

“Banking Act exemptions and section 66 guidelines”

APRA Discussion Paper

Banking Act exemptions and section 66 guidelines

SECOND SUBMISSION FROM BELL POTTER CAPITAL LIMITED

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(“BPC”)

Introduction

This is our second submission on the proposals contained in the APRA Discussion Paper “Banking Act exemptions and section 66 guidelines”. Our first submission specifically addressed the catastrophic impact of no transition period for our business.

In this paper we address the broader issues. We also attach our submission to ASIC in relation to ASIC’s CP199.

Proposal

We believe that APRA should continue to allow at-call debentures to be issued and that there are mechanisms which would provide an appropriate combination of investor protection and investor education. In our case, our debenture issue allows us to provide products and services specifically designed to cater for the specialist needs of stockbroking clients.

If APRA is unwilling to continue to provide an exemption for all investors, then as a fall-back position, we request APRA provides an exemption for wholesale investors as defined in the Corporations Law. We note that APRA has made specific mention of retail investors in its paper. We believe that APRA’s position as set out in its Discussion Paper is to continue to allow the issuing of at-call debentures to wholesale investors but it is not entirely clear.

Alternative approaches

Rather than simply ban at-call debentures, APRA should use its powers under section 11 to exempt specific issuers who agree to meet certain financial covenants. This approach would harmonise with ASIC proposals in CP199. Further we do not understand why APRA believes there are not sufficient powers under the existing arrangements so that ASIC and Trustees can ensure that issuers have sufficient assets to meet their requirement to repay their liabilities to investors. If further powers, and in particular protection for Trustees are required, then these should be identified and created.

Again as a fall-back position we think there is merit in distinguishing between retail and wholesale clients.

Case for a continuing exemption

In the case of the business of Bell Potter Capital we believe that we provide a good service to our clients which is well run and well secured. We would welcome a 'mid-range' prudential capital and supervisory regime that allowed us to continue to operate our business. The current minimum capital requirement of \$50m for an ADI is simply too high for firms of our size and nature. We believe it would be productive for APRA to consider whether:

- It could implement a scaled capital regime for small debenture businesses, and/or
- Whether a regime similar to that proposed by ASIC (mandatory minimum capital, enhanced auditor and trustee supervision)

could meet the concerns of APRA and the global principles as espoused in the *Core Principles of Effective Banking Supervision*

Use of Certain Terms

Following release of ASIC RG159 we already avoid the use of terms such a deposit, replacing it generally with "investment". Finding a convenient replacement for the word "at-call" is more difficult.

Transaction Functionality

APRA's paper refers to certain transactions which it proposes to prohibit for RFCs.

In our view the use of BPay and Direct Credit to allow incoming funds to be added to a client's investment is critical. In the case of our business model, this includes the direction of dividends. For that matter a wide range of financial products allow BPay and Direct Credit for adding funds.

We **do not allow clients** to:

- Withdraw using use BPay or to direct debit
- Access their funds via ATM
- Write cheques

In short, in our case it is already very clear to clients we do not provide a full transactional service. Our products and services are designed only to meet their needs in operating their investment portfolio.

Safety of at-call facilities

APRA has objected to at-call debentures because they are most 'bank-like'. Yet, from an investor's safety perspective, the ability to call for your funds at any time is a key benefit. In BPC's case our assets all have a term of less than one year and all of our margin loans are repayable on demand. Where investor debenture funds are not required, the surplus is held in bank (big 4) deposits with terms of less than 6 months.

If we can satisfy APRA that our clients do not regard our accounts as having the same investor protections as a transactional bank account, then from both a risk and a functionality perspective we believe we should be allowed to continue to issue at-call debentures.

Our clients need for at-call facilities

In specific industries such as stockbroking, the continuation of at-call debentures would allow us to continue to provide required services to our clients. For example, our margin lending product integrates with our at-call debenture product to allow clients to hold either a credit or debit balance.

In stockbroking, intraday movements of funds are frequently required and such movements are typically not well facilitated by the banking system in general. While we may be able to facilitate these movements through some specialist banking products, having an in-house capability enables us to provide a better and more integrated service.

