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24 May 2013

Mr Neil Grummitt  
General Manager  
Policy, Research and Statistics  
Australian Prudential Regulation Authority  
GPO Box 9836  
**SYDNEY** NSW 2001

Dear Mr Grummitt,

**RE: BANKING ACT EXEMPTIONS AND SECTION 66 GUIDELINES**

We write in response to the APRA's above mentioned Discussion Paper released in April 2013. The Lutheran Laypeople's League of Australia Incorporated (LLL) is grateful for the opportunity to respond to the Discussion Paper.

The LLL previously also responded to the APRA questionnaire in May 2012 and also sent correspondence dated 8 October 2012 in relation to the potential direction of the banking exemption. No response or acknowledgement of those communications was received from APRA.

As stated in previous communications, we would welcome the opportunity to engage in dialogue with APRA regarding the potential future direction of the exemption.

**1. BACKGROUND**

We note in the introduction of the Discussion Paper a range of assertions pertaining to banking activity in Australia and the historic reflections of APRA in providing exemptions to organisations that are not authorised deposit taking institutions (ADIs).

The two main categories of exemption canvassed in the paper are those that pertain to Registered Financial Corporations (RFCs) and Religious Charitable Development Funds (RCDFs). It would appear from the tone of the paper that APRA views both categories of exemption as having historical overtones that warrant review and indeed that there are a number of commonalities in relation to these two categories of exemption.

At the outset of this response, the LLL makes the point that its own activities as a RCDF are quite distinct from an RFC and believes it is imperative that APRA acknowledge the uniqueness of charitable activity in the sector. This is an essential theme of this communication and the comments offered.

## **1.1 History of LLL and deposit-taking**

In its founding documents of 1921, it is clearly recorded that the individual constituents of the Lutheran Church chose a course in action that enabled them to pool resources for the specific purpose of providing resources to the Church.

The LLL was so established and the enduring vision of Lutheran constituents pervades very strongly in the history of the LLL, its current mode of operations and its future.

Previous information and correspondence to APRA has demonstrated the extremely conservative and successful model of ministry that LLL has used over a very long period of time. In simplistic terms, LLL receives deposits from members and supporters of the LCA (Lutheran Church of Australia) constituency and these funds are used to provide ministry support to the LCA.

The transactions entered into by the LLL in relation to its core activities are predominantly of three types:

- Administration of depositors' funds involving deposits, withdrawals and interest credited to depositors where applicable (some deposits are made interest free at the discretion of the depositor). Importantly, this occurs on a highly liquid and 'at call' basis.
- Provision of loans to the LCA that meet strict criteria and financial parameters. This involves drawdowns, repayments and interest charges. The LLL is constitutionally restricted to making loans exclusively to the LCA. All loans are guaranteed by the LCA and the LCA also provides an indemnity to the LLL against loss in the event of a loan default.
- Investment of funds with Authorised Deposit-taking Institutions (ADI's) in the form of fixed interest and capital secure investments that are highly liquid (term deposits, bank bills etc). This is a crucial part of capital adequacy and prudential management.

The deposit and loan components of these transactions take place on a non-commercial basis whereby interest rates and margins are governed with the intent of securing depositors' funds while providing optimal benefit for charitable purposes.

LLL has had very strong prudential practices throughout its 90 year history and has both constitutional and operational requirements in relation to the safeguarding of assets. These practices have been exemplified over a long period whereby the LLL has experienced a sustained level of financial stability and an exemplary record of prudential management and the safeguarding of depositors' funds.

## **1.2 History of the banking exemption**

The LLL was formally included in the Banking exemption order No. 1 of 2006 as issued by APRA. No previous exemptions from the Banking Act had been applied for or held by the LLL.

The availability of the formal exemption from the Banking Act in 2006 has enabled LLL to operate with certainty in relation to its position under the Banking Act since this time. In this regard, the LLL acknowledges and appreciates the commitment of APRA to extend the current exemption to 27 June 2014.

In the context of the above history, it should be noted that the inclusion of LLL under the current available banking exemption, and the notion that LLL is therefore considered a RCDF via that exemption, occurred some 80 years after successful operation in Australia as a charitable entity.

