
THE BANKING REGULATION REVIEW

FIFTH EDITION

EDITOR
JAN PUTNIS

LAW BUSINESS RESEARCH

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The Banking Regulation Review

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THE BANKING REGULATION REVIEW

Fifth Edition

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JAN PUTNIS

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EDITOR'S PREFACE

The past year has seen a number of critically important bank regulatory initiatives reach interim conclusions.

In the European Union we have seen the finalisation and coming into force of the primary measures that are required to implement Basel III, as well as – at long last – political agreement on the Recovery and Resolution Directive and the principal elements of the banking union proposals. We have also seen the first foray of the European Commission into bank structural reform, with its controversial proposal for EU legislation on that subject, after the enactment of detailed domestic bank structural reform measures in a number of member states.

In the United States, the past year has seen the culmination of a number of regulatory initiatives, including the issue of final rules implementing the Volcker Rule and the issue of rules that will require large foreign banking groups to establish intermediate holding companies for their US subsidiaries. Both of these sets of rules stem from the Dodd-Frank Act: predictions that numerous legal careers would be made by that legislation are so far proving to be accurate.

I refer to these developments above as ‘interim conclusions’ because, of course, even though a period of primary rule-making has reached a conclusion, the full implications are still emerging. That said, there are helpfully more certainties now about the future direction of banking regulation than was the case a year ago. The combination of that fact, generally improving western economies and shareholder pressure has made many banks take the plunge and start to reorganise and restructure.

Recovery and resolution planning work remains a powerful driver of structural reform. It does not, however, require a particularly sophisticated legal and regulatory view to conclude that the world remains far from a position where we can have confidence that a global systemically important bank could be resolved in an orderly manner today without significant disruption and damage to the world economy. The fact that some regulators occasionally argue to the contrary disregards the detailed work that still has to be done so that governments and regulators may have a good chance of attaining that confidence in the next few years. But that work is, in general, progressing and reassuringly

shows no real sign of faltering yet as memories begin to fade of just how close the world came to economic calamity during the financial crisis.

Divergent approaches to structural reform in different countries could, however, make group-wide resolution more difficult to achieve. Localism, in the form of requirements that banking subsidiaries hold additional, more loss-absorbent capital and additional pools of liquidity, and have boards of directors with a significant independent membership, all have the potential to threaten the concept of a global banking group unless careful thought is given in such groups to how to address these challenges. The ways in which banking groups can best coordinate their relationships with multiple regulators are high on this agenda.

Perhaps the most difficult challenge facing banks in their relationships with their regulators is that of how to reconcile the need for close and cooperative working relationships with those regulators against the backdrop of seemingly never-ending conduct-related investigations and enforcement action. This difficulty varies according to which regulator is carrying out the investigation and the extent to which the investigation relates to matters that are historic and which the banking group concerned has taken steps to address. The challenge is clearly greatest where a major investigation concerns recent conduct and is led by a regulator with which the relevant bank requires good relations in order to achieve its commercial objectives to the satisfaction of its customers and shareholders.

It will be increasingly important for banks to appreciate the capacity of the more material investigatory and enforcement activity to shape business structures as much as structural reform itself. The changes to the ways in which certain markets and trading operations will be organised in the future in response to enforcement activity will be at least as significant as the changes that are brought to those markets and operations by, for example, resolution planning.

The upheaval that all of this implies for some banks' corporate and business structures, as well as for their staff, is combining with changes to previously held assumptions about the profitability of certain activities as Basel III capital requirements bite. The result is uncertainty, but with some grounds for cautious optimism, at least for those banking groups that are less seriously affected by conduct investigations and are firmly on the road to developing simpler, more capital-efficient structures.

Banks that have adopted a properly integrated and global approach to structural reform will, in my view, reap the benefits. While, in the short term, that is likely to be more expensive from a resourcing perspective, in the long term it should achieve savings. It is all too easy to address each regulatory initiative as it comes along, not recognising that this reactive approach runs the risk of structural muddle and missing out on developing business models that address multiple regulatory concerns at the same time. It is to be hoped that more regulators start to recognise positive proactivity on the part of banks not just as commercial astuteness but as a contribution to the restoration of trust that is required to make bank regulatory reform a success.

One increasingly important aspect of reform in the banking sector concerns the capital structures of banking groups. The requirement for more and higher quality loss-absorbing capital under Basel III, coupled with the introduction of bail-in as a resolution tool in a number of important banking jurisdictions, means that banking groups are having to rethink which company or companies they will use to raise capital

and what form that capital will take. Particularly in Europe, the issue of additional Tier I capital and other contingent capital instruments has added complexity to banks' capital structures and a need for banks to engage with current and potential investors to explain those structures.

This fifth edition of *The Banking Regulation Review* contains submissions provided by authors in 56 jurisdictions between late February and mid-April 2014, as well as the chapters on 'International Initiatives' and the European Union. Preparing the chapters has been a particularly onerous task for the authors this year because many of their clients have now moved from observing the regulatory revolution that has taken place in the banking sector to taking tangible steps to reorganise in order to make themselves fit for the new world in which the sector finds itself. My thanks go to all of the authors for their dedication in completing their chapters.

Thank you also to Adam Myers, Shani Bans, Nick Barette and Gideon Robertson at Law Business Research Ltd for their patience, understanding and – above all – great effort in preparing this edition.

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Jan Putnis

Slaughter and May

London

May 2014

Chapter 4

AUSTRALIA

*Louise McCoach and David Landy*¹

I INTRODUCTION

Australia has a sophisticated and stable banking industry, which provides a full range of banking and financial services and products.

The banking market is dominated by four major Australian banks, measured by market capitalisation: Australia and New Zealand Banking Group Limited (ANZ), Commonwealth Bank of Australia (CBA), National Australia Bank Limited (NAB) and Westpac Banking Corporation (Westpac).²

Subject to limited exceptions,³ only banks authorised by the Australian Prudential Regulation Authority (APRA) as an authorised deposit-taking institution (ADI) may carry on a banking business in Australia. As at 14 February 2014, there were 171 ADIs⁴ comprising 29 Australian ADIs⁵ (being 21 Australian banks and eight subsidiaries of foreign banks), 41 foreign ADIs,⁶ nine building societies, 85 credit unions and seven specialist service providers to the banking sector.

In addition, two entities are authorised to be non-operating holding companies (NOHCs). NOHCs are holding companies of ADIs which have authority from APRA under Section 11AA of the Banking Act 1959 (Cth) (the Banking Act). When a body

1 Louise McCoach and David Landy are partners at Clayton Utz. The authors would like to acknowledge the assistance of Melanie Aspinall in the preparation of this chapter.

2 Australian Bankers' Association Inc, 'History of Banks' at www.bankers.asn.au/Banks-of-Australia/History-of-Banks.

3 See Section II, *infra*, for further details.

4 APRA publishes and maintains a list of ADIs at www.apra.gov.au/adi/pages/adilist.aspx.

5 That is, an ADI incorporated in Australia, whether as a subsidiary of a foreign bank or not.

6 That is, ADIs not incorporated in Australia.

corporate seeks authority to be an ADI, APRA's permission may be conditional upon the applicant's holding company obtaining authority to be a NOHC.⁷

II THE REGULATORY REGIME APPLICABLE TO BANKS

i Principal regulators

The principal regulators of the banking and finance system are the Reserve Bank of Australia (RBA), APRA and the Australian Securities and Investments Commission (ASIC).⁸

The RBA (established by the Reserve Bank Act 1959 (Cth) (the Reserve Bank Act)) is Australia's central bank and has had a long-standing responsibility for the overall stability of the financial system, monetary policy and the safety and efficiency of Australia's payment systems.⁹ Determination and implementation of RBA policy are vested in the Payments Systems Board and the Reserve Bank Board.¹⁰ However, the RBA has no role in prudential supervision of ADIs (or other financial institutions).

Technically, exchange control is also an RBA function; however, at a practical level, there is no need for RBA approval where foreign exchange transactions are conducted through money market dealers and foreign exchange dealers authorised by ASIC.¹¹

With the introduction of the Autonomous Sanctions Regulations 2011 under the Autonomous Sanctions Act 2011 (Cth), the RBA is no longer responsible for the administration of sanctions in the context of foreign exchange control. This responsibility now resides with the Department of Foreign Affairs and Trade (DFAT). The Minister for Foreign Affairs and Trade is given the power to designate a person or entity, to whom the provision of assets is prohibited.¹²

APRA (established by the Australian Prudential Regulation Authority Act 1998 (Cth)(the APRA Act)) was established for the purpose of regulating bodies in the financial sector.¹³ It is responsible for the licensing and prudential supervision of all ADIs and NOHCs authorised by APRA. It is also responsible for the prudential supervision of life and general insurance companies and superannuation funds. Its supervisory powers come from a range of legislation, principally, from the Banking Act, the Life Insurance Act 1995 (Cth) and the Superannuation Industry (Supervision) Act 1993 (Cth).

In performing its functions and powers, APRA is required to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, to promote financial system stability in Australia.¹⁴ The APRA Act also requires APRA to seek to avoid any action that is likely to have a

7 Banking Act, Section 11AA.

8 The sole regulator of Australian registered companies and a regulator of financial services.

9 Reserve Bank Act, Section 10B(3).

10 Reserve Bank Act, Section 8A.

11 RBA, 'Foreign Exchange Dealers', at www.rba.gov.au/fin-stability/fin-inst/forex-dealers.html.

12 Autonomous Sanctions Regulation 2011, Regulation 14.

13 APRA Act, Section 8.

14 APRA Act, Section 8(2).

detrimental effect on the financial system stability in New Zealand¹⁵ on the grounds that the four major Australian banks have almost a 90 per cent share of the banking system assets in New Zealand.¹⁶

Although APRA is subject to ministerial direction on its policies and priorities¹⁷ it is the Australian government's intention that APRA should have operational independence, free from government intervention.¹⁸ Accordingly, the minister responsible for administering the APRA Act¹⁹ is prohibited from giving a direction to APRA in relation to a particular case.²⁰

ASIC (established by the Australian Securities and Investments Commission Act 2001 (Cth)(the ASIC Act)) has responsibility for monitoring and promoting market integrity and consumer protection²¹ including through its oversight of the disclosure and market conduct of Australian companies, and for licensing in relation to financial products and services. ASIC, working with the RBA, is also responsible for taking certain regulatory actions to minimise systemic risk in clearing and settlement systems. In this regard, ASIC has powers under the Corporations Act 2001 (Cth) (the Corporations Act)²² relating to the licensing, standard setting and direction of providers of clearing and settlement facilities.²³

ii Other key regulators

The Australian Treasury is responsible for advising the government on the stability of the financial system and on legislative and regulatory matters pertaining to financial system infrastructure.²⁴

The Australian Competition and Consumer Commission (ACCC) is the national competition and consumer protection agency responsible for promoting compliance with competition law through administering and enforcing the Competition and Consumer Act 2010 (formerly the Trade Practices Act 1974) and a range of other legislation. It was established in 1995 following the amalgamation of the Trade Practices Commission and the Prices Surveillance Authority. The ACCC's role is to promote competition and fair trading in the market place and provide for consumer protection and regulation of national infrastructure for the benefit of all Australians. The ACCC promotes

15 APRA Act, Section 8A.

16 IMF Country Report No 12/313, November 2012, p. 23.

17 APRA Act, Section 12(1).

18 See Explanatory Memorandum, Australian Prudential Regulation Authority Amendment Bill 2003 (Cth), paragraphs 3.18 and 3.19.

19 The ministers responsible for administering the APRA Act are the Treasurer and the Assistant Treasurer.

20 APRA Act, Section 12(3).

21 Australian Securities and Investments Commission Act 2001 (Cth), Section 12A(2).

22 The Australia-wide legislation relating to corporations, securities, financial products and related markets.

23 RBA and APRA, 'Macroprudential Analysis and Policy in the Australian Financial Stability Framework', p. 3, September 2012, at www.rba.gov.au/fin-stability/resources/2012-09-map-aus-fsf/pdf/2012-09-map-aus-fsf.pdf.

24 Ibid, p. 2.

competitive markets by penalising companies that promote their market influence through deliberately misleading consumers, or employing restrictive trade practices.

The Australian Transaction Reports and Analysis Centre (AUSTRAC) is Australia's anti-money laundering regulator and specialist financial intelligence unit (FIU). Its role is to oversee compliance with anti-money laundering legislation by a wide range of financial service providers including all ADIs. AUSTRAC was established in 1989 under the Financial Transactions Reports Act 1988 (the FTR Act), initially as an FIU. Its role was expanded under the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (the AML/CTF Act). In its role as AML/CTF regulator, AUSTRAC supervises regulated entities compliance with customer identification, reporting, record keeping and other requirements under the AML/CTF Act and FTR Act.

iii Inter-agency cooperation

At an inter-agency level, the Council of Financial Regulators (the CFR) aims to promote cooperation and collaboration between the RBA, APRA, ASIC and the Australian Treasury.²⁵ As specified in its Charter,²⁶ the CFR aims to contribute to the efficiency and effectiveness of financial regulation by providing a forum for discussion and collaboration between its members, in order to:

- a* identify important trends and issues in the financial system;
- b* ensure that appropriate coordination mechanisms are in place for responding to actual and potential instances of financial instability; and
- c* harmonise regulatory and reporting requirements.

The CFR also provides advice to the Australian government on the adequacy of Australia's financial regulatory arrangements and oversees the objectives and implementation of financial distress management in times of financial crisis. This function is facilitated by a memorandum of understanding (MoU)²⁷ signed by the four Council members, which provides a formal framework of cooperation among the various agencies, including the exchange of information.²⁸

iv Inter-governmental cooperation

Primarily through the Asia-Pacific Economic Forum (APEC), Australia also engages with its regional neighbours on a continuing basis to advocate greater harmonisation and improvements in the regulatory standards for financial institutions in the Asia Pacific

25 Ibid, p. 3.

26 RBA, 'The Council of Financial Regulators' Charter', 13 January 2004, at www.rba.gov.au/fin-stability/reg-framework/cfr-charter.html.

27 Memorandum of Understanding on Financial Distress Management between the members of the Council of Financial Regulators.

28 Section 56 of the APRA Act enables APRA to provide confidential information to other domestic financial regulators, such as ASIC, the RBA and AUSTRAC. Confidential information can be exchanged with these agencies provided such information is required to enable them to carry out their supervisory functions.

region. The Melbourne APEC Finance Centre has been established to study and assist emerging regulatory regimes,²⁹ and the Centre for International Finance and Regulation, opened in 2010, provides financial regulators from the Asia Pacific with specialised training.³⁰ In addition, APRA works with the Indonesian Capital Market and Finance Institutions Supervisory Agency to assist in the development of regulatory regimes, and the RBA is a member of the Executive Meeting of East Asia-Pacific Central Banks, where central banks discuss financial issues in an informal manner.³¹

The Australian government has also created numerous bilateral institutions and relationships to assist in developing supervisory standards in the region, normally through MoUs, with foreign financial sector regulators that have supervisory responsibility for banking operations of material interest to APRA. This is particularly the case with New Zealand and the United Kingdom,³² where the bulk of Australian banks' overseas operations are based. In the case of New Zealand, where almost all banking services are provided by Australian banks, the Trans-Tasman Council on Banking Supervision was created to promote a joint approach by Australia and New Zealand to banking supervision.³³ Numerous MoUs have also been entered into with other prudential regulators including Hong Kong, China and Bank Negara Malaysia, the Malaysian supervisory body, to establish strategic cross-border cooperation in relation to global financial services to ensure efficiency and effectiveness of regulation in the overall financial systems.³⁴

v ADI authorisation

Any entity that wishes to carry on a banking business in Australia is required to be authorised by APRA as an ADI unless it has the benefit of an exemption.³⁵ APRA has the right to revoke an ADI authorisation for stated reasons; for example, at the request of the holder or where its continuance would not be in the best interests of depositors of the holder or contrary to the national interest.³⁶

29 See generally, Melbourne APEC Finance Centre, www.apec-melbournefincen.org.au/.

30 Minister for Financial Services, *Superannuation and Corporate Law*, Establishment of a Centre for International Finance and Regulation, 11 March 2010.

