RESPONSE PAPER

APRA's approach to new entrant authorised deposit-taking institutions

August 2021

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Executive Summary

APRA released a Discussion Paper *APRA's approach to new entrant authorised deposit-taking institutions* and an accompanying information paper *ADIs: New entrants – a pathway to sustainability* on 18 March 2021 for industry consultation. The information paper detailed APRA's proposals for its revised approach to the application of its prudential and supervisory frameworks to new entrants, with the discussion paper setting out a summary of the revisions and their rationale. The proposed revisions included clearer expectations about the need to launch products, a clear approach for setting prudential capital requirements for newly-licensed authorised deposit-taking institutions (ADIs), and a greater emphasis on preparing for a potential exit.

APRA sought industry feedback on the proposals. The approach was broadly supported, with some specific areas suggested for adjustment or clarification.

This paper sets out and responds to the feedback received, indicating enhancements to APRA's approach following the consultation period. The approach remains consistent with the proposal set out in the consultation package, with the most significant clarifications relating to milestones in the progression of a licence application.

Accompanying this paper is the final information paper *ADIs: new entrants – a pathway to sustainability* and ADI Licensing Guidelines which are available on APRA's website at http://www.apra.gov.au.

Chapter 1 - Introduction

Background

On 10 August 2020, the Australian Prudential Regulation Authority (APRA) announced it would review its licensing approach for ADIs, including the Restricted ADI licensing framework launched in 2018. The Restricted ADI framework was designed to promote competition in the banking sector by providing a pathway for aspiring ADIs to gain a licence to conduct limited banking business while they prepare to meet the more stringent requirements of a full ADI licence[1].

On 18 March 2021, APRA released a Discussion Paper *APRA's approach to new entrant authorised deposit-taking institutions*. The discussion paper was accompanied by a draft information paper *ADIs: New entrants – a pathway to sustainability*.

The information paper set out the details of APRA's proposed approach to the application of its prudential and supervisory frameworks to new entrants, both at the point of licensing and during the period the new entrant is building a sustainable business. The discussion paper summarised the rationale for the main revisions to APRA's approach.

The approach set out in the information paper represented a strengthening of the prudential and supervisory frameworks as they apply to new entrants. The revisions sought to recognise that the typical application of APRA's prudential and supervisory frameworks are not always well-suited to the common characteristics of new entrants. New entrants face heightened risks and uncertainty. In some areas these risks are markedly different than those faced by established ADIs, such as the high ongoing resourcing needs to fund the growth of business and operational expansion. The proposed approach sought to ensure that a new entrant is equipped to manage the heightened risks arising from a growing business, strengthening the chances of success, while also increasing financial safety in general and depositor protection in particular.

Written submissions on these proposals were invited from all interested parties by 30 April 2021.

Submissions received

APRA received 10 written submissions. These submissions came from potential new banking industry entrants, industry associations and professional services firms. Submissions that were not marked as confidential are available on APRA's website.

All respondents generally supported APRA's proposed approach to the licensing and supervision of new entrant ADIs. However, some sought clarification of, or raised concerns about, particular elements of the proposed approach. The most common areas related to:

- Requests for more or less specific detail in APRA's approach;

[1] For the purposes of clarity, in this paper only, the term ADI is used in distinction to Restricted ADI.

- Timeframe and milestones;
- Deposit restrictions;
- Capital requirements;
- Requests for clarity on concepts, or more detailed definitions.

APRA's response to these issues is set out in Chapter 2. In addition, APRA made supporting changes to the information paper to improve clarity in a number of areas.

APRA's approach to new entrant ADIs

Accompanying this paper are the following documents:

- Information paper – ADIs: new entrants – a pathway to sustainability;
- Guidelines – Licensing: Locally-incorporated ADIs; and
- Guidelines – Overseas Banks: Operating in Australia.

These documents cover APRA's approach to new entrant ADIs and incorporate the changes made in response to feedback received during consultation on the information paper.

Potential applicants should contact APRA at licensing@apra.gov.au with any questions about the application process.

Chapter 2 - Response to submissions

This chapter details the feedback received and APRA's response.

