PricewaterhouseCoopers (Australia)

Productivity Commission urges more competition in Australia's financial system

PricewaterhouseCoopers Consulting (Philippines) Inc.

Competition Alert! The new notification threshold for mergers & acquisitions

PwC International Business Reorganisations Network – Monthly Legal Update

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Contents

Welcome

Welcome to the tenth edition of the PwC International Business Reorganisations (**IBR**) Network Monthly Legal Update for 2018.

The PwC IBR Network provides legal services to assist multinational organisations with their cross-border reorganisations. We focus on post-deal integration, pre-transaction separation and carve outs, single entity projects, and legal entity rationalisation and simplification as well as general business and corporate and commercial structuring.

Each month our global legal network brings you insights and updates on key legal issues multinational organisations.

We hope that you will find this publication helpful, and we look forward to hearing from you.

In this issue

In our October 2018 issue:

- PricewaterhouseCoopers (Australia) examines the Productivity Commission's inquiry report, *Competition in the Australian Financial System*; and
- PricewaterhouseCoopers Consulting (Philippines) Inc. reports on a new notification threshold for mergers and acquisitions.

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PricewaterhouseCoopers (Australia) – Productivity Commission urges more competition in Australia's financial system

At a glance

On 3 August 2018, the Productivity Commission (**Commission**) publicly released its inquiry report, *Competition in the Australian Financial System* (**Report**), with a number of far reaching recommendations aimed at improving consumer outcomes and enhancing the competitiveness of Australia's financial system and the wider economy.

In detail

The Commission has recognised that the Australian economy has generally benefited from having a financial system that is strong, innovative and profitable. However, the Commission has found that the stability of the financial system has shielded large banking and insurance institutions from rigorous competition, which has diminished value for customers.

The Report follows the draft report released by the Commission in February 2018 (see our summary **here**). The Commission has proposed 34 recommendations aimed at getting Australia's financial markets to be workably competitive and yield better consumer outcomes.

The current competition landscape

The Report identifies a number of reasons for flagging price competition in Australia's financial market. Major market participants - the big four banks and major insurers - command entrenched market power due to favourable regulatory arrangements, funding advantages and operational efficiency, vertical and horizontal integration, and consumer inertia and disengagement from financial services.

Financial advisers are presented with conflicting incentives to sell and recommend in the face of an overwhelming array of products and associated prices, in circumstances where regulation is heavy-handed and often misdirected.

The Commission believes that policy initiatives, including intervention by APRA, have largely favoured the stability of the financial system to the detriment of competition in the financial services industry.

As a direct result, the Commission has proposed 34 recommendations seeking to alter the incentives of Australia's banks, brokers, insurers and advisers, in order to reform financial system governance, with the aim of stimulating competition and yielding better consumer outcomes.

We briefly discuss some of the key recommendations below.

A "best interest" obligation in the home loans market

The Report recommends an amendment to the *National Consumer Credit Protection Act 2009* (Cth) to introduce a "best interest" obligation to all credit licensees who provide home loans or home loan services, such as mortgage brokers operating under a credit licence.

This best interest obligation mirrors the language of the obligations involved in the provision of personal advice to retail clients, which was introduced in 2012 as part of the Future of Financial Advice reforms and contained in Part 7.7A, Division 2 of the *Corporations Act 2001* (Cth).

Namely, the provider of credit in the form of home loans – whether a lender or mortgage broker – will have a duty to:

a act in the best interests of the client;

b issue recommendations appropriate to the client, having regard to the duty to act in their best interests;

c prioritise the interests of the client in the event of conflict; and

d ensure certain information is disclosed to the client.

Credit licensees would also be responsible for ensuring that their representatives comply with these obligations. The Commission has also recommended that legal responsibility be extended to lenders who have an ownership interest in firms that hold a credit licence.

Ban on trailing and other specified commissions

Despite substantial industry contention, the Commission is of the view that the existing practice of offering trailing commissions provides brokers with a strong incentive to recommend lenders and products that pay higher commissions on their products, irrespective of what may be in their clients' best interests.