31 Financial Services Institute of Australasia and Access Economics, *Navigating Reform: Australia and the Global Financial Crisis*, October 2009, pp. 40–43; Australia-Japan Research Centre, *The Basel Process and Regional Harmonisation in Asia*, Pacific Economic papers No. 326 April 2002, The Australian National University, p. 2.

32 See memorandum of understanding between the APRA and FSA, November 2003; see memorandum of understanding between APRA and RBNZ, May 2012.

33 Reserve Bank of New Zealand, memorandum of understanding concerning co-operation in banking and insurance supervision, May 2012, at www.rbnz.govt.nz/regulation_and_supervision/banks/relationships/4810737.html

34 Minister for Financial Services, Superannuation and Corporate Law, 'Leadership Challenges for the New Era', speech at 6th World Islamic Economic Forum, Kuala Lumpur, Malaysia, 19 May 2010.

35 Banking Act, Sections 8, 9 and 11.

36 Banking Act, Section 9A.

An entity will be engaging in 'banking business' for the purposes of the Banking Act³⁷ if it engages in:

- a* specific prescribed activities, including the taking of money on deposit and the making of advances of money; or
- b* a more general concept of banking within the meaning of Paragraph 51(xiii) of the Australian Constitution (the case law with respect to this concept is not entirely clear; however, it suggests that the acceptance of deposits alone may be sufficient to constitute the carrying on of a banking business).

There are three options relevant to ADI authorisation:

- a* a body corporate incorporated in Australia can apply for Australian ADI status;
- b* a non-operating holding company of a group of companies that includes one or more ADIs can apply for NOHC status; and
- c* a foreign body corporate can apply for foreign ADI status. On authorisation by APRA as a foreign ADI, the body corporate will also be required to register in Australia as a foreign company under the Corporations Act (that registration will not, at a practical level, impose obligations greater than those that the foreign body corporate will assume in order to maintain its foreign ADI status).

Applying for Australian ADI status

APRA determines the criteria and information requirements for granting or rejecting a banking authority and publishes these in the ADI Authorisation Guidelines (the Guidelines) available on APRA's website.³⁸ The Guidelines specify a range of criteria for bank applications, including a requirement that proposed new banks must have at least A\$50 million in Tier I capital and be able to comply with the prudential standards on capital adequacy³⁹ from the commencement of their banking operations,⁴⁰ unless they are the branch of a foreign bank.⁴¹ Australian branches of foreign banks are not required to have capital in Australia, but the foreign bank must meet capital requirements of the home regulator, which must be comparable.⁴²

An institution may, however, be authorised as an ADI without being designated as a bank, in which case it would not be subject to the A\$50 million threshold in Tier I capital. There is no minimum threshold stated for such an institution, although minimum capital adequacy in accordance with APRA's prudential standards would be required.⁴³

37 Banking Act, Section 5.

38 APRA, 'ADI Authorisation Guidelines', April 2008, at www.apra.gov.au/adi/Documents/ADI-Guidelines-11-4-081.pdf.

39 See Section II.ii, 'Regulatory capital', *infra*, for details.

40 APRA, 'ADI Authorisation Guidelines', April 2008, at www.apra.gov.au/adi/Documents/ADI-Guidelines-11-4-081.pdf, paragraph 16.

41 *Ibid*, paragraph 15.

42 *Ibid*, paragraph 16.

43 *Ibid*, paragraph 15.

Applying for NOHC status

NOHC status is available only to an Australian-incorporated company that does not carry on a business other than ownership and control of its subsidiary group.

NOHC status may be sought to allow a group to diversify across (for example) banking, insurance, funds management and securities, or because APRA will not grant a subsidiary ADI status unless the parent holds NOHC status, or for a purpose connected with the Financial Sector (Shareholdings) Act 1998 (see Section VII.I, *infra*, for further details).

Substantively, APRA's requirements for NOHC status are the same as for Australian ADI status.

By Section 11AA of the Banking Act, NOHC authorisation 'operates as an authority in relation to the [holding company] and any ADIs that are subsidiaries of the [holding company] from time to time'.

Applying for foreign ADI status

Foreign banks wishing to undertake banking business in Australia must have a foreign ADI authorisation.⁴⁴ Foreign ADIs can operate in Australia as an Australian-incorporated subsidiary or on a branch basis. An Australian subsidiary of a foreign ADI is subject to the same regulatory, supervisory and reporting regime as Australian-owned ADIs, but foreign ADIs operating through bank branches are not subject to certain prudential requirements.⁴⁵

APRA requires a foreign body corporate that is seeking foreign ADI status to provide detailed information to APRA as part of the application process, including details about the supervisory arrangements to which the foreign body corporate is subject in its home jurisdiction.⁴⁶

There are two key restrictions on operating through branches as a foreign ADI that typically make it impractical for foreign banks to carry on retail operations as a foreign ADI:

- a* foreign ADIs are not permitted to accept initial deposits from Australian residents of less than A\$250,000;⁴⁷ and
- b* a foreign ADI must disclose to prospective depositors that Division 2 of the Banking Act, which contains statutory protections for depositors, does not apply to it.⁴⁸

As a result of these restrictions, foreign banks typically conduct their retail operations in Australia through locally incorporated subsidiaries that have Australian ADI status and their wholesale operations through an entity that has foreign ADI status. In that

44 Ibid, paragraph 6.

45 Ibid, paragraph 7.

46 Ibid, paragraphs 16–17.

47 Ibid, paragraph 35.

48 Ibid, paragraph 36 and Banking Act, Section 11E(2). Note also that APRA is unable to apply to wind up foreign ADIs and the Minister is not entitled to make a declaration under Section 16AD in relation to them. The effect of this is that the Australian government guarantee of 'protected accounts' under the Financial Claims Scheme does not apply to deposits with foreign ADIs. For further details on the Financial Claims Scheme, see Section VI.iii, *infra*.

case, APRA requires banking transactions between the foreign ADI and the subsidiary Australian ADI to be at arm's length and on commercial terms.⁴⁹

A foreign bank that does not have ADI status may:

- a subject to prior approval from APRA, operate through a representative office in Australia for liaison and research activities only.⁵⁰ A bank operating in Australia on this basis will also need to be registered with ASIC as a foreign company, as the liaison activities will constitute carrying on business in Australia for the purposes of the Corporations Act;⁵¹
- b access Australia's wholesale capital markets to raise funds by issuing securities subject to certain conditions – a single issue of debt securities should not, by itself, constitute carrying on business in Australia and so avoids the need for registration with ASIC as a foreign company and for any specific approval for the issuance of the debt securities;⁵²
- c use the word 'bank' (or similar) when issuing debt securities in Australia provided that:
 - the debt securities are offered and/or traded in parcels of at least A\$500,000; and
 - all documentation clearly states that the issuer is not an authorised ADI;⁵³
- d operate as a 'registered entity' under the Financial Sector (Collection of Data) Act 2001 (Cth) (the FSCD Act) and take money on deposit subject to certain conditions;⁵⁴ and
- e avoid the need to apply for and hold an Australian financial securities licence (AFSL) for some arranging, underwriting and intermediating services in 'financial products' (which is widely defined) where those services are provided to wholesale clients and where the foreign bank is regulated by an approved overseas regulatory authority;⁵⁵ however, unless that service was occasional only, the bank would need to register with ASIC as a foreign company if it was taken to be 'carrying on a business' in Australia.

APRA consent to use the word 'bank' and other restricted words or expressions

Authorisation to carry on a banking business does not automatically allow an ADI to use restricted words or expressions in its company or trading name and to describe or advertise its business. Section 66 of the Banking Act prohibits the use of restricted words and expressions unless APRA has given consent. The restricted words are 'bank', 'banker' and 'banking'; the restricted expressions are 'building society', 'credit union', 'credit society', 'purchased payment facility provider' and 'PPF provider'; and words or expressions of like import. Consent to use a restricted term is usually concurrently

49 APRA Guidelines, 'ADI Authorisation Guidelines', April 2008, paragraphs 42–45.

50 Banking Act, Section 67. And see APRA's Guidelines on Being Authorised as a Representative Office of a Foreign Bank, March 2007, paragraph 7(a).

51 See Part 1.2 Division 3 of the Corporations Act.

52 Corporations Act, Section 21(3)(f) Part 1.2 Division 3. But see also ASIC RG 121.

53 Banking (Exemption) Order No. 82 (23 September 1996).

54 Banking (Exemption) Order 96 (22 May 2003).

55 Corporations Act, Section 911A(2)(h).

applied for with the application for, and granted with, ADI authorisation. Consent will normally be granted where APRA is satisfied that the consent would not defeat the purpose of the restriction: the protection of the public.⁵⁶

Exemption from ADI authorisation

Section 11 of the Banking Act gives APRA the power to exempt an institution from the requirement to have an ADI authorisation to conduct banking business in Australia. Exemptions are rare and generally only given in circumstances where APRA forms the view that it would not be appropriate for the body to be regulated by the ADI regime.

The Section 11 exemptions are generally made by way of class order. There is one exemption currently in force, namely Banking (Exemption) Order No. 96 (22 May 2003) (the Banking Exemption Order 96), which exempts corporations entered in the register of entities maintained by APRA under Section 8 of the FSCD Act (RFCs).⁵⁷

The Banking Exemption Order 96 provides that RFCs are not prohibited from engaging in activities that would otherwise constitute banking business where the entity takes money on deposit:

- a* by offering, and issuing or selling, securities (within the meaning of Part 6D.2 of the Corporations Act 2001);
- b* by issuing or selling a financial product (within the meaning of Part 7.9 of the Corporations Act); or
- c* otherwise.

Where the relevant offer, sale or issue is to retail investors, however, the exemption is conditional on the entity giving a warning (the prudential supervision warning) in the relevant disclosure document, that:

- a* the registered entity is not authorised under the Banking Act and is not supervised by APRA; and
- b* the investment will not be covered by the depositor protection provisions in Section 13A of the Banking Act.

RFCs are not required to issue the prudential supervision warning to professional investors.

RFCs make up a relatively small part of the Australian financial sector⁵⁸ and include the following types of company:⁵⁹

- a* Money market corporations, which operate primarily in wholesale markets and borrow from and lend to large corporations and government agencies.⁶⁰

56 APRA Guidelines, 'Implementation of Section 66 of the Banking Act 1959', January 2006, Paragraph 35–37.

57 FSCD Act, Section 5(3).

58 IMF Country Report No 12/313, November 2012, p. 35.

59 APRA, 'Main Types of Financial Institutions', March 2012, at www.rba.gov.au/fin-stability/fin-inst/.

60 Formerly, some money market corporations were permitted to use the expressions 'merchant bank', 'merchant banker', or 'merchant banking' in relation to their business. However, APRA has taken a view that the word 'merchant bank' and its derivatives are no longer in

- b* Finance companies, which raise funds from wholesale markets and from retail investors to provide loans to households and small to medium-sized businesses.
- c* Securitiser, which are special purpose vehicles that issue securities backed by pools of assets; they are generally associated with the financial institution in whose name those assets stand.

These non-ADI financial institutions are regulated by ASIC, not APRA. However, as an RFC, they are required to provide statistical information to APRA under the FSCD Act⁶¹ (see Section III.ii, *infra*, for further details).

Registration under the FSCD Act does not mean that the entity is subject to supervision by APRA, nor does that registration convey any approval or authorisation by APRA.

III PRUDENTIAL REGULATION

i Relationship with APRA

Prudential supervision function

APRA has the power to establish and enforce prudential standards⁶² for ADIs, NOHCs, life insurance companies, general insurance companies and superannuation funds.⁶³ Prudential standards have the force of law and an ADI or authorised NOHC must comply with them.⁶⁴

The prudential standards are supplemented by prudential practice guides (PPGs), other guidance and letters to industry that provide non-enforceable, non-binding guidance on certain prudential matters.⁶⁵

Non-adherence to guidance is not a formal breach of the prudential standards.

The internal processes and procedures through which APRA supervises the compliance of ADIs with standards, PPGs and letters, include APRA's Probability

widespread use, having been overtaken by the term 'investment bank'. Therefore, unless permitted to carry on a banking business under the Banking Act, money market corporations are not authorised to use the expression 'merchant bank' and its derivatives in relation to their business; Banking (Exemption Order) No. 104 dated 18 August 2005 (revoked); and Banking (Exemption) No. 1 of 2012 dated 31 January 2012.

61 FSCD Act Sections 9 and 13(9). (The FSCD Act does not apply to small corporations (those with assets with less than A\$5 million) and companies involved only in related intercompany loans).

62 Copies of APRA's prudential standards are available at: www.apra.gov.au/#.

63 Banking Act, Section 11AF; Insurance Act 1973 (Cth), Section 32; Life Insurance Act 1995 (Cth), Section 230A; and Superannuation Industry (Supervision) Act 1993 (Cth), Section 34C.

64 Prudential standards can be made under Section 11AF of the Banking Act. An instrument made under 11AF of the Banking Act is a legislative instrument (Section 11AF(7B)). See Section 5 and 6 of the Legislative Instruments Act 2003 for the effect of instruments declared to be legislative instruments.

65 Copies of APRA's PPGs and other guidance are available at: www.apra.gov.au/adi/PrudentialFramework/Pages/authorised-deposit-taking-institutions-ppgs.aspx.

and Impact Ratings System (PAIRS) and Supervisory Oversight and Response System (SOARS). PAIRS is the tool by which APRA assesses the probability that an ADI may fail to honour its obligations to depositors and the potential impact should it fail. APRA then transforms the PAIRS rating into a SOARS stance for the entity ('Normal', 'Oversight', 'Mandated Improvement' or 'Restructure') as well as a forward-looking Supervisory Action Plan for the ADI.⁶⁶

The prudential standards published by APRA cover a broad range of topics including capital adequacy, funds management and securitisation, liquidity management, large exposures, equity associations, credit quality, corporate governance and outsourcing.

APRA is entitled to determine⁶⁷ whether a prudential standard applies to all ADIs or NOHCs or one or more specified ADIs or NOHCs. The prudential standards therefore vary in their application to ADIs and NOHCs. The regulatory model adopted by APRA requires those bodies to which the prudential standards apply to be largely responsible for the implementation and monitoring of those standards. While APRA does require regular reports from ADIs, NOHCs and their subsidiaries, the Banking Act⁶⁸ and the prudential standards make it clear that the onus rests with these bodies to report to APRA any significant actual or prospective breach of a prudential standard. Such reports must be given to APRA as soon as practicable (and in any case no later than 10 business days) after the reporting entity becomes aware of the actual or prospective breach.⁶⁹ A failure by an ADI (or any of its group members) to comply with the breach reporting regime under the Banking Act is an offence that carries a penalty of 200 penalty units.⁷⁰ In extreme circumstances, officers of the relevant ADI may also be criminally liable.

To this extent the prudential standards are largely self-regulating. At the same time, if APRA has reason to believe that an ADI or NOHC has contravened or is likely to contravene a prudential standard, APRA has the power to issue directions requiring that ADI or NOHC to undertake (or not undertake) certain actions in respect of prudential matters, including requiring compliance with the relevant prudential standard, removing a director or senior manager or requiring an audit (an 'APRA Direction').⁷¹

Non-compliance with an APRA Direction is an offence,⁷² which carries a penalty of 50 penalty units. If an ADI or NOHC fails to comply with an APRA Direction, APRA has the power to revoke its authorisation.⁷³ An officer of an ADI or NOHC is guilty of

66 APRA, 'Probability and Impact Rating System' June 2012 at www.apra.gov.au/AboutAPRA/Pages/PAIRS-1206-HTML.aspx.

67 Banking Act, Section 11AF.

68 For example, see Banking Act Section 62A(1B).

69 Banking Act, Section 62A(1B)(c). Note 'significant' is defined in Section 62A(1C) for the purposes of Section 62A(1B).

70 Banking Act, Section 62A(1B). Under the Crimes Act 1914 (Cth), Section 4AA, one penalty unit currently equates to A\$170.