The potential removal of the exemption now threatens the very fabric of the LLL and undermines the iconic and visionary work of its founders. It is imperative, therefore, that LLL make this submission to APRA in order for a mutually agreeable future of responsible, charitable deposit-taking to be determined.

### **1.3 International Monetary Fund**

The LLL accepts and encourages the increased scrutiny that APRA is applying to the 'taking of deposits' in the Australian financial system. Furthermore, the observations made by the International Monetary Fund (IMF) as referenced in the discussion paper of the LLL are duly noted.

In this regard, it is apparent from the Discussion Paper that the major theme of APRA is undergirded by the recommendation of the IMF to achieve the following:

*“ Revise the condition 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.”*

The preliminary content attributed to the IMF in the Discussion Paper is quite revealing in relation to the major sources of concern that are being contemplated by the above recommendation. In this regard, the IMF makes feature of 'major global institutions' as benefiting from existing exemptions and clearly identifies 'deposit-like' facilities being offered to the public as the substance of its concerns.

These themes are entirely consistent with commercial exploitation of the current banking exemption arrangements in Australia and leads specifically to the identification of RFCs. There appears to be no direct contemplation in these themes by the IMF relevant to charitable entities.

### **1.4 LLL's response to the discussion paper**

In this response, the LLL seeks to firstly address the important distinction between 'public offerings' in a commercial setting and those that it provides as a RCDF.

The LLL also seeks to address the very important distinctions between RFC activity and RCDFs including the reasons why it would not be feasible for the LLL to move toward an RFC model.

APRA's Discussion Paper also identifies the possibility of charitable entities becoming a registered management investment scheme. The LLL sees no

capacity to pursue this form of activity and does not explicitly deal with this alternative in this response.

Finally, the LLL puts forward two alternatives as to how the central concerns of APRA may be suitably addressed in the context of retaining the exemption or otherwise providing a mechanism by which charitable entities could feasibly become authorised to accept deposits under existing banking laws.

## **2. 'RETAIL' DEPOSIT-TAKING & CHARITABLE WORKS**

The Discussion Paper is very clear in respect to the notion that deposit-taking activity should be authorised in relation to making public offerings. In this respect, APRA refers to 'retail investors' as being a homogenous term applicable to RFCs and RCDFs.

In responding to the Discussion Paper the LLL believes it is highly appropriate to compare the notion of 'retail investor' that is derived from the IMF commercial language as compared to that applicable to charitable works.

We respond to this notion purely from the perspective of LLL and in the context of our current practices of mobilising ministry while protecting depositors' funds.

### **2.1 Composition of LLL depositors**

As explained in previous correspondence, LLL's constitutional mandate is to act as a servant to the LCA. It does so by lending solely to projects of the Church and at discounted interest rates to market.

The LLL receives the majority of its access to funding from accepting deposits from Lutheran constituents and supporters. This includes both LCA organisations together with individuals who support the charitable objects of the LLL.

Deposits received from individuals are generally either constituent members of an LCA organisation or a supporter of an LCA project. It is easy for LLL to measure the support of the deposit base for LCA projects as the majority of loans are subject to a 'matching deposits' clause.

The matching deposits process has been very successful for the LLL in relation to ensuring local projects are funded by local depositors and that there is clear acknowledgement from the deposit base regarding the charitable nature of this activity.

### **2.2 Concept of 'retail deposits'**

Due to the nature of the LLL and its operation, it is difficult to think or define the deposit base in the concept of a 'retail' framework. This is emphasised by the notions briefly explained above.

Furthermore, under the current exemptions held by the LLL, both through APRA's banking exemption and ASIC's class order, all depositors of the LLL are compelled to acknowledge that depositing funds at the LLL is made for the

primary purpose of supporting the LLL and not for investment purposes. This is highlighted in our motto 'Finance with a Mission'.

