Discussion Paper

Banking Act exemptions and section 66 guidelines

April 2013

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Australian Prudential Regulation Authority

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Preamble

In order to undertake banking business in Australia, a body must be incorporated and authorised as a deposit-taking institution by APRA. APRA may give an exemption from the need to be authorised, although an exemption will generally only be provided in limited circumstances and subject to certain conditions.

Under the *Banking Act 1959* (Banking Act), a number of words and expressions are restricted in use within the context of a financial business, unless APRA has provided written consent for a person or class of persons to use those words and expressions.

In the context of recent developments, both domestically and internationally, APRA has reviewed the operation of the exemption orders made under the Banking Act, as well as the rules governing the use of restricted words and expressions. This paper contains proposals to amend existing exemptions and the use of restricted terms as set out in the *Guidelines on Implementation of Section 66 of the Banking Act 1959* (Section 66 guidelines).

APRA is seeking comments from interested parties on the proposals set out in this Discussion Paper and the accompanying draft Section 66 guidelines.

The draft Section 66 guidelines are available on the APRA website at:

http://www.apra.gov.au/adi/PrudentialFramework/Pages/adi-consultation-packages.aspx

Submissions should be sent to exemptiondp@apra.gov.au by not later than 24 May 2013 and addressed to:

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Submissions may be the subject of a request for access made under the *Freedom of Information Act 1982* (FOIA). APRA will determine such requests, if any, in accordance with the provisions of the FOIA. Information in the submission about any APRA regulated entity that is not in the public domain and that is identified as confidential will be protected by section 56 of the *Australian Prudential Regulation Authority Act 1998* and will therefore be exempt from production under the FOIA.

Contents

Glossary **5**

Chapter 1 — Introduction **6**

Chapter 2 — Proposed amendments to RFC exemption order **8**

2.1 Terminology 8

2.2 At-call products 8

2.3 Use of certain facilities not allowed 9

Chapter 3 — Religious charitable development funds **10**

Chapter 4 — Section 66 guidelines **12**

Chapter 5 — Request for cost-benefit analysis information **13**

Glossary

ADI	Authorised deposit-taking institution as defined in the *Banking Act 1959*
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATM	Automatic Teller Machine
Banking Act	*Banking Act 1959*
BCC	Business cost calculator
EFTPOS	Electronic Funds Transfer at Point of Sale
RFC Exemption Order	Banking (Exemption) Order No. 96
FCS	Financial Claims Scheme
FSCODA	*Financial Sector (Collection of Data) Act 2001*
IMF	International Monetary Fund
RCDF	Religious charitable development fund
RCDF Exemption Order	Banking exemption No. 1 of 2011
Retail investor	A person who would be a retail client under section 761G of the *Corporations Act 2001*
RFC	Registered financial corporation as defined under the FSCODA
Section 66 guidelines	*Guidelines on Implementation of Section 66 of the Banking Act 1959*

Chapter 1 – Introduction

Under the *Banking Act 1959* (Banking Act), a body corporate that wishes to undertake 'banking business' in Australia must be authorised by APRA as a deposit-taking institution. Banking business is defined as taking deposits (other than as part-payment for goods or services) and making advances of money, as well as other financial activities prescribed by regulation[1]. Once authorised, the body corporate is an authorised deposit-taking institution (ADI), which means that it has been able to satisfy APRA that it meets the requirements for authorisation. There are a number of classifications of ADIs, including banks, building societies and credit unions, amongst others.

There are other entities whose activities fall within the definition of banking business but that have been granted an exemption by APRA from the need to be authorised.

Registered entities, or Registered Financial Corporations (RFCs), are one such class of entity. Under the *Financial Sector (Collection of Data) Act 2001*, a corporation is a registrable corporation if it meets certain conditions – in particular, that its sole or principal business activities in Australia are the borrowing of money and the provision of finance. While the business of registered entities falls within the definition of 'banking business' under the Banking Act, such entities – commonly referred to as finance companies – have historically been exempt from the need to be ADIs.

Another class of entity granted an exemption by APRA from the need to be authorised is religious charitable development funds (RCDFs). RCDFs are funds that have been set up to borrow and use money for religious and/or charitable purposes. This exemption is also historical in nature.

The current exemption orders require disclosures to an investor in products offered by an RFC or RCDF that such entities are not ADIs and are not supervised by APRA, and that the investments are not subject to the depositor protection provisions in the Banking Act. These disclosure requirements seek to ensure that investors are not under the impression that exempted entities are effectively the same as ADIs, and the products they offer the same as ADI products.

1 Refer to subsection 5(1) of the *Banking Act 1959* (Banking Act).

Recent developments

The past five years have seen considerable turmoil internationally in banking systems and in non-prudentially regulated financial sectors ('shadow banking' systems). Australia has not experienced distress in its banking system. However, several failures have occurred in the non-prudentially regulated financial sector, some involving retail investors.

