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APRA

Mr Jason McNamara
Executive Director
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Department of the Prime Minister and Cabinet
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Dear Mr McNamara,

Regulation Impact Statement – final assessment second pass

I am writing in relation to the attached Regulation Impact Statement (RIS) prepared for the proposals with respect to Registered Financial Corporations (RFCs). The regulatory burden to business, community organisations and/or individuals has been quantified and offsets have been identified and quantified using the Regulatory Burden Measurement framework. These have been agreed with your office.

I am satisfied that the RIS addresses the concerns raised in your letter of 20 June 2014. Please refer to APRA's responses as set out in the Attachment to this letter.

Accordingly, I am satisfied that the RIS now meets best practice consistent with the *Australian Government Guide to Regulation*.

I submit the RIS to the Office of Best Practice Regulation for formal final assessment.

Yours sincerely,

Charles Littrell
Executive General Manager
Australian Prudential Regulation Authority
27 October 2014

Attachment A: APRA responses

General Comments

1. The RIS refers to policy guidance provided by the previous Government. This should be updated to reflect the policies of the current Government. All other references to the Government should be updated to ensure they are current.

   APRA's response

   APRA has reviewed the RIS and modified references to 'Government' to ensure they appropriately reference the previous Government or the (current) Government. We note that the former and current Chairs of APRA have engaged with the Minister of the current Government on this matter to ensure that the Government is informed as to APRA's proposals.

2. To our reading it is difficult to understand the Registered Financial Corporation (RFC) market from the discussion in the RIS. This restricts our ability to comprehend the significance of the claimed problems and potential impacts of each option. Consequently, the RIS could explain the following (a short paragraph on each point would be useful):

   a. What products and services do RFCs offer? And how does this differ from ADIs and other financial institutions?
   b. What are the benefits of someone investing with an RFC relative to an ADI or another financial institution? You may like to refer to risk/return factors and local presence.
   c. For how long have RFCs existed? And for how long have at-call deposits been offered by RFCs?
   d. How has the nature of RFCs changed since the Wallis inquiry (which noted that the banking exemption for RFCs should be maintained)? You may like to consider how RFCs have growth since the Wallis inquiry.
   e. How significant are RFCs in the context of the retail banking sector? And how has this changed over time?

   APRA's response

   APRA has inserted additional information on RFCs in the Background section of the RIS (refer to page 2 of the RIS).

   a. As at 2012, there were over 300 RFCs in Australia comprising money market corporations (MMCs) and finance companies. MMCs are typically involved in similar activities to investment banks (commercial loans and trading securities) whereas finance companies are generally involved in the provision of motor vehicle, consumer or business finance. APRA's proposals do not affect all RFCs – they will only impact on those finance companies that issue debentures to retail investors.

b. In some cases there is very little to distinguish RFC offerings from traditional banking products, for example RFC retail products include transactional banking features such as the ability to transact at-call and using features such as BPay, EFTPOS, cheque and internet. One reason why a person might invest with an RFC, rather than an ADI, is due to the potential for higher returns. Other reasons are likely to be similar to the considerations a customer makes when choosing any entity to invest their money with – convenient location; past experience or reputation; recommendation from a friend/family member; low fees; personalised service; advertising etc.

c. RFC is a generic term capturing entities whose sole or primary business is the borrowing of money and the provision of finance. Finance companies, which are one type of RFC, came to prominence in the 1960s but existed well before this time. While RFCs have traditionally relied on wholesale funding, some RFCs moved increasingly into the retail investor market after 1998. In particular, this retail funding has been increasingly sourced via product offerings that bear very close similarities to traditional banking products with associated transactional banking facilities. It is these types of products, offered to retail investors, that APRA's proposals are seeking to limit as their presence has increasingly blurred the lines between the regulated ADI sector and the RFC sector.

d. As the RIS notes, the Financial System Inquiry Final Report (Wallis Report) 1997 noted that 'finance companies did not take deposits but funded their operations, mainly in the wholesale market, through the issue of debentures that were subject to the public fundraising provisions of the *Corporations Act 2001* (refer to page 3 of the RIS). APRA's proposals seek to reinforce this distinction.