As a result, the Commission recommends that:

a all trailing, volume-based and campaign-based commissions be phased out, starting from 2019;

b an alternative system under which up-front commissions be paid by lenders, rather than a fixed-fee structure paid by customers, to ensure customers do not desert brokers and smaller lenders, wiping out competition in the industry;

c in the absence of shifting broker remuneration from lenders to customers, a formal best interest obligation be introduced, as an offset to conflicts of interest; and

d the current industry practice of restricting commission clawback arrangements to 18 months to two years should be imposed by Australian Securities and Investments Commission (**ASIC**) across all lenders and include a ban on commission clawback being passed on to borrowers.

Creation of Principal Integrity Officer role

To further establish compliance with the best interest duty, the Commission has recommended that all banks or authorised deposit-taking institutions (**ADIs**) appoint independent Principal Integrity Officers (**PIOs**).

The PIO would be accountable to the board and advise on remuneration and other practices inconsistent with the best interest duty, as well as reviewing internal business practices for compliance. The PIO will also report to the ASIC in the event that the board persistently fails to comply with the best interest duty, or where the board provides unsatisfactory responses to the PIO's reports on compliance.

The Commission expects the consultation process on the creation of the PIO role to start by the end of 2018.

Deferred sales model for add-on insurance sales

ASIC has already published its proposal to mandate a deferred sales model for all sales of add-on insurance by car dealerships. The Commission echoed its support for the proposal and suggested a proposed minimum deferral period of 7 days running from the day on which the consumer applies for or purchases the insurance product.

The Commission further urged the establishment of a Treasury-led working group to extend the operation of the deferred sales model to all other add-on insurance products, to ensure consumers are better placed to exert competitive pressure on prices and quality for such products.

Open access regime for the New Payments Platform

Australia's digital payment system, the New Payments Platform (**NPP**), supports over AUD 1 trillion in real-time transactions each month and acts as a substantial source of payment data, allowing money and data to be transferred instantaneously.

The Commission has suggested the establishment of a formal access regime, to be monitored by the Payments System Board (**PSB**), to open the NPP to other market participants. The Report specifically recommends that the RBA "reduce technical barriers" for new financial institutions to enter the NPP, and enable existing institutions to provide more efficient services by:

a broadening access to the NPP for specialist payment providers, without the need to hold a banking licence in the form of an ADI;

b reviewing the fees set by participants of the NPP and transaction fees set by NPPA; and

c requiring that all transacting participant entities that use an overlay service to share de-identified transaction level data with the overlay service provider.

The Commission further recommended that by mid-2019, the ACCC together with the PSB complete an investigation into methods to improve functionality of the NPP, including additional functionality for PayID which is to be implemented by end of 2019.

Impact of APRA's prudential measures on competition

The Commission has pointed to stifling effects on competition by recent APRA interventions, in particular its directive in 2017 to ADIs to limit the flow of new interest-only lending to 30% of their new residential mortgages. The Commission linked this intervention to static market shares, increased interest rates on new and existing investment loans, and higher lenders' profits. As interest on investment loans is tax-deductible, the Commission has attributed an estimated loss of $500 million per year in tax revenue. To prevent curtailing effects on competition in the future, the Commission has recommended that APRA avoid blanket rules on the industry and instead look to the underlying risk of each individual ADI's loan book. It is further suggested that APRA undertakes and publishes annual quantitative reviews of its prudential interventions, incorporating a cost-benefit analysis as to its effects on market participants and competition.

ACCC to champion competition on Council of Financial Regulators (CFR)

The Commission has identified that no single Australian financial regulator has been tasked with the discrete responsibility to promote competition in the financial services industry. In the past, APRA has intervened to negotiate the balance between maintaining systemic stability and inducing competition, but inevitably it must prioritise its mandate of stability.

Building on APRA's submission to the inquiry that APRA has appreciated engaging with the ACCC prior to CFR discussions, the Commission has suggested that the ACCC is best placed to be a 'champion of competition' within key industry forums. The Commission urges the appointment of the ACCC as a permanent member of the CFR to guide consideration of competition implications resulting from potential regulatory intervention.

The takeaway

The Federal Government is expected to frame its formal response to the Commission's recommendations later this year, after receiving the first report of the Royal Commission into misconduct in the banking industry.