In response to the collapse of Banksia Securities Limited, which was an RFC, the Australian Government announced in December 2012 that the Australian Securities and Investments Commission (ASIC) and APRA would consult on a number of proposals to strengthen the regulation of finance companies that issue debentures to retail clients[2]. ASIC is consulting on reforms involving the introduction of capital and liquidity requirements for such RFCs that, while not replicating the prudential framework for ADIs, will be substantially tougher than is presently the case. In addition, ASIC is proposing to strengthen required disclosures and to clarify the powers and duties of trustees in relation to companies that issue retail debentures[3].

In this Discussion Paper, APRA is proposing requirements aimed at reducing the likelihood that an investor, and particularly a retail investor, in an RFC would confuse such an investment with an ADI deposit or other deposit-like product. APRA also believes that similar measures are appropriate in respect of RCDFs that currently accept funds from retail investors.

The relevant global principle governing the permissible activities of banking institutions is set out in the *Core Principles for Effective Banking Supervision*[4]. This principle requires, *inter alia*, that the taking of deposits from the public be reserved for institutions that are authorised and prudentially supervised as deposit-taking institutions. In its 2012 review of

2 Refer to the media release from the Minister for Financial Services and Superannuation at http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2012/093.htm&pageID=003&min=brs&Year=2012&DocType=0.

3 Refer to ASIC's website for further details at: http://asic.gov.au/asic/asic.nsf/byheadline/13-024MR+ASIC+consults+on+reforms+to+regulation+of+the+debenture+sector.

4 For further details refer to the Bank of International Settlements website, *Core Principles for Effective Banking Supervision* at http://www.bis.org/publ/bcbs230.htm.

Australia's observance of these Core Principles, as part of its Financial Sector Assessment Program, the International Monetary Fund (IMF) noted:

'Australian law permits the existence of non-authorised and non-supervised deposit-taking institutions. The number of such institutions is small and the scale of their activities is predominantly *de minimis*, however there are major global institutions benefitting from this exemption within the Australian market and deposit-like facilities are being offered to the public[5].'

The IMF recommended that APRA:

'Revise the conditions for exemption from section 11 of the Banking Act for RFCs to ensure, at a minimum, that such exemptions be limited to institutions reliant wholly on wholesale funding[6].'

The proposed reforms outlined in Chapters 2 and 3 will remove the ability of non-prudentially regulated entities to offer products to retail investors that look like deposit or transactional banking accounts provided by ADIs.

Restricted terms

Sections 66 and 66A of the Banking Act prohibit the use of certain words and expressions when used in the context of a financial business, unless APRA has provided consent to a person to use those words or expressions. A review of the Section 66 guidelines has been undertaken in response to recent changes in the classification of some ADIs. Details are set out in Chapter 4.

5 Australia, Basel Core Principles for Effective Banking Supervision. Detailed Assessment of Observance (21 November 2012). Refer to http://www.apra.gov.au/AboutAPRA/Publications/Pages/default.aspx

6 Refer to footnote 5.

Chapter 2 – Proposed amendments to RFC exemption order

Banking (Exemption) Order No. 96 (RFC Exemption Order), signed in May 2003, exempts an RFC from the need to comply with the Banking Act provided the entity complies with conditions set out in the Order. Essentially, the RFC Exemption Order requires that an RFC must, under certain circumstances, provide a prudential supervision warning to an investor, to the effect that:

- the RFC is not authorised under the Banking Act and is not supervised by APRA; and
- the investment will not be covered by the depositor protection provisions in section 13A of the Banking Act.

The purpose of the prudential supervision warning is to ensure that investors are properly informed and aware that products offered by RFCs, such as retail debenture issues, are not afforded the same protection as deposits in ADIs. However, the public response to recent failures in the non-prudentially regulated financial sector has highlighted the risks to retail investors associated with such investments, and the need for greater safeguards. A particular concern is that terminology used for products offered by RFCs tends to be the same as that used by ADIs. For example, RFCs may market their investment products using terminology including 'at-call' and 'deposit'. In the mind of a retail investor, this could lead to uncertainty – notwithstanding existing disclosure requirements – as to the nature of the product offered, or provide the false impression that such products have the same level of security as 'at-call' accounts, deposits and similarly named products offered by ADIs.

Consistent with the Government's announcement[7], APRA is proposing a number of changes to the RFC Exemption Order to reduce the potential for retail investors in products offered by RFCs to form a view that they are investing in the equivalent of 'bank-like' or 'ADI-like' products. The proposed changes are set out below.