e. More recently, the assets of the RFC sector have declined from around $250 billion in mid-2008 to $150 billion at July 2014.This partly reflects the more difficult funding environment that has existed since the onset of the financial crisis, which resulted in some RFCs scaling back their operations. As noted in the RIS - 'over recent years, the traditional funding model of RFCs, based mainly on wholesale fundraising, has been replaced for a number of RFCs by reliance on fundraising from retail investors' (refer to page 4 of the RIS).

f. In total, RFCs accounted for approximately five per cent of financial system assets as at December 2013. As noted above, the assets of the RFC sector have declined in recent years. Even though RFCs are relatively small, individual RFCs, through their operation in small communities and the nature and extent of their business, may be significant within the local community in which they operate. As demonstrated by the collapse of Banksia Securities Limited (Banksia)[1], while not a large entity, the

[1] All references to Banksia in this document are references to Banksia Securities Limited.

impact on some small communities in which it operated was significant.

The Problem

Current Regulation

3. In the context of motivating further Government intervention in this market it would be useful for the RIS to give an overview of how RFCs are currently regulated. This would enable a clearer understanding of the relative significance of the additional regulatory consequences resulting from the preferred policy option. For example:
   a. What are the current disclosure, capital adequacy and liquidity requirements for RCFs?
   b. How do these requirements relate to ADIs in terms of their significance?

APRA's response

a. As noted in the RIS (page 2), through the operation of the Banking (Exemption) Order No 96, RFCs are not prudentially regulated by APRA – hence they are not subject to capital adequacy or liquidity requirements. However, they are required to meet disclosure, licensing and conduct requirements administered by the Australian Securities and Investments Commission (ASIC) in respect of all financial companies. RFCs with assets exceeding $200 million are also required to meet APRA reporting requirements which involves the provision of certain information to APRA.

b. From a prudential perspective the difference between ADIs and RFCs is relatively straight-forward – ADIs are prudentially regulated and RFCs are not. Among other implications, this means that retail investors of RFCs are not protected by the depositor protection provisions in the Banking Act or the Financial Claims Scheme, unlike investors in ADIs. These differences are significant with the prudential framework applicable to ADIs, including the relevant legislation, affording ADI retail depositors with protection not available to investors in RFCs.

4. Following discussion of point 2 the RIS should provide an assessment of the efficiency and effectiveness of current regulations as they relate to the problems described in the RIS. For example:
   a. To what extent do the capital and liquidity requirements manage maturity mismatch issues?
   b. Are all RFCs complying with their disclosure obligations? If not, how many?
   c. Why are current disclosure requirements not adequate in aiding investor comprehension? In particular, why aren't the current Exemption Order conditions requiring RFCs to acknowledge they are not authorized under the Banking Act sufficient enough to aid investor comprehension?

APRA's response

a. As noted in response to question 3, APRA does not regulate RFCs and they are not subject to mandatory capital or liquidity requirements.

b. RFCs who meet certain asset thresholds are required to report data to APRA on a regular basis. While APRA reviews this data it does not actively review disclosure requirements of entities that it does not regulate. APRA does, however, investigate any matter brought to its attention concerning the possible breach of conditions of an Exemption Order that it administers.

c. The RIS sets out why APRA considers disclosure requirements are not in themselves adequate in aiding investors (refer to pages 3-5 and 8-9 of the RIS). As noted in the RIS, ASIC – which is responsible for consumer disclosure matters - has noted in a report on *Financial Literacy and behavioural change*, shortcomings with disclosure requirements in Product Disclosure Statements, prospectuses and annual reports.

The recent interim report from the Financial System Inquiry (FSI) also notes the shortcomings of disclosure as noted by the public submissions it has received:

'Australia's regulatory framework relies heavily on disclosure to protect and empower consumers.

Submissions support a view that the disclosure framework is not achieving its objectives. The current disclosure regime produces complex and lengthy documents that do not always enhance consumers' understanding of financial products and services, and impose significant costs on industry participants.