The implementation of any recommendations accepted by the Federal Government is likely to require the involvement and cooperation of a number of key government agencies as named in the Report, including APRA, ASIC, ACCC and the Treasury. Some recommendations will also require new legislation such as that necessary to amend the *National Consumer Credit Protection Act 2009* (Cth).

The combination of these factors and pending response from the Australian Government, means that the actual implementation of measures may not readily satisfy the Commission's proposed deadlines commencing end-2018.

This insight focuses on high-level insights into a number of the key recommendations. The full Report can be found on the Productivity Commission's website: **here**.

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PricewaterhouseCoopers Consulting (Philippines) Inc. – Competition Alert! The new notification threshold for mergers and acquisitions

At a glance

The Philippine Competition Commission (**PCC**) is the government body which is tasked to protect, promote and maintain fair competition in the Philippine markets. Under the Philippine Competition Act, it is empowered to review and strike down agreements which substantially prevent, restrict, or lessen competition in the Philippines.

Previously, in cases of mergers and acquisitions (M&**As**), the parties thereto are required to notify the PCC if the aggregate annual gross revenue or the value of the assets in the Philippines, and the transaction value exceeds One Billion Pesos.

This notification threshold was increased on 1 March 2018. Now, parties to M&As are required to notify the PCC of the intended M&A if the annual aggregate gross revenue or value of the assets in the Philippines exceeds Five Billion Pesos, and the transaction value exceeds Two Billion Pesos.

In detail

Coverage of the Philippine Competition Act

Parties

The law is enforceable against any person or entity engaged in any trade, industry and commerce in the Philippines or in international trade, industry or commerce having direct substantial and reasonably foreseeable effects in the Philippines, including those that result from acts done outside the territory of the Philippines.

Transactions

a Anti-competitive agreements

b Abuse of Dominant Position

c Mergers and Acquisitions

On 1 March 2018, the PCC issued Memorandum Circular No. 18-001 amending the notification threshold requirements for M&A.

Mergers and Acquisitions

M&As are one of the covered transactions which requires the review of PCC before the parties to the M&As may execute and implement the same. Under the law, the PCC shall review M&As upon notification of the parties or upon its own initiative.

New Threshold

Initially, the notification threshold was set at One Billion Pesos for both the aggregate annual gross revenue or the value of the assets in the Philippines of at least one of the acquiring or acquired entities, and transaction value. Thus, parties to M&As who satisfy these requirements are required to notify the PCC.

With the issuance of Memorandum Circular (**MC**) No. 18-001, the notification threshold was increased to Five Billion Pesos for the aggregate annual gross revenue or value of the assets in the Philippines, and Two Billion Pesos for the transaction value.

The MC provided notification guidelines for the new threshold involving the following transactions:

a *Proposed merger or acquisition of assets in the Philippines,* outside *the Philippines, or inside and outside the Philippines*

The parties need to notify the PCC if (a) the aggregate annual gross revenues in, into or from the Philippines, or value of the assets in the Philippines of the ultimate parent entity of at least one of the acquiring or acquired entities, including that of all entities that the ultimate parent entity controls, directly or indirectly, exceeds Five Billion Pesos, and (b) the value of the transaction exceeds Two Billion Pesos.

b *Proposed acquisition of voting shares of a corporation or of an interest in a non-corporate entity*

Notification of the proposed acquisition shall be submitted to the PCC if (a) the gross revenue from sales in, into, or from the Philippines or the aggregate value of the assets in the Philippines that are owned by the corporation or non-corporate entity or by entities it controls, other than assets that are shares of any of those corporations, exceeds Two Billion pesos, and (b) as a result of the proposed acquisition of voting shares of a corporation or an interest in a non-corporate entity, the acquiring entity, in the aggregate, carry more than the following percentages in the outstanding voting shares of the corporation, or profits or assets of the non-corporate entity:

i thirty-five percent (35%); and

ii Fifty percent (50%), if the entity or entities already own more than the percentage set out in subsection I above, as the case may be, before the proposed acquisition.

c *Acquisition in excess of the 35% threshold*

Where an entity has already exceeded the 35% threshold for an acquisition of voting shares, or the 35% threshold for an acquisition of an interest in a non-corporate entity, another notification will be required if the same entity will exceed 50% threshold after a further acquisition of either voting shares or an interest in a non-corporate entity.

d *Joint venture transaction*

In a joint venture transaction, notification is required if (a) the aggregate value of the assets that will be combined in the Philippines or contributed into the proposed joint venture exceeds Two Billion Pesos, or (b) the gross value generated in the Philippines by assets to be combined in the Philippines or contributed into the proposed joint venture exceeds Two Billion Pesos.

