"Banking Act exemptions and section 66 guidelines"

APRA Discussion Paper

Banking Act exemptions and section 66 guidelines

SUBMISSION FROM BELL POTTER CAPITAL LIMITED

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("BPC")

Introduction

Thank you for the opportunity to provide comments on the proposals contained in the APRA Discussion Paper "Banking Act exemptions and section 66 guidelines". We are concerned by the proposals contained in the consultation paper, but more particularly we are extremely concerned by the impact on our business and our clients of the transition period APRA proposes, as set out in the discussion paper and in its Media Release.

Our comments below are limited to the catastrophic effect of the proposed transition period – as we now understand it - on our business, staff and clients. We intend to make a further submission on the broader issues in the coming days.

In summary we submit that a reasonable transition period is provided in relation to any substantive regulatory change implemented by APRA. For BPC this would require a timetable where:

- BPC can continue to open new client accounts until 30 June 2014 and continue to offer at-call debentures to those clients
- BPC be permitted to continue to issue at-call debentures to existing clients until 30 June 2015.

Later in this submission we will provide reasons explaining the need for a minimum two year transition period.

Issues with the Discussion Paper

In our view, the Discussion Paper was unclear in relation to the proposed transition period. We immediately contacted APRA following the release on the paper to obtain clarification and are now concerned that the interpretation of the transition period provided to us by APRA is not reflective of APRA's formal view.

Specifically APRA stated to us that all debentures on issue at 1 July 2013 could remain until the next "roll over", and that by "roll over" APRA means the rollover of the next prospectus. Given our business is virtually entirely at-call and that a single at-call debenture is issued to each client (explained in more detail below), we not unreasonably took this to mean that existing at-call clients could remain until the existing prospectus rolled in June 2014.

We are now concerned that APRA is resiling from the position it stated in its email to us on 23 April, and that its intention is to ensure all at-call debentures are repaid on 1 July 2013, which will effectively require us to shut down our business.

<u>BPC Business Model</u>

In making this submission, we believe it is important that APRA understands that our business model is unique and certainly stands apart from the issuers of fixed term debentures secured by interests in real property.

BPC is a Registered Financial Corporation ("RFC") and issues debentures pursuant to two prospectuses (the Cash Account and the Direct Cash Account). We fully comply with the disclosures required by APRA to be made to investors in relation to the products that we offer.

BPC is a wholly owned subsidiary of Bell Financial Group Limited ("BFG" - a company listed on the ASX) and was set up to provide cash management and margin lending services predominantly to stockbroking client of BFG. It has operated in this way since May 2006. The funds invested in BPC by clients (via the issue of debentures) are used to provide margin loans to other BPC clients. Repayment of principal and interest is guaranteed by BFG.

A typical debenture client establishes a Cash Account and links it to their share trading account. Each client establishes an at-call account which is represented by a single at-call debenture which evidences the amount owing to the client. The amount owing under that debenture will change whenever the client invests further amounts, or withdraws amounts.

Typically, when share are sold, the funds are transferred to the cash account and the value owing under the debenture increases. When the client purchases shares, the funds are transferred out to settle the purchase and the amount owing under the debenture decreases

The client is provided with a BSB and account number which represents their debenture account and clients typically provide these details to other financial entities eg share registries, fund managers, superfunds, CHESS, for the purpose of ongoing investment into the cash account.

Although we offer fixed term debentures, the bulk of our debentures (97%) are at-call – our clients typically prefer to ensure that funds can be redeemed very quickly to ensure they are able to take market opportunities when they arise. Some of the at-call accounts are used to meet margin requirements on derivative positions and funds are therefore required to be moved intra-day. Our clients would typically not find it acceptable that their debenture investments were 'locked up' for a minimum of 31 days.

We currently have approximately 40, 000 clients to whom we have issued debentures totalling $167m.

Our margin lending clients also establish an at-call cash account (whose balance is evidenced by a single at-call debenture) for the purposes of holding cash separately when they do not wish to pay down their margin loans, offsetting cash against a pre-paid loan or simply holding a credit balance. Our debenture product therefore is integrated into our margin lending product.

Impact

We make the following points:

- BPC has been in operation since 2006. In that time it has never failed to pay interest or capital to its debenture investors nor has it suffered anything other than minor operational losses in the margin lending book. Both BPC's assets and liabilities are at-call.
- In our view the current proposal is procedurally unfair and gives us no time to seek alternatives for our clients and our business. The consultation papers are due on the 24th March and it would be reasonable to assume that it should take APRA a period of weeks to consider those submissions. This leaves no time between APRA's determination and the effective date.
- In the event that we need to restructure our product, we have 40,000 clients to whom we would need to communicate, provide information and seek instructions.
- Our clients would need to obtain information about other products, make decisions and implement the transfer of their funds following redemption of their debentures. Clients must be given a reasonable time to make informed financial decisions about the transfer of their investment.
- Our clients provide their cash account details to CHESS, ASX, share registries, fund managers, ATO, superannuation funds etc– and these other organisations will need time to obtain new instructions from clients.
- BPC would need to implement significant changes to our IT, reporting and CRM systems including to de-integrate with Stockbroking, margin lending and client reporting systems.
- In the event that BPC was not able to arrange alternative sources of funding for its entire margin lending business at very short notice, we would need to call in at least some margin loans. We would be unable to provide reasonable time for our margin lending clients to refinance to other lenders and therefore may be required to force sell the assets of those clients.
- BPC would suffer irreparable reputational and financial damage. Our business could be shut down in a disorderly manner.