71 Banking Act, Section 11CA(1), 11CA(2).

72 Banking Act, Section 11CG(1).

73 Banking Act, Section 9A and Section 11AB(2)(a).

an offence if the officer's duties include ensuring compliance by the entity with an APRA Direction and the officer fails to take reasonable steps towards fulfilling this duty.⁷⁴

Other functions

APRA has a statistical information collection function under the FSCD Act.⁷⁵ The FSCD Act provides APRA with the power to collect a range of financial data from all ADIs, NOHCs and their subsidiaries, including the following:

- a* data relating to exposures, impaired assets, liquid assets, commercial property, securities held and issued and other financing arrangements;⁷⁶ and
- b* data on capital adequacy, fair values, market risk, repricing analysis, off-balance sheet business, securitisation, specialised lending and other exposures.⁷⁷

Foreign ADIs are also required to provide information to APRA in relation to their Australian branches, regarding standardised credit risk (off-balance sheet exposures), repricing analysis, off-balance sheet business and securitisation.

Consequences of an ADI failure

Part II of the Banking Act gives APRA broad powers to intervene in the affairs of an ADI in a range of circumstances.⁷⁸ In the case of an ADI failure, Section 13A of the Banking Act gives APRA broad powers, acting on its own or through the appointment of an administrator, to investigate the affairs of an Australian ADI or take control of an Australian ADI's business in the following circumstances:

- a* the ADI informs APRA that it is likely to become unable to meet its obligations or that it is about to suspend payment;
- b* APRA considers that in the absence of external support (1) the ADI may become unable to meet its obligations or may suspend payment, or (2) it is likely that the ADI will be unable to carry on banking business in Australia consistently with the interests of its depositors or with the stability of the financial system in Australia; or
- c* the ADI becomes unable to meet its obligations or suspends payment.⁷⁹

It is an offence if an Australian ADI does not immediately inform APRA if it considers that it is likely to become unable to meet its obligations, or that it is about to suspend payment.⁸⁰

74 Banking Act, Section 11CG(2).

75 FSCD Act, Section 13.

76 For more detailed information, see APRA Reporting forms and instructions at www.apra.gov.au/adi/ReportingFramework/Pages/reporting-forms-and-instructions-adis.aspx.

77 For more detailed information, see APRA Reporting forms and instructions at www.apra.gov.au/Statistics/Basel-II-reporting-forms-and-instructions-for-all-ADIs.cfm.

78 Banking Act, Section 13A(1)(iv).

79 Banking Act, Section 13A.

80 Banking Act, Section 13.

Where an ADI statutory manager (being either APRA or an administrator of an ADI's business appointed by APRA)⁸¹ is in control of an Australian ADI's business and APRA considers that the ADI is insolvent and cannot be restored to solvency within a reasonable period, then APRA may apply to the Federal Court of Australia for an order that the ADI be wound up.⁸²

APRA's powers under the Banking Act to investigate, take control of, or apply for an ADI to be wound up, do not extend to foreign ADIs.⁸³

In September 2012, the Australian Treasury released a consultation paper, 'Strengthening APRA's Crisis Management Powers',⁸⁴ which outlines proposals for reform in this area, including proposals to strengthen and extend APRA's powers over distressed and potentially distressed ADIs, NOHCs, life insurance companies, general insurance companies and superannuation funds. Although submissions on the paper closed on 14 December 2012, the Australian government is yet to release an official response to the consultation process.

Priority for application of assets of an ADI in Australia

Section 11F of the Banking Act requires that the assets in Australia of foreign ADIs be available to meet liabilities in Australia in priority to other liabilities of that ADI. If an Australian ADI becomes unable to meet its obligations or suspends payment, Section 13A(3) of the Banking Act sets out priorities for the application of the Australian assets of that ADI: first to APRA for the recovery of moneys paid and costs incurred by APRA under the Financial Claims Scheme (see Section VI.iii, *infra*, for further details),⁸⁵ then to account holders with protected accounts, then to the RBA, then to the providers of emergency financial support certified by APRA and then to other liabilities (if any) in the order of their priority apart from the operation of the Banking Act.

An Australian ADI is guilty of an offence if it does not hold assets (excluding goodwill and any assets or other amount excluded by the prudential standards set by APRA) in Australia of a value greater than or equal to the total amount of its deposit liabilities in Australia and APRA has not authorised the ADI to hold assets of a lesser value.⁸⁶

81 Banking Act, Section 13A(2).

82 Banking Act, Section 14F.

83 Banking Act, Section 11E.

84 APRA, 'Strengthening APRA's Crisis Management Powers: Consultation Paper', September 2012, at www.treasury.gov.au/ConsultationsandReviews/Consultations/2012/APRA.

85 See www.apra.gov.au/crossindustry/fcs/pages/default.aspx.

86 Banking Act, Section 13A(4). In 'Strengthening APRA's Crisis Management Powers: Consultation Paper', it has been argued that the s 13A(3) hierarchy of priorities applying to Australian ADIs unduly constrains statutory managers from implementing a recovery plan for distressed ADIs. Therefore, it has been proposed that the schemes of priorities not apply where a statutory manager has been appointed over an ADI. Note, for the purpose of distribution of an ADI's assets under Section 13A, the assets of an ADI are taken not to include any interest in any asset of a cover pool securing covered bonds issued by the ADI.

RBA as lender of last resort

If an ADI is unable to meet its obligations or is likely to suspend payments, the RBA has a discretion to act as a lender of last resort.⁸⁷ This discretion arguably allows the RBA to lend monies to any ADI (regardless of whether or not that ADI is an Australian ADI or a foreign ADI). That said, the RBA has previously stated that it will only lend to an ADI if it is experiencing solvency difficulties and the RBA considers that the rest of the Australian financial system would be seriously affected by the failure.⁸⁸

Since Australia's Federation in 1901, last-resort support has been provided sparingly by the RBA (and its predecessor), including support to the Primary Producers Bank in 1931, and three private banks in their efforts to fund illiquid building societies between 1974 and 1979.⁸⁹

ii Management of banks

The Corporations Act

The Corporations Act requires an Australian ADI to have a minimum of three directors, at least two of whom must ordinarily reside in Australia. There is no statutory requirement for any other organ of management (board committees, supervisory boards, etc.). Nor is there any statutory rule governing the make-up of the board. The ultimate responsibility for management remains at the board level; the existence, role and responsibilities of board committees (including credit committees) are an internal management matter and do not receive any recognition under the Corporations Act, other than by Section 198D, which provides that decisions made by validly delegated board committees are as effective as decisions made by the board itself.

There are three main actors in the management of Australian ADIs (in common with all Australian incorporated companies): executives, executive directors and non-executive directors. Directors (both executive and non-executive) are subject to statutory duties of care, diligence and good faith. Those statutory duties also apply to non-directors who are involved in making decisions that affect a substantial part of the company's business or who have the capacity to affect significantly the company's financial standing.

Directors and executives owe their duties to the corporate entity, rather than to shareholders. The constitution of a wholly-owned subsidiary can include a provision enabling its directors to act in the interests of its holding company. Otherwise, the Corporations Act does not relevantly distinguish between holding and subsidiary companies.

The Corporations Act does not prescribe any limits on the remuneration of directors and executives, although there are limits on the level of retirement benefits that can be paid without shareholder approval and a prohibition on hedging unvested

87 Reserve Bank Act, Sections 8 and 26.

88 See speech by RBA Governor Macfarlane in 1999 quoted at p. 67 in Bryan Fitz-Gibbon & Marianne Gizycki, 'A History of Last Resort Lending and Other Support for Troubled Financial Institutions in Australia', research discussion paper 2001-07, System Stability Department Reserve Bank of Australia, (2001).

89 Bryan Fitz-Gibbon & Marianne Gizycki, 'A History of Last Resort Lending and Other Support for Troubled Financial Institutions in Australia', research discussion paper 2001-07, System Stability Department Reserve Bank of Australia, (2001) p. 68.

remuneration by key management personnel of disclosing entities (which includes entities listed on the Australian Securities Exchange (ASX)).

In addition, the Corporations Act requires all reporting entities, including ADIs, to maintain proper financial records that would enable the preparation of true and fair financial statements.⁹⁰ Through its requirement for a financial report and directors' report to be prepared each year by disclosing entities,⁹¹ the Corporations Act imposes responsibilities on an ADI's management for its financial record-keeping systems and the reliability of the data produced by the ADI.

The Corporations Act also regulates directors and officers of foreign ADIs, although not to the same extent that Australian ADIs are regulated.

APRA Prudential Standards

APRA imposes governance requirements on all ADIs under Prudential Standard CPS 510 – Governance (CPS 510),⁹² although foreign ADIs only have to comply with selected provisions.

CPS 510 explicitly states that the board of directors bears ultimate responsibility for governance of an ADI and specifies governance principles under which, *inter alia*:

- a* there are rules for the size and composition of boards and management of ADIs;
- b* ADIs must have a written remuneration policy which, although not subject to quantitative limits, must comply with general rules to ensure that remuneration is aligned with long-term financial soundness and prudent risk-taking, and which must prohibit directors and senior officers from hedging equity-linked deferred remuneration before it is fully vested;
- c* all ADIs must have a board audit committee; and
- d* Australian ADIs must have a board remuneration committee.

CPS 510 also states that '... the Board must ensure that directors and senior managers have the full range of skills needed for the effective and prudent operation of the bank'.⁹³ This includes the requirement for directors, collectively, to have the necessary skills, knowledge and experience to understand the risks of the bank, including its legal and prudential obligations, and to ensure that the bank is managed in an appropriate way taking account of these risks.⁹⁴ Prudential Standard APS 222 – Associate and related

90 Corporations Act, Section 286.

91 Corporations Act, Section 301.

92 CPS 510 was introduced in July 2012 and consolidates the governance obligations of ADIs, general insurers and life companies into one prudential standard. It replaces APS 510, GPS 510 and LPS 510 (which are now revoked) and extends auditor independence requirements found in its predecessors. On 1 January 2015, a revised CPS 510 will come into effect to implement APRA's heightened expectations in relation to governance standards; see APRA, 'APRA releases consolidated prudential standards', 12 September 2011, at www.apra.gov.au/MediaReleases/Pages/11_17.aspx.

93 APRA Prudential Standard CPS 510 – Governance p. 5, at [www.apra.gov.au/CrossIndustry/Documents/Final-Prudential-Standard-CPS-510-Governance-\(January-2014\).pdf](http://www.apra.gov.au/CrossIndustry/Documents/Final-Prudential-Standard-CPS-510-Governance-(January-2014).pdf).

94 Ibid.

entities (APS 222) imposes similar responsibility on the board of directors and senior management in relation to the overall risk at a group level.

As a result of CPS 510 and other prudential standards that detail specific governance risks and functions,⁹⁵ the board of directors and senior management of an ADI are required to fully understand the risks the organisation faces and be in a position to ensure that all such risks are identified, monitored and managed.⁹⁶

ASX Listing Rules

If listed on the ASX, an ADI needs to comply with the ASX Listing Rules, which require each listed entity to publish an annual report that indicates whether the entity has complied with the guidelines set out in the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations and, if it has not complied, why not.

iii Regulatory capital: associated concepts and requirements

Regulatory capital

The prudential standards relating to regulatory capital are found in Prudential Standard APS 110 – Capital Adequacy to Prudential Standard APS 117 – Capital Adequacy: Interest Rate Risk in the Banking Book (Advanced ADIs). They are based on the standards set out in the Basel III framework⁹⁷ and aim (among other things) to ensure that Australian ADIs maintain adequate capital, on both an individual and group basis, to act as a buffer against the risks associated with their activities,⁹⁸ including by:

- a* holding minimum levels and ratios of certain types of capital;
- b* establishing and maintaining internal processes to monitor and notify of any 'significant changes' in their capital base;
- c* having a process for applying 'risk weights' to each credit risk to which the Australian ADI is exposed;
- d* having a process for 'quantifying certain credit risk components to determine capital requirements for a given credit exposure';
- e* keeping their retail banking, commercial banking and other banking businesses separate and applying different operational risk capital requirements to each area of business; and
- f* keeping separate internal processes to 'manage, measure and monitor' operational, market and interest rate risks.

The prudential standards relating to regulatory capital do not apply to foreign ADIs, which are expected to meet comparable capital adequacy standards in their home jurisdictions.⁹⁹

95 For example, see Prudential Standard APS 310 – Audit and Related Matters which requires the Board and Chief Executive Officer to annually attest that the risk management system is operating effectively. In addition, on 1 January 2015, Prudential Standard CPS 220 – Risk Management, will come into effect.

96 IMF Country Report No 12/313, November 2012, p. 116.

97 See generally www.bis.org/bcbs/basel3.htm.

98 APS 110.

99 APS 110, Paragraph 3.

Consistency with Basel III framework

Since the release of the Basel III consultation package in December 2010,¹⁰⁰ APRA has been actively involved in implementing a series of updates to its prudential standards to ensure consistency with the capital requirements of the Basel III framework.

In September 2012, APRA published a final set of prudential standards¹⁰¹ that gave effect to major elements of the Basel III capital reforms in Australia. Subsequently, in November 2012, APRA issued a package of final measures, including requirements for counterparty credit risk, which completed APRA's implementation of the Basel III capital reforms for ADIs.¹⁰² Under these revised standards, new capital requirements took effect in Australia on an accelerated basis from 1 January 2013, subject to certain transitional arrangements.¹⁰³

An important component of the Basel framework is the public disclosure of regulatory information (referred to as 'Pillar 3' within the framework). The Pillar 3 disclosure requirements for remuneration and capital, which were updated under Basel III, have been implemented in Australia via a revised Prudential Standard APS 330 – Public Disclosure, which came into effect on 30 June 2013. The standard sets minimum requirements for the public disclosure of information on an ADI's risk profile, risk management, capital adequacy, capital instruments and remuneration practices so as to contribute to the transparency of financial markets and to enhance market discipline.

In addition, on 1 January 2015, Prudential Standard CPS 220 – Risk Management, will come into effect. CPS 220 is a proposed cross-industry prudential standard that has been introduced to harmonise and consolidate APRA's risk management requirements for ADIs, general insurers and life companies into one prudential standard. A new CPS 510 will also come into effect on 1 January 2015 to align APRA's governance requirements relating to risk management with the enhanced requirements of CPS 220.¹⁰⁴

100 The consultation package included Basel Committee on Banking Supervision, 'Basel III: A global regulatory framework for more resilient banks and banking systems', December 2010, at www.bis.org/publ/bcbs189.pdf; and Basel Committee on Banking Supervision, 'Basel III: International framework for liquidity risk measurement, standards and monitoring', December 2010, at www.bis.org/publ/bcbs188.pdf.

101 APRA, 'Implementing Basel III capital reforms in Australia' September 2012 at www.apra.gov.au/adi/PrudentialFramework/Pages/Implementing-Basel-III-capital-reforms-in-Australia-September-2012.aspx.

102 APRA's Prudential and Reporting Standards are available online on APRA's external website at: www.apra.gov.au/adi/PrudentialFramework/Pages/prudential-standards-and-guidance-notes-for-adis.aspx and www.apra.gov.au/adi/ReportingFramework/Pages/ADI-Reporting.aspx.

103 See Clayton Utz publication, Louise McCoach, 'APRA's welcome transitional relief to Basel III counterparty credit risk measures implementation', 22 November 2012, at www.claytonutz.com.au/publications/edition/22_november_2012/20121122/apras_welcome_transitional_relief_to_basel_iii_counterparty_credit_risk_measures_implementation.page.

104 APRA, 'APRA releases harmonized standard and proposed guidance on risk management,' 31 January 2014 accessed 27 March 2014 at www.apra.gov.au/mediareleases/pages/14_04.aspx.

On 17 March 2014, the Basel Committee released a report¹⁰⁵ assessing the compliance of APRA's revised capital prudential standards with the Basel III capital framework. The report concluded that Australia's capital prudential standards were overall compliant, notwithstanding that of the 14 components reviewed, it assessed two components as falling short of full compliance: aspects of APRA's implementation of the definition of capital and the internal ratings-based approach for credit risk. The other components of the Basel III framework were assessed as compliant in the report with only some non-material or non-significant differences.

