the review and remediation framework developed as part of this project	$8,481,742 (1192 customers) (11 advisers)	$3,036,164 (245 customers) (9 advisers)	N/A	$1,431,482 (103 customers) (9 advisers)	$4,510,890 (137 customers) (11 advisers)
Compensation paid under previous or existing remediation processes	$5,047,871 (17 customers) (4 advisers)	$6,677,105 (182 customers) (11 advisers)	$6,575,952 (501 customers) (12 advisers)	$815,694 (82 customers) (3 advisers)	$6,862,021 (250 customers) (13 advisers)
Compensation paid under complaints process	$1,193,034 (57 customers) (15 advisers)	$1,530,804 (127 customers) (23 advisers)	$1,091,748 (27 customers) (11 advisers)	$2,512,570 (70 customers) (25 advisers)	$1,632,802 (44 customers) (14 advisers)
Total compensation paid including under remediation and complaints	$14,722,648 (1266 customers) (24 advisers)	$11,244,073 (554 customers) (29 advisers)	$7,667,700 (528 customers) (17 advisers)	$4,759,746 (255 customers) (26 advisers)	$13,005,713 (431 customers) (17 advisers)

Note 1: The data in this table has been compiled and interpreted by ASIC from the information received from the institutions. It relates to the currently identified high-risk advisers whose non-compliant conduct occurred between 1 January 2009 and 30 June 2015. It is current up to 31 December 2017 and differs from REP 515 in that it only includes amounts actually paid to clients.

Note 2: The compensation figures are rounded to the nearest dollar.

Note 3: An adviser or a customer can appear under more than one compensation type.

Note 4: As part of its pilot work under the review and remediation framework developed as part of this project, NAB focused on an adviser whose non-compliant conduct commenced before 1 January 2009. NAB has paid $11,633,831 as compensation to affected customers (as at 31 December 2017). These figures do not appear in this table.

Note 5: The figures recorded for CBA do not include compensation amounts paid under its other large-scale remediation programs as noted in 15-083MR, 16-415MR and CBA's Open Advice Review Program.

Note 6: The figures recorded in this table do not include the compensation amounts paid in relation to fees-for-no-service issues, as noted in REP 499 and 17-438MR.

Source: Institutions, ASIC

Remediation program progress update

All institutions are reviewing the advice received by customers of their identified high risk advisers.

ASIC continues to oversee the implementation and expert assurance of the remediation work undertaken by the institutions. The institutions are also undertaking, and seeking expert assurance of, work to identify any high-risk advisers not identified by their previous monitoring and supervision processes.

ASIC committed to providing regular reports on the progress of the remediation being made to customers who suffered a loss or detriment.

In addition, ASIC has ongoing investigation or surveillance activities in relation to more than 50 individual advisers within the scope of the work in REP 515. ASIC will publicly report on the outcomes from these activities as they progress.

As at 31 January 2018, ASIC has publicly reported upon regulatory outcomes achieved in relation to 42 advisers who fall within the scope of the work in REP 515.

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Thursday 9 March 2017

17-056MR ASIC and ASBFEO join forces to ensure bank lenders meet unfair contract laws

Australian Government | Australian Small Business and Family Enterprise Ombudsman | ASIC Australian Securities & Investments Commission

Australian lenders including the country's big four banks have substantial work to do to eliminate unfair terms from their loan agreements, a joint review of small business standard form contracts undertaken by ASIC and the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) has revealed.

ASIC and the ASBFEO reviewed small business loan contracts from eight lenders and found there's been a failure to take sufficient steps to comply with their new obligations under unfair contract terms (UCT) legislation.

This is despite being provided with a one year transition period, ahead of last year's November implementation deadline.

ASIC and the ASBFEO are sending a very clear message that lenders need to immediately take steps to ensure their standard form loan agreements fully comply with the new legislation.

In their initial review ASIC and the ASBFEO found lenders continue to use clauses of concern such as:

- Terms that give lenders a very broad discretion to unilaterally vary terms and conditions of the contract;
- Terms that provide for loan 'default' (such as non-monetary default) in a very broad range of circumstances, rather than where the borrower has materially defaulted on their obligations;
- Terms that absolve the lender from responsibility for conduct, statements or representations that the lender makes to borrowers outside of the contract (otherwise known as 'entire agreement clauses'); and
- Terms that too broadly indemnify the lender against losses, costs, liabilities and expenses.

Both ASIC and the ASBFEO have also reiterated their support for the recommendations made by the independent review of the Code of Banking Practice – undertaken by Mr Phil Khoury – in relation to small business loan contracts.

The additional protections for small business borrowers proposed by the Code Review are long overdue and consistent with the recent ASBFEO inquiry into small business loans. Banks must move quickly to implement:

- A prohibition on non-monetary default clauses where the borrower is meeting their obligations under the contract;
- 90 days' notice period where a loan facility will not be extended; and
- More comprehensive access to the Financial Ombudsman Service.

ASIC Deputy Chair Peter Kell said: 'ASIC is committed to ensuring the UCT provisions help to raise small business lending standards. Where we identify a potentially unfair term we will work with the lender to remove or amend the term, and we have already started to raise these issues with lenders. If the lender refuses to do so we will consider all regulatory options, including taking the matter to court as ultimately a court can decide whether or not a term is unfair.'

ASBFEO Kate Carnell said: 'I'm firmly of the belief that the loan contract terms as they currently stand, fail to comply with the UCT law.

'Once again, repeated calls for the banks to amend their practices are falling on deaf ears, despite inquiry after inquiry highlighting major flaws in the way they treat their small business customers.'

Background

The unfair contract term protections for consumers in the *Australian Securities and Investments Commission Act 2001* (ASIC Act) were extended to cover standard form small business contracts entered into, or renewed, on or after 12 November 2016.

In February 2016, ASIC released Information Sheet 211 *Unfair contract term protections for small businesses* (INFO 211). This information sheet gives guidance to assist small businesses understand how the law deals with unfair terms in small business contracts for financial products and services, and the protections that are available for small businesses.

In INFO 211, ASIC also outlined its expectations that financial product issuers review their standard form small business contracts to remove any terms that could be considered to be unfair to ensure compliance by 12 November 2016.

ASIC is responsible for enforcing the unfair contract terms law in relation to financial products and services. For other goods and services, enforcement of the unfair contract terms law is shared between the Australian Competition and Consumer Commission (ACCC) and the State and Territory consumer protection agencies.

ASIC and the ACCC have worked together to help small businesses understand the unfair contract term protections. On 16 March 2016, the two agencies hosted a webinar to provide practical guidance about the protections for small businesses, including a discussion of the types of terms that may be unfair and what action small businesses can take if they receive a contract that contains an unfair term.

Small businesses that are concerned about whether a contract term is unfair can make a complaint directly to their financial services provider or to the relevant external dispute resolution scheme if the dispute is not resolved, or directly to ASIC.

The Code of Banking Practice is a voluntary code of conduct which sets standards of good banking practice for member-banks of the Australian Bankers' Association.