Reasons that disclosure does not always inform consumers include low levels of financial literacy, disengagement due to lack of time or motivation, behavioural biases, and the length and complexity of disclosure documents. This situation makes it difficult for consumers to compare products, understand risks and make informed decisions.'[2]

The Collapse of Banksia

5. The RIS discusses Banksia but offers no economic or market specific analysis or relevant context. Given the significance of the event in the context of the problem it would be useful for the RIS to provide both general economic and market specific analysis of Banksia in relation to the issues outlined in this RIS (investor comprehension, the availability of at-call accounts, and maturity mismatch).

For example, in terms of general economic analysis:

a. Was the collapse of Banksia a relatively normal economic event that one would expect in an efficient market economy that is accompanied by uncertainties, risks, and profits and loss? Or was the collapse of Banksia an abnormality that could be a symptom on an inefficient market?

b. Was the collapse a major or minor event in the context of the RFC financial system

[2] Page 1-20 'Financial System Inquiry Interim Report'; July 2014 http://fsi.gov.au/publications/interim-report/

and the economy more generally?

c. Were the consequences of the collapse contained or did they spread?

d. To what extent did investors in Banksia have responsibility for availing themselves of relevant information when making their decisions to invest? Did they do this? Why or why not?

e. What were the underlying reasons for retail clients investing in Banksia? Did they relate to risk and return, or other factors?

f. Was the collapse of Banksia within the *spectrum of risk* required for economic efficiency?

APRA's response

a. The administrator's report into the collapse of Banksia provides a number of reasons as to why it failed, including:

- 'Relatively high risk lending to borrowers where the underlying property is:
    - in a rural or regional location (where the general decline in the domestic property market has been most significant);
    - vacant land (in some cases, without a commercially viable development approval) that does not generate an income stream to support interest/loan repayments; and
    - in the infant stages of the development cycle (i.e. residential subdivisions).
- High levels of loan arrears (approximately $146 million) and a substantial number of mortgagee-in-possession properties (approximately $112 million);
- Inadequate provisioning policies having regard to the number of loans in default/arrears and irregular valuations to support the underlying value of the security property;
- The funding mismatch between debentures that are due for repayment versus borrowers' loans that extend for longer periods (and in practice, are renewed for extended periods);
- The Company's low equity levels leading to solvency concerns following even minor losses on the loan portfolios;
- Global credit and property market conditions making borrower refinance at the time of loan maturity more difficult.'[3]

b. The collapse of Banksia is considered minor in the context of its size relative to the RFC sector and the overall economy. However, as noted previously the impact on some communities in which it operated was significant.

c. The collapse of Banksia was contained. While the specific events that led to Banksia's collapse were entity-specific, the more common theme of funding longer-dated liabilities with short-term funding is not confined to Banksia.

[3] McGrathNicol Corporate Recovery. *Banksia Securities Limited Cherry Fund Limited (Receivers and Managers Appointed to both companies). Receivers and Managers' Report to debenture holders*. 7 December 2012.

d. Before committing to a financial product, investors should confirm that they have read and understood the terms and conditions of the product they are investing in. However, as noted earlier, there are many shortcomings in relying on disclosure to inform investors. Treasury's submission to the Financial System Inquiry, in April 2014, noted that the collapse of Banksia 'highlighted the challenges for investors in distinguishing between Banksia, a debenture issuer, and an authorised deposit-taking institution regulated by APRA that is covered by the depositor protection arrangements of the Financial Claims Scheme.'

So investors in Banksia are likely to have declared that they had read and understood the terms and conditions of the products they had invested in. However any such declarations clearly had shortcomings for reasons cited earlier (low levels of financial literacy, disengagement due to lack of time or motivation, behavioural biases, and the length and complexity of disclosure documents).

e. The motivations of retail investors in Banksia have not been reported. It is reasonable to assume that the motivations were similar to those identified earlier as to the benefits of someone investing with an RFC relative to an ADI.

f. Given the reasons for Banksia's collapse it would seem reasonable to conclude that its failure was due to managerial failure as noted at point (a) above.

In terms of market specific analysis:

g. How many people invested in Banksia believing it was a bank? Has there been any consultation with these investors?

h. To what extent did misinformed investments contribute to Banksia's collapse?

j. In the absence of at-call accounts do you consider similar consequences would have occurred? Why?

k. How did maturity mismatch contribute to the collapse of Banksia?

