



Response to Submissions

Registered Financial Corporations

25 November 2014

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Preamble

In April 2013, APRA released a consultation package on proposed changes to certain exemption orders under the *Banking Act 1959* (Banking Act) as well as draft revised guidelines on the implementation of section 66 of the Banking Act.

A number of institutions that undertake 'banking business', as defined in the Banking Act, are currently exempt from the need to be authorised as deposit-taking institutions. Such exemptions are generally historical in nature. The exemptions cover Registered Financial Corporations (RFCs) and religious charitable development funds (RCDFs), which are funds that have been set up to borrow and use money for religious and charitable purposes.

Although the consultation package addressed RFCs and RCDFs, this response paper only addresses the proposals and submissions received in relation to RFCs.

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Glossary

Term	Definition
At-call	For the purposes of the RFC Exemption Order, means any debenture payable on demand or up to and including 30 days from when a retail investor makes an investment in a retail product
ADI	Authorised deposit-taking institution as defined in the <i>Banking Act 1959</i>
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATM	Automatic Teller Machine
Banking Act	<i>Banking Act 1959</i>
BPAY	BPAY facility offered by BPAY Pty Limited ACN 079 137 518
Corporations Act	<i>Corporations Act 2001</i>
Debenture	Has the meaning given in section 9 of the <i>Corporations Act 2001</i>
Discussion paper	<i>Banking Act exemptions and section 66 guidelines</i> , APRA, April 2013
EFTPOS	Electronic Funds Transfer at Point of Sale
FCS	Financial Claims Scheme
RCDF	Religious charitable development fund
Retail investor	A person who would be a retail client under section 761G of the <i>Corporations Act 2001</i>
Retail product	Securities, a financial product, or any other arrangement involving the taking of money on deposit offered to a retail investor

Term	Definition
RFC	Registered Financial Corporation, being a corporation to which the RFC Exemption Order applies
RFC Exemption Order	Banking (Exemption) Order No 96
RG 69	<i>Regulatory Guide 69: Debentures and notes: Improving disclosure for retail investors, ASIC</i>
Wholesale investor	A person other than a retail investor

Executive summary

In April 2013, APRA released a discussion paper *Banking Act exemptions and section 66 guidelines* (discussion paper) on proposed changes to certain exemption orders under the *Banking Act 1959* (Banking Act) as well as revised guidelines on the implementation of section 66 of the Banking Act.

A number of institutions that undertake 'banking business', as defined in the Banking Act, are currently exempt from the need to be authorised as deposit-taking institutions. Such exemptions are generally historical in nature. The exemptions cover Registered Financial Corporations (RFCs) and religious charitable development funds (RCDFs). This response paper deals only with the proposals and submissions related to RFCs. The proposals to amend the RFC Exemption Order, consistent with the then Government's proposals announced in December 2012, are designed to strengthen the regulation of finance companies that issue debentures to retail clients. APRA will respond separately concerning RCDFs.

A total of 13 submissions were received on the RFC proposals. While several submissions were supportive of the proposals, others raised concerns, particularly with the proposed requirement that all retail debenture offerings have a minimum maturity of 31 days. Responses argued that this proposal would not necessarily provide appropriate investor protection but would detrimentally affect RFC business models. Other submissions focussed on the need to ensure appropriate transition for RFCs to any new regime. There were also some comments on specific technical issues and requests for clarification on certain aspects of the proposals.

After consideration of the responses received, APRA has amended its proposals in response to some of the comments made, particularly in relation to the requests for appropriate transition periods. APRA considers, however, that key aspects of the proposals remain appropriate and, as such, should be reflected in the revised exemption order. This response paper also clarifies technical points raised in submissions. The RFC Exemption Order will be modified to reflect the changes set out in this paper.

Chapter 1 - Introduction

1.1 Overview

APRA released a discussion paper *Banking Act exemptions and section 66 guidelines* (discussion paper) for comment on 19 April 2013. The discussion paper addressed proposals to amend *Banking (Exemption) Order No. 96* (the RFC Exemption Order), which applies to RFCs and *Banking exemption No. 1 of 2011*, which applied to RCDFs.

APRA received a total of 13 submissions on proposals relating to RFCs. This response paper deals with the proposals and submissions related to RFCs only. In finalising its position with regard to the RFC Exemption Order, APRA considered matters raised in submissions while at the same time seeking to ensure that the prudential objectives described in the discussion paper are achieved.

1.2 Clarification of meaning of key terms

APRA used certain terms in its discussion paper but specific definitions of those terms were not provided. For the purposes of the RFC Exemption Order, the terms in question have the following meanings:

At-call - For the purposes of the RFC Exemption Order, means any debenture payable on demand or up to and including 30 days from when a retail investor makes an investment in a retail product;

Debenture - has the meaning given in section 9 of the *Corporations Act 2001*;

Retail investor - means a person who would be a retail client under section 761G of the *Corporations Act 2001*; and

Retail product - means securities, a financial product, or any other arrangement involving the taking of money on deposit offered to a retail investor.