While it is not ASIC's role to endorse contract terms or to state that they are unfair, ASIC may apply to a court to have a term declared unfair if it is in the public interest to do so. Any party to the contract may also apply to the court if they are not satisfied with the outcome of the dispute resolution process.

Only a court or tribunal can decide whether a term is unfair.

If a court or tribunal finds that a term is 'unfair', the term will be void—that is, it is not binding on the parties. The rest of the contract will continue to bind the parties to the extent it is capable of operating without the unfair term.

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Tuesday 16 May 2017

17-139MR ASIC and ASBFEO hold banks to account on unfair contract terms

Australian Government | Australian Small Business and Family Enterprise Ombudsman | ASIC Australian Securities & Investments Commission

Following intervention by the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) and the Australian Securities and Investments Commission (ASIC), the big four banks are taking action to protect small businesses from unfair terms in loan contracts.

Following a round table hosted by ASBFEO and ASIC, the big four banks have committed to a series of comprehensive changes to ensure all small business loans entered into or renewed from 12 November 2016 will be protected from unfair contract terms.

ASBFEO and ASIC have publicly raised concerns that lenders, including the big four banks, needed to lift their game in meeting the unfair contract terms legislation.

The big four banks have committed to:

- Removing 'entire agreement clauses' from small business contracts. These are concerning terms that absolve the lender from responsibility for conduct, statements or representations they make to borrowers outside of the contract.
- Removing financial indicator covenants from many applicable small business contracts. For example, loan-to-valuation ratio covenants that give lenders the power to call a default when the value of secured property falls, even where a small business customer has met financial repayments, will be removed.
- Removing material adverse event clauses from all small business contracts. These are concerning terms that give lenders the power to call a default for an unspecified negative change in the circumstances of the small business customer.
- Significantly limiting the operation of indemnification clauses. These are concerning terms that aim to broadly protect the lender against losses, costs, liabilities and expenses that arise even outside the control of the small business borrower.
- Significantly limiting the operation of unilateral variation clauses. In addition to providing applicable small business customers with a minimum of 30 days notice for any contract changes, banks will clearly limit the circumstances in which unilateral variations can be made.

The banks have agreed to contact all small business customers who entered into or renewed a loan from 12 November 2016, about the changes to their loans. In many cases, banks have agreed to implement the changes so that they apply to all existing applicable small business customers.

The banks have agreed to significantly limit the operation of potentially concerning contract clauses (such as financial indicator covenants) to loan products where such clauses are essential to the operation of the product (such as margin lending contracts). Where such clauses continue to exist, banks will re-draft them to ensure that they are clear, transparent and limited to the appropriate circumstances.

ASBFEO and ASIC have made it clear to the banks that simply including the word 'reasonable' in contracts does not go far enough.

The ASBFEO, Kate Carnell, said that her role was to consider the interests of small business and to ensure that the unfair contract term legislation was working across all industries. She said it was clear what “unfair” means – to protect the interests of the advantaged party, in this case it is the banks, against the interests of small business.

Ms Carnell said: “The banks have been given every opportunity, including a one-year transition period from November 2015, to eliminate unfair contract terms from their loan agreements and their response has been unsatisfactory.”

ASIC Deputy Chairman Peter Kell said: "We made it clear that lenders had to significantly improve their lending agreements to small business to ensure they meet the new rules."

“It is important that the banks have committed to improving
their small business loan contracts. ASIC will be following up with the big four banks – and other lenders – to ensure that small business contracts do not contain unfair terms."

Background

From 12 November 2016, the unfair contract terms legislation was extended to cover standard form small business contracts with the same protections consumers are afforded. In the context of small business loans, this means that loans of up to $1 million that are provided in standard form contracts to small businesses employing fewer than 20 staff are covered by the legal protections.

In March 2017, ASBFEO and ASIC completed a review of small business standard form contracts and called on lenders across Australia to take immediate steps to ensure their standard form loan agreements comply with the law (refer: 17-056MR).

ASIC has released Information Sheet 211 *Unfair contract term protections for small businesses* (INFO 211) which gives guidance to assist small businesses understand how the law deals with unfair terms in small business contracts for financial products and services, and the protections that are available for small businesses.

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Thursday 15 March 2018

18-073MR ASIC reports on changes to small business loan contracts by big four banks

ASIC has today released a report setting out the details of the changes made by the big four banks to remove unfair terms from their small business loan contracts of up to $1 million.

The report, *Unfair contract terms and small business loans* (REP 565), provides more detailed guidance to bank and non-bank lenders about compliance with the unfair contract terms laws as they relate to small business.

The report follows the announcement in August 2017 that the big four banks had committed to improving terms of their small business loans following work with ASIC and the Australian Small Business and Family Enterprise Ombudsman (ASBFEO). (See 17-287MR).

ASIC Deputy Chair Peter Kell said, 'The UCT report provides further guidance to help banks and other lenders ensure that their small business loans are fair, and do not breach the rules prohibiting unfair contract terms.'

The report:

- Identifies the types of terms in loan contracts that raise concerns under the law
- Provides details about the specific changes that have been made by the banks to ensure compliance with the law
- Provides general guidance to lenders with small business borrowers to help them assess whether loan contracts meet the requirements under the unfair contract terms law

'ASIC will review small business lending contracts across the market. There are no excuses for failure to comply with the UCT laws, and we will consider all regulatory options available to us if we identify lenders whose unfair contracts break the law.'

ASIC will monitor the four banks' use of the clauses to ensure they are not applied or relied on in an unfair way. ASIC will also examine other lenders' loan contracts to ensure that their contracts do not contain terms that raise concerns under the unfair contract terms law.

ASIC and ASBFEO will continue work together to ensure small business loan contracts comply with the unfair contract terms law.

Download REP 565

Background

Unfair contract terms protections were extended to small business from 12 November 2016.

ASIC and the ASBFEO have been working with the big four banks to ensure their small business loan contracts meet the standards that are required by the unfair contract terms law (refer: 17-139MR).

Small business loans are defined as loans of up to $1 million that are provided in standard form contracts to small businesses employing fewer than 20 staff are covered by the legal protections.

In August 2017, ASIC and the ASBFEO welcomed the changes to small business loan contracts by the big four banks (refer 17-278MR) that have:

- Ensured that the contract does not contain ‘entire agreement clauses’ which prevent a small business borrower from relying on statements by bank officers (e.g. about how bank discretions will be exercised)
- Limited the operation of broad indemnification clauses
- Addressed concerns about event of default clauses, including ‘material adverse change’ events of default and specific events of non-monetary default (e.g. misrepresentations by the borrower)
- Limited the circumstances in which financial indicator covenants will be used in small business loans and when breach of a covenant will be considered an event of default
- Limited their ability to unilaterally vary contracts to specific circumstances with appropriate advance notice.

Last updated: 15/03/2018 05:41

ASIC

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REPORT 565

Unfair contract terms and small business loans

March 2018

About this report

This report details the changes made by the 'big four' banks to their small business loan contracts, in order to comply with the unfair contract terms law.