In a number of other areas, APRA's prudential standards go beyond the minimum Basel III capital requirements.¹⁰⁶ For example, in exercising its discretion in relation to the definition and measurement of capital, APRA's prudential standards in these areas have resulted in a more conservative capital adequacy regime for Australia than is required under Basel III. APRA has also implemented some aspects of the Basel III framework ahead of the agreed time line and does not draw a distinction between internationally active and internationally non-active ADIs. These elements provide for a more rigorous implementation of the Basel III capital framework in Australia.

The key requirements of APRA's revised prudential standards implementing the capital reforms are summarised below.

Regulatory capital requirements for Australian ADIs

Capital adequacy requirements for Australian ADIs are set out in a number of prudential standards, most notably APS 110 and Prudential Standard APS 111 – Capital Adequacy: Measurement of Capital. Under APS 110, an Australian ADI is required to maintain, at all times, a minimum level of capital on both a standalone and consolidated basis. The minimum standard requires Australian ADIs to maintain a prudential capital ratio (PCR) of at least 8 per cent of its total risk-weighted assets¹⁰⁷ unless APRA indicates that a higher PCR is required.¹⁰⁸ In practice, APRA requires all Australian ADIs to have PCRs above the minimum requirements.¹⁰⁹

For the purposes of determining an Australian ADI's risk-based capital ratio (and compliance with its PCR), its total risk-weighted assets is calculated as the sum of:¹¹⁰

- a its risk-weighted on-balance sheet and off-balance sheet assets determined based either on a standardised approach using external credit ratings or on an internal ratings based approach as approved by APRA;¹¹¹

105 Basel Committee on Banking Supervision, 'Regulatory Consistency Assessment Programme (RCAP) Assessment of Basel III regulations – Australia' at www.bis.org/bcbs/implementation/l2_au.pdf.

106 See Annex 10 of the Basel Committee on Banking Supervision, 'Regulatory Consistency Assessment Programme (RCAP) Assessment of Basel III regulations – Australia' at www.bis.org/bcbs/implementation/l2_au.pdf for a listing of such requirements.

107 APS 110, Paragraph 22.

108 APS 110, Paragraph 23.

109 IMF Country Report No 12/313, November 2012, p. 56.

110 APS 110, Attachment A, Paragraph 4.

111 As determined in accordance with APS 112 and 113.

- b 12.5 times the sum of capital charges relating to its operational and market risks and interest rate risks on its banking books;¹¹² and
- c its exposures (on a risk-weighted adjusted basis) to securitisations.¹¹³

Under APS 110, the capital to be maintained by an Australian ADI in order to meet its PCR may be comprised of Tier I capital and Tier II capital, net of all specified regulatory adjustments including deductions.¹¹⁴ The new criteria that an instrument must meet to qualify as Tier I or Tier II capital took effect on 1 January 2013 and are set out in APS 111. Under transitional rules, additional Tier I or Tier II instruments that have been issued before 1 January 2013 and satisfy certain criteria¹¹⁵ may continue to enjoy their status as additional Tier I or Tier II instruments, notwithstanding that they do not satisfy the new criteria introduced on 1 January 2013. To the extent such transitional instruments are recognised by APRA, they will be subject to phase-out arrangements.¹¹⁶

Tier I capital

Tier I capital comprises capital that satisfies certain essential characteristics under APS 111, including that it constitutes a permanent and unrestricted commitment of funds which ranks behind the claims of depositors and other creditors in the event of a winding-up. Tier I capital is divided into two categories: (1) ‘common equity Tier I capital’, which includes an Australian ADI’s paid-up ordinary shares provided these satisfy certain criteria,¹¹⁷ retained earnings, undistributed current-year earnings, accumulated other comprehensive income and other disclosed reserves including foreign currency translation reserve and certain minority interests arising from the issue of ordinary shares to third parties by a fully consolidated subsidiary, and (2) ‘additional Tier I capital’, which includes instruments issued by Australian ADIs that satisfy certain criteria¹¹⁸ including that they are paid-up, perpetual, subordinated, contain no step-ups or other incentives

112 As determined in accordance with APS 114, 115, 116 and 117.

113 As determined in accordance with APS 120.

114 See APS 110, Paragraph 22 and the definition of ‘Regulatory Capital’ in APS 111, Paragraphs 7–8.

115 See APRA media release, ‘To All locally incorporated authorised deposit-taking institutions – Interim arrangements for additional Tier I and Tier II capital instruments’, 30 March 2012, at www.apra.gov.au/adi/PrudentialFramework/Documents/Interim_arrangements_AT1_and_T2_capital_instruments_30_March_2012.pdf; APRA media release, ‘To All locally incorporated authorised deposit-taking institutions – Basel III capital: interim arrangements for Additional Tier I and Tier II capital instruments’, 28 September 2012, at www.apra.gov.au/adi/Documents/20120928-Letter-to-industry-on-interim-arrangements.pdf; APRA Media Release, ‘To All locally incorporated authorised deposit-taking institutions – Interim arrangements for additional Tier I capital instruments’, 27 May 2011, at www.apra.gov.au/adi/Publications/Documents/Basel-III-interim-Tier-1-criteria_FINAL.pdf.

116 APS 111, Attachment K.

117 APS 111, Attachment B.

118 APS 111, Attachment E.

to redeem, satisfy the requirements for loss absorption referred to below and cannot be callable by the issuer within five years.¹¹⁹

Tier II capital

Tier II capital comprises all other components of capital that fall short of Tier I capital but nonetheless contribute to the overall strength of an Australian ADI as a gone concern. Tier II capital instruments must satisfy certain criteria set out in APS 111 including that they be paid-up, have a minimum maturity of at least five years, are subordinated to all claims except Tier I capital, contain no step-ups or other incentives to redeem and satisfy the requirements for loss absorption referred to below.¹²⁰

Loss absorption requirements

Both additional Tier I capital and Tier II capital instruments must meet the requirements for loss-absorption set out in APS 111. Under those requirements, additional Tier I capital and Tier II capital instruments must include a provision that they will be written off or converted into ordinary shares of the relevant Australian ADI where a ‘non-viability trigger event’ has occurred.¹²¹ A ‘non-viability trigger event’ will occur in respect of an Australian ADI if:

- a APRA issues a notice to the ADI that conversion or write-off is necessary because, without it, APRA considers that the ADI would become non-viable; or
- b APRA determines (and notifies the ADI) that without a public sector injection of capital, or equivalent support, the ADI would become non-viable.¹²²

Minimum capital requirements

The amount of Tier I and Tier II capital to be included in an Australian ADI’s capital base for capital adequacy purposes, net of all required deductions as described below, is subject to the relevant Australian ADI maintaining the following minimum capital requirements:¹²³

- a a common equity Tier I capital ratio of 4.5 per cent;
- b a Tier I capital ratio of 6.0 per cent; and
- c a total capital ratio of 8.0 per cent.

New capital buffers

In line with the Basel III framework, the minimum capital requirements will be supplemented by the introduction of new capital conservation and countercyclical buffers. The capital conservation buffer will require Australian ADIs to set aside an additional amount of common equity Tier I capital equal to 2.5 per cent of an Australian ADI’s total risk-weighted assets unless determined otherwise by APRA.¹²⁴ The countercyclical

119 APS 111, Paragraphs 27–29 and Attachment E.

120 APS 111, Paragraphs 30–33 and Attachment H.

121 APS 111, Attachment J, Paragraph 1.

122 APS 111, Attachment J, Paragraph 3.

123 APS 110, Paragraph 22.

124 APS 110, Paragraph 25.

buffer will require Australian ADIs to hold additional common equity Tier I capital of between zero and 2.5 per cent (as determined by APRA) of an Australian ADI's total risk-weighted assets.¹²⁵ APRA has chosen not to implement the Basel III transitional arrangements for capital conservation buffers. Instead, capital conservation buffers will apply in Australia in full from 1 January 2016¹²⁶ and APRA will have the ability to impose the new countercyclical buffer from the same date.¹²⁷

Any depletion of common equity Tier I capital below the buffer requirements will have the effect of bringing into force capital distribution constraints.¹²⁸ These constraints will operate to prevent Australian ADIs from making distributions affecting their common equity Tier I capital such as dividends and share buybacks. The percentage of earnings that an Australian ADI will be unable to distribute when subject to a capital distribution constraint will depend on the degree to which the capital buffer requirements have been depleted.¹²⁹

Also in line with the Basel III framework, APRA has announced that it will impose a domestic systemically important banks (D-SIBs) capital buffer on certain of Australia's largest banks.¹³⁰ This announcement was followed by the release of an information paper by APRA in December 2013 outlining its D-SIBs framework, which will come into effect on 1 January 2016.¹³¹ The information paper provides details on the methodology used by APRA to identify D-SIBs in Australia. APRA's assessment methodology has regard to the Basel Committee's four key indicators of systemic importance: size, interconnectedness, substitutability and complexity. Under the D-SIBs framework, the capital buffer must be met by common equity Tier I capital and will be implemented as an extension of the capital conservation buffer. On this basis, APRA has designated Australia's largest ADIs¹³² as D-SIBs and has set a 1 per cent capital buffer for them. Although the Basel Committee has also proposed the introduction of an additional capital buffer for global systemically important banks (G-SIBs),¹³³ no Australian banks

125 Ibid.

126 APS 110, Paragraph 24.

127 APS 110, Paragraph 29.

128 APS 110, Attachment B.

129 Ibid.

130 See *Australian Financial Review*, 'Future Forums: Banking' at www.afr.com/p/futureforums/video_future_forums_banking_nndsIFSAvBWEun3P3LyVjO.

131 See APRA, 'Information Paper: Domestically systemically important banks in Australia' at www.apra.gov.au/adi/Publications/Documents/Information-Paper-Domestic-systemically-important-banks-in-Australia-December-2013.pdf.

132 Australia's largest ADIs were determined by APRA as Australia and New Zealand Banking Corporation, Commonwealth Bank of Australia, National Australia Bank and Westpac Banking Corporation per APRA, 'APRA releases framework for domestic systemically important banks in Australia' at www.apra.gov.au/mediareleases/pages/13_40.aspx

133 Basel Committee on Banking Supervision, 'Global Systemically Important Banks: updated assessment methodology and the higher loss absorbency requirement, July 2013, at www.bis.org/publ/bcbs255.pdf.

currently qualify as G-SIBs.¹³⁴ As such, it is unlikely that the G-SIBs capital buffer will be implemented by APRA for Australian ADIs in the near future.

Deductions

For the purposes of determining an Australian ADI's capital requirements, certain deductions are required to be made from its Tier I and Tier II capital.¹³⁵ The deductions to be made from common equity Tier I capital include the following items: asset impairment, deferred tax, fair value gains and losses arising from certain assets, certain goodwill and intangibles, all holdings of own Tier I capital instruments, gains from sale of assets to a securitisation and any surplus or deficit in certain ADI sponsored superannuation funds.

In addition, the following items must be deducted from the corresponding category of capital (subject to some exceptions):

- a* direct, indirect and synthetic equity exposures,¹³⁶ guarantees and other forms of capital support, and holdings of additional Tier I capital and Tier II capital instruments in ADIs and overseas deposit-taking institutions and their subsidiaries, insurance companies and other financial institutions;¹³⁷ and
- b* holdings of its own capital instruments, whether held directly or indirectly, unless otherwise exempted in writing by APRA or unless eliminated under Australian Accounting Standards from the relevant category of capital.¹³⁸

Impact on business

Regulatory capital requirements play an important role in the business activities of an Australian ADI particularly given the different risk weights assigned to various assets in determining the Australian ADI's risk-based capital ratio. Accordingly, regulatory capital considerations have a significant influence over the types of transactions entered into by an Australian ADI and the manner in which it conducts its activities.

For example, changes to the capital adequacy standards proposed by the Basel III reforms will impact the capital planning activities of Australian ADIs and restrict the range of instruments that they will be able to issue to satisfy their capital adequacy requirements.

Consolidated supervision

APRA has a consolidated supervision framework and various powers under this to limit the risk to an ADI as a result of its associations and dealings with related entities. The relevant prudential standards include APS 110 and APS 222.

APS 110 is relevant because it determines the capital adequacy requirements of Australian ADIs in accordance with the following classifications:¹³⁹

- a* stand-alone entities (Level 1);

134 Financial Stability Board; 2013 Update of group of globally systemic important banks (G-SIBS) 11 November 2013 at https://www.financialstabilityboard.org/publications/r_131111.pdf.

135 APS 111, Attachment D.

136 As defined in APS 113, Paragraphs 49–52.

137 APS 111, Attachment D, Paragraph 8.

138 APS 111, Attachment D, Paragraph 15.

139 APS 110, Paragraph 10.

- b* single-industry groups (Level 2); and
- c* conglomerate groups (Level 3).

APS 110 requires Australian ADIs that form part of a conglomerate group to satisfy the specific capital requirements for Level 3 groups. On 14 December 2012, APRA released a consultation package comprising eight draft prudential standards aimed at tightening the Level 3 supervision of conglomerate groups to enhance depositor protection.¹⁴⁰ This consultative package focused on two of components of APRA's Level 3 framework being the group governance and risk exposure requirements for conglomerate groups. On 9 May 2013 APRA released a further consultative package,¹⁴¹ which addressed the remaining two components of the Level 3 framework: risk management and capital adequacy requirements for conglomerate groups. On 26 September 2013, APRA also released for consultation proposed reporting standards relating to the capital adequacy of conglomerate groups.¹⁴² Data collection under the proposed reporting standard is intended to assist APRA to ensure conglomerate groups are capitalised in accordance with the proposed capital adequacy prudential standards that were released for consultation in May 2013. Conglomerate groups will be required to comply with the new standards under the Level 3 framework from 1 January 2015. The collection of data under the proposed reporting standard will commence with the first reporting period ending after 1 January 2015. The final prudential and reporting standards implementing the enhanced Level 3 supervision of conglomerate groups are yet to be released by APRA.

To supplement the specific capital adequacy requirements for conglomerate groups under APS 110, APRA has developed additional prudential standards aimed at minimising contagion risk between conglomerate group members. These additional standards are set out in APS 222.

Under APS 222, each Australian ADI that heads a conglomerate group is required to provide APRA with details of the ADI's group members, group management structure, its intra-group support arrangements, any intra-group exposures and any other information required by APRA for supervision of the group.¹⁴³ Where an Australian ADI is part of a conglomerate group headed by an authorised NOHC, the same reporting obligations apply to the ADI and its subsidiaries.¹⁴⁴ Australian ADIs are also required to notify APRA in advance of any intended changes in the composition or operations of its group structure which has the potential to materially alter the overall risk profile of the ADI.¹⁴⁵ In addition, Australian ADIs are required to provide APRA with an outline of

140 APRA Media Release, 'APRA releases consultation package for the supervision of conglomerate groups (Level 3), 14 December 2012 at www.apra.gov.au/mediareleases/pages/12_34.aspx.

141 See APRA accessed 18 March 2014 at www.apra.gov.au/CrossIndustry/Consultations/Pages/Supervision-of-conglomerate-groups-May-2013.aspx.

142 See APRA accessed 18 March 2014 at [www.apra.gov.au/CrossIndustry/Documents/Level-3-Discussion-Paper-Proposed-Level-3-Reporting-Requirements-\(Sept-2013\).pdf](http://www.apra.gov.au/CrossIndustry/Documents/Level-3-Discussion-Paper-Proposed-Level-3-Reporting-Requirements-(Sept-2013).pdf).

143 APS 222, Paragraph 8(a).

144 APS 222, Paragraph 8.

145 APS 222, Paragraph 8(c).

their group risk management policies and the procedures used to measure and manage overall group risk exposure.¹⁴⁶

APS 222 also imposes various requirements and restrictions on the use of a common brand name by an Australian ADI and other members in the Australian ADI's conglomerate group, the distribution of financial products by an Australian ADI on behalf of other group members and the Australian ADI's participation in group operations.¹⁴⁷ These requirements also apply to foreign ADIs (and their subsidiaries operating in Australia) and to non-ADI entities operating in Australia that are directly owned by the foreign parent of an ADI or by the parent's subsidiaries.¹⁴⁸

As the prudential supervisor of Australian insurance companies and superannuation funds, APRA also has powers to ensure the prudent management of these entities within an Australian banking group.¹⁴⁹ See Section V.ii, *infra* for further details on the prudential supervision of superannuation funds. See Section V.iii, *infra*, for further information on the prudential supervision of insurance companies.