There are a number of other features that distinguishes LLL depositors with the behavioural model of 'retail deposits'. These include the following:

- LLL does not canvas the general public for deposits and is restricted in doing so primarily under ASIC's class order.
- There have been only minor and infrequent changes to its deposit interest rate in the last thirty years.
- Some LLL depositors elect to deposit funds on a non interest bearing basis to further assist Lutheran projects.
- LLL's deposit base has demonstrated strong resilience to market and economic conditions. As an example, the deposit base of the LLL was very static during the global financial crisis and was unaffected through the period where the Australian government guaranteed deposits of banking institutions in Australia.

### **2.3 Banking exemption and 'retail deposits'**

APRA's contemplations in withdrawing the current banking exemption of RCDFs that receive certain kinds of deposits are of high concern to the LLL. In our view, APRA has not duly considered the significant difference in making public offerings in a commercial sense to the notion of charitably motivated deposit-taking.

The deposit and loans function of the LLL is deeply intertwined in that there are substantive links between the intentions of the depositor and the charitable works of the LLL. Failure to recognise these links would greatly restrict the supporter base of the LLL and its capacity to act as a financial servant of the LCA.

In our view, it is appropriate that all depositors acknowledge that they hold funds at RCDFs for charitable purposes and that this should by definition restrict them from being considered 'retail' no matter what their form or quantum.

We contend that APRA should not withdraw the banking exemption based on a classification of 'retail' deposits. Rather, we suggest that the exemption should be recognised as appropriate for charitable entities but should be subject to prudential supervision of some form that is acceptable to APRA and feasible for RCDFs. We explore this notion further in section 5 of this report.

## **3. OPERATING AS AN RFC**

The LLL views the nature of operating a Registered Finance Corporation as incompatible with its charitable objects and substance of operation over nearly a century. The LLL has no desire to offer debenture products under a guise that has philosophical alignment with commercial revenue raising and associated risks.

In its Discussion Paper on page 6 under 'recent developments' APRA makes mention that:

*"... several failures have occurred in the non-prudentially regulated financial sector, some involving retail investors."*

The mention of the high profile failure of Banksia Securities as an RFC features strongly in this critique. This is a prelude in the paper to observations made by the IMF which, we have already noted above, appear to make no contemplation of entities that operate with a charitable disposition.

It would appear therefore to be counter-intuitive that APRA would prefer RCDFs to operate as RFCs by removing the exemption for charities which have a 'public element'. As noted at Section 2 above, the LLL does not view this alignment as being congruent in any way.

### **3.1 Proposed changes to RFCs**

The proposed tightening of operations pertaining to use of products and restrictions of 'at call' products by RFCs appear to be measures directed at commercial revenue raising. We also note the concurrent mooted changes to prudential requirements for such issuers as identified with ASIC Consultation Paper 199 for debenture issuers.

The LLL once more reiterates its strong support of appropriate measures to increase prudential supervision of all fundraising and deposit-taking in Australia.

Nevertheless, changes proposed to the operation of RFCs further emphasise that for the LLL it would not be an appropriate vehicle for the provision of its charitable works.

As noted above, the LLL operates as an authentic financial intermediary where the fluidity of deposits and loans are undergirded by ease of access to those funds and modern transaction mechanisms. This includes 'at call' accounts and 'Bpay' facilities.

Once more, the LLL recognises that such fluidity and accessibility carries a significant burden in relation to prudential management. The uniqueness of the LLL is emphasised in this regard including the 'matching deposits' concept and the notion of only lending to the LCA under a legal guarantee and indemnity.

These concepts are not transportable to an RFC model which would restrict fundraising to non-liquid debentures and dismantle the core activity of the LLL which has been successful for over 90 years.

## **4. 'TREASURY' MODELS OF RCDFs**

We note that APRA is considering the notion of providing a new form of banking exemption for RCDFs that operate as 'de facto' corporate treasuries.

Crucial to this possible form of exemption would be the restriction of not being able to accept funds from 'retail investors'. The definition of 'retail' deposits is again a key aspect of this proposed measure and our comments at Section 2 above are once more highly relevant.

In the case of the LLL, it would not be possible or pragmatic to delineate depositors that are of a 'household' nature from those that are institutionally Lutheran as the distinction has no practical meaning in relation to mode of operation or prudential protection. This is because by its very nature, the Lutheran Church safeguards all non-institutional depositors through its guarantee and indemnity requirements.