This report will also be relevant for other lenders who provide loans to small business and assist them in meeting their obligations.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

Contents

Executive summary

Small business contracts and unfair contract terms

1 Small businesses, like consumers, are often offered contracts for financial products and services on a ‘take it or leave it’ basis, commonly entering into contracts where they have limited or no opportunity to negotiate the terms. These are known as ‘standard form’ contracts.

2 With effect from 12 November 2016, the unfair contract terms provisions applying to consumers under the Australian Consumer Law were extended to cover standard form small business contracts. For loan contracts, the new laws generally cover small business loans of up to $1 million.

Note: In this report, we refer to these provisions as the ‘unfair contract terms law’. ASIC is responsible for enforcing the unfair contract terms law in relation to financial products and services: see Div 2 of Pt 2 subdiv BA of the *Australian Securities and Investments Commission Act 2001* (ASIC Act).

3 The unfair contract terms law protects small businesses in all sectors of the economy, not just in the financial services sector. For example, the Australian Competition and Consumer Commission (ACCC) published a report to outline the common terms of concern that it found in its review of small business contracts across different industries (e.g. advertising and telecommunications), and to discuss the types of changes that businesses made: see ACCC, *Unfair terms in small business contracts: A review of selected industries* (November 2016).

4 Following the commencement of the unfair contract terms law, ASIC and the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) conducted a review of small business loan contracts offered by the big four banks. ASIC and the ASBFEO were concerned that the banks had not done enough to bring their small business loan contracts into compliance with the law. In August 2017, ASIC and the ASBFEO announced the changes being made by the banks to address our concerns.

Note: In this report, we refer to the big four banks as ‘the banks’.

5 This report:

(a) provides more detailed information about the changes made by the banks to their small business loan contracts to reduce the risk of non-compliance with the unfair contract terms law; and

(b) outlines the types of terms that raise concerns under the unfair contract terms law that other lenders to small business customers should consider when they assess whether they need to make any changes to their small business loan contracts to comply with the law.

Note: For more information on how the unfair contracts law applies to small business contracts for financial products and services, see Information Sheet 211 *Unfair contract term protections for small businesses* (INFO 211).

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Changes to small business loan contracts

6 Following intervention by ASIC and the ASBFEO, the banks have made the changes set out in Table 1, which will apply to all small business loan contracts entered into or renewed from 12 November 2016 (i.e. when the unfair contract terms law applied to small business contracts).

Table 1: Summary of changes to small business loan contracts

Issue	Changes made by the banks
Entire agreement clauses	Clauses that prevent lenders from being held contractually responsible for conduct, statements or representations made to small business borrowers outside the written contract are likely to be unfair. Three banks did not have entire agreement clauses in their small business loan contracts; one bank removed the clause from its small business loan contracts. The banks have confirmed that their small business loan contracts now do not contain clauses that have this effect or the clauses will no longer be applied to their small business loan contracts. This means that statements by bank staff about, for example, how the loan contract operates may form part of the contract subject to normal legal principles.
Broad indemnification clauses	Clauses that require borrowers to cover losses, costs and expenses incurred due to the fraud, negligence or wilful misconduct of the bank, its employees or agents or a receiver appointed by the bank are likely to be unfair. The banks have confirmed that any clauses that have this effect have been removed or the clauses will no longer be applied to their small business loan contracts. This means that borrowers will not be responsible for costs incurred due to the fraud, negligence or wilful misconduct of people or entities who are outside the borrower's control or who act on the instructions of the lender.
Event of default clauses	*Material adverse change events of default*—Clauses that allow lenders to treat a loan as being in default because of any unspecified 'material adverse change' are likely to be unfair. These clauses gave the banks a very broad discretion to call a default against the borrower without giving the borrower any clarity about what types of change could result in a default. The banks have confirmed that these clauses have been removed or will no longer be applied to their small business loan contracts. *Specific events of non-monetary default*—The banks have also considerably limited the specific events of default listed in the loan contract that could allow the bank to call a default (other than for non-payment) and terminate a loan contract with the small business borrower (e.g. a misrepresentation made by the borrower to the lender): see Table 2 in the appendix for details. The wording of these specific events may still be broad enough for an event to trigger a disproportionate enforcement action by the lender. For example, even though 'misrepresentation' is listed in small business loan contracts as a specific event of default, if a minor misrepresentation by the borrower such as an incorrect date of birth, led to a default and enforcement under the loan contract, this could be a disproportionate enforcement action. To deal with the potential for a disproportionate effect, lenders should: • provide a reasonable period for a borrower to remediate a breach of a specific event; and • adopt a materiality threshold so that a breach of a specific event must create a material risk to the lender of monetary default, or of being unable to enforce its rights against any secured property, before it can take enforcement action.

Issue	Changes made by the banks
Financial indicator covenants	The use of a breach of some financial indicator covenants such as loan-to-valuation ratio (LVR) in small business loans to trigger a default and enforcement of the loan could be unfair where a breach of a particular covenant by a small business borrower does not present a material credit risk to the lender. In these cases, a term entitling the lender to call a default based on a breach of the covenant is likely to create an imbalance in rights and obligations of the parties that would cause detriment to the borrower and is not reasonably necessary to protect the legitimate interests of the lender. Some banks have limited the use of financial indicator covenants by: • removing financial indicator covenants (e.g. LVR) as triggers for default for most small business loans except for specialised loans such as property development, margin lending and foreign currency loans; and • removing financial indicator covenants for property investment loans. The banks have also limited the impact or consequences of some of these breaches of financial indicator covenants on borrowers: • two banks agreed that where there was a breach of a financial indicator covenant, they would not call a default unless that breach creates a material credit risk for the bank; and • one bank agreed to treat a breach of covenant in cash flow lending as a review event (and not a default event), entitling the bank to take other action but not an enforcement action. We encourage other lenders to adopt a similar approach.
Unilateral variation clauses	Clauses that give lenders a broad ability to vary contracts without agreement from the small business borrower have a high risk of being unfair as they cause a significant imbalance in the rights of the lender and small business borrower (in favour of the lender) and are unlikely to be reasonably necessary to protect the legitimate interests of the lender if they can be used in a broad range of circumstances to make a broad range of variations to the contract. The banks have limited their variation clauses to specific defined circumstances set out in the contract (e.g. interest rate changes). Where such a variation would cause the borrower to want to exit the contract by repaying or refinancing, the banks will now provide a period of between 30 and 90 calendar days for the borrower to do so before the variation takes effect.

Next steps

7 The banks will use multiple channels to advise small business borrowers about the changes, including directly contacting all relevant small business borrowers who entered into or renewed a loan from 12 November 2016.

8 ASIC will monitor the banks' use of the changed clauses, particularly those relating to financial indicator covenants, variations and specific events of non-monetary default to ensure that they are being applied as agreed and are not relied on by the banks in a way that is unfair to small business customers.

9 We will also undertake further work to examine small business loan contracts from other lenders to ensure that these contracts do not contain unfair terms.

A Small business contracts and unfair contract terms

Key points

The unfair contract terms law applies to standard form small business contracts entered into, or renewed, on or after 12 November 2016, where the upfront price payable does not exceed $1 million if the contract is for longer than 12 months.