APRA's response

APRA does not have access to Banksia investors, but anecdotally reports have indicated that many investors did not understand that their investments were not covered by the Financial Claims Scheme. APRA undertook a public consultation on its proposals in 2013 and Banksia investors had the option of submitting their views to the proposal. No submissions were received from individual investors.

APRA does not consider that the presence of at-call accounts directly caused or contributed to the collapse of Banksia. However, the presence of at-call accounts with transactional banking functionality could reasonably have led investors to believe that Banksia was prudentially regulated and that their investments were protected.

A maturity mismatch is not necessarily an issue in itself – the key point is whether a maturity mismatch is appropriately managed and mitigated. There was a maturity mismatch in the books of Banksia, but the adequacy of the management of the maturity mismatch was an issue highlighted in the liquidator's report as contributing to Banksia's failure.

6. Further to this, the RIS does not explain how the collapse of Banksia relates to, and reflects a systemic issue in, the RFC market. For example:
   a. Is the Banksia collapse an isolated incident in the history of the RFC market, or have there been similar examples over the years?
   b. Did Banksia offer similar products and have a similar investor base to current RFCs?

APRA's response

The collapse of Banksia is not an isolated incident in the history of the RFC market nor was the collapse of Banksia considered a systemic issue. However, Banksia did offer similar products to existing RFCs. As APRA does not regulate RFCs it does not have detailed information on their investor profile, but as their offerings are similar to those of Banksia we must presume their investor profiles would not differ significantly.

Investor Comprehension

7. The RIS asserts that regulatory intervention is required because a portion of retail investors do not understand that RFCs are not banks. The RIS should provide direct evidence to support this claim. For example:
   a. Has there been any consultation undertaken with investors in RFCs? If so, what were the outcomes?
   b. Is it possible to estimate the portion of retail investors who do not know RFCs are not ADIs?
   c. Do RFCs consider that anyone has invested with them that did not understand they were investing in an RFC?

APRA's response

APRA undertook a public consultation on its proposals in 2013. This consultation was open to all interested parties. No submissions were received from individual investors.

We do not consider it possible to estimate the portion of retail investors who do not know that RFCs are not ADIs. Even if asked directly, the biases to effective disclosure and understanding, including low levels of financial literacy, could still lead to a misleading response.

From a prudential perspective, the issue is broader than some retail investors not understanding that RFCs are not ADIs. RFCs who offer retail products to customers with bank-like facilities are conducting retail banking business without the requisite authorisation to do so. While they are exempt from the need to be authorised, that authorisation was given in a time when RFCs were funded from wholesale sources, typically provided by professional investors, rather than small less sophisticated investors or indeed individuals seeking simple banking facilities. It is appropriate, given the changed circumstances, that the conditions applicable to entities that operate outside the regulated sector be adjusted to minimise the risk to retail investors to a reasonably acceptable level while allowing RFCs to continue to operate in their traditional wholesale funding markets. It appears that only a small number of RFCs are operating in the retail market and taking advantage of their exempt status to raise funds from retail investors without the safeguards that the regulated sector is required to adhere to, however, there is potential for this risk to grow should other RFCs decide to enter the retail funding market by offering retail products with bank-like facilities APRA’s proposals are designed to reduce these risks.

8. The RIS appears to proceed on the basis financial institutions have primary responsibility for ensuring that investors are adequately informed before investing. The RIS should discuss the extent to which investors are responsible informing themselves before making investments and managing consequent returns or losses from these investments.

APRA’s response

The issuer of a product has a responsibility to ensure that an investor has all relevant information necessary in order to make an informed decision in deciding whether to invest in that product. The general understanding for persons investing in retail banking products is that the risk to their principal is low or non-existent and any loss would be made good by the government. Investors in such products expect that their principal will be returned in full. APRA’s proposals are designed to ensure investors in RFCs understand that they are not investing in an ADI, and that the features of the products they invest in are not such that an investor might reasonably consider that the product is the same as a banking product, and with the same security that comes with such products.

9. Consistent with point 7, are misinformed investments only considered a 'problem' where the investor incurs a loss? Or is it also considered a problem when an investor profits from a misinformed decision? You may wish to refer to economic efficiency issues (i.e. an inefficiently high level of 'uninformed' demand relative to 'informed' demand).