Respondents were broadly supportive of APRA's approach, variously suggesting it was appropriate for APRA to:

- Focus on sustainability, as a prerequisite to providing competition and delivering innovation.
- Focus on the areas demonstrated to be of higher risk to new entrants.
- Recognise differences between new and established ADIs.
- Strike a balance between supporting new entrants, and ensuring financial stability and protecting the interests of depositors.
- Prepare for the possibility that a new entrant may not be successful.
- Provide more detailed guidance to prospective applicants, especially regarding expectations around capital, product launch and preparing for potential exit.
- Provide greater clarity and transparency about APRA's expectations regarding the structure of capital instruments, ownership and legal structure.

2.1 The level of specific detail in APRA's approach

Compared with the 2018 Restricted ADI information paper, the draft 2021 information paper provided extra detail on APRA's supervisory approach and expectations during the restricted phase. It also, for the first time, provided published guidance on APRA's supervisory approach in the period following the grant of an ADI licence, as well as expectations for direct ADI applicants.

Comments received

Several respondents suggested that APRA's overall approach should be to provide more specific detail on requirements regarding the licence assessment and supervision processes. The rationale given was that the clearer APRA's exact expectations, the easier it is for applicants or newly-licensed entities to meet them.

Meanwhile other respondents suggested that APRA's overall approach should be less rigid and more flexible regarding the licence assessment and supervision processes. The rationale given was that when considering innovative business models and practices, a tailoring of approach to individual applicants was necessary.

APRA response

APRA's view is that the information paper will act to increase transparency and consistency of approach, while still allowing for diversity and innovation. APRA has balanced the need to provide sufficient information and set expectations with the need not to adopt a 'one size fits all' approach. Prospective applicants may also speak directly with APRA and applicants have frequent engagement with APRA during the assessment process, providing an avenue for more specific questions.

The updated ADI licensing guidelines, published concurrently with the final information paper, provide further clarity and address a number of points of detail raised in comments received.

2.2 Timeframe and milestones

The draft information paper contained limited references to the expected timeframe of a licence application assessment, or significant milestones along the way.

Comments received

Several respondents addressed the topics of timeframes and milestones in the licence application assessment process. Suggestions included:

- An 'investor friendly licensing path' or 'roadmap' for the process, where APRA provides an indicative timeline with milestones that need to be reached. This would allow applicants to show investors and their Board where they are in the process.

- APRA to provide illustrative examples of a 'quick' assessment process and a 'slow' assessment process, including commentary on any reasons for delay.

- APRA to provide greater clarity and transparency around particular aspects of the assessment process, such as:

    i) which teams within APRA an applicant should expect to engage with (especially regarding IT risk)
    ii) the likely timing of their involvement
    iii) steps in the decision-making process regarding the application
    iv) timeframes for APRA to respond to applicant's information provision and to applicant queries.

APRA response

APRA agrees that it would be helpful to be clearer on existing milestones and how these are reached, and what they signify. The final information paper includes extra material on these topics and the updated ADI licensing guidelines provide further information, including stylised flow diagrams illustrating the application assessment process.

A licence assessment is generally an iterative process with an applicant submitting and then resubmitting documents, either in response to APRA feedback, or as the applicant's circumstances change, or as it refines its proposal. Once APRA is satisfied that it has a final and substantially complete application, a licensing decision is ordinarily made within 90 days. The application process from submission of formal application until substantially complete may take twelve - eighteen months depending on the readiness of the applicant and complexity of the business.

2.3 Deposit restrictions

The draft information paper reconfirmed that Restricted ADIs are subject to a deposit limit of $2m on the aggregate balance of all protected accounts. It also stated that newly-licensed ADIs may be subject to ongoing deposit restrictions in the initial period.

Comments received

One respondent suggested that the $2m limited for Restricted ADIs should be raised to $5m. The rationale given was that the current limit increases a Restricted ADI's dependence on capital injections. Another suggested that the current limit – allied with the 'staff, family and friends' provision– was insufficient to allow a Restricted ADI to test its target market.