A term in a standard form small business contract is 'unfair' if:

- it would cause a significant imbalance in the parties' rights and obligations arising under the contract;
- the term is not reasonably necessary to protect the legitimate interests of the party that would benefit from its inclusion; and
- the term would cause financial or other detriment (e.g. delay) to a small business if it were to be applied or relied on.

Which contracts are covered?

10 Small businesses commonly enter into 'standard form' contracts for financial products and services, including business loans, credit cards and client or broker agreements.

11 The unfair contracts law applies to standard form small business contracts entered into, or renewed, on or after 12 November 2016, where:

(a) the contract is for the supply of financial goods or services (this includes a loan contract);

(b) at least one of the parties is a 'small business' (i.e. a business employing fewer than 20 people, including casual staff employed on a regular and systematic basis); and

(c) the upfront price payable under the contract does not exceed $300,000, or $1 million if the contract is for more than 12 months. Most small business loan contracts are for periods of more than 12 months, so the monetary limit is generally $1 million.

Note: For the purposes of subparagraph 11(c), any interest payable on the loan is excluded from the upfront price payable.

12 The unfair contract term law applies to these contracts as follows:

(a) If a term of a contract is varied on or after 12 November 2016, the law applies to the varied term but not to the rest of the contract.

(b) If a contract is automatically renewed (i.e. 'rolled over') on or after 12 November 2016, the law applies from the renewal date.

(c) If a contract is rolled over on a periodic basis (e.g. month-to-month), the law applies from the first new period starting on or after 12 November 2016.

13 Small business contracts that are covered by an industry code, such as the Code of Banking Practice administered by the Australian Bankers' Association (ABA) or the Customer Owned Banking Code of Practice, may also have other protections, including protections that are similar to those provided under the unfair contract terms law.

When is a term of a small business contract unfair?

14 A term in a standard form small business contract is 'unfair' if:

(a) it would cause a significant imbalance in the parties' rights and obligations arising under the contract;

(b) the term is not reasonably necessary to protect the legitimate interests of the party that would benefit from its inclusion; and

(c) the term would cause financial or other detriment (e.g. delay) to a small business if it were to be applied or relied on.

15 In determining whether a term of a contract is unfair, the following factors are also relevant:

(a) the extent to which the term is transparent; and

(b) the contract as a whole.

16 A term is considered to be 'transparent' if it is:

(a) legible;

(b) expressed in reasonably plain language;

(c) presented clearly; and

(d) readily available to any party affected by the term.

17 If a court finds that a term in a standard form contract is unfair, it makes a declaration to that effect and the term is void (i.e. as if it never existed): see s12GND and 12BF of the ASIC Act, respectively. The term is void from the outset, not from the time of the court's declaration and the term is likely to be unfair and void in all identical contracts (although in some cases, the circumstances of a particular customer may affect a finding of unfairness for that particular contract). The remainder of the contract will continue to bind parties if it can operate without the unfair term.

Note: See *Australian Competition and Consumer Commission v Chrisco Hampers Australia Ltd* (2015) 239 FCR 33 where the court declared a term void in all identical contracts.

18 If a person has acted in reliance on a contractual term which is later declared to be unfair and hence void, that person may have acted without legal authority and be subject to common law claims for damages. For example, the person may be liable in tort in relation to trespass on land or for taking

possession of property without a valid contractual entitlement to do so. Alternatively, the person may be liable for breach of contract because the contractual exception or defence they relied on is void, or the person may have to repay money which they had no valid contractual entitlement to keep.

19 If a court declares a term to be unfair and the term is likely to cause a class of persons who were not parties to the proceedings to suffer loss or damage, ASIC may seek an order to compensate non-parties in the same or later proceedings. The court may make such orders as it thinks appropriate against the party advantaged by the term—for example, to redress, prevent or reduce loss or damage to non-parties: see s12GNB and 12GNC of the ASIC Act.

20 The orders the court can make include orders:

(a) declaring all or part of a contract to be void;

(b) varying a contract;

(c) refusing to enforce some or all of the terms of a contract or arrangement;

(d) directing a party to refund money or return property to the small business affected; and

(e) directing a party to provide services to the small business affected at the party's expense.

21 In addition, if a court has declared that a term is unfair and a party subsequently seeks to apply or rely on the unfair term (including in an identical contract with another party), this will be treated as a contravention of the ASIC Act: see s12GD and 12GM. The remedies available for such a contravention include:

(a) an injunction;

(b) an order to provide compensation or prevent injury to any small business affected by the contravention that applies for an order (or on whose behalf ASIC applies for an order); and

(c) any other orders the court considers appropriate.

What is ASIC's role?

22 Since 1 July 2010, ASIC has administered the law to deal with unfair terms in standard form consumer contracts for financial products and services including loans. From 12 November 2016, the unfair contract terms law was extended to cover standard form small business contracts with the same protections provided to consumers.

23 ASIC deals with the unfair contract terms law in relation to financial products and services. For other goods and services, enforcement of the unfair contract terms law is shared between the ACCC and the state and territory consumer protection agencies.

24 Generally, we do not take action on behalf of individual consumers or businesses. For small businesses, there are a number of options available to enforce their rights, including:

(a) making a complaint directly to the lender;

(b) if the lender is unable to resolve the issue, making a complaint to the financial services provider's external dispute resolution scheme (e.g. the Financial Ombudsman Service or the Credit and Investments Ombudsman); and

(c) taking court action against the lender.

Work done by ASIC and ASBFEO

25 In February 2017, the ASBFEO released a report to outline the findings and recommendations of its inquiry into small business loans: see ASBFEO, *Inquiry into small business loans* (February 2017).

26 In March 2017, ASIC and the ASBFEO found that eight lenders, including the banks, had failed to take sufficient steps to comply with their obligations under the unfair contract terms law after a review into their standard form small business loan contracts: see Media Release (17-056MR) *ASIC and ASBFEO join forces to ensure bank lenders meet unfair contract laws* (9 March 2017).

27 In May 2017, the banks committed to make a series of major changes on a range of issues identified by ASIC and the ASBFEO to make it more likely that all small business loans entered into or renewed from 12 November 2016 will comply with the unfair contract terms law. This commitment followed a roundtable discussion hosted by ASIC and ASBFEO: see Media Release (17-139MR) *ASIC and ASBFEO hold banks to account on unfair contract terms* (16 May 2017).

28 We continued to work with the banks on the detail of the necessary changes and in August 2017, ASIC and the ASBFEO announced that the changes agreed to by the banks significantly reduce the risk of unfair contract terms in their small business loan contracts: see Media Release (17-278MR) *Big four banks change loan contracts to eliminate unfair terms* (24 August 2017).

B Changes to small business loan contracts

Key points

For small business loan contracts of up to $1 million, the banks have:

- ensured that the contract does not contain ‘entire agreement clauses’ which prevent statements by bank officers (e.g. about how bank discretions will be exercised) from forming part of the contract;
- limited the operation of broad indemnification clauses;
- addressed concerns about event of default clauses, including ‘material adverse change’ events of default and specific events of non-monetary default (e.g. misrepresentations by the borrower);
- limited the circumstances in which financial indicator covenants will be used in small business loans and when breach of a covenant will be considered an event of default; and
- limited their ability to unilaterally vary contracts to specific circumstances with appropriate advance notice.