Chapter 2 – Key issues

The RFC Exemption Order was made on 22 May 2003 and exempts an RFC to whom it applies from the need to comply with section 8 of the Banking Act, provided the entity complies with conditions set out in the Order. In the discussion paper, APRA set out a number of proposals to amend the RFC Exemption Order, consistent with the then Government's proposals announced in December 2012, designed to strengthen the regulation of finance companies that issue debentures to retail investors. Responses to submissions expressed a number of concerns in relation to APRA's proposals.

2.1 At-call products

RFCs are currently able to offer products allowing immediate withdrawal of funds if an investor so desires. APRA proposed to restrict the use of the term 'at-call' by RFCs. In addition, APRA proposed that RFCs not allow retail investors to redeem their funds at-call; instead, retail debenture offerings would be required to have a minimum maturity period of 31 days.

Comments received

While some submissions were supportive of the proposal, others indicated concern due to the potentially negative effect on investors and RFCs. One response suggested that alternative mechanisms would achieve an appropriate combination of investor protection and investor education without the need to apply an 'at-call' restriction. Other comments suggested shorter minimum periods ranging from 48 hours through to 14 days.

APRA's response

APRA has considered the submissions received and, in particular, whether disclosure can of itself achieve a sufficiently clear distinction between products offered by RFCs and those offered by authorised deposit-taking institutions (ADIs). APRA remains concerned that the availability of 'at-call' products may provide the false impression that

such products have the same level of security as 'at-call' products offered by ADIs, notwithstanding existing disclosure requirements. APRA therefore remains of the view that the provision of 'at-call' products by RFCs could lead to uncertainty in the mind of a retail investor as to the nature of the product offered. It is also noted that the restrictions on at-call products only affect six RFCs, being less than two per cent of all RFCs. The at-call holdings of these RFCs represent a small fraction of overall liabilities of the RFC industry.

The 31-day minimum term is intended to reflect a timeframe that does not convey the impression that a product is an at-call product or can be transacted upon such that it could reasonably be confused with deposit products held with an ADI. Most people receive regular income on a fortnightly or monthly basis, which suggests that a timeframe greater than 14 days, and possibly greater than 30 days, is appropriate for an investment to not be considered transactional. APRA has therefore settled on the minimum period that achieves the objective of differentiating debenture issuers from ADIs in this respect. Consequently, APRA will proceed with its proposal to restrict the use of the term 'at-call' by RFCs and the ability of RFCs to offer at-call debenture products to retail investors. Instead, retail debenture offerings by RFCs will be required to have a minimum maturity period of 31 days.

2.2 Transition arrangements

APRA originally proposed that the new requirements would take effect from 1 July 2013. This would have meant that any funds raised from 1 July 2013 would have been required to have a minimum initial maturity period of 31 days from that date. The discussion paper also indicated that existing debenture issues would have a transition period of up to three years to comply with the proposed requirements but 'at-call' products would need to comply immediately.

Comments received

The proposed transition period resulted in the greatest number of comments. APRA received numerous enquiries about the proposed transition period both prior to the close of the consultation period and in formal submissions. Submissions indicated the importance of ensuring adequate transition as well as general uncertainty as to how the transition was intended to work, notably with respect to at-call products.

APRA's response

The intention of the proposal was that RFCs would not be able to offer at-call investments to retail investors from 1 July 2013, and by that date existing retail at-call funds would need to be redeemed by customers or converted to debentures with a minimum 31-day maturity. The transition period of up to three years was only intended to apply to debenture issues that had term maturities (i.e. not 'at-call' investments). APRA did not consider at-call accounts as falling within this category and so proposed that from 1 July 2013 RFCs should not have any 'at-call' products.

In response to the concerns expressed by RFCs, APRA issued a letter on 24 May 2013¹ proposing an extended transition period for existing at-call retail investments. That proposal was that, for retail at-call investments:

- from 1 July 2013, no new at-call accounts would be allowed to be accepted by RFCs; and
- existing accounts at 30 June 2013 may continue to be operated at-call until 30 June 2014.

Given APRA's clarification was released on 24 May 2013, some submissions were able to comment on it before the consultation period closed. These submissions, as with the comments received on the original proposal, argued that APRA should provide a 12-month transition period with respect to all at-call investments, including being able to write new at-call business during this period.

1 Refer to <http://www.apra.gov.au/adi/PrudentialFramework/Documents/130524-letter-at-call-transition-May-2013.pdf>

APRA acknowledges that an adequate transition period is appropriate to allow time for RFCs to manage the conversion of existing at-call products to term debentures or other forms of funding, and to adjust funding of their balance sheets as necessary to comply with the revised conditions. APRA also recognises the time that has passed since APRA set out its original proposals, and that RFCs have been aware of these proposals for some time. Balancing these considerations APRA will amend the transition arrangements as detailed below.

At-call products

An RFC will:

- from 1 July 2015, not be allowed to offer or accept new at-call accounts; and
- be allowed to continue to operate at-call accounts in existence at 30 June 2015 until 31 December 2015.