One respondent urged caution on the use of ongoing deposit restrictions following issuance of an ADI licence, suggesting that they should be used only very sparingly. The rationale given was that it might restrict a new ADI's growth. It was also suggested that any restrictions needed to be communicated to an ADI well in advance, to allow financial projections and forecasts to prospective investors to account for them.

APRA response

APRA was not persuaded that the $2m aggregate deposit limit should be increased for a Restricted ADI. The purpose of product launch in the restricted phase is not to test the target market, but to demonstrate operational readiness for full public launch. This does not require a large deposit limit. Further, APRA allows concessions for Restricted ADIs under the prudential framework as they build their resources and capabilities, predicated on confidence that an orderly and successful return of deposits will be relatively straightforward if the Restricted ADI is unsuccessful; deposit limits contribute to this confidence.

Raising the deposit limit would not reduce reliance on capital raising, because any such increase would necessitate a matching increase in minimum capital requirements. Moreover, deposits cannot be used to fund expenditure – only income or capital can.

APRA's intention is not to restrict a new ADI's growth when it occurs in a measured, controlled and proportionate manner. This includes where assets and liabilities grow at a reasonably similar rate, supported by adequate governance and risk management which evolve appropriately and commensurate with the ADI's risk profile, coupled with a credible option to execute an exit from banking business. This means that, where a deposit restriction is imposed, it may be removed as the ADI is able to demonstrate the above to APRA.

APRA will communicate any deposit restrictions to ADIs as far in advance as it is able.

2.4 Capital requirements

The draft information paper described APRA's approach to setting prudential capital requirements (PCRs) for a newly-licensed ADI, including a 'highest of' three methods methodology.

Comments received

One respondent suggested that the risk-weighted assets (RWA) methodology, with a nominal dollar amount floor, would be simpler. The rationale given was that it would be too complex for a newly-licensed ADI to manage its capital to a shifting PCR.

One respondent suggested that newly-licensed ADIs should not be subject to lower capital requirements than long-established ADIs.

APRA response

APRA was not persuaded that the highest of three methods methodology was either conceptually inappropriate or overly complex to implement. Each of the three methods is designed to address particular potential circumstances of a new applicant, and the risks arising from them. In order to be licensed as an ADI, an applicant will need to have the capability to manage its capital against requirements, including as these requirements shift. Nevertheless, the method that produces the (highest and therefore) binding outcome for determining PCR is expected to change infrequently. For most new entrants, as they grow their business and operations, the binding requirement is likely to be generated through the nominal floor or forecast operational expenditure method. Once the ADI is more established it will have a balance sheet of sufficient size and composition that it will transition to the RWA method.

Given that capital requirements for newly-licensed ADIs will be set on a 'highest of' three methods basis – and where one of those methods is based on that applied to established ADIs – capital requirements for a newly-licensed ADI will not be below that of an equivalent established ADI. The ratio of RWAs specified by APRA under the RWA method is very likely to be higher for a new ADI than for an established ADI, given the former are higher risk, and the final information paper has been amended to reflect that.

2.5 Requests for clarity on concepts, or more detailed definitions

A significant proportion of comments received requested clarity on particular topics, or more detailed definitions of terms used. The table below addresses the main issues raised.

Feedback or questions	APRA response	Changes arising
Does an applicant have the choice of pathway (restricted or direct), or is that determined by APRA?	Prospective applicants will need to agree the most suitable pathway with APRA, as part of the pre-application process.	The final information paper includes additional commentary on the common characteristics of a direct ADI applicant.