We also note that the restrictions proposed under the 'treasury' model exemption would prevent the use of market-place products such as BPay. The LLL makes strong and appropriate use of BPay together with other non-cash payment facilities including electronic transacting under appropriate licence arrangements including our Australian Financial Services Licence (AFSL) which was granted in 2009. To restrict this form of transacting would once more be highly prohibitive to the LLL.

## **5. AUTHORISED DEPOSIT-TAKING**

The contention of APRA that it is not appropriate for RCDFs to continue to be exempt from the need to be authorised, or at least supervised, under the Banking Act is generally accepted and not objectionable.

In our view, however, the Discussion Paper does not make adequate provision or allowances for the special nature of RCDFs to achieve the status as being 'authorised'. It is not feasible or appropriate for the LLL to operate as an RFC or under the restrictions of a 'treasury' model. The arguments presented in this paper are comprehensive in this regard.

The LLL suggests that APRA may consider two alternatives in order to provide RCDFs with a more realistic future in enabling its charitable works to continue:

1. The continuation of an exemption but with accompanying prudential requirements or 'light touch' regulation. This is referred to below as a 'contingent exemption'.
2. The creation of a clear pathway for RCDFs to meet the requirements of becoming authorised to take deposits under the guidelines applicable to the Banking Act. This is referred to below as 'pathway to ADI'.

We explore these concepts further as follows.

### **5.1 Contingent exemption**

LLL is open to a stronger sense of regulatory input and emphasis on the financial health of RCDFs. In this regard, LLL has always adopted a 'benchmarking' approach in relation to the relevant prudential aspects of the Banking Act that it views as relevant to measuring financial health.

While a full compliance regime of the Banking Act would be onerous and restrictive to its charitable focus, it is not unreasonable for the LLL to need to respond to some forms of regulatory measurement in relation to its deposit-taking activity.

In this sense, the LLL would be open to a 'light-touch' regulatory regime of some form that under-girds future exemption from the Banking Act.

In the previous forms of providing exemption orders APRA has stipulated various conditions in relation to the provision of the exemption. These are contained in the current Banking Exemption No 1 of 2011.

It would appear feasible that a future exemption could expand the conditions to include prudential management and capital adequacy requirements. These conditions could be strongly directed toward the concerns that APRA has identified in its Discussion Paper. An appropriate compliance regime could also be installed.

## **5.2 Pathway to ADI**

APRA itself recognises that a valid response to the potential winding back of the exemption is for RCDFs to seek authorisation to become an ADI.

The LLL intends to perform a full feasibility of whether it is indeed possible to become an ADI while also maintaining a charitable disposition. In its early work in this regard, it is evident that the LLL would have little problem in achieving the core financial requirements or the majority of regulations.

The more problematic aspects would be in relation to legal form, ownership and governance requirements.

The LLL contends that APRA should seriously consult with RCDFs to identify what unique aspects of their activity are naturally prohibitive in relation to being able to seek authorisation to take deposits.

We note that there is clearly some scope under the Banking Act for APRA to consider different classifications of ADIs and also to provide some flexibility with respect to certain aspects. The discussion paper itself in the introduction notes:

*“ There are a number of classifications of ADIs, including banks, building societies and credit unions, amongst others.”*

The notion of APRA enabling RCDFs to move toward becoming authorised as an ADI would be in our view an extremely valuable and sensible tone of its intended consultation. We make the following observations in relation to various aspects of the process that might be considered.

### *5.2.1 Banking business concepts*

APRA's Authorisation Guidelines published in April 2008 suggests that 'banking business' consists of both taking deposits and making advances of money. The guidelines make it clear that applicants need not offer a full range of banking services on authorisation but may choose to provide specialised services. The ability to be registered in this regard pertains to the demonstration of expertise in the applicants selected area of operation.

The LLL contends that it has accumulated significant expertise over 90 years in the provision of 'specialised services' to customers that wish to support the cause of the Lutheran Church. Accordingly, any 'banking business' it seeks to operate would be specialised in the form of the narrow deposits and loans function of the Lutheran movement and those sympathetic to its charitable objects.