IV CONDUCT OF BUSINESS

i Confidentiality

Banks in Australia have a strict duty of confidence in relation to customer account details. At common law, there is a duty not to disclose to third parties the state of a customer's account or any transactions on the account. The leading authority is the English case of *Tournier*.¹⁵⁰ The duty covers all information relating to the account, including information obtained as a consequence of the relationship between the customer and the bank.

The four commonly agreed exceptions to the duty in *Tournier* are when the use or disclosure is consented to by the customer, compulsory under law, pursuant to a public duty or necessary for the interests of the bank.

ii Consumer credit legislation

The National Consumer Credit Protection Act 2009 (the NCCP Act) (including the National Credit Code that comprises Schedule 1 to the Act) and related legislation came into effect on 1 July 2010.

This NCCP legislation is the principle source of regulation for the provision of consumer credit and consumer leases in Australia. It is a national regime that replaces the Uniform Consumer Credit Codes that previously applied in individual states and territories of Australia. The legislation prescribes a comprehensive licensing regime for all persons who engage in 'credit activities', which includes the provision of consumer credit,

146 APS 222, Paragraph 9.

147 APS 222, Paragraphs 21–31.

148 APS 222, Footnotes 7–9.

149 Superannuation Industry (Supervision) Act 1993 (Cth), Section 6, Retirement Savings Accounts Act 1997 (Cth), Section 3.

150 *Tournier v. National Provincial and Union Bank of England Ltd* [1924] 1 KB 461; [1923] All ER Rep 550.

and imposes responsible lending requirements on all licensees. It was enacted in response to an Australian government report on financial services and credit products in June 2008.¹⁵¹

Credit is only regulated under the NCCP Act if, *inter alia*, it is provided wholly or predominantly either:

- a* for personal, domestic or household purposes; or
- b* to purchase, renovate or improve residential property for investment purposes or to refinance credit used for such purposes.

With respect to licensing, any person who engages in ‘credit activities’ as defined in the NCCP Act is required to hold an Australian credit licence. At a high level, there are two categories of persons who will engage in credit activities for the purposes of the Act and will therefore need to be licensed:

- a* ADIs and other credit providers, mortgagees and beneficiaries of guarantees and providers of consumer leases and persons who perform the obligations of, or exercise the rights of those persons; and
- b* persons who provide a credit service, which is defined as the provision of credit assistance (which includes suggesting or assisting the entry into of a consumer contract or consumer lease with a particular credit provider or lessor) or acting as an intermediary (which is broadly defined and intended to capture all persons in the chain between the customer and the credit provider) for the purpose of securing a consumer contract or a consumer lease.

Licensees are subject to a number of general conduct obligations and must also comply with the ‘responsible lending’ requirements set out in the NCCP Act. The ‘responsible lending’ requirements include obligations for licensed credit providers to:

- a* make reasonable inquiries about the consumer’s requirements and objectives in relation to the credit contract and about the consumer’s financial situation;
- b* take reasonable steps to verify the consumer’s financial situation; and
- c.* to undertake an assessment as to whether a proposed credit contract will be unsuitable for the consumer before entering into the credit contract or making an unconditional representation to a consumer that the credit provider considers the consumer is eligible to enter a credit contract with the licensee.

The National Credit Code (the NCC) imposes prescriptive disclosure obligations and processes on a wide range of activities relating to the entry and ongoing conduct of consumer credit or consumer lease transactions, as well as providing consumers with certain rights to challenge unjust transactions or unconscionable interest or charges or to apply for variations on the grounds of hardship.

Both the NCCP Act and the NCC contain various sources of both civil and criminal liability for failures to comply.

151 Australian Treasury, ‘Financial Services and Credit Reform Green Paper’, June 2008, at www.treasury.gov.au/documents/1381/PDF/Green_Paper_on_Financial_Services_and_Credit_Reform.pdf.

In August 2012 the NCCP Act was amended by the Consumer Credit Legislation Amendment (Enhancements) Act 2012 (the Enhancements Act). The Enhancements Act, which came into effect on 1 March 2013, imposes additional obligations in relation to consumer leases, short-term small amount loans and reverse mortgages. This includes additional responsible lending obligations and new disclosure requirements.

In addition, the Enhancements Act:

- a* introduced a cap on the maximum amount of interest credit providers can charge under small amount credit contracts and other credit contracts regulated by the NCC; and
- b* amended the hardship provisions in the NCC to make it easier for borrowers to apply for hardship relief.

iii Privacy

Up until 12 March 2014, handling of personal information by private sector organisations in Australia was regulated by the National Privacy Principles (the NPPs) which comprise Schedule 3 to the Privacy Act 1988 (Cth) (the Privacy Act). They regulated all handling of personal information, including in relation to the collection, use and disclosure of ‘personal information’.

Additionally, Part IIIA of the Privacy Act comprehensively regulates the conduct of credit providers, credit reporting agencies and certain other entities in relation to credit information and credit reports. *Inter alia*, Part IIIA regulates the use and disclosure of credit reports and credit information by credit-reporting bodies and credit providers and provides customers with rights to obtain copies of their credit reports.

The Privacy Act has been amended by the Privacy Amendment (Enhancing Privacy Protection) Act 2012 (the Amendment Act) which was passed on 29 November 2012 and received royal assent on 12 December 2012. The Amendment Act implements the Australian government’s first stage response to the Australian Law Reform Commission’s 2008 report, ‘For Your Information: Australian Privacy Law and Practice’. The new provisions came into force on 12 March 2014.

The Amendment Act has amended the Privacy Act in a number of important ways including:

- a* creating a single set of Australian Privacy Principles (the APPs), which will apply to both Commonwealth agencies and private sector organisations (replacing the existing NPPs and the Information Privacy Principles that apply to the Commonwealth public sector);
- b* implementing a more comprehensive credit reporting regime that, which, *inter alia*, provides for access in the credit reporting system in Australia to a number of additional data sets not previously permitted under Part IIIA; and
- c* clarifying the functions and powers of the Commissioner and improving the Commissioner’s ability to resolve complaints and promote privacy compliance.

The APPs mirror the NPPs in many respects but are structured differently, to more accurately reflect the life cycle of personal information from collection to disclosure. The APPs also expand the protections afforded to individuals regarding their personal information in certain areas, and impose new obligations in relation to the collection,

handling and maintenance of personal information by APP entities. Key changes include the introduction of a new regime to regulate direct marketing and a new ‘accountability’ regime for transfers of personal information outside Australia.

iv Anti-money laundering

The AML Act imposes obligations on ‘reporting entities’ (which include banks) who provide ‘designated services’ (which is widely defined to include many financial transactions). These obligations include implementing an AML/CTF compliance programme, verifying the identity of customers, reporting specified types of transactions and suspicious matters, performing ongoing customer due diligence and maintaining accurate records.

v Consumer protection

The ASIC Act regulates consumer protection in relation to financial services, and covers, *inter alia*, unconscionable conduct, misleading and deceptive conduct and false or misleading representations.

The ASIC Act also includes an unfair contract terms regime, which commenced on 1 July 2010. Under the regime, a term in a standard form contract that is found to be unfair is void. A term will be unfair if it causes a significant imbalance in the parties’ rights and obligations arising under the contract and it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term, subject to certain exclusions.

vi Banking ombudsman services

Persons who hold an Australian Credit Licence (which will include most banks and credit providers) are required by ASIC to be members of an ASIC-approved external dispute resolution scheme. To date, there are two: the Financial Services Ombudsman and the Credit Ombudsman Service Limited.

vii Australian financial services licensing regime

Subject to limited exceptions, a person who carries on a ‘financial services business’ in Australia must hold an AFSL covering the provision of the financial services.¹⁵²

‘Financial service’ includes the provision of financial product advice, dealing in a financial product and making a market for a financial product, where ‘financial product’, ‘dealing’ and ‘making a market’ are widely defined to include many banking products and services.¹⁵³

An exemption from the need for an AFSL in respect of the provision of a financial service is available to an APRA-regulated body where the service is one in relation to which APRA has regulatory or supervisory responsibilities and the service is provided only to wholesale clients.¹⁵⁴

152 Corporations Act, Section 911A(1).

153 Corporations Act, Section 766A.

154 Corporations Act, Section 911A(2)(g).

Bodies regulated by APRA include ADIs and NOHCs.¹⁵⁵

The distinction between a wholesale client (in respect of whom the exemption applies) and a non-wholesale (or retail) client is critical. There are specific categories of wholesale client that differ depending on the particular class of product or service being provided. For products other than general insurance products, superannuation products and retirement savings account products a wholesale client will include 'sophisticated clients', 'professional investors' and persons certified as having a gross income of A\$250,000 for each of the last two financial years or net assets of A\$2.5 million. However, the most commonly used criterion to be certain that a financial service or financial product is provided to a wholesale client is the A\$500,000 test: persons who invest more than A\$500,000 in respect of a financial product will be 'wholesale' for that investment and any financial services which relate to that investment.¹⁵⁶

It follows that the provision of financial products and services by an ADI to a non-wholesale (or retail) client requires an AFSL.

An application for an AFSL is made to ASIC; therefore it is additional to the application to APRA for ADI authorisation. It is unlikely that an ADI will not satisfy the requirements of ASIC in relation to the AFSL. In short the application to ASIC must provide evidence of ability to satisfy statutory obligations and which involves providing ASIC detailed information in relation to internal management and operations and information demonstrating the experience and qualifications of management. Once licensed, an AFSL holder must provide periodic reports to ASIC with regard to compliance with its AFSL.

The Corporations Act imposes onerous requirements upon AFSL holders in relation to disclosures to retail clients, although there is some relief in relation to basic deposit products.

In June 2012, the Australian government enacted legislation aimed at supplementing the financial services licensing regime with broader investor protections.¹⁵⁷ The reforms are in response to industry feedback on a 'Future of Financial Advice' (FoFA) package released by the Australian government in April 2010.¹⁵⁸ Following a 12-month transition period, compliance with the FoFA regime became mandatory on 1 July 2013. In essence, the key elements of the FoFA regime affect financial services providers (and in particular, financial advisers) and introduce, *inter alia*:

- a* a ban on commissions and volume-based payments and any other type of remuneration structure that creates a conflict of interest;
- b* a requirement for all financial advisers to be subject to a statutory duty to act in the best interests of clients when giving advice;

155 APRA Act, Section 3(2).

156 Corporations Act, Sections 761G and 761GA.

157 Corporations Amendment (Future of Financial Advice) Act 2012 (Cth) passed by Parliament on 25 June 2012; Corporations Amendment (Further Future of Financial Advice Measures) Act 2012 (Cth) passed by Parliament on 25 June 2012.

158 Parliamentary Joint Committee on Corporations and Financial Services, inquiry into financial products and services in Australia, 23 November 2009.

- c* an ability for clients to opt out of ongoing fee arrangements at any time and the requirement on financial advisers to renew ongoing fee arrangements with their clients at least every two years;¹⁵⁹
- d* the grandfathering of existing remuneration arrangements made before 1 July 2013 in relation to client investments; and
- e* an expansion of ASIC's licensing and enforcement powers.

Despite the FoFA regime having only been in place for approximately 18 months, the newly elected Australian government launched draft legislation proposing extensive reforms to the FoFA regime, in an attempt to deliver on their election commitment to reduce compliance costs and remove red tape from the financial services industry. At the time of writing, these reform proposals have not been finalised.

viii Derivatives

In line with its G20 commitments, Australia is moving towards increased regulation of the over-the-counter (OTC) derivatives market.

On 3 January 2013, the Corporation Legislation (Derivative Transactions) Act 2012 (Cth) (the Derivatives Act) came into effect, setting out a framework for the reform of the OTC derivatives market by introducing a new Part 7A into the Corporations Act.

The new Part 7A does not impose any obligations itself, but rather, empowers the Minister to prescribe a class of derivatives as subject to one or more of the following mandatory obligations:

- a* trade reporting;
- b* central clearing; or
- c* trade execution.

Prior to exercising this power, the Minister is required to consult with ASIC, APRA and the RBA and to prepare a regulation impact statement concerning the utility, feasibility and impact of the relevant mandatory obligation(s) on the affected markets. Once a class of derivatives is prescribed by the Minister, ASIC may make derivative transaction rules (DTRs). These are detailed rules regarding the scope, duration, applicability and consequences for non-compliance with the mandatory obligation(s). DTRs are to be developed by ASIC in consultation with the public and relevant bodies such as APRA and the RBA. All DTRs must be approved by the Minister and the Minister may pass regulations limiting the classes of persons and transactions to which the DTRs apply.

Failure to comply with DTRs will trigger civil penalty provisions in the Corporations Act but will not invalidate the relevant derivative transactions themselves.

On 11 July 2013, DTRs were phased into effect to impose mandatory reporting obligations on banks and financial intermediaries.¹⁶⁰ These DTRs are subject to the Corporations Amendment (Derivatives Transactions) Regulation 2013 (the Derivatives Transactions Regulation), which temporarily restricts ASIC from imposing requirements

159 Please note that ASIC has the ability to exempt advisers from this requirement if they are satisfied that the adviser is subject to an appropriate 'professional code'.

160 Derivative Transaction Rules (Reporting) 2013.

on end-users of OTC derivatives until after 31 December 2014. The Derivatives Transactions Regulation also establishes enforceable undertakings and infringement notices in respect of DTR contraventions. The DTRs in relation to mandatory reporting are currently confined to the following classes of derivatives prescribed by the Minister:

- a* credit derivatives;
- b* interest rate derivatives;
- c* foreign exchange derivatives;
- d* equity derivatives; and
- e* commodity derivatives (other than electricity derivatives).¹⁶¹

ASIC has also introduced rules in relation to the regulation and licensing of derivatives trade repositories. These rules allow for the recognition of overseas trade repositories that are subject to an overseas regulatory regime that is sufficiently equivalent to the regime applying in Australia.¹⁶²

In the latest step in Australia's implementation of the G20 derivatives reforms, the Australian government released a consultation paper in February 2014¹⁶³ seeking stakeholder views on whether ASIC should exercise its rule-making powers under the new Part 7A to mandate the central clearing of interest rate derivatives denominated in sterling, US dollars, yen or euro (the 'G4' currencies). The consultation paper proposes that any central clearing mandate would only apply to large financial institutions with significant cross-border activity in the relevant products. The consultation paper sets out an indicative list of these financial institutions.

The Australian government is still in the early consultation stages regarding mandatory central clearing of other derivatives, such as AUD-IRDs and North American and European-referenced credit derivatives. In general terms, it will wait for recommendations from future market assessments before considering a clearing mandate for these other asset classes. Despite this, the Australian government has started to seek feedback on a broader clearing mandate beyond the G4 currencies, as well as the appropriateness of trading platforms for mandatory derivatives trading.

ix Personal property reforms

On 31 January 2014 the two-year transitional period of the Personal Property Securities Act 2009 (Cth) (PPSA) came to an end. The PPSA, which commenced formal operation in January 2012, implemented a single national legal framework to deal with, *inter alia*, the creation and enforcement of security interests in personal property, the priority of

161 Corporations (Derivatives) Determination 2013, Section 4.

162 ASIC Regulatory guide 249 – Derivative trade repositories, July 2013, at [www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/rg249-published-11-July-2013.pdf/\\$file/rg249-published-11-July-2013.pdf](http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/rg249-published-11-July-2013.pdf/$file/rg249-published-11-July-2013.pdf).