Feedback or questions	APRA response	Changes arising
	Eligibility for either pathway is ultimately at APRA's discretion.	
The restricted phase is for a maximum period of two years. APRA may consider extending the time limit in some circumstances, though only where APRA assesses that the Restricted ADI is able to transition to an ADI licence in a short timeframe past the two-year limit – can applicants apply for an extension past the two year period?	APRA's general expectation is that Restricted ADIs will either progress to ADI within two years or exit banking business, and its project plans should reflect this. Where an ADI is not successful at progressing its business, APRA will not allow it to maintain a 'shell licence'. APRA will consider granting an extension only in exceptional circumstances, such as it did recently for one RADI that was impacted by the licensing suspension.	None required.
What are the minimum parameters of a limited launch (e.g. minimum number of customers, minimum aggregate dollar amount)?	Given the range of potential products APRA is not able to specify expected parameters around a limited launch. The applicant must be able to demonstrate to APRA operational readiness for a full public launch.	The final information paper has been amended to make this clearer.
Customers offered a new deposit product during the restricted phase are expected to consist of staff of the Restricted ADI and their families and friends – is there any flexibility in this definition?	APRA's underlying policy intent is predicated on the view that an orderly and successful return of deposits will be easier to achieve if all depositors have some personal connection to the Restricted ADI. As such, other persons such as contractors or staff of service providers may be suitable.	The final information paper has been amended to reflect this, also to make it clearer that this stipulation applies to deposits only (not income-producing asset products), and that APRA will agree an alternative approach for deposit products that are not for individual persons (e.g. SMEs).
Other members of the general public should not be able to apply for a new release deposit product from a Restricted ADI – can a waitlist of customers for full public launch be taken during the restricted phase?	Yes. APRA's expectation apply only to the limited launch.	None required.
Restricted ADIs are not expected to grow significantly beyond a $100 million balance sheet – does that apply to a pre-existing prepaid card product?	Yes, where customer funds are held on the Restricted ADI's own balance sheet – and noting the general requirements of the *Payments System Regulation Act*. Where the Restricted	The final information paper has been amended to reflect this.

Feedback or questions	APRA response	Changes arising
	ADI's prepaid card is issued under a 'white label' agreement with another provider, no specific size restriction applies.	
Are there any restrictions on a pre-existing prepaid card product for a direct ADI applicant?	No, again noting the general requirements of the *Payments System Regulation Act*.	None required.
APRA expects that entities will seek to operate with capital well above their PCR level – can APRA provide greater guidance on expectations for excess capital over minimum requirements?	APRA's view is that internal management buffers should be set according to an entity's own risk appetite. APRA will not set expectations for buffers above PCRs, as those amounts would themselves become *de facto* PCRs. APRA will however challenge applicants on the appropriateness of their limits; entities should to be prepared to justify their chosen limits and demonstrate they are adequate.	None required.
For a new ADI, where appropriate, APRA will specify an alternative methodology for calculating the operational risk capital requirement under the RWA method – to be used instead of the normal methodology outlined in relevant prudential standards – can APRA provide greater guidance on an alternative methodology?	APRA is currently reviewing its approach to determining operational risk capital requirements for small ADIs, including new ADIs[2]. In the meanwhile, APRA will agree a suitable methodology with applicants on a case-by-case basis.	None required.
A new ADI will be expected to achieve a full public launch of products very shortly after being granted a licence – can APRA provide a definition of 'very shortly after'?	Applicants should propose a full public product launch schedule, which will be considered by APRA on a case-by-case basis. APRA's general expectation is that launch will occur within 6 months of authorisation. Should products not be launched within 12	The final information paper has been amended to reflect this.

[2] Revisions to the capital framework for authorised deposit-taking institutions | APRA.

Feedback or questions	APRA response	Changes arising
	months of authorisation, this may be grounds for revocation of the licence.	
Various issues regarding acceptable legal structures and ownership arrangements.	APRA is currently working on producing updated guidelines on the authorisation of Non-Operating Holding Companies, and on applications for exemption from the *Financial Sector Shareholding Act.* These are both intended to be published later in 2021.	Once published, the planned guidelines will address many of the issues raised regarding acceptable legal structures and ownership arrangements.

Chapter 3 - Next steps

Accompanying this paper is an information paper *ADIs: new entrants – a pathway to sustainability* describing APRA's approach to new entrant ADIs. The approach will be applied from the date of this paper. This paper is also accompanied by revised licensing guidelines for both locally-incorporated ADIs and overseas banks looking to operate in Australia. This response paper and the accompanying information paper and guidelines are available on APRA's website at http://www.apra.gov.au.