APRA’s response

As articulated in response to question 7, from a prudential perspective the issue relates to ensuring that entities conducting banking business, particularly when this involves accepting funds from retail investors in the form of banking products, have the requisite authorisation. Rather than the efficiency of information in the demand distribution, the question is whether an investment is covered by the financial claims scheme and whether an entity is prudentially regulated.

10. The RIS states at page 5 that investors are being misled. The RIS should expand on this claim. For example:

   a. What evidence is there to support this claim?

   b. Does this constitute *misleading or deceptive conduct* as defined under the

Australian Consumer Law? If so, has the ACCC taken any action?

c. To what degree does the marketing material of RFCs contribute to the mistaken belief that they are an ADI?

d. What are the market incentives (i.e. reputation damage) associated with misleading consumers?

APRA's response

a. The RIS states that '[t]he collapse of Banksia and subsequent investor reaction has demonstrated that the disclosure requirements in the current RFC Exemption Order have not prevented misunderstanding by investors…'. The RIS goes on to quote from an ASIC report that found 'While disclosures are a mechanism for informing investors, they are not adequate as the sole mechanism for ensuring that investors are not misled…'. The point being that other mechanisms, in addition to disclosure, are required to reduce the risk that an investor may be misled. The RIS does not state that investors are being misled, although APRA accepts the references used do point to this possibility.

b. APRA does not consider that this constitutes misleading or deceptive conduct.

c. The marketing material of RFCs is similar to that of ADIs, and this, in itself, may contribute to the mistaken belief that they are an ADI.

d. As already noted, APRA has not established a view that RFC investors are being misled. To the extent that investors believe that RFCs offer the same protections as ADIs, they will continue to invest in RFCs. This in itself is a strong market incentive.

Maturity mismatch

11. The RIS notes that, in relation to the Wallis inquiry, *' ...since companies' liabilities were longer term with less than five per cent of liabilities at call, and since maturity mismatch would be minor; the threat of a run or contagion would be remote.*' In relation to the seven affected RFCs, the RIS should explain what has changed since the Wallis inquiry in the context of maturity mismatch. For example:

a. Are more than 5 per cent of total liabilities at call?

b. How significant is the maturity mismatch issue for individual entities, the sector and the economy?

c. Have RFCs been found to accept a greater level of risk with regards to maturity mismatching as compared to other banking institutions?

d. How significant is the risk that RFCs will be subject to a run on funds, considering the current stability of the Australian economy? In other words, why would RFCs have sub-optimal maturity mismatches?

APRA's response

a. APRA's data is not granular enough to determine the level of liabilities at-call at an entity or sector level.

b. In essence, for RFCs who are heavily reliant on retail investor funding, it appears to be the case that there is a material maturity mismatch between the duration of retail funds taken and loans made by RFCs as was demonstrated in the case of Banksia. However, as noted earlier maturity mismatch in itself is not necessarily an issue if it is managed and mitigated appropriately. APRA does not have any insight into the management of the maturity mismatch in RFCs, as these entities are not regulated by APRA.

c. In terms of RFCs relative to ADIs, the key difference is that ADIs are required to meet capital and liquidity requirements designed to allow them to continue to operate during a period of stress, unlike RFCs. They are also subject to prudential supervision and risk assessment. As the liquidator of Banksia noted, 'BSL was thinly capitalised throughout the period examined (with an equity ratio of approximately 3.5%). This structure exposed BSL to immediate solvency concerns in the event of even minor losses on its loan portfolio.

For example, in broad terms, if more than 3.5% of total assets (substantially consisting of BSL's loan book) were unrealisable as at 30 September 2012, the company would have insufficient resources to meet its total obligations to debenture holders.'[4]

d. The current stability of the Australian economy is not necessarily a mitigating factor against a potential run on an RFC. The fear of investors (mistakenly or not) that an RFC is, or might become, insolvent would be sufficient to trigger a run. Clearly that can happen irrespective of the broader health of the domestic economy.