Our service is not used for everyday banking requirements of clients and specifically we do not offer cheque facilities, credit card facilities, ATM access.

We are already subject to RG156 which means we do not use the words deposit in our advertising material. Going forward we would continue to be regulated by ASIC and its proposals as contained in Consultation Paper 199.

Indeed, the bulk of problems in the debenture sector have arisen from term debentures, not at-call.

In short, we believe there is scope for APRA to continue to provide an exemption for businesses such as ours, which are in our view already well regulated.

Impact of wide ranging regulatory change

The current regulatory direction in Australia, including the impact of Future of Financial Advice (FOFA), risks concentrating the bulk of financial services in the hands of a small number of large banks. In our view having a diversity of financial providers and products is important to the long term health of the financial services sector.

The cumulative impact of existing debenture reform and FOFA is yet to be seen.

Other comments on APRA's Paper

We understand that APRA has pointed to statements by the IMF. The comments by the IMF as reproduced in the APRA discussion paper make no specific mention of at-call products. The *Core Principles for Effective Banking Supervision* appears, according to the APRA paper, to require "the taking of deposits from the public be reserved for institutions that are authorised and prudentially supervised as deposit taking institutions".

The IMF's key issue appears to be with global institutions benefitting from the exemption, not small domestic players noting that our scale is *de minimis*. This issue can be addressed by APRA using its powers to make specific rather than general exemptions.

Investor Education and quality advice

A key issue raised by APRA appears to be the problem that "In the mind of a retail investor, this (similar terminology) could lead to uncertainty – notwithstanding existing disclosure requirements – as to the nature of the product offers, or provide a false impression that such products have the same level of security as 'at-call' accounts...offered by ADIs".

In simple terms APRA is concerned that investors can't understand what they read, and that the solution to that problem is to cease to allow the product (debentures with maturity date of less than 31 days) to exist. With respect, our view is that narrowing the range of financial products available to clients is not good policy nor does it ensure a good regulatory outcome. The issue of enhanced investor education, together with quality advice in the case where investors are not financially literate enough to make solo decisions is a far more sophisticated response and one that is only starting to be addressed by parliament and regulators. In our view, the enhanced regulation of, and minimum capital regime for, debenture issuers as proposed by ASIC, together with other recently implemented regulatory changes (such as Future of Financial Advice – FOFA) will address concerns around investor protection and quality of professional advice. In our view further work needs to be undertaken in relation to the standard of investor education in Australia to ensure clear and concise disclosure is properly assessed and prudent, appropriate decisions are taken by investors.

Replacement Product

In the case that APRA does not provide Bell Potter Capital with a continuing exemption from section 11 we will consider launching a managed investment scheme to provide clients with the functionality they require and an opportunity for our business to continue.

We estimate the cost of this transition below.

Risks to business:

If reasonable transition is not provided we believe our business may suffer reputational damage which may lead to the loss of future business. To provide a sense of scale; we currently make a net profit before tax of approximately \$2m a year and believe as market conditions recover that that profitability will grow.

We emphasise, that even if APRA does not provide reasonable transition, clients are not at risk of losing funds. The issue is much more a loss of functionality and services which will require significant administrative effort on behalf of our clients and their advisers. The requirement, to open a large number of new accounts, redirect dividends, proceeds from sales etc is a very significant problem, especially if it is required to be done in less than a month.

Costs impacts

Legal and compliance costs of converting to a management investment scheme: \$250k

Systems costs: \$100k

Converting accounts to a new structure 40,000 times \$30-50 per account including need documentation and staff time to transit accounts: \$1.2-2m

Loss of funding (say \$50m) replaced by higher cost funding (higher by 1%).

In many cases we pay a trailing commission to advisers from funds raised through our debenture issue. Existing accounts can continue to receive trailing commissions under the grandfathering provisions in FOFA. The trailing commissions will be lost if new facilities need to be created.

Conclusion

We understand APRAs concerns but we believe we have outlined a number of approaches which would allow us to continue to offer uninterrupted services to our clients while still meeting APRAs regulatory needs. We welcome the opportunity to discuss these issues directly with APRA.

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