Term products (i.e. other than 'at-call')

All term products must comply with the new conditions as set out in this response paper by the **earlier** of the next rollover date of the product or 30 June 2016.

A term product that has a rollover date after 30 June 2016 will need to comply with the requirements by 30 June 2016. An RFC will not be required to cancel existing term debenture products that have a rollover date later than 30 June 2016. Rather, they must ensure that the holders of such products are notified of any modified conditions that will apply from 30 June 2016. In this regard, an RFC should seek legal advice about its obligations under the *Corporations Act 2001*, Product Disclosure Statement requirements and any other disclosure requirements mandated by ASIC.

2.3 Early release of benefits

This issue was not specifically dealt with in the discussion paper.

Comments received

A number of submissions expressed concerns about whether, or to what extent, RFCs would be able to release funds early in cases of exceptional circumstances that qualify as hardship.

APRA's response

APRA did not specifically address the issue of early release of funds arising from exceptional circumstances in the discussion paper. APRA is sympathetic to the concerns expressed in submissions as to the likely detrimental impact for individuals who have invested in term products and then suffer unexpected hardship that could warrant the early release of their funds. APRA will therefore allow RFCs to release funds in cases of demonstrated exceptional circumstances that may lead to hardship. APRA expects that RFCs will have a formal documented procedure for the early release of funds and that there will be few instances where early release is granted.

2.4 Application of proposals to wholesale investments

APRA's proposals were intended to remove the ability of RFCs to offer products to retail investors that look like deposit or transactional banking accounts provided by ADIs.

Comments received

Some submissions questioned whether the proposals, or certain aspects of the proposals, only applied in respect of retail business or whether they also applied to wholesale business.

APRA's response

APRA notes, for clarification, that the proposals only apply to retail products offered to retail investors. This will be clarified in the RFC Exemption Order as follows:

- restrictions on the use of the words 'deposit' and derivatives thereof and 'at-call' only apply in relation to retail business. That is, an RFC

will not be allowed to use these words to market, advertise or otherwise in connection with the retail business it undertakes;

- at-call debenture products - the restriction on offering at-call debenture products, the minimum 31 day term for debentures and repayment options for an investor on maturity of debenture products are only intended to apply in relation to products offered to retail investors. They will not apply to products offered to wholesale investors; and
- use of certain facilities including ATMs, BPAY, EFTPOS and cheque account facilities - the restrictions on offering these facilities will only apply with respect to products offered to retail investors. They will not apply to products offered to wholesale investors.

2.5 Prudential supervision warning

Currently, when offering securities or financial products to an investor, RFCs must provide the investor with a warning (the prudential supervision warning) in the manner specified in the exemption order. The warning is to the effect that the RFC is not supervised by APRA under the Banking Act and that an investor will not have the right to priority of repayment that is conferred on depositors by section 13A of the Banking Act.

APRA did not make any proposals in its discussion paper with respect to the prudential supervision warning.

Comments received

APRA received a submission that queried whether there would be merit in amending the prudential supervision warning required to state that investors in RFC products are not covered by the Financial Claims Scheme (FCS) that applies in respect of deposits held in protected accounts of ADIs. Responses also queried whether the prudential supervision warning should be included in all promotional material issued by an RFC, not just in offer documents.

APRA's response

While APRA did not specifically consult on this matter, APRA sees merit in amending the prudential supervision warning to advise retail investors that their investments are not afforded protection under the FCS. APRA will remake the RFC Exemption Order accordingly. RFCs will need to include a statement, as part of the prudential supervision warning provided in every disclosure document relating to securities and in product disclosure documents for financial products, to the effect that the product is not covered under the FCS.

The revised prudential supervision warning will take effect from 1 January 2016. For the avoidance of doubt this relates to new and existing material, meaning RFCs will have until 1 January 2016 to update the prudential supervision warning on existing materials.

2.6 Options on maturity of debentures

The discussion paper proposed 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 the investment be rolled over.

Comments received

A number of submissions questioned APRA's proposals concerning the need for an investor to actively indicate how their investment is to be applied each time it matures. Some submissions indicated that investors generally do not respond to requests to indicate what they want done with their investment on maturity. Some submissions also made reference to ASIC's *Regulatory Guide 69: Debentures and notes: Improving disclosure for retail investors* (RG69), highlighting its requirements for dealing with rollovers of investments.

APRA's response

APRA's proposals in this regard are designed to reduce the potential for retail investors to form a view they are investing in 'bank-like' or 'ADI-like' products. It is also intended to ensure that investors make a conscious decision when reinvesting their funds. APRA accepts the arguments in submissions that investors often do not elect what they want to do with their funds on maturity. RFCs will therefore, in the absence of direction from the investor, be allowed to roll a maturing debenture investment into another debenture with the same terms and conditions, noting that the minimum 31-day maturity will apply. Where a retail investor indicates they do not wish their investment to rollover, then the options for payout will be as consulted on. That is, the funds must be repaid to the investor via cash, cheque or direct credit to an account at an ADI.



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