The changes by the banks will apply to all relevant small business loan contracts entered into or renewed from 12 November 2016 (i.e. when the unfair contract terms law applied to small business contracts).

Entire agreement clauses

29 ‘Entire agreement’ clauses typically state that the contract, as agreed to by the parties, represents all of the rights and obligations between the parties (i.e. the contract document represents the ‘entire agreement’).

30 ASIC was concerned that entire agreement clauses or similar terms in small business loan contracts may be unfair as they could absolve the lender from any contractual responsibility for conduct, statements or representations that the lender’s staff may have made to small business borrowers about how the contract would operate (e.g. how the bank would exercise its discretions during or on review of the loan).

31 Three banks did not have entire agreement clauses in their small business loan contracts; one bank removed the entire agreement clause from its small business loan contracts. The banks have confirmed that their small business loan contracts now do not contain entire agreement clauses or similar terms, or the clauses will no longer be applied to their small business loan contracts.

Risk for lenders: Entire agreement clauses

The risk of non-compliance with the unfair contract terms law is likely to be high if small business loan contracts contain any terms that seek to absolve the lender from contractual responsibility for conduct, statements or representations they make to borrowers about the contract.

Broad indemnification clauses

32 Broad indemnification clauses in small business loan contracts are terms that make the borrower liable to the lender for losses, costs, liabilities and expenses suffered or incurred by the lender, including those that may arise outside the control of the small business borrower.

33 ASIC was concerned that broad indemnification clauses that impose an obligation on a small business borrower to indemnify the lender for losses, costs, liabilities and expenses caused by fraud, negligence or wilful misconduct of the *lender* (including its employees, contractors and agents and appointed receivers) are likely to create an imbalance in rights and obligations of the parties which would cause detriment to the borrower and are not reasonably necessary to protect the legitimate interests of the lender.

34 Although receivers are often appointed under security documents as the borrower's agent in law, in practice they are chosen by the lender, act in the lender's interests to recover value and act on the instructions of the lender. It is the lender not the borrower who can take steps to manage and mitigate the risk of fraud, negligence or wilful misconduct by the receiver and it is not fair for the borrower to indemnify the lender for consequences of such conduct.

35 In *Australian Competition and Consumer Commission v JJ Richards & Sons Pty Ltd* [2017] FCA 1224 (*ACCC v JJ Richards*), the court declared unfair and void a broad indemnification clause which required the small business customer to indemnify JJ Richards (a waste management service provider) for all liabilities, claims, damages, actions, costs and expenses which may be incurred by JJ Richards as a result of or arising out of or otherwise in connection with the agreement.

36 The court found that the broad indemnification clause created a significant imbalance in rights and obligations of the parties because it created an unlimited indemnity in favour of JJ Richards, even where the loss incurred by JJ Richards is not the fault of the small business customer or could have been avoided or mitigated by JJ Richards: see *ACCC v JJ Richards* at [56].

37 In *Australian Competition and Consumer Commission v ByteCard Pty Limited* 301 FCA 2013 (*ACCC v ByteCard)*, the Federal Court found that, in a consent judgment about a consumer standard form contract with an internet service provider, an indemnity was unfair and void because it required the consumer to indemnify the internet service provider even where the liability loss or damage may have been caused by the internet service provider.

38 The banks have confirmed that their indemnification clauses will not require a small business borrower to reimburse the lender for any losses, costs, expenses and liabilities which arise from the fraud, negligence or wilful misconduct of:

(a) the lender;

(b) the lender's officers, employees, contractors or agents; or

(c) any receivers appointed by the lender over the secured property.

Risk for lenders: Broad indemnification clauses

The risk of non-compliance with the unfair contract terms law is likely to be high if a clause requires a small business borrower to reimburse the lender for losses, costs, expenses and liabilities incurred by the lender arising from the fraud, negligence or wilful misconduct of:

- the lender; or
- the lender's officers, employees, contractors or agents; or
- any receivers appointed by the lender over the secured property.

Events of default clauses

General considerations

39 Events of default clauses describe the events or circumstances which constitute a default by the borrower and which entitle the lender to apply default consequences (such as a higher default interest rate). Typically there are many events of default specified in a loan contract. The most obvious is a failure by the borrower to pay an amount of principal or interest or other payment when due (i.e. a *monetary* default).

40 Others are *non-monetary* events (i.e. not based on a failure to pay money to the lender) which may present a change in credit risk to the lender. Non-monetary events of default can include a misrepresentation by the borrower, a failure to maintain insurance, a breach of a covenant, an unauthorised use of the borrowed funds or a change in control of the borrower company.

41 Often non-monetary events of default are described at a high level of generality. They can encompass circumstances that create a significant credit risk for the lender (e.g. a misrepresentation that significantly overstates the borrower's preceding two years' of income or the value of their assets) and can also include circumstances that do not expose the lender to significant credit risk (e.g. a minor misrepresentation about the borrower's place of birth).

42 The effect is to give lenders a broad discretion about whether to treat a particular event or circumstance within the general description of an event of default as an actual default. A material adverse change event of default clause gives extremely wide discretion to the lender—if the lender considers that *any* change in circumstances is materially adverse, it can call a default.

43 Typically, loan contracts also give lenders a broad discretion about the consequences that can be imposed for a default. These consequences may include one or more of the following:

(a) applying default interest rates;

(b) stopping further drawdowns;

(c) appointing investigating accountants to report on the business;

(d) reducing the size of the loan and requiring repayment of some principal;

(e) changing the repayment terms (e.g. to increase the size and frequency of repayments);

(f) requiring immediate repayment of all principal and interest; and/or

(g) enforcing guarantees and securities, including by appointing a receiver and manager over the business, and selling the business and secured property.

44 It is common for the terms of the loan contract to give the lender a broad discretion about whether to call a default (because events of default are defined very broadly) with a broad discretion about what consequences to impose if a default is called. A lender may choose to exercise such broad discretion even where it has not been exposed to significant credit risk because of other commercial drivers (i.e. for reasons that are not directly related to the specific small business borrower that may have technically triggered an event of default).

45 For example, the ASBFEO found that non-monetary default clauses allow lenders to trigger a default where risk factors may have changed, even when the small business borrower has continued to meet their regular repayments. It also found that while lenders use these clauses to limit their risk, they often confer broad and unilateral power to recoup funds lent or vary loan terms and conditions: see ASBFEO's Small Business Loans Inquiry at p. 28.

46 These combined discretions present a significant risk of the terms being unfair because they empower the lender to respond to an event in a way which is significantly disproportionate to the credit or other risk to the lender created by the event. The terms are likely to be unfair if the combined broad discretions are not reasonably necessary to protect the legitimate interests of the lender.

47 In response to ASIC's concerns, the banks have limited these two discretions under their terms to more precisely specify events of default which presented a credit risk to the lender and to ensure that the consequences imposed by the lender were not significantly disproportionate to that risk.