M&As in parts

M&As consisting of successive transactions, or acquisition of parts of one or more entities shall be treated as a single transaction if they are to take place within a one-year period between the same parties, or any entity they control or are controlled by or are under common control with another entity or entities.

Notification Process

Form

Before the execution of an M&A agreement, the parties shall submit with the PCC a Notification Form which shall be signed by an individual or officer authorized to sign the same on behalf of the entity. The Form shall be certified by the signatory that the contents in the Form are true and accurate of his/her personal knowledge and/or based on authentic records.

The parties may notify on the basis of a binding preliminary agreement such as memorandum of agreement, term sheet or letter of intent. In this case, the Form shall be accompanied by an affidavit attesting to the fact that a binding preliminary agreement has been executed and that each party has an intention of completing the proposed transaction in good faith.

Waiting Periods

Under the MC, parties shall not consummate the M&A agreement before the expiration of the relevant periods for notification.

After the notification has been submitted, the PCC has 15 days to determine whether the Form and other relevant requirement have been completed accordingly. The PCC may either inform the parties of documents they may have failed to submit or notify the parties that Notification is sufficient to commence Phase I review of the M&A.

Thereafter, the PCC will conduct the Phase I review within 30 days. If there is a need for a more comprehensive and detailed analysis of the M&A under Phase II, the PCC shall inform the parties and request for additional information and/or documents. The request for additional information and/or documents has the effect of extending the review period for an additional 60 days within which the parties may not consummate the M&A agreement (Phase II review).

The parties have 15 days from receipt of the request to provide the additional information and/or documents to the PCC. The notification shall be deemed expired if the parties failed to provide the requested information and/or documents within 15 days from receipt of the request. As such, the parties must refile their notification.

It is provided in the MC that the total period for review of the M&A shall in no case exceed 90 days from the time the initial notification by the parties is deemed complete.

Thus, when the above periods have expired and no decision has been promulgated for whatever reason, the M&A shall be deemed approved and the parties may proceed to implement or consummate the transaction.

Effect of Failure to Notify

An M&A that meets the new threshold and does not comply with the notification requirements and waiting periods under Philippine Competition Act and its implementing rules and regulations (**IRR**) shall be considered void. Further, it will subject the parties to an administrative fine of 1% to 5% of the value of the transaction.

Effects of Prohibited M&As

If the PCC determines that the M&A is prohibited under Philippine Competition Act and its IRR, and does not qualify for exemption, the PCC may:

a prohibit the implementation of the agreement;

b prohibit the implementation of the agreement unless and until it is modified by changes specified by the PCC; or

c prohibit the implementation of the agreement unless and until the pertinent party enter into legally enforceable agreements by the Commission.

Prohibited M&As and Exceptions

As a general rule, M&A agreements that substantially prevent, restrict, or lessen competition in the Philippines in the relevant market or in the market for goods or services, as may be determined by the PCC, shall be prohibited.

Nevertheless, the prohibition shall not apply if the parties are able to establish that the M&A (a) shall bring about or is likely to bring out gains in efficiencies greater than the result of a restrictive or limited competition, or (b) a party to the M&A agreement is faced with actual or imminent financial failure, and the agreement represents the least anti-competitive arrangement among the known alternative uses for the failing entity's assets.

Applicability of the New Notification Threshold

The new notification threshold shall not apply to M&As pending review by the PCC, notifiable transactions consummated before the effectivity of the new threshold guidelines, and transactions already subject of a decision by the PCC.

M&A agreements executed after the effectivity of the new notification threshold guidelines (i.e. 20 March 2018) shall be subject to the notification requirements of said guidelines.

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