163 Australian government, 'Implementation of Australia's G20 over-the-counter derivatives commitments – Proposals Paper – G4-IRD central clearing mandate', February 2014, at <http://treasury.gov.au/-/media/Treasury/Consultations%20and%20Reviews/Consultations/2014/G20%20over%20the%20counter%20derivatives%20commitments/Key%20Documents/PDF/Proposals-Paper-Central-clearing-G4-IRD.ashx>.

competing security interests (and other interests) in personal property, when a person takes an interest in personal property free of a security interest and the establishment of a national register of security interests in personal property. During the two-year transitional period many security interests provided for by security agreements that were in force when the legislation formally commenced operation enjoyed temporary perfection. From 1 February 2014 this temporary perfection no longer applies. In order to enjoy the benefits of perfection under the PPSA secured parties need to register (or otherwise perfect) their security interests on the register established under the PPSA, including those security interest that arise under arrangements that predate the operation of the legislation. The operation of the PPSA will be reviewed by the Australian government. That review must be completed by 30 January 2015.

x Deregulation

In 2013, in an attempt to deliver on their election commitment, the newly elected Australian government launched a red tape reduction program aimed at reducing unnecessary red tape costs for individuals, businesses and community organisations by at least A\$1 billion per year. To increase the whole-of-government focus of the deregulation agenda, an Office of Deregulation was created on 18 September 2013 to, *inter alia*, provide deregulation policy advice to the Australian government.

The Australian government recently introduced legislation to repeal more than 10,000 acts and regulations, the largest single bulk repeal in Australia's history.

xi Financial system review

In late November 2013, the Australian government announced a 'root and branch' inquiry into Australia's financial system.¹⁶⁴ David Murray, AO, has been appointed to chair the inquiry, which will be the third major inquiry in the past 30 years after the 1981 Campbell Inquiry and the 1997 Wallis Inquiry. The new inquiry is charged with examining how the financial system should be positioned to best meet Australia's evolving needs and support economic growth. It will involve a broad-based review of developments in the banking and finance sector since 1997 and will consider a number of areas including competition, superannuation, insurance, governance structures, management of financial and systemic risk and the payments system. Proceeding from the Australian government's broader deregulation agenda, the inquiry aims to develop recommendations that will foster an 'efficient, competitive and flexible financial system' consistent with principles of 'financial stability, prudence, integrity and fairness'. The four primary areas of focus for the inquiry will be: (1) the allocation of Australian-sourced capital to minimise the Australian economy's volatility to global capital markets; (2) the balance between competition, innovation and efficiency against stability and consumer protection; (3) the role and impact of technology, innovation and evolving consumer preferences; and (4) greater integration between Australia and the international scheme for financial regulation. An interim report is expected in September 2014, with a final report by November 2014.

164 Prime Minister and Treasurer joint media release, 'Financial System Inquiry', dated 20 November 2013, at <http://jbh.ministers.treasury.gov.au/media-release/037-2013/>.

V SUPERANNUATION AND INSURANCE

Each of Australia's four major banks are part of a financial services conglomerate that includes a superannuation trustee company and an insurance company. As such, the operation of the Australian banking market is inextricably linked with the superannuation and insurance industries.

i Superannuation

The superannuation industry forms part of the modern Australian retirement income system, which is comprised of the following 'three pillars':

- a* a publicly provided age pension;
- b* mandatory private superannuation savings; and
- c* voluntary saving (including voluntary superannuation saving).

A strong retirement income system supports many of the macroeconomic ends that a sophisticated and stable banking industry seeks to deliver. This has led to many parallel regulatory developments in both the superannuation and banking industries. Accordingly, the banking and superannuation industries intersect at various points.

The prudential regulator, APRA, is the principal regulator of the superannuation industry, and has been since 1998. ASIC also has responsibilities in this area. APRA has recently been empowered to make and enforce prudential standards for the superannuation industry in much the same way that APRA already makes and enforces prudential standards in respect of ADIs, NOHCs, life insurance companies and general insurance companies. The new prudential standards developed for the superannuation industry are discussed in further detail below.

In general, employers in Australia contribute on a quarterly basis a percentage of an employee's salary or wages into a fund established to comply with superannuation legislation requirements (known as a complying superannuation fund). At present, the minimum level of contributions by an employer in respect of an employee is 9.25 per cent of that employee's ordinary time earnings.

Employees generally have the right to choose a superannuation fund and move their superannuation savings between funds. Although the minimum superannuation contribution is currently 9.25 per cent, any employer and employee can contribute additional amounts. These voluntary contributions may be made as part of the overall terms and conditions of employment.

Alternatively, employees may make additional contributions to superannuation through salary reductions.

If the minimum contribution is not made by the employer, a special tax, called the superannuation guarantee charge (SGC), is imposed upon the employer. While contributions are not compulsory under legislation, the SGC makes contributing to a superannuation fund the lower-cost option for employers.

A complying superannuation fund is taxed at the concessional rate of up to 15 per cent of its assessable income. Capital gains, including gains on the disposal of shares and other securities held by the fund, are taxed at the rate of 10 per cent where the asset was held for 12 months or more. The Australian government also allows deductions for

employers' superannuation contributions and deductions for contributions by people who are substantially self-employed.

In general, superannuation fund members are unable to access retirement benefits until they retire after a minimum age, known as the 'preservation age', or they meet a specified condition of release (for example, reach the age of 65, death, permanent incapacity). The preservation age for persons born before 1 July 1960 is 55 years. For persons born after this date but before 30 June 1964, there is a gradual increase in the preservation age up to 60 years. For all persons born after 30 June 1964 the preservation age is 60 years. Payments made from a taxed superannuation fund to persons aged 60 or more are tax-free.

In December 2010, the Australian government responded to the Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System (the 'Cooper Review' or 'Super System Review') by announcing its 'Stronger Super' package of reforms, which is made up of four main parts:

- a* 'MySuper' reforms that seek to create a new simple low-cost default superannuation product, which will replace the current default superannuation arrangements. The current default arrangements relate to superannuation funds to which employers make compulsory superannuation contributions for employees who do not choose a superannuation fund. These funds are either selected by the relevant employer or nominated through an industrial award or enterprise agreement;
- b* 'SuperStream' reforms that aim to streamline back-office administration and make transactions cheaper and more efficient;
- c* governance measures to improve trustee decisions; and
- d* a range of measures relating to self-managed superannuation funds.

In 2011, the Australian government engaged in further consultation regarding Stronger Super and introduced a number of bills, which, have now become law. The first tranche of the legislation for Stronger Super comprised the Superannuation Guarantee (Administration) Amendment Act 2012 (Cth), the Superannuation Legislation Amendment (MySuper Core Provisions) Act 2012 (Cth) and the Tax Laws Amendment (Stronger, Fairer, Simpler and Other Measures) Act 2012 (Cth).

The Superannuation Guarantee (Administration) Amendment Act 2012 (Cth) commenced on 29 March 2012 and was intended to gradually increase the superannuation guarantee from 9 per cent to 12 per cent between 1 July 2013 and 1 July 2019. The increase to 9.25 per cent was effected on and from 1 July 2013. The new federal government has introduced legislation to pause the rate at 9.25 per cent for two years (so that the increase to 9.5 per cent would occur on 1 July 2016, rather than 1 July 2014), and then gradually increase by half a percentage point each year until it reached 12 per cent on and from 1 July 2021. The amending legislation – the Minerals Resource Rent Tax Repeal and Other Measures Bill 2013 (Cth) – passed the Australian House of Representatives but did not pass the Australian Senate and is now not proceeding. Whether the legislation will ever be made law will depend on the composition of the Senate after 1 July 2014.

The Superannuation Guarantee (Administration) Amendment Act 2012 (Cth) also increases the age limit for superannuation contributions from 70 to 75, although the Australian government has indicated that its ultimate objective is to remove the age limit

altogether.¹⁶⁵ The Superannuation Legislation Amendment (MySuper Core Provisions) Act 2012 (Cth) received royal assent on 28 November 2012. The Act aims to create a workable framework for the MySuper product. Important features of the Act are:

- a* superannuation funds will only be allowed to offer one MySuper product, although there will be exceptions for trustees and corporate brands in limited circumstances;
- b* trustees will need to obtain APRA authorisation for MySuper products offered; this will be done by showing that the product proposed to be offered complies with the core MySuper product characteristics and the trustee complies with enhanced trustee obligations; and
- c* new rules regarding charges to members and a list of allowable fee types.

The Tax Laws Amendment (Stronger, Fairer, Simpler and Other Measures) Act 2012 (Cth), which commenced on 29 March 2012, provides low income earners with a tax concession on their superannuation contributions.

The second tranche of Stronger Super legislation is contained in the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012 (Cth) (the TOPS Act), which received royal assent on 8 September 2012. The Act brings into effect two key areas of reform. First, it empowers APRA to make prudential standards.¹⁶⁶ APRA has now released 12 prudential standards. The final prudential standards include six standards¹⁶⁷ covering matters common to other APRA-regulated industries (e.g., banking and insurance), where APRA's approach has been to harmonise requirements between regulated industries. The remaining prudential standards¹⁶⁸ cover matters that are specific to superannuation. These include reforms the Australian government recommended that APRA implement as prudential standards, as well as the relocation of some existing requirements and guidance into new standards. The standards commenced on 1 July 2013.

Furthermore, APRA has issued an additional Superannuation Prudential Standard, SPS 410 MySuper Transition, which commenced on 1 January 2013. APRA also released a suite of prudential practice guides that provide guidance on the implementation of the standards.

Second, with respect to trustee and director duties, the TOPS Act implements several reforms including:

- a* expanding the covenants for registrable superannuation trustee licensees;

165 See Parliament of Australia, 'Superannuation Guarantee (Administration) Amendment Bill 2011: Second Reading', at <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22chamber%2Fhansard%2F3641b583-a42e-4045-9472-07db51574a42%2F0016%22>.

166 Superannuation Legislation Amendment (Trust Obligations and Prudential Standards) Act, Part 3A.

167 SPS 220 Risk Management, SPS 231 Outsourcing, SPS 232 Business Continuity Management, SPS 310 Audit and Related Matters, SPS 510 Governance and SPS 520 Fit and Proper.

168 SPS 114 Operational Risk Financial Requirement, SPS 160 Defined Benefit Matters, SPS 250 Insurance in Superannuation, SPS 521 Conflicts of Interest and SPS 530 Investment Governance.

- b* applying new duties to trustees of registrable superannuation entities that offer a MySuper product; and
- c* applying personal duties to the directors of corporate trustees in their own right, all of which commence on 1 July 2013.¹⁶⁹

The third and fourth tranches of the Stronger Super reforms are each respectively contained in the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012 (Cth), which received royal assent on 3 December 2012, and the Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Act 2013, which received royal assent on 26 June 2013. These tranches introduced a range of reforms that support and add to the first and second tranches, including the following:

- a* setting rules regarding fees, by which entry fees will be banned and criteria provided for charging fees in superannuation, including for the charging of financial advice;
- b* requiring all superannuation funds to provide minimum levels of life and total permanent disability insurance;
- c* improving APRA's ability to gather information and requiring disclosure and publication of key information in relation to superannuation funds;
- d* allowing only superannuation funds that offer a MySuper product (and exempt public sector superannuation schemes) to be eligible as default funds in modern awards and enterprise agreements;
- e* allowing exemptions from MySuper for members of defined benefits funds;
- f* providing rules for eligible rollover funds and requiring trustees to transfer certain balances, known as 'accrued default amounts', of members to a MySuper product by 1 July 2017;
- g* voiding any provision in the governing rules of a fund that requires the trustee to use a specified service provider, investment entity or financial product;
- h* empowering APRA to issue infringement notices as an alternative to criminal prosecution in respect of certain breaches of the Superannuation Industry (Supervision) Act 1993 (Cth)(the SIS Act);
- i* requiring trustees of superannuation funds to provide reasons for decision in certain circumstances and extending the time limits in which a member can lodge a complaint;
- j* imposing additional requirements on entities regulated by both APRA and ASIC; and
- k* requiring a member who has suffered loss or damage caused by a director's contravention of the SIS Act to seek leave from the court before bringing an action, and extending the legal defence available to directors and trustees to include breaches of MySuper obligations.

The majority of these proposed reforms took effect on 1 July 2013.

¹⁶⁹ Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012 (Cth), Schedule 1.

ii Insurance

Insurance companies (other than health insurance companies) are regulated by APRA in accordance with the Life Insurance Act 1995 (Cth), the Insurance Act 1973 (Cth) and different sets of prudential standard that apply separately in respect of life insurance and general insurance. In circumstances where an insurer is part of a consolidated group, certain capital adequacy requirements are required to be addressed in respect of the parent entity in addition to the insurer.¹⁷⁰ In those circumstances, the prudential standards will apply to the parent entity, the insurer as well as subsidiaries.

In January 2013, APRA published revised prudential standards affecting Australian life and general insurers following a review of its prudential supervision of insurance companies (LAGIC). The revised standards are aimed at improving the risk sensitivity of capital standards so that:

- a* an insurer's regulatory capital requirement better reflects its risk profile;
- b* a minimum level of protection is provided to policyholders regardless of the type of policy held and of the business model or structure of the insurer; and
- c* the capital to be held by each insurer changes in line with changes to the levels of risk to which it is exposed.¹⁷¹

The new standards effectively harmonise APRA's approach to the regulation of capital held by Australian life and general insurers with the capital standards applicable to Australian ADIs.

APRA is currently consulting on how to harmonise risk management prudential standards across APRA-regulated industries,¹⁷² and how data is collected from counterparties to reinsurance in the specific sectors of general and life insurance.¹⁷³

VI FUNDING AND LIQUIDITY

i Funding sources

In order to support their lending, Australian ADIs primarily source their funds from customer deposits and (domestic and international) wholesale markets.

170 See, for example, GPS 113 and GPS 111.

171 APRA discussion paper, 'Review of capital standards for general and life insurers', 13 May 2010, at [www.apra.gov.au/CrossIndustry/Documents/GLI_DP_RCSGILI_032010_v7\[1\].pdf](http://www.apra.gov.au/CrossIndustry/Documents/GLI_DP_RCSGILI_032010_v7[1].pdf).

172 APRA, 'Harmonising cross-industry risk management requirements – January 2014', at www.apra.gov.au/CrossIndustry/Pages/January-2014-Consultation-Risk-Management.aspx.

173 APRA, 'Reinsurance Counterparty Reporting Requirements – December 2013', at www.apra.gov.au/lifs/Pages/Reinsurance-Counterparty-Reporting-Requirements-December-2013.aspx; APRA, 'Reinsurance counterparty data collection for general insurers – December 2013', at www.apra.gov.au/GI/PrudentialFramework/Pages/Response-to-submissions-reinsurance-counterparty-data-December-2013.aspx.

ii Impact on liquidity standards

A critical aspect of bank funding activities is the need for ADIs to maintain adequate liquidity. APRA sets liquidity requirements and guidelines for Australian ADIs through prudential standard APS 210 Liquidity (APS 210) and Prudential Practice Guide on Liquidity (APG 210).

APS 210 requires an ADI¹⁷⁴ to ‘maintain an adequate level of liquidity to meet its obligations as they fall due across a wide range of operating circumstances’.¹⁷⁵ It vests an ADI’s board and management with the responsibility to maintain an appropriate liquidity management strategy,¹⁷⁶ which must be regularly reviewed by the ADI to ensure it reflects current circumstances.¹⁷⁷

In setting the appropriate liquidity management strategy, the majority of banks are required to apply the ‘scenario analysis’ approach (incorporating a worst case idiosyncratic name crisis) which specifically requires banks to consider adverse contractual and behavioural cash flows including undrawn commitments and other off-balance sheet liabilities.¹⁷⁸

Other banks with relatively straightforward business models are subject to a minimum liquidity holding (MLH) regime.¹⁷⁹ The MLH regime specifies a level of eligible liquid assets (as a percentage of liabilities) that must be held. That level is determined on a case-by-case basis and any off-balance sheet commitments must be factored into that judgment. In practice, the MLH regime is not applied to banks that have significant non-retail off-balance sheet commitments.¹⁸⁰

APS 210 was revised in January 2014 to implement certain of the Basel III global liquidity reforms in Australia. From 1 January 2015, the newly revised APS 210 will prescribe two liquidity regimes for ADIs:

- a* one for smaller ADIs with simpler, retail based business models, which will continue to be regulated by the MLH regime under the pre-January 2013 version of APS 210, with some minor modifications; and
- b* another for larger and more complex ADIs (LCR ADIs), which replaces the scenario analysis for LCR ADIs with a requirement to satisfy the new tests under the Basel III global liquidity standards:¹⁸¹
 - the liquidity coverage ratio (LCR), which aims to promote short-term resilience of the ADI’s liquidity risk profile by ensuring that it has sufficiently

174 Some of the requirements in APS 210 are confined to select categories of ADIs including Australian ADIs, Australian branches of foreign ADIs and foreign-owned subsidiaries of ADIs.