Material adverse change events of default

48 Clauses in small business loan contracts about material adverse change events of default allow lenders to apply default consequences to the loan for an unspecified negative change in the borrower's circumstances, even if the borrower is meeting their financial obligations in full and on time under the contract.

49 These clauses can be very broad and are likely to be unfair to the borrower where:

(a) the adverse event did not represent a material risk to the lender of a monetary default or of the lender being unable to enforce its rights against the secured property; or

(b) the contractual response of the bank to the event was not reasonable or proportionate to the increased risk to the bank and the lender terminated the loan and accelerated repayment of loan amount.

50 The banks have confirmed that material adverse change event clauses have been removed or will no longer be applied to their small business loan contracts.

Risk for lenders: Material adverse change events of default

The risk of non-compliance with the unfair contract terms law is likely to be high if lenders have clauses about material adverse change events of default and similar terms that allow lenders to terminate the loan for an unspecified negative change in the small business borrower's circumstances.

Specific events of non-monetary default

51 As part of the ABA's response to the ASBFEO's Small Business Loans Inquiry, the banks have agreed to limit specific events of non-monetary default resulting in enforcement action to the following events:

(a) unlawful behaviour;

(b) insolvency, bankruptcy and administration;

(c) other creditor enforcement;

(d) misrepresentation;

(e) use of the loan for non-approved purposes;

(f) dealing with loan security property improperly or without consent;

(g) change of beneficial ownership of company (except as permitted);

(h) loss of licence or permit to conduct business;

(i) failure to provide proper accounts; and

(j) failure to maintain insurance.

Note: The ABA's original list of six events has been re-categorised into ten events.

52 In ASIC's view, a risk remains that the wording of these events is still broad enough for an event to be used to trigger a disproportionate enforcement action by the lender. For example, it would be unfair to a small business borrower if a minor and inconsequential misrepresentation by the borrower (e.g. an incorrect place of birth) led to a default under the loan contract, even though 'misrepresentation' is a specific event of default in the ABA's list.

53 We consider that lenders should:

(a) provide a reasonable period for a borrower to remediate a breach of a specific event (if it is remediable); and

(b) adopt a materiality threshold so that a breach of a specific event must create a material risk to the lender of a monetary default or of the lender being unable to enforce its rights against any secured property.

Note: This could be done by incorporating a credit risk-related materiality element into the definitions of the specific events, or applying a separate material credit risk test before enforcement action is taken based on the event occurring.

54 Based on our discussions with the banks, it seems clear that:

(a) insolvency, bankruptcy and administration events cannot be remediated by the borrower and would automatically meet a materiality threshold;

(b) for a failure to provide proper accounts, a materiality threshold cannot be applied without receiving the relevant accounts that must be submitted by the borrower; and

(c) for an unlawful behaviour event, an event that poses a material risk to the bank's reputation or the bank's own compliance with the law may justify calling a default even if the event did not present a material credit risk.

55 The banks have each taken a slightly different approach to:

(a) whether specific events are remediable; and

(b) how to adopt a material credit risk threshold, by either including a credit risk-related materiality element in the definitions of specific events and/or by applying a separate material credit risk test before enforcement action is taken based on the event occurring.

Note: See Table 2 in the appendix for a summary of the banks' approach to specific events of non-monetary default.

56 We have also observed that some banks include a term in their general business loan contracts that any breach of any other agreement with the bank (e.g. a guarantee or security agreement to support the loan contract or a separate financing agreement) will constitute a breach of that contract (sometimes called a 'cross-default' clause). We expect that cross-default clauses should not operate in a way that is inconsistent with the commitments made by the banks limiting the permissible non-monetary events of default in the loan contract.

57 In other words, we expect that the banks will not be entitled to call a default under a small business loan contract because a non-monetary event of default has occurred under a separate security agreement or separate financing agreement if that default did not meet the bank's commitments about the types of non-monetary defaults that can be included in the small business loan contract (i.e. the non-monetary default event under the other agreement was not within the agreed list of specific events of non-monetary default). Otherwise, there is a risk that a cross-default clause in a small business loan contract may be an unfair contract term.

58 Banks could achieve this outcome by, for example:

(a) specifying that the cross-default clause in the small business loan contract could not trigger a default under that contract unless the non-monetary event of default in the other agreement was included in the agreed list of permissible non-monetary events of default for small business loan contracts; or

(b) ensuring the non-monetary events of default in the other agreement fall within the agreed list of permissible non-monetary events of default for small business loan contracts.

59 Three banks have restricted the use of cross-default by ensuring that the non-monetary events of default in their security agreement and/or other finance agreements will be limited to the list of permissible non-monetary events of default in the small business loan contract.

60 One bank in our review previously included in its list of default events for its general small business loan contract, a broadly-worded cross-default clause that gave the bank the power to call a default under the small business loan contract because of any event of default under a separate security agreement or financing agreement.

61 After we raised concerns about the extent of the broadly-worded cross-default clause, the bank agreed that it will revise its use of the clause so that the cross-default clause in the small business loan contract cannot trigger a default under the loan contract unless the non-monetary default event under the other agreement is included in the agreed list of permissible non-monetary events of default for small business loan contracts.

62 We will monitor the use by the banks of clauses relating to specific events of non-monetary default to ensure they are not being applied inappropriately or unfairly to small business loans. In particular, we will examine the banks' use of:

(a) specific events of non-monetary default to ensure disproportionate enforcement actions are not being taken in response to a breach of an event; and

(b) cross-default clauses to ensure that the clauses are not used in a way that is inconsistent with the banks' commitment to limit specific events of non-monetary default in small business loan contracts.

Risk for lenders: Specific events of non-monetary default

The risk of non-compliance with the unfair contract terms law is likely to be high if lenders do not:

- provide a reasonable period for a borrower to remediate a remediable breach of a specific event;

- adopt a materiality threshold (e.g. by incorporating a credit risk-related materiality element into the definitions of the specific events, or applying a separate materiality credit risk test); and
- limit cross-default clauses so that they operate in a way which is consistent with the commitments made by the banks to restrict the permissible non-monetary events of default in the loan contract.

Financial indicator covenants

63 In general, a financial indicator covenant in a small business loan is a condition about the financial position or operations of the business (typically in the form of a ratio) that the small business borrower must meet.

64 For example, a covenant may specify:

(a) the proportion of monthly income earned to the amount of monthly interest owed that must be met (known as an 'interest cover ratio'); or

(b) the ratio of the value of the loan to the value of the secured property that the loan cannot fall below (the 'loan to valuation ratio' or LVR).

65 ASIC was concerned that the use of some covenants in small business loans as triggers for default and enforcement could be unfair where a breach of a particular covenant by a small business borrower does not present a material credit risk to the lender. In these cases, a term providing that any breach of the covenant is or can be a default is likely to create an imbalance in rights and obligations of the parties which would cause detriment to the borrower and is not reasonably necessary to protect the legitimate interests of the lender.

66 We acknowledge that most financial indicator covenants are useful monitors of the financial performance of the borrower's business and the value of the security for some products, particularly where the value of the asset which supports the loan can fluctuate significantly in a short space of time (e.g. the LVR in margin lending facilities).