### *5.2.2 Legal structure and ownership*

We note that the Banking Act generally only allows corporations to carry on banking business in Australia. It is not clear how congruent such provisions are with the legal form that would apply to most RCDFs.

Most charitable entities in Australia operate as a company limited by guarantee or an incorporated association. One would expect both types of entity to meet the definition of 'body corporate' as required under the Banking Act.

However, an important aspect of these legal forms is the absence of shareholders. This would of course render the restrictions over corporate ownership of an ADI irrelevant but raises significant questions as to the governance and control aspects that those provisions contemplate.

An alternative to the corporate model allowable by APRA would appear to be to operate through a 'mutual' ownership structure. This may, on the face of it, be a more appropriate legal structure for RCDFs but has significant barriers given the notion that the 'ownership' of a mutual would vest entirely in its 'customers'. This is unlikely to have any working solution for a RCDF that exists to serve charitable objects.

It is not currently apparent that a workable ownership structure under the current Banking Act applies to RCDFs that may seek authorisation to become an ADI. We contend that this should not be the case given the APRA Discussion Paper suggests RCDFs consider seeking such authorisation.

The LLL would of course be willing to examine its legal structure in order to comply with the Banking Act and to meet the guidelines in relation to authorisation.

Important consultation from APRA is required in order to understand what legal form would be appropriate and acceptable for LLL to operate as an ADI while also not compromising its charitable mandate.

### *5.2.3 Governance*

Closely related to the legal and ownership requirements of the Banking Act is the need for RCDFs to determine how to meet the governance standards as articulated in Prudential Standard CPS 510. We note in this regard various aspects pertaining to independence, composition, accountabilities, remuneration and various other aspects.

LLL has very strong governance protocols that are highly appropriate to its legal form, prudential considerations and charitable objects including relationship to the Lutheran Church. It is nevertheless not straightforward to adapt the propriety of these governance principles to the requirements of the Banking Act.

Consultation from APRA in this area would be highly warranted in authentically encouraging RCDFs to apply for authorisation under the Banking Act.

## **6. CONCLUDING REMARKS**

LLL is strongly supportive of working through a consultative approach with APRA that represents a firm commitment to exploring an appropriate regulatory regime rather than a restriction over its charitable activity.

There are significant aspects of the Discussion Paper issued by APRA that are in fact entirely restrictive in their substance. These aspects are those that would force RCDFs toward a path of operating as an RFC or to otherwise prohibit the taking of 'household' deposits without appropriate regulatory alternatives.

The LLL emphasises its strong desire to consult in the area of exploring a more sophisticated exemption that includes 'light touch' regulation together with the possibility of enabling LLL to transition to becoming an authorised deposit taker. Both possibilities require significant engagement.

In anticipation of future consultation, the LLL makes some minor remarks in relation to the following areas.

### **6.1 Section 66 guidelines**

The LLL understands the intent of the revised Section 66 guidelines that accompany the Discussion Paper. The LLL does not currently believe any of its depositors have a confused understanding of the nature of the debenture facility it offers. In this regard, both ASIC and APRA currently require clear disclosure to be made to all such depositors.

The central theme of the suggested changes to Section 66 guidelines is to mitigate the possibility that investment into debenture products is misunderstood to be an investment in an authorised bank deposit. The LLL questions whether these changes are necessary given the significant changes proposed by APRA, together with those proposed by ASIC, in relation to the issuing and disclosure of debenture products.

The LLL is hopeful that a consultative pathway to a 'contingent exemption' model or 'pathway to ADI' will concurrently relieve the need for any changes of terminology to be required by the LLL in relation to its deposit and loan facility.

### **6.2 Cost-benefit analysis**

We note APRA's request for responses to its Discussion Paper to be accompanied by a comprehensive cost-benefit analysis. The LLL has struggled to determine how to conduct such analysis given the uncertainty of future directions that may be pursued.