175 APS 210, p. 1.

176 APS 210, p. 4; in relation to a foreign ADI, the responsibilities of the Board in APS 210 are to be fulfilled by the senior officer outside Australia.

177 APS 210 p. 10.

178 Paragraphs 50–59 of APS 210 and paragraphs 70–78 of APG 210.

179 Paragraphs 60–62 of APS 210 and paragraph 135 of APG 210.

180 IMF Country Report No 12/313, November 2012, p. 99.

181 Draft ‘Prudential Standard APS 210 Liquidity’ 1 November 2011 and APRA Discussion Paper, ‘Implementing Basel III Liquidity Reforms in Australia’, 16 November 2011, at www.apra.gov.au/adi/documents/adi_dp_iblr_november_2011.pdf.

high-quality liquid assets to survive an acute short-term stress scenario lasting 30 days; and

- the net stable funding ratio (NSFR), which aims to promote resilience over a longer period by creating incentives for ADIs to fund their activities with more stable sources of funding relative to the liquidity profile of their assets. The NSFR also accounts for contingent liquidity needs arising from off-balance sheet commitments. The NSFR is tested over a period of one year.

LCR ADIs will have until 2015 to meet the LCR standard and 2018 to meet the NSFR standard, which is in line with the timetable for Basel III. However, while APS 210 currently includes the LCR rules, it is silent on the NSFR rules. APRA has indicated that it will wait until the Basel Committee has finalised the NSFR rules before introducing these into APS 210.

In order to satisfy the LCR standard, ADIs must hold high-quality liquid assets that fall into two categories:

- a* Level 1 assets: these assets are limited to cash, central bank reserves that can be drawn down in times of stress and certain categories of government debt. Level 1 assets can comprise an unlimited share of the liquid asset pool for the purposes of the LCR and are not subject to a haircut under the LCR; and
- b* Level 2 assets: these assets include certain other categories of government debt and highly rated corporate bonds (issued by non-bank issuers) and covered bonds that have a proven track record as a reliable source of liquidity in the markets. Level 2 assets may not comprise more than 40 per cent of the overall liquid asset pool for the purposes of the LCR and will have haircuts applied to their current market value (a minimum of 15 per cent haircut must be applied to Level 2 assets). The Basel Committee has also given national regulators the discretion to allow certain additional assets to be counted towards the LCR calculation (i.e., Level 2B assets). These Level 2B assets are highly rated residential mortgage-backed securities and certain listed non-financial equities.

APRA has opted not to recognise any Level 2B assets at this stage. Given Australia's relatively low levels of government debt, this may result in insufficient Level 1 and Level 2 assets being available to meet the demand for those assets by ADIs seeking to satisfy the LCR standard. To address this situation (both in Australia and in other jurisdictions in a similar position), the Basel Committee has announced that it will accept alternative standards for determining liquid assets for LCR purposes in the affected jurisdictions, including the recognition of committed liquidity facilities with a central bank for a fee. Consistent with this, the RBA and APRA announced on 17 December 2010 that an ADI will be able to establish a committed secured liquidity facility with the RBA (CLF) to cover any shortfall between the ADI's holding of high-quality assets and the LCR requirements.¹⁸² The RBA

182 RBA and APRA, 'Australian Implementation of Global Liquidity Standards', joint media release 17 December 2010, at www.rba.gov.au/media-releases/2010/jmr-10-31.html.

has confirmed that the CLF access fee will be 0.15 per cent per annum applying to both drawn and undrawn commitments, which must be paid monthly in advance.¹⁸³

The CLF will only be available to the larger Australian ADIs (approximately 40 in number) as APRA has indicated that it does not intend to apply the LCR requirements to smaller ADIs.¹⁸⁴ ADIs wishing to apply for the CLF are required to make an annual application to APRA outlining their Australian-dollar liquidity requirements in the context of the LCR and the resulting forecast of their required CLF size. APRA will require all eligible ADIs to first demonstrate that they have taken all reasonable steps towards meeting their LCR requirements through their own balance sheet management before relying on the RBA facility. To assist APRA with this assessment, the RBA will supply, on an annual basis, an estimate of the aggregate amount of Australian-dollar high-quality liquid assets that could reasonably be held by ADIs. APRA will set the size of the CLF for a particular ADI in proportion to that ADI's target Australian-dollar net cash outflows. Therefore, ADIs will not be able to use the CLF to assist them meet shortfalls in the LCR as a result of their foreign-currency net cash outflows.

Securities that ADIs can use as collateral under the CLF will include all securities eligible for repoing under the RBA's normal market operations. In addition, the RBA has stated that self-securitised residential mortgage-backed securities will also be eligible under the CLF. Should an ADI lack a sufficient quantity of residential mortgages, the RBA has also indicated that it will consider other 'self-securitised' assets on a case-by-case basis.¹⁸⁵ As part of the annual CLF assessment process, APRA will assess the suitability of an ADI's CLF collateral mix including whether it 'has an appropriate degree of diversification, and are not concentrated in debt securities of a particular type, issuer, credit quality or tenor'.

iii Financial Claims Scheme and government guarantee scheme for large deposits and wholesale funding

The global financial crisis prompted the Australian government to establish two schemes in October 2008 under which the Australian government guaranteed certain obligations of ADIs. The Financial Claims Scheme (FCS) was established to effect a government guarantee of deposits of up to A\$1 million with Australian ADIs. The Guarantee Scheme for Large Deposits and Wholesale Funding (the Guarantee Scheme) was established to effect a government guarantee of larger deposit balances with ADIs and certain ADI wholesale funding liabilities.

183 RBA, 'The RBA Committed Liquidity Facility', Media Release 16 November 2011, at www.rba.gov.au/media-releases/2011/mr-11-25.html.

184 RBA and APRA, 'Australian Implementation of Global Liquidity Standards', Joint Media Release 17 December 2010, accessed on 23 December 2012 at www.rba.gov.au/media-releases/2010/jmr-10-31.html; APRA, 'Discussion Paper – Implementing Basel III Liquidity Reforms in Australia' 16 November 2011 at www.apra.gov.au/adi/documents/adi_dp_iblr_november_2011.pdf.

185 Ibid.

Under the FCS, which is administered by APRA,¹⁸⁶ the Australian government guarantees certain ‘protected accounts’¹⁸⁷ (originally with a cap of up to A\$1 million) held at an Australian ADI in the event that the ADI becomes a ‘declared ADI’.¹⁸⁸ Under the Banking Act, an ADI will become a ‘declared ADI’ if APRA has applied to the Federal Court of Australia to wind up that ADI and the Minister has made a declaration under Section 16AD of the Banking Act.¹⁸⁹

In May 2011, APRA released a FCS consultation paper that proposed that the FCS be automatically activated either at the time that APRA applies to the court for a winding up of an insolvent ADI or at the time that the court issues a winding-up order. That consultation paper also proposed that the Treasurer should have a discretion to activate the FCS when APRA appoints a statutory manager to an ADI, before APRA applies for the winding-up of the ADI. As at the date of this publication, these proposed amendments have not been implemented in the Banking Act. The FCS was initially introduced as a temporary measure, but was confirmed as a ‘permanent feature of the Australian financial system’ in October 2011.¹⁹⁰ From 1 February 2012, a new cap was introduced for ‘protected accounts’ of A\$250,000 per person per ADI.¹⁹¹

To ensure adequate protection of protected accounts under the FCS should an ADI become a ‘declared ADI’, as defined under the Banking Act, each ADI is required to comply with Prudential Standard APS 910 – Financial Claims Scheme (APS 910), which took effect from 1 January 2012, subject to a two year transition period. The key requirements of APS 910 include the following:

- a* an ADI must identify each unique account holder, to the extent practicable;
- b* an ADI must develop and implement a single customer view (SCV). The SCV identifies the aggregate protected accounts held by each account holder under the FCS with an ADI;¹⁹²
- c* an ADI must put in place processes and controls to ensure the integrity of SCV data; and
- d* the systems and data required by this prudential standard must be subject to both external audit and sign-off by the chief executive officer.

186 The FCS was given force by the Financial System Legislation Amendment (Financial Claims Scheme and Other Measures) Act 2008 (Cth), and the Banking Amendment Regulations 2008 (No.1).

187 Banking Act, Sections 5(4),(5),(6) and (7).

188 See Banking Act, Section 5 for the definition of ‘declared ADI’ and Banking Act, Section 16AF.

189 Banking Act, Sections 14F and Section 16AD.

190 APRA Fact Sheet 7, ‘Financial Claims Scheme’, at www.apra.gov.au/AboutAPRA/.../APRA_FS7_122011_v1.pdf.

191 Australian government and Treasury paper, ‘New Permanent Financial Claims Scheme Cap to Protect 99% of Australian Deposit Accounts in Full’, 11 September 2011, at <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/109.htm&pageID=003&min=wms&Year=&DocType=0>.

192 APRA media release, ‘APRA releases new prudential standard for Financial Claims Scheme’, 11 March 2014, at www.apra.gov.au/MediaReleases/Pages/11_30.aspx.

APS 910 was updated on 24 June 2013 and now includes additional minimum requirements relating to payment, reporting and communications that an ADI must meet.¹⁹³ ADIs have until 1 July 2014 to comply with these new requirements.

The Guarantee Scheme is administered by the RBA and was ‘designed to promote financial system stability in Australia, by supporting confidence and assisting eligible ADIs to continue to access funding at a time of considerable turbulence’.¹⁹⁴ Under the Guarantee Scheme, customers with total deposit balances over A\$1 million at a single Australian-owned or incorporated ADI (and Australian residents with total deposit balances over A\$1 million at a single foreign ADI) were entitled, subject to their ADI making an application to the RBA for the Guarantee Scheme to apply to such deposits, to the benefit of an Australian government guarantee on the portion of their balances over A\$1 million (with the first A\$1 million of a customer’s deposit held with any Australian ADI falling under the FCS). Up until 24 March 2010, ‘eligible institutions’ (which included Australian ADIs and, subject to certain additional requirements, foreign ADIs) were also able to apply to the RBA for the Guarantee Scheme to extend to certain types of wholesale funding liabilities.¹⁹⁵ For Australian ADIs, those liabilities had to, *inter alia*, be senior unsecured debt instruments with a term of no more than 60 months.¹⁹⁶ For foreign ADIs those liabilities had to, *inter alia*, be senior unsecured debt instruments with a term of no more than 15 months (i.e., short-term wholesale funding liabilities).¹⁹⁷ The Guarantee Scheme closed to new liabilities on 31 March 2010.¹⁹⁸ It also closed to all term deposits and ‘at call’ deposits held at any foreign ADI by an Australian resident on 31 December 2009.¹⁹⁹

The Guarantee Scheme remains in force for liabilities or deposits in respect of which an application was made or accepted prior to 24 March 2010:

a for guaranteed wholesale funding liabilities up to 60 months from 31 March 2010 (in other words, up to 31 March 2015);

193 APRA media release, ‘APRA releases final prudential standard for Financial Claims Scheme’, 24 June 2013, at www.apra.gov.au/MediaReleases/Pages/13_19.aspx.

194 Australian Government Guarantee website, ‘About the Scheme’, at www.guaranteescheme.gov.au/.

195 Australian Treasury media release ‘Government Withdraws Bank Funding Guarantee and State Guarantee’, 7 February 2010, at www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/013.htm&pageID=003&min=wms&Year=&DocType=0.

196 Australian Government Paper, ‘Australian Government Guarantee Scheme for Large Deposits and Wholesale Funding Rules’, Schedule 3, www.guaranteescheme.gov.au/rules/pdf/scheme-rules-20042011.pdf.

197 Ibid

198 Australian Treasury media release ‘Government Withdraws Bank Funding Guarantee and State Guarantee’, 7 February 2010, at www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/013.htm&pageID=003&min=wms&Year=&DocType=0.

199 Australian government paper, ‘Australian Government Guarantee Scheme for Large Deposits and Wholesale Funding Rules’, Schedule 3, at www.guaranteescheme.gov.au/rules/pdf/scheme-rules-20042011.pdf.

- b* for term deposits held at Australian ADIs up to 60 months from 31 March 2010 (in other words, up to 31 March 2015); and
- c* for ‘at-call deposits’ held at Australian ADIs, up to October 2015.²⁰⁰

iv Tax issues

Liability for Australian income tax is based on the dual tests of source and residence and is determined in accordance with the Income Tax Assessment Act 1936 (Cth) and the Income Tax Assessment Act 1997 (Cth) (together, ‘the Australian Tax Act’).

Under the Australian Tax Act, an Australian resident is subject to tax on all income derived, irrespective of whether the income is Australian or foreign sourced, and all net capital gains. As a general rule, under Australian domestic law, a non-resident will be subject to Australian tax only in respect of income derived from an Australian source. Capital gains derived by a non-resident are generally not subject to Australian tax unless they are derived from the direct or indirect holding of an interest in Australian real property or in respect of an asset held in carrying on business through an Australian permanent establishment.

An Australian-resident subsidiary of a foreign bank would therefore be subject to tax in Australia on its worldwide income at the company tax rate (currently 30 per cent). A foreign bank that does not carry on business through an Australian branch, on the other hand, would be subject to Australian income tax in respect of its Australian sourced income. However, where the foreign bank is resident in a country with which Australia has concluded a double tax agreement (DTA), the business profits of the foreign bank would generally not be taxable in Australia where the foreign bank does not have a permanent establishment in Australia.

The Australian Tax Act contains specific provisions for the taxation of Australian branches of foreign banks. Pursuant to those provisions:

- a* the branch is treated for certain purposes as if it were an entity separate from the foreign bank, with the result that intra-bank transactions (including loans and derivative transactions) between the branch and another part of the foreign bank will be recognised for taxation purposes;
- b* for the purposes of determining the foreign bank’s Australian tax liability, the branch will be treated as if it were a non-resident company and all of the income of the branch will be deemed Australian sourced;
- c* where an amount is recorded in the branch’s accounting records as having been provided to the branch by the foreign bank, that amount will be treated as a loan, and an amount recorded in the branch’s accounts as ‘interest’;
- d* where an amount is recorded in the branch’s accounting records as being ‘interest’:
 - the branch will be entitled to a deduction for the interest, but the deduction cannot exceed the amount equal to LIBOR;²⁰¹ and

200 Australian Government Guarantee website, ‘Questions & Answers about the Guarantee Scheme Closure to New Liabilities’, at www.guaranteescheme.gov.au/qa/closure.html#.

201 The Board of Taxation completed its review of tax arrangements applying to permanent establishments (including the appropriateness of the current LIBOR cap on the deductibility of interest) and provided its report to the Assistant Treasurer in April 2013. The timing for release

- the foreign bank will be treated as having derived the interest, and will be subject to interest withholding tax at a concessional rate of 5 per cent; and
- e* in certain circumstances, income and capital losses may be transferred between the branch and other Australian subsidiaries of the foreign bank.

Certain foreign banks may choose not to apply these provisions in respect of a year of income. The election is made on an annual basis and is only available where the foreign bank is a resident of a country with which Australia has concluded a DTA and the tax treatment under that DTA is more favourable. However, the interest withholding tax provisions would still apply even where such an election is made.

v Withholding tax

Interest and dividends paid to a non-resident by an Australian resident are taxed on a withholding basis: tax will be withheld from interest at a rate of 10 per cent, and from a dividend paid from untaxed profits, at a rate of 30 per cent. There is no withholding from dividends paid from after tax profits (those dividends are fully franked) or conduit foreign income (foreign income derived by an Australian subsidiary that is repatriated as a dividend to a foreign parent). These rates of withholding may be further reduced where the foreign bank is resident in a jurisdiction with which Australia has concluded a DTA. Foreign banks resident in Finland, France, Japan, New Zealand, Norway, South Africa, the United Kingdom and the United States may be eligible for the interest withholding tax exemption under the applicable DTA, subject to certain safeguards, including in relation to back-to-back loans.

vi Taxation of financial arrangements

The Australian Tax Act contains comprehensive rules for the taxation of financial arrangements. These provisions provide methods for calculating gains and losses arising from financial arrangements (of which some are elective), and the time at which these gains and losses will be brought to account for income tax purposes. These methodologies are intended to reflect the different methods that may be used in financial accounting standards for dealing with financial assets and liabilities.