67 The ABA's response to the ASBFEO's Small Business Loans Inquiry was that financial indicator covenants would be retained as triggers for calling a default for the following types of loans:

(a) property investment and property development loans; and

(b) specialised lending transactions including margin lending, loans to self-managed superannuation funds (SMSFs), bailment, invoice discounting, foreign currency loans, and tailored cash flow lending.

68 We recognise that the banks have limited the types of small business loans that use these financial indicator covenants as triggers for calling a default. The banks' position is that the covenants are set at a reasonable level to monitor the credit risk of the particular loan and that they are reasonably necessary to protect the legitimate interests of the banks for these particular loans.

69 We engaged with the banks to obtain specific commitments about which types of small business loans would continue to use financial indicator covenants and which covenants would be used for those loans. As a result:

(a) the banks have removed financial indicator covenants for property investment loans;

(b) two banks will apply a materiality threshold to the use of these covenants so that a breach of a covenant must present a material credit risk to the bank before it can treat the breach as an event of default;

(c) one bank has limited the use of financial indicator covenants to four types of products (i.e. property development, SMSF loans, margin lending and foreign currency loans); and

(d) one bank will treat a breach of covenant in cash flow lending as a review event (and not a default event), entitling the bank to take other action but not an enforcement action.

Note: See Table 3 in the appendix to this report for a summary of financial indicator covenants that are typically used by the banks.

70 As noted in paragraph 67, the ABA response to the ASBFEO report reserved the right to use financial indicator covenants as events of default in 'specialised lending transactions', which was defined inclusively as margin lending, loans to SMSFs, bailment, invoice discounting, development finance, foreign currency loans, and tailored cash flow lending.

71 ASIC expects that banks will not expand their use of this category of 'specialised lending transactions' to cover a wide range of small business lending products. We consider that this category covers only those lending contracts where it is reasonable to include carefully targeted financial indicator covenants as events of default so that the bank can manage the risk of a payment default, due to the following characteristics of the facility:

(a) the unpredictable nature of the borrower's likely cash flow to repay the facility;

(b) the expected volatility in the value of the security property; or

(c) the limited recourse nature of the facility.

72 A question remains whether a term of the loan contract that makes every breach of a financial indicator covenant a trigger for calling a default and enforcing the loan is unfair. One issue is disproportionate response to a breach of a covenant. For example, an interest cover ratio covenant may require income to be six times interest. A fall in income to 5.5 times interest would be a breach of the covenant but not necessarily one that presents a material credit risk for the lender which requires enforcing the loan. If the term entitles the lender to enforce the loan for any breach of any financial indicator covenant, regardless of whether the breach creates a material risk of non-payment or of inability to enforce any security, the term may be unfair.

73 We will monitor the use of these covenants by the banks to ensure they are not being applied inappropriately or unfairly to small business loans. In particular, we will examine the banks' use of covenants to ensure disproportionate enforcement actions are not being taken in response to a breach of a covenant.

Risk for lenders: Financial indicator covenants

The risk of non-compliance with the unfair contract terms law is likely to be high if the contract entitles lenders to treat every breach of a financial indicator covenant as an event of default entitling enforcement action, even where the breach does not present a material credit risk to the lender (i.e. the risk of a monetary default or of the lender being unable to recover the amount of the loan from the secured property).

Unilateral variation clauses

74 Unilateral varation clauses in small business loans are terms that give lenders (but not borrowers) a very broad discretion to unilaterally vary terms and conditions of the contract, without the consent of the small business borrower. The unfair contract terms law identifies this type of clause in a list of terms that may be unfair.

75 In *ACCC v JJ Richards*, the court declared unfair and void a term which allowed JJ Richards to unilaterally increase its prices for any reason. The court found that such a term created a significant imbalance because no such corresponding right was given to the small business customer to terminate the contract or obtain a change in the scope or scale of the service provided by JJ Richards, or a lower price: see *ACCC v JJ Richards* (at [56]).

76 Broad unilateral variation clauses were also found to be unfair by the Federal Court in a consent judgment in *ACCC v ByteCard* in July 2013 (see paragraph 37) and by the Victorian Civil and Adminstrative Tribunal in *Director of Consumer Affairs Victoria v AAPT Limited* [2006] VCAT 1493 at [54] and *Director of Consumer Affairs Victoria v Trainstation Health Clubs Pty Ltd* [2008] VCAT 2092 under the similar Victorian unfair contract terms law which predated the Australian Consumer Law: see Pt 2B of the *Fair Trading Act 1999* (Vic).

77 These clauses cause a significant imbalance in the rights of the lender and small business borrower (in favour of the lender) and are unlikely to be reasonably necessary to protect the legitimate interests of the lender where the breadth of the circumstances in which they can be used and the types of variations they can be used to create.

78 For example, in addition to a list of specified changes that a bank could make, one bank's small business loan contract previously contained a unilateral variation clause that allowed the bank to make changes to any of the terms and conditions of the contract other than the changes as specified in the list.

79 We consider that lenders can reduce the risk of non-compliance with the unfair contract terms law if a variation clause only allows specified types of terms, or terms with a specified subject matter (rather than 'any' term or 'any other' term), to be varied in specified ways and the specific circumstances in which the clause may be used are clearly expressed.

80 Case law on unfair contract terms in consumer contracts also suggests that the imbalance created by a unilateral variation clause can also be counterbalanced if the borrower has sufficient advance notice of the variation before it comes into effect to give the borrower a real and reasonable opportunity to exit the contract without penalty rather than accept the variation. This reduces the likelihood of significant imbalance in rights and obligations and of detriment.

81 A borrower cannot exit a loan contract without repaying the loan. A real and reasonable opportunity to exit a loan contract (i.e. repay by selling assets or a business or arrange re-finance of the loan contract) is likely to mean at least 30 calendar days (but for larger drawn facilities this may be 90 to 120 days).

82 The borrower should also not incur fees, costs or detriment under the contract for exercising the option to exit the contract because of the change.

83 The banks have taken different approaches to dealing with this issue:

(a) Three banks removed clauses that allow variations to any clause or 'any other clause' in any circumstances, and retained the ability to vary in specific circumstances (e.g. changes to a rate of interest when a benchmark rate changes or changes to a margin on a base interest rate when certain promotional conditions are no longer met).

(b) One bank retained its clause that allows variations to 'any other clause' but qualified the clause so that the change can only be made if it is 'not adverse' to the borrower. The bank will provide 30 calendar days' notice if the change is not adverse to any borrower affected by the change.

84 In relation to advance notice periods:

(a) One bank will now provide 90 calendar days' notice if a variation only applies to the particular small business borrower's contract and if the change is materially adverse to the borrower.

(b) One bank will now provide 90 calendar days' notice for all changes unless the change is not adverse to any borrower affected by the change.

(c) Two banks will now provide 30 calendar days' notice or such longer period as may be required under the Code of Banking Practice.

85 As the unfair contract terms law is not prescriptive, in general the longer the notice period, the smaller the risk that the unilateral variation clause will be found to be unfair by a court.

