



14 April 2011

To All Authorised Deposit-taking Institutions Operation of Foreign Banks in Australia

Under the *Banking Act 1959*, foreign banks are required to be licensed by APRA as authorised deposit-taking institutions (ADIs) in order to conduct banking business in Australia. APRA also authorises representative offices for foreign banks that otherwise wish to maintain a permanent establishment in Australia. Representative offices are generally granted an exemption under Section 66 of the Banking Act in order to use the restricted term 'bank' in connection with their activity in Australia. However, they must limit their activities to those prescribed by APRA for representative offices.¹

Over time, reflecting the global nature of banking business and the centralisation of many functions, foreign banks operating in Australia as branches have conducted some aspects of their local operations from offshore or outside the branch. In general, APRA does not have a fundamental concern with these types of operational structures but notes that they have the potential to lessen APRA's ability to provide effective prudential supervision of the local operations.

Recently, APRA has received a number of proposals from foreign banks wishing to conduct activities with Australian customers from their offshore offices. As a result, APRA is issuing this letter to clarify its policy expectations with respect to business conducted in Australia, or with Australian customers, by foreign banks.

Consistent with the Basel Committee on Banking Supervision's principles on home-host country supervision, APRA has generally taken the position that foreign banks soliciting and operating an active business in Australia should be subject to Australian prudential regulation and supervision, regardless of where the business is booked. However, APRA would not object to a foreign bank conducting business with Australian counterparties from its offshore offices provided:

- the foreign bank does not maintain an office or permanent staff in Australia, including staff employed by another entity within the banking group that conducts business on its behalf;
- the foreign bank is not soliciting business from retail customers in Australia;
- all business contracts and arrangements are clearly transacted and booked offshore, and are subject to an offshore legal and regulatory jurisdiction; and
- the foreign bank does not breach Section 66 of the Banking Act. APRA will not provide exemptions from Section 66 for foreign banks operating in Australia other than in conjunction with the limited activities of a representative office.

APRA has never been inclined to license a 'brass plate' operation of a foreign bank as an ADI. Similarly, APRA would expect to revoke the ADI license of a foreign bank that transferred all of its substantive operations and book of business to offshore offices. Further, APRA expects that

¹ See the *ADI Authorisation Guidelines* April 2008, on APRA's public web site www.apra.gov.au.

a foreign bank licensed as a foreign ADI in Australia will book its Australian business in the Australian branch, unless APRA otherwise agrees to an alternative treatment for specific business activities where local booking is not practical. The foreign ADI is expected to maintain local staffing sufficient to demonstrate adequate local control over the Australian business and compliance with all of APRA's prudential requirements applicable to foreign ADIs.

Where APRA is aware that a foreign bank is conducting a material level of banking activity with Australian residents and booking this business in an offshore office, we would also notify the parent bank and local regulator and request assurance that the regulator is aware of this activity and that the activity is subject to its supervision.

Separately, APRA has a longstanding policy of imposing standard conditions on foreign bank branches that prohibit the branch from accepting initial deposits or other funds for amounts less than \$250,000 from any source, with limited exceptions. The purpose of these conditions is to prohibit foreign ADIs, which are not subject to the full range of the Banking Act protection and APRA's prudential requirements, from financing their activities from retail sources.

APRA applies a principles-based approach to application of these licence conditions. From time to time, APRA receives proposals for activities which are clearly inconsistent with the intent of these licence conditions. As a result, APRA notes the following points:

- APRA's licence conditions apply to the whole of a foreign ADI's activities in Australia, not only the component of its activities that comprises 'banking business' as defined in the Banking Act;
- APRA's intent in including 'other funds' within the prohibition on retail fund-raising is to encompass a broad range of financial instruments, not limited to deposits or similar products. 'Other funds' will include, for example, securities, bonds, debentures, deferred purchase agreements, derivatives and other structured investments, where they involve the raising of funds;
- in applying the prohibition on retail fund-raising, APRA looks through to the ultimate investor or depositor from which funds are raised. Raising funds through an intermediary (e.g. brokers or fund managers) does not exclude these liabilities from application of the prohibition;
- APRA will view arrangements to circumvent the \$250,000 minimum for deposit accounts, such as lending funds to provide the initial deposit for the account, as a breach of the conditions on the ADI authority; and
- the prohibition on retail fund-raising is not intended to prohibit foreign bank branches from conducting bona fide lending to retail borrowers; however, such activities must not involve the borrower depositing funds in a manner that would breach the licence conditions.

If you have any questions on these matters, please contact your APRA Responsible Supervisor or for non-APRA supervised entities, APRA's General Manager, Enforcement.

Yours sincerely



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