Amendments have been made to the TOFA provisions so that Australian branches of foreign banks can rely on their audited APRA reports to satisfy the financial accounting and auditing requirements for the purposes of the Division 230 timing elections.

vii Thin capitalisation

Thin capitalisation provisions apply to foreign-controlled Australian entities, as well as foreign banks carrying on business through an Australian branch. These provisions will limit debt deductions where the relevant entity does not meet minimum equity funding

of the Board's report to the public is a matter for the Australian government to decide. In line with past practice, it is expected that the report will be available at the time the government releases its response to the report: www.taxboard.gov.au/content/content.aspx?doc=reviews_and_consultations/permanent_establishments/default.htm&pageid=007.

requirements. A foreign bank may elect to group its Australian branch together with its wholly-owned Australian subsidiaries for this purpose.

viii Debt-equity characterisation

Whereas returns paid in respect of ‘debt interests’ may generally be deductible, returns paid in respect of ‘equity interests’ are not deductible. The Australian Tax Act contains a prescriptive set of rules which must be applied to determine whether an interest constitutes a ‘debt interest’ or an ‘equity interest’ for Australian tax purposes.

Tax regulations that commenced on 12 December 2012 removed uncertainty regarding the debt-equity characterisation of certain hybrid capital instruments as a result of the Basel III capital reforms and insurance capital reforms. As a result, eligible Tier II instruments issued by ADIs on or after 1 July 2013 are not precluded from being treated as debt for tax purposes. This means that returns paid in respect of such instruments may potentially be deductible.

ix Transfer pricing

Australia also has a transfer pricing regime that applies to cross-border transactions involving related parties. An arm’s-length principle is used to calculate the Australian taxable income that would be expected to be derived if the parties were dealing at arm’s length with each other. These provisions apply equally to dealings between a foreign bank and its Australian branch.

Australian transfer pricing rules are currently under reform.

x The US Foreign Accounts Tax Compliance Act (FATCA)

The FATCA provisions were introduced by the US government in March 2010 to combat tax evasion by US persons holding investments in non-US accounts or in non-US financial institutions.

FATCA imposes a 30 per cent withholding tax on an extensive list of payments, including payments to non-participating foreign financial institutions (FFIs)²⁰² and other payees that have not complied with the FATCA requirements. FATCA also imposes a broad range of other obligations on FFIs, including reporting and due diligence obligations. The US Internal Revenue Service (IRS) website explains the FATCA compliance obligations in further detail.

Since the introduction of FATCA, the IRS has entered into a number of intergovernmental agreements (IGAs) on FATCA with other nations, under which the reporting obligations are owed to the home jurisdiction tax revenue authorities. This is because in many cases, the laws of other nations prevent an FFI from reporting under FATCA to the IRS.

On 22 February 2014, the Treasurer of Australia and the United States Secretary of the Treasury held a joint press conference, where it was announced by the United

202 Non-US financial institutions.

States Secretary of the Treasury that the United States and Australia have completed an IGA on FATCA in substance, and ‘plan to sign it very soon’.²⁰³

The next step after signing will be to introduce Australian domestic legislation to give the IGA legal effect in Australia.

By entering into an IGA, the Australian government has sought to facilitate Australian compliance with FATCA by reducing the Act’s overall burden on Australian business.

xi Goods and services tax

Australia has a broad-based goods and services tax (GST) imposed at a rate of 10 per cent on the supply of goods and services in Australia. The supply of certain goods and services, including the supply of most banking and financial services, are exempt from GST (in Australia called ‘input taxed’). Others, including exported goods and services, are zero rated (or, in Australia, called ‘GST free’).

VII CONTROL OF BANKS AND TRANSFERS OF BANKING BUSINESS

i Control regime

Corporations Act

An Australian ADI that has more than 50 shareholders, or that is listed on the ASX, is subject to the takeover provisions in Chapter 6 of the Corporations Act, which prohibit the acquisition of more than 20 per cent of the voting shares in a company unless the acquirer follows one of a number of prescribed routes that require the terms applicable to that acquisition to be made available to all shareholders for acceptance or rejection.

Related provisions require the public disclosure of shareholdings of 5 per cent or more in a company listed on ASX and allow both a listed company and ASIC to issue compulsory tracing notices to uncover the beneficial owners of shares held through nominees and trustees.

The Corporation Act restricts an Australian ADI from financially assisting a person to acquire shares in the Australian ADI (or its holding company) without shareholder approval unless the assistance does not materially prejudice the interests of the Australian ADI (or its shareholders) or the Australian ADI’s ability to pay its creditors.

The Foreign Acquisitions and Takeovers Act

The Foreign Acquisitions and Takeovers Act 1975 (Cth) (FATA) imposes a regime under which certain acquisitions of interests in Australian companies, including Australian ADIs, must be notified to the Australian government. The government can refuse permission for an acquisition that is contrary to the national interest.

203 Joe Hockey and Jack Lew press conference, Australia 2014 G20, 22 February 2014, Transcript of Audio, <https://www.g20.org/sites/default/files/documents/transcripts/Treasurer%20Joe%20Hockey%20and%20US%20Treasury%20Secretary%20Jack%20Lew%20Press%20Conference%20Transcript.pdf>.

The following transactions are compulsorily notifiable (with the following monetary thresholds being indexed annually for inflation):

- a* the acquisition by a foreign person of a substantial interest in an Australian corporation with total assets that exceed A\$248 million (unless the acquirer is a US or New Zealand investor, in which case the notification threshold is A\$1,078 million);
- b* takeovers of offshore companies whose Australian subsidiaries' gross assets exceed A\$248 million; and
- c* direct investments by foreign governments and their agencies irrespective of size, including proposals to establish new businesses.

A person is taken to hold a substantial interest in a corporation if that person, alone or with any associates, is in a position to control 15 per cent or more of the voting power in the corporation or holds interests in 15 per cent or more of the issued shares in the corporation. (The terms 'control', 'interest' and 'associates' have extensive meanings.)

According to the policy statement of the Foreign Investment Review Board,²⁰⁴ foreign investment in the Australian banking sector needs to comply with the Banking Act, the Financial Sector (Shareholdings) Act 1998 (Cth) (FSSA) and banking policy.

Acquisitions of interests by US or New Zealand investors in financial sector companies, as defined by the FSSA (which includes banks), are exempt from FATA. The FSSA continues to apply.

The FSSA

A person wishing to hold more than 15 per cent voting control of a financial sector company must apply to the Treasurer (being a cabinet minister of the Australian government) and provide the required supporting information.²⁰⁵ The Treasurer may only grant the application if he or she is satisfied that the proposed acquisition is in the national interest.

Banking Act

Although the Banking Act regulates banking business in Australia, there is no formal approval required by APRA under the Banking Act for the acquisition of shares in an Australian ADI. However, given the ambit of APRA's powers, it is customary when acquiring a large stake in an Australian ADI to include a condition precedent to address the possibility that APRA could act to block or impose conditions on a proposed acquisition.

ii Transfers of banking business

The Financial Sector (Business Transfer and Group Restructure) Act 1999 (Cth) (the FS Act)²⁰⁶ gives effect to a statutory regime that allows an Australian ADI to transfer all or part of its banking business to another Australian ADI. The transferring body and receiving body must be established in an Australian state or territory that has enacted legislation that ensures that the receiving body is taken to be the successor in law to the

204 Australian Foreign Investment Policy, 2013.

205 Set out in Section 13 of the FSSA.

206 Formerly the Financial Sector (Transfers of Business) Act 1999 (Cth).

transferring body to the extent of the transfer. All Australian states and territories have enacted such legislation.

For a voluntary transfer of business to take effect, APRA must receive a complying application, the transfer must be adequately adopted by the transferring body and the receiving body in accordance with specified transfer rules (for example, by approval of the body's members in general meeting), the transfer must be approved by APRA, and APRA must issue a certificate of transfer stating the transfer is to take effect. APRA may also approve mechanisms specified by either or both the transferring body or the receiving body for determining things that are to happen, or that are taken to be the case, in relation to assets and liabilities that are to be transferred, or in relation to the transfer of business that is to be effected.

Once a certificate of transfer from APRA comes into force, the receiving body becomes the successor in law of the transferring body to the extent of the transfer. That is, the transferred assets and liabilities become assets and liabilities of the receiving body without any transfer, conveyance or assignment, and to the extent of the transfer, the duties, obligations, immunities, rights and privileges applying to the transferring body apply to the receiving body. The terms and conditions of employment (including any accrued entitlement to employment benefits) of employees of the transferring body are not affected by these successor arrangements. Subject to certain exceptions, a transfer effected under the Act does not cause the receiving body, transferring body or any other person to be in breach of an Australian law or any contractual provision prohibiting, restricting or regulating the assignment or transfer of any asset or liability, or release any surety from all or any of the surety's obligations.

In granting its approval, APRA must have regard to the interests of the depositors of the transferring body and the receiving body, and the interests of financial sector as a whole. APRA must also consult with the ACCC, ASIC and the Commissioner of Taxation in deciding whether to approve the transfer (unless those agencies have notified that they do not wish to be consulted). APRA may impose conditions as part of its approval.

APRA may also issue internal transfer certificates under the FS Act that enable the transfer of assets or liabilities (or both) between two bodies corporate that are part of the same company group as part of a proposal by an Australian ADI for a restructure that would make the Australian ADI a subsidiary of a non-operating holding company.

APRA may also make a determination under the FS Act that a compulsory transfer of a business from one ADI to another Australian ADI occur where the transferring body has breached the Banking Act, the transferring body has informed APRA that it considers it is likely to become unable to meet its obligations or that it is about to suspend payment, and in other limited specified circumstances.

VIII THE YEAR IN REVIEW

The Australian economy grew at a relatively steady pace from 2012 to 2013, albeit a little below trend, caused by the economy adjusting to the decline in Australia's terms of trade and the peaking of record levels of mining investment. The relatively high exchange

rate, as well as weak domestic demand, continued to affect business confidence while consumers remained wary about spending in the face of slowly rising unemployment.²⁰⁷

Notwithstanding the more subdued domestic economy, the Australian banking system performed relatively well over 2013. The major banks' profitability remains strong, partly supported by cost-cutting initiatives, while the aggregate profitability of the regional banks is expected to improve following some one-off sales and write-offs of troubled portfolios. The easing of global financial conditions also gave Australian banks reliable access to global term funding markets at spreads that fell to their lowest level since the financial crisis began.²⁰⁸

Improving the resilience of the Australian financial system through APRA's Basel III implementation has been a constant regulatory theme for 2013. Banks were in a good position to meet the new Basel III capital requirements introduced in Australia from the start of 2013, and over recent years have strengthened their funding and liquidity positions ahead of the phasing in of the new LCF and NSFR liquidity requirements.

Alongside Basel III implementation, Australia has progressed its G20 commitment to transition standardised OTC derivatives to central clearing. Although the reforms implementing the transition have gathered pace over the past 12 months, cross-border issues have complicated their implementation and required regulators to work closely with the derivatives industry to avoid subjecting Australian banks to multiple and potentially conflicting sets of rules.

Australia's official commencement of its 2014 presidency of the G20 on 1 December 2013 will give the government a valuable opportunity to influence the economic policies of the major economies of the world and contribute to a healthy, growing and resilient global economy.

IX OUTLOOK AND CONCLUSIONS

Following a change in the Australian government in 2013, 2014 is likely to be dominated by the newly elected government's increased focus on boosting Australia's economic prosperity through lower taxes, more efficient government, less policy and regulatory uncertainty, and more competitive businesses. The new government has announced a number of measures that it will implement to meet its objectives in this area, including the repeal of unnecessary, inefficient or outdated regulation to decrease the costs of doing business in Australia by A\$1 billion per year.

The new government has also committed to conducting a major financial system inquiry to provide a road map for the direction of Australia's financial system over the next decade so that it is best positioned to meet Australia's evolving needs and support its economic growth well into the future. One of the key tasks of the inquiry will be to review the regulatory settings currently underpinning the Australian financial system.

207 Australian Prudential Regulation Authority 2013 Annual Report, at www.apra.gov.au/AboutAPRA/Publications/Pages/Annual-Report.aspx, p. 8.

208 RBA, 'Reserve Bank of Australia Annual Report', 2 October 2013 at www.rba.gov.au/publications/annual-reports/rba/2013/pdf/2013-report.pdf, p. 1.

Its recommendations could have enduring implications for Australia's banking sector, particularly if competition is given a higher weighting in the resulting regulatory settings.

The continuing growth of the Australian superannuation industry²⁰⁹ will further increase the significance of this sector for the Australian economy and could lead to further reforms in this area. Recent developments in the self-managed superannuation fund (SMSF) sector have already attracted the attention of the regulators. Although this sector does not currently pose material risks to financial stability, its importance to the financial health of Australian households means that it warrants careful observation in the period ahead. Changes to Australian legislation in recent years have allowed superannuation funds, including SMSFs, to borrow for investment, including property investments. Since then, leveraged property holdings by SMSFs have increased and this type of investment strategy is being heavily promoted. The Australian regulators are cautiously assessing whether this sector now represents a vehicle for potentially speculative property investment that did not exist in the past.

The Australian market is likely to see a resurgence of more complex and riskier products in 2014 to satisfy the 'search for yield' encouraged by Australia's historically low interest rate environment. ASIC is monitoring developments in this area to ensure that retail investors fully appreciate and price in the risks embedded in more complex products. More broadly, ASIC is formally consulting on the regulation of complex products in retail markets and recently released a report²¹⁰ outlining the risks posed by these complex products and ASIC's related regulatory initiatives.

Another focus for the industry in the period ahead will be implementing APRA's forthcoming liquidity standard, which puts into effect key elements of the Basel III liquidity framework in Australia. The banking sector will also be preparing to meeting APRA's proposed qualitative prudential standards covering risk management, risk appetite and risk culture, which are due to come into effect from 1 January 2015. Implementing these will place increasing pressures on bank boards and management, who are also navigating a myriad of issues to improve data quality and management to support their risk management frameworks.

Given the deregulatory focus of the new Australian government, Australian regulators will be expected to implement their reform agendas for 2014 to 2015 in a manner that strikes an appropriate balance between ensuring that markets are stable and provide appropriate protections to investors on the one hand, and the government's clear aims to minimise the regulatory burden for business and promote market efficiency and competition on the other. Australian regulators will also be expected to balance the benefits of promoting a globally coordinated approach to regulation with ensuring that global regulatory settings are implemented appropriately for Australia's domestic markets.

209 'Australian superannuation funds are expected to grow from A\$1.5 trillion to A\$3 trillion by 2020', see Thomson Reuters, *The State of Regulatory Reform 2014: A special report*, p. 41.

210 See the ASIC report on regulating complex products (REP 384) published on 31 January 2014.

Appendix 1

ABOUT THE AUTHORS

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Louise McCoach is a partner in Clayton Utz's banking and financial services group. Her practice covers a broad range of banking and regulatory work, including advising on prudential supervision matters and the regulation of financial institutions. Ms McCoach also has extensive experience in debt capital markets, securitisation and derivatives including acting for creditors to securitisation restructures and advising on related enforcement and insolvency-remoteness issues. Ms McCoach's experience extends to acting on CDO transactions and innovative derivatives-based facilities for commercial paper programmes and advising on associated regulatory, capital adequacy and netting issues.

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David Landy is a partner in Clayton Utz's corporate advisory and M&A group and has over 20 years' experience. His broad range of corporate law experience includes mergers and acquisitions, corporate and financial market regulation and general corporate and commercial advice.

Mr Landy has extensive experience in corporate and financial market regulation (including Corporations Act, ASX Listing Rules and ASX Settlement Rules), mergers and acquisitions, capital management (share buybacks and capital reductions), capital raisings, Australian Securities Exchange (ASX) listings, employee share plans and equity incentive plans and Financial Services Reform.

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