As noted at Section 5.2 above, the LLL is intending to conduct a thorough feasibility of becoming an authorised deposit-taker. To adequately perform this task, the LLL is dependent upon the disposition of APRA to respond to the apparent barriers that exist for RCDFs to pursue such an action.

Upon gaining further indicative direction by APRA, LLL would be pleased to prepare and submit comprehensive cost-benefit analysis.

### **6.3 Social opportunity cost**

Closely associated with the theme of cost-benefit analysis, LLL suggests that APRA should consider the impact of its potential reforms on the social fabric of Australia.

As noted in this response, the LLL is restricted by its constitution in its lending capacity to entities and projects of the LCA. The activities of the LCA find their form in a range of faith based organisations and this includes:

- Local churches and communities.
- National and State church ministry organisations.
- National college for theological training and accreditation.
- Schools and colleges.
- Welfare organisations.
- Residential aged care organisations.

The LLL currently provides significant resources to these categories of LCA organisations in the form of discounted loans, treasury support and transactional efficiency. These organisations have access to transactional deposit facilities earning 4.25% and access to loans generally at 5.0%.

Depositors who support this activity have the comfort of a capital adequacy level as benchmarked against APS 110 which currently measures at 19.8%.

In its annual report for 2012, the LLL estimated that the value of economic benefit provided to the LCA through the provision of discounted loans and services was in excess of \$13 million in that year.

The capacity for LCA organisations to refinance the current loan book held with the LLL into the commercial borrowing sector represents a massive leakage of social capital and the likely demise of significant altruistic activity in Australia. This loan book is currently valued in excess of \$330 million.

It seems counter-intuitive that APRA would contemplate destabilising such a socially responsible organisation without enabling it to retain its activity within an appropriately regulated or authorised environment.

### **6.4 Liquidity considerations**

Further to the above observations pertaining to social opportunity cost, the LLL is highly concerned that APRA may not have considered the full extent of its proposed changes to the exemption for RCDFs with respect to the liquidity impact within the Australian financial system.

RCDFs such as the LLL that are no longer able to offer short term deposit facilities will quickly find that its deposit base is significantly eroded. The capacity for such organisations to pay out 'at call' deposits would inevitably require the calling in of loans. This in turn would only be possible via the refinancing of loans through another means and this may not be possible via a revamped RCDF or via the Australian financial system.

The LLL has very significant and strong liquidity management processes to prevent any form of 'run' or deterioration of deposits to trigger viability or prudential issues. The changes mooted by APRA in its Discussion Paper would, however, most likely lead to such an event.

We implore APRA to give very strong consideration to this matter and once more request that the proposed removal of the banking exemption for healthy RCDFs such as the LLL be reconsidered.

## **6.5 Transition and timing**

In accord with this submission, it is clearly LLL's desire to move toward a regulatory environment that enables continuation of charitable activity as a functional financial intermediary of the LCA.

As noted at Section 5 of this report, it is the desire of the LLL to do so via an exemption regime that thoroughly addresses the primary concerns of APRA while maintaining the ability to operate as it currently does. The alternative of shifting toward an authorisation model for providing 'at call' deposits is the second preference of the LLL and would be strongly pursued.

Either of these courses of action will inevitably require some adjustment for the LLL and certainly for other RCDFs. It will be imperative that APRA provide adequate transition time for the sector to move accordingly.

Clearly, the more severe implications of the APRA proposals such as those explored at Section 6.4 above would be more far reaching and detrimental. It would be crucial for APRA to recognise the significant need to address the timing and transition issues necessary to circumvent significant adverse consequences of such circumstances.

In acknowledging therefore that APRA proposes to extend the current exemption to 23 June 2014, we believe that any change to current exemption arrangements after this time will require a significant period of lead time and transition.

We are reminded of APRA's commitment to work through a consultative approach to this matter. Accordingly, LLL would greatly welcome the opportunity to engage in direct dialogue with you regarding potential future directions of the banking exemption.

I would be pleased to have any personal contact with you in relation to this matter and may be contacted directly on [REDACTED] or via email at [REDACTED]

Yours sincerely,

**The Lutheran Laypeople's League of Australia Incorporated**



**Allen Kupke**  
Chief Executive Officer