We accept APRAs rationale for deciding to revoke an exemption that been in place for at least 10 years. We do not understand nor do we accept that it is reasonable for APRA to do so without providing a reasonable time for businesses to respond. BPC has complied with all requirements of APRA and ASIC. We have sought to actively and positively engage with regulators and Government to improve our industry. We have done nothing wrong and yet the proposed decisions in relation to timing appear punitive. We do not understand nor is it canvassed in the APRA discussion paper why a business such as ours is effectively given just days to restructure or shut down.

In the event APRA continues with its proposed transition timeframe, there cannot be an orderly transition for our business. The outcome will be disorderly for our business, our staff, our clients and our industry partners. We will suffer financial and reputational damage.

What we propose

We propose that APRA provides a transition period which ensures we are given a reasonably sufficient time to engage in an orderly restructure of a business. In particular:

- we are provided with a minimum of 12 months (preferably 18 months to allow from unanticipated roadblocks!) during which we can continue to take new debenture clients;
- a further 12 – 18 months after that when we can continue to seek funds from existing clients – but no new debenture clients;
- an end date, after which all at-call debentures must be repaid, of not less than 2 years from APRA announcing its final position (and preferably 3 years); and
- this timing is consistent with APRAs stated transition timetable that existing issues are provided with a transition period of up to 3 years.

We believe the above timing will enable us to engage in an orderly wind up of our debenture business and restructure our funding arrangements around a new product (presumably a Managed Investments Scheme). In particular, it will enable us to:

- continue to operate our margin lending business in an orderly fashion;
- develop appropriate new product documentation and systems;
- seek and obtain all necessary regulatory licences and approvals;
- ensure our debenture clients are well informed about the issues and the planned restructure arrangements such that they have time to take advice or otherwise make informed decisions about their investments; and
- implement compliance and education plans for our staff and financial advisers.

Specifically, during the initial part of the transition period (12 – 18 months) BPC will need to:

- research and develop an alternative product structure which seeks to meet the particular needs of our specialised client base;
- develop the appropriate legal documents including client disclosure documents;
- restructure associated client documentation both on-line and physical documents;
- develop the legal, regulatory, operational and compliance structures to support the new product;
- seek and obtain necessary regulatory approvals and licences; and
- modify existing systems and/or invest in new systems support

An initial estimate of the cost of the initial transition phase is $250k - $300k.

During the second phase of transition (approximately 12-18 months) BPC will need to:

- provide detailed information and product documentation to existing clients;
- physically implement a process whereby existing clients who wish to migrate to the new product are assisted to do so;
- work with clients to provide assistance where required to re-instruct dividend, managed investment, superannuation etc payment instructions to new account details; and
- transfer the clients to the new product structure.

In support of this proposal we note:

- the specialised nature of our client base;
- the fundamental need for an at-call account to meet client's requirements;
- the relative small size of our business; and
- the fact that we are guaranteed by our parent.

We would be pleased to provide any other information or meet with APRA if this would assist.

Rowan Fell

Executive Director
Bell Potter Capital Limited

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Glenda Berry

General Manager
Bell Potter Capital Limited

[redacted]

Attachment 1 Timeline

ASIC released its consultation paper 199 on 13 February 2013. This paper proposed significant tightening of the oversight of debenture issuers – particularly in relation to the role of the trustee and auditor, as well as the commencement of a mandatory minimum capital regime.

BPC provided comments to ASIC in relation to Consultation Paper 199 on 28 March 2013.

APRA released its consultation paper on 19 April which promulgated APRAs intention to revoke the exemption which has operated since May 2003 and under which debenture issuers are not required to be ADIs if compliant with APRAs requirements. We are not aware that APRA had foreshadowed this proposal at any time in the past.

The wording of the proposed transition was ambiguous (at least in relation to our business) and we sought urgent clarification from APRA (by phone and by email) of its intentions on 23 April.

On 23 April we receive an email response (attached) from Hannah Cole, Senior Policy Officer at APRA which sought to clarify APRA's transition period proposals. Quoting from Ms Cole's email:

> *"Another way to read the transition period, and as noted in the discussion paper – it is the earlier of the next rollover date (once the proposed new requirements take effect on 1 July 2013) and not later than 30 June 2016 where the next rollover date is after 30 June 2016"* and
>
> *"Yes, the next rollover date as specified in the prospectus for issues already in place at 1 July 2013"*

As BPCs debenture issue is already in place it is not unreasonable that we took this to mean that, although we could not issue any further at –call debentures, all existing at-call debentures could remain until the prospectus rolled over in June 2014.

Our Trustees (The Trust Company) inform BPC on 16 May that in discussions it had had with senior policy officers at APRA, APRA had conveyed that the above interpretation was not correct, and that APRAs intention was that all at-call debentures must be repaid on 1 July 2013.