2.1 Terminology

Currently, there are no restrictions on the use of terms such as 'deposit' and 'at-call' by RFCs. As noted, this may lead to confusion in the minds of investors in such products that a 'deposit' or an 'at-call' account has the same characteristics and features, including prudential oversight and depositor protection, as deposit products offered by an ADI. Recent events have demonstrated that the existing prudential supervision warning required of RFCs is not sufficient in itself to protect retail investors. APRA therefore proposes to restrict the use of the words 'deposit' and 'at-call', and derivatives of those words, by RFCs by including additional conditions on the RFC Exemption Order.

2.2 At-call products

RFCs are currently able to offer products allowing immediate withdrawal of funds if an investor so desires. APRA proposes to restrict the use of the term 'at-call' by RFCs. In addition, APRA proposes that RFCs not allow retail investors to redeem their funds at-call. Rather, retail debenture offerings would be required to have a minimum initial maturity period of 31 days, so that for all practical purposes investments with RFCs are not able to be used for transactional banking activities. An investor would not be able to redeem, and an RFC would not be able to repay, any funds for 31 days from the date they are invested.

APRA proposes that an RFC would be required upon maturity of a debenture to either repay an investor's funds via cash, cheque or direct credit to an account at an ADI, or to roll the investment into another debenture with a term of at least 31 days if the investor has requested that its investment be rolled over.

7 Refer to footnote 2.

2.3 Use of certain facilities not allowed

APRA proposes to not allow RFCs to provide certain transaction facilities, including Automatic Teller Machine (ATM) access to an account with the RFC, BPAY, Electronic Funds Transfer at Point of Sale (EFTPOS) and cheque account facilities.

2.4 Transition

APRA proposes that these new requirements would take effect from 1 July 2013. Any funds raised from 1 July 2013 would need to comply with the proposed requirements. However, existing retail debenture issues would be allowed a transition period of up to three years in which to become compliant with the proposed requirements. Existing debenture issues would be required to comply with the proposed requirements at the earlier of their next rollover date or 30 June 2016.

Chapter 3 – Religious charitable development funds

RCDFs are currently exempt from the need to be authorised under the Banking Act via Banking Exemption No. 1 of 2011 (RCDF Exemption Order), provided they meet the conditions that attach to that Order. The current RCDF Exemption Order expires on 27 June 2013. APRA proposes to extend the RCDF Exemption Order, with the same conditions as currently apply, for a further period of one year until 27 June 2014.

There are 59 RCDFs in Australia, raising in aggregate over $7 billion in liabilities. Of this, around $1.1 billion is sourced from individuals and $6.3 billion is sourced from entities comprising the denominational or other affiliates of each RCDF (refer to Box 1).

RCDFs accepting retail deposits do so without the prudential oversight that applies to deposits held at ADIs. The existing RCDF Exemption Order requires an RCDF to disclose that it is not prudentially supervised by APRA and that contributions do not obtain the benefit of depositor protection. As noted earlier, however, the public response to recent RFC failures has demonstrated that, even with such disclosures, investors may still consider that the security of their investment is equivalent to a deposit with an ADI. APRA is therefore of the view that it is not appropriate to continue to exempt an RCDF from the need to be authorised under the Banking Act where it is offering products to retail investors.

Accordingly, APRA proposes to withdraw the current RCDF Exemption Order for RCDFs accepting investments from retail investors as from 28 June 2014.

An RCDF wishing to offer retail-type products would have to seek authorisation to become an ADI, register as an RFC or operate a registered managed investment scheme. These options would provide retail investors with greater safeguards than at present.

However, APRA considers it is appropriate that RCDFs operating as *de facto* corporate treasuries for their affiliates, and not taking funds from retail investors, continue to receive a Banking Act exemption. APRA proposes that this exemption order will include conditions that the RCDF will:

- not accept funds from retail investors;
- not use the word 'deposit' or its derivatives in relation to its activities; and
- not offer BPAY facilities. RCDFs are already prevented from offering ATM, EFTPOS and cheque account facilities.

For this class of RCDF, APRA proposes a common class exemption from 28 June 2014, with five-year reviews thereafter.

APRA will consult with RCDFs over the next 12 months on the implementation of these proposals and may consider a longer transition period on a case-by-case basis where necessary.