86 We will monitor the use of these clauses by the banks to ensure they are not being applied unfairly to small business loans.

Risk for lenders: Unilateral variation clauses

The risk of non-compliance with the unfair contract terms law is likely to be high if:

- a unilateral variation clause allows the lender a broad discretion to unilaterally vary any terms or conditions of the contract in unspecified ways, and the relevant circumstances in which the variation power can be used are not specifically and clearly expressed; and
- sufficient advance notice of the variation is not given to allow a small business borrower to have a real and reasonable opportunity to exit the contract (e.g. by refinancing or selling assets if needed to repay the facility) without penalty rather than accept the variation.

C Next steps

Key points

The banks will use multiple communication channels to advise their small business borrowers about the changes, including directly contacting all relevant small business borrowers who entered into or renewed a loan from 12 November 2016.

ASIC will monitor the individual banks' use of the changed clauses to determine if they are in fact applied or relied on in an unfair manner.

We will also conduct a review of small business loan contracts from other lenders, including bank and non-bank lenders to ensure that their small business contracts do not contain unfair terms.

Communication with small business

87 The banks will use multiple communication channels (e.g. internet banking notifications, emails, mail, press release, website banners) to advise small business borrowers about the changes that apply to all relevant small business loan contracts entered into or renewed from 12 November 2016 (i.e. when the unfair contract terms law applied to small business loans).

ASIC monitoring and follow-up work

88 To ensure that the changes do not operate unfairly in practice, ASIC will monitor the banks' use of the changed clauses to ensure they have been applied and are not relied on in an unfair manner.

89 We may also undertake further work to examine small business loan contracts from other lenders to ensure that these contracts do not contain unfair terms.

90 ASIC will continue to work with the ASBFEO when assessing the results of the monitoring work.

Appendix: Summary of the banks' approaches to small business loan contracts

Table 2: Specific events of non-monetary default

Specific events	Summary of the banks' approaches
Unlawful behaviour	• Three banks will allow a breach to be remediable and provide a period ranging from 10 business days to 30 calendar days for remediation. • Three banks will adopt a materiality threshold.
Other creditor enforcement	• All four banks will not allow a breach to be remediable. • All four banks will adopt a materiality threshold.
Misrepresentation	• Two banks will allow a breach to be remediable and provide a period of 30 calendar days for remediation. • All four banks will adopt a materiality threshold.
Use of the loan for non-approved purpose	• All four banks will allow a breach to be remediable and provide a period ranging from 10 business days to 30 calendar days for remediation. • Three banks will adopt a materiality threshold.
Improper dealing with loan security or without consent	• Two banks will allow a breach to be remediable and provide a period ranging from 5 business days and 30 calendar days for remediation. • All four banks will adopt a materiality threshold.
Change of beneficial control of company except as permitted	• All four banks will allow a breach to be remediable and provide a period ranging from 10 business days to 30 calendar days for remediation. Note: One bank will only allow a breach to be remediable for a change of ownership or control of company except as permitted. • All four banks will adopt a materiality threshold. Note: One bank will adopt the threshold for a change in management only, and one bank will adopt the threshold for a change of ownership or control of company except as permitted.
Loss of licence or permit to conduct business	• All four banks will allow a breach to be remediable and provide a period ranging from 10 business days to 30 calendar days for remediation. • Three banks will adopt a materiality threshold.
Failure to provide proper accounts	• All four banks will allow a breach to be remediable and provide a period of 30 calendar days for remediation. • One bank will adopt a materiality threshold.
Failure to maintain insurance	• All four banks will allow a breach to be remediable and provide a period ranging from 10 business days to 30 calendar days for remediation. • One bank will adopt a materiality threshold.

Table 3: Financial indicator covenants

Loan type	Covenants typically used by the banks
Property development	• LVR • Cost-to-complete
SMSF lending	• LVR
Margin lending	• LVR
Foreign currency loans	• Currency equalisation clause

Key terms

Term	Meaning in this document
ABA	Australian Bankers' Association
ACCC	Australian Competition and Consumer Commission
ACCC v ByteCard	*Australian Competition and Consumer Commission v ByteCard Pty Limited* 301 FCA 2013
ACCC v JJ Richards	*Australian Competition and Consumer Commission v JJ Richards & Sons Pty Ltd* [2017] FCA 1224
ASBFEO	Australian Small Business and Family Enterprise Ombudsman
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
Australian Consumer Law	Uniform legislation for consumer protection in Sch 2 to the *Competition and Consumer Act 2010*, which applies as a law of the Commonwealth of Australia and is incorporated into the law of each of Australia's states and territories
banks	The Australia and New Zealand Banking Group Limited. the Commonwealth Bank of Australia (including Bankwest), the National Australia Bank of Australia, and Westpac Banking Corporation and St George Bank (including Bank of Melbourne and BankSA)
big four banks	See 'banks'
financial indicator covenant	A condition (typically in the form of a ratio) that the small business borrower must meet (e.g. staying above or below a level specified in the contract)
materiality threshold	A measure of whether a breach of a specific event creates a material risk to the lender of a monetary default or of the lender being unable to enforce its rights against any secured property Note: This could involve incorporating a credit risk-related materiality element into the definitions of the specific events, or applying a separate material credit risk test.
s12GND (for example)	A section of the ASIC Act (in this example, numbered 12GND), unless otherwise specified
small business loan contract	A standard form contract for a small business loan
SMSF	Self-managed superannuation fund
unfair contract terms	The unfair contract terms provisions applying to consumers under the Australian Consumer Law, which were extended to cover standard form small business contracts under $1 million with effect from 12 November 2016

Related information

Headnotes

Australian Consumer Law, broad indemnification clauses, entire agreement clauses, events of default clauses, financial indicator covenants, material credit risk, small business, small business borrowers, small business contracts, small business loans, unfair contract terms, unilateral variation clauses

Legislation

ASIC Act, Div 2 of Pt 2, subdiv BA

Competition and Consumer Act 2010, Sch 2

Fair Trading Act 1999 (Vic), Pt 2B

Cases

Australian Competition and Consumer Commission v Chrisco Hampers Australia Ltd (2015) 239 FCR 33

Australian Competition and Consumer Commission v ByteCard Pty Limited [2013] 301 FCA

Australian Competition and Consumer Commission v JJ Richards & Sons Pty Ltd [2017] FCA 1224

Director of Consumer Affairs Victoria v AAPT Limited [2006] VCAT 1493

Director of Consumer Affairs Victoria v Trainstation Health Clubs Pty Ltd [2008] VCAT 2092

Information sheets

INFO 211 *Unfair contract term protections for small businesses*

Media and other releases

17-056MR *ASIC and ASBFEO join forces to ensure bank lenders meet unfair contract laws* (9 March 2017)

17-139MR *ASIC and ASBFEO hold banks to account on unfair contract terms* (16 May 2017)

17-278MR *Big four banks change loan contracts to eliminate unfair terms* (24 August 2017)

Other references

ACCC, *Unfair terms in small business contracts: A review of selected industries* (November 2016)

ASBFEO, *Inquiry into small business loans* (February 2017)