Box 1 Key data for religious charitable development funds

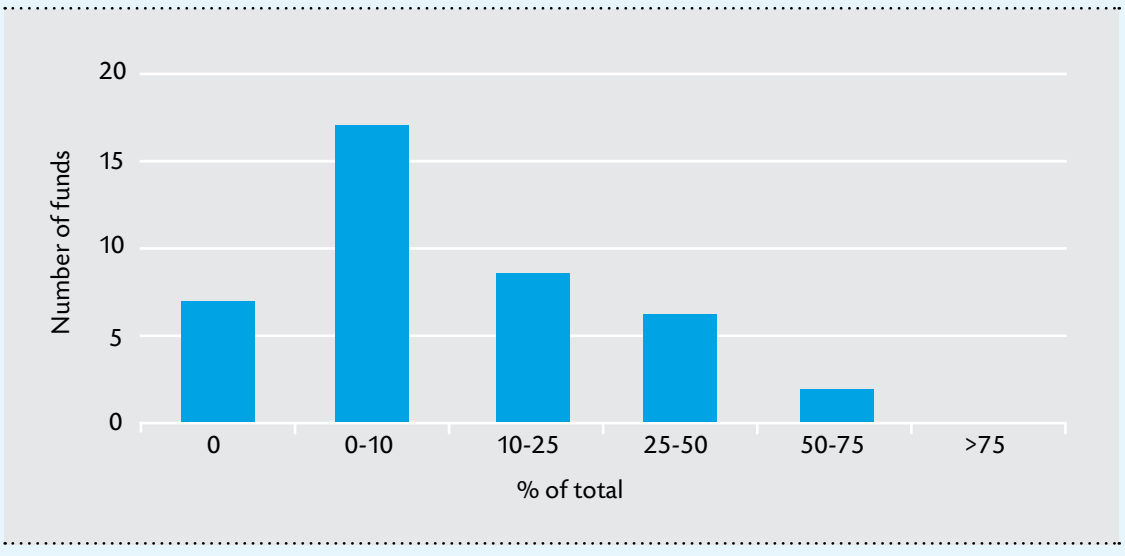
APRA undertook a survey of religious charitable development funds in early 2012, including seeking details on key financial data. Following is a summary of key data for 2011 provided by 51 RCDFs; eight funds did not respond.

Total funding liabilities	$7, 420 million
Of which:	
Investments attributable to retail investors	$1, 106 million
Other investments	$6, 314 million
Number of funds providing data	51
Number of funds accepting investments from individuals	42 (/51)

Distribution of assets

The following table shows the percentage of funds that are sourced from retail investors by number of funds.

Retail funds as a percentage of total funds



Chapter 4 – Section 66 guidelines

Sections 66 and 66A of the Banking Act place restrictions on the use of certain terms, for example 'bank', 'banker', 'building society' and 'credit union', when used in relation to a financial business[8]. The purpose of this restriction is to ensure that such terms are not used in a way that might mislead or give a perception that a business is regulated by APRA under the Banking Act.

Over the last few years, there have been changes to the classifications of ADIs as a consequence of some credit unions and building societies becoming banks. APRA has reviewed the Section 66 guidelines to ensure they remain current.

The draft of the revised Section 66 guidelines accompany this Discussion Paper. The main proposed changes include clarifying:

- what APRA considers to be 'financial business';
- the operation of section 66 and APRA's powers to grant consents and exemptions, and the requirements for exemption to use certain restricted terms;
- that an ADI that wishes to operate as a bank must hold at least $50 million in Tier 1 capital (this requirement is set out in the *ADI Authorisation Guidelines* (April 2008));
- that ADIs wishing to operate as a credit union must have a mutual ownership structure, as set out in ASIC's *Regulatory Guide 147 Mutuality – Financial institutions*;
- that credit unions and building societies (specified in the current Credit Union and Building Society Consent)[9] may use the expressions 'banker' and 'banking' in marketing and branding material to describe their banking services, but may not use the term 'bank'. In addition, the terms 'banker' and 'banking' may not be used as part of a registered corporate, business or trading name, or as part of an internet domain name by a credit union or building society; and
- that ADIs with a mutual structure may use the phrase 'mutual banking'.

8 'Financial business' has the meaning given in section 66(4) of the Banking Act.

9 Consent to use Restricted Expressions issued under paragraph 66(2)(c) of the Banking Act – issued 19 May 2000.

Chapter 5 – Request for cost-benefit analysis information

To improve the quality of regulation, the Australian Government requires all proposals to undergo a preliminary assessment to establish whether it is likely that there will be business compliance costs. In order to perform a comprehensive cost-benefit analysis, APRA welcomes information from interested parties.

As part of the consultation process, APRA requests respondents to provide an assessment of the impact of the proposed changes and, specifically, the marginal compliance costs entities are likely to face. Given that APRA's proposed requirements may impose some compliance costs, respondents may also indicate whether there are any other requirements relating to them that should be improved or removed to reduce compliance costs. In doing so, please explain what they are and why they need to be improved or removed.

Respondents are requested to use the Business Cost Calculator (BCC) to estimate costs to ensure that the data supplied to APRA can be aggregated and used in an industry-wide assessment. APRA would appreciate being provided with the input to the BCC as well as the final result. The BCC can be accessed at www.finance.gov.au/obpr/bcc/index.html.

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