In relation to maturity mismatches, again the issue is around how RFCs manage and mitigate these risks. The reasons that could be sub-optimal are that appropriate risk management requires experienced resources which an RFC may not be able to access or afford. In some cases an RFC may simply not be aware of the risks it is running. Further, in the absence of prudential regulation, the incentive or discipline to have appropriate risk management systems in place is significantly reduced.

12. The RIS refers to proposed measures by ASIC to address the financial viability and soundness of an RFC. The RIS should outline what these proposed measures are, and discuss the extent to which they may alleviate any maturity mismatching risk in the RCF sector.

APRA's response

ASIC's proposals, and the problem they are seeking to address, are beyond the remit of

[4] McGrathNicol 2012, p.17

APRA to discuss as part of its proposals in relation to RFCs, although it is noted that in developing its proposals APRA has discussed and coordinated its response with ASIC. Those measures are separate from, and seek to address different issues, from the measures proposed by APRA. APRA's proposals are intended to reduce the risk that an investor in an RFC would confuse their investment with an ADI deposit or other deposit-like or transactional ADI product (refer to page 7 of the RIS). Issues around financial viability and soundness of RFCs are not within APRA's regulatory purview.

Other issues

13. The RIS should explain what practical implications will arise as a result of Australia not conforming to global banking principles (apart from reputational risk).
    a. It may be useful to draw on countries that are in a similar position to Australia.

APRA's response

Even in the absence of global principles, including those relevant to the issue APRA is seeking to address here, this matter would still be of concern for APRA and necessitate action to ensure that unregulated entities are not conducting business that they clearly are not authorised to undertake.

As noted on page 7 of the RIS:

> ' While it is recognised that shadow banking entities have a role to play in financial intermediation, such entities undertake the same (or similar) activities as regulated entities but without the rigorous scrutiny that applies to the prudentially regulated sector. This allows bank-like institutions to raise deposit-like funding to make bank-like loans, which they can do with considerably more gearing than regulated entities. Shadow banking entities can therefore earn potentially large profits but their investors can be susceptible to significant losses; the size of shadow banking systems can also pose systemic risks in some jurisdictions. For these reasons, global policymakers have been promoting a sharper boundary between the regulated and unregulated banking systems and greater oversight of shadow banks that pose systemic risks.'

If Australia does not adopt measures, consistent with international principles, then it will not be affording the same protections to retail investors that similar institutions in other jurisdictions are required to comply with. As demonstrated with the failure of Banksia, and the more recent issues with another RFC in Victoria, failure to adopt such measures will led to retail investors continuing to face increased risk of loss of their investments due to unauthorised entities offering banking products and without any of the safeguards that investors typically expect of such products and product issuers.

14. The RIS discusses the shadow banking system and suggests that significant problems could arise from its existence. The RIS should discuss what role RFCs play in the context of the shadow banking system and the consequent risks that may emanate from this system. For

example:

a. How large is Australia's shadow banking system?
b. How much of the shadow banking system is comprised of RFCs?

APRA's response

In APRA's view, the RIS makes no assertion that significant problems could arise simply from the existence of the shadow banking sector in Australia. APRA is of the view that problems could arise from not having a sufficiently clear distinction between ADIs and unregulated RFCs, and it is this distinction the measures are intended to address.

At July 2014, total assets of the shadow banking sector were approximately $150 billion, of which $110 billion was attributable to finance companies and the remainder to money market corporations.

Options

15. The RIS currently considers three options: the status quo; fully implement the proposals; or seek voluntary adoption of the proposals. Consultation revealed a number of other options that should be considered in this RIS and accompanied by a full impact analysis and assessment of feasibility against the stated objectives.

These options are:

a. Requiring retail investors in RFC products to sign a statement acknowledging they understand the RFC is not prudentially regulated. We understand page 8 discusses why it is considered that this option is not feasible. However, this is a genuine policy option that should be analysed in depth.
b. Providing an exemption so that wholesale investors can continue to invest in at-call deposits.

APRA's response

a. APRA has provided the three genuine options it considers most appropriate for consideration, and has not undertaken detailed analysis of options that do not appropriately address the areas of concern. As noted in the RIS, and in this response, disclosure in and of itself has been shown not to be a sufficient tool to focus investors on what it is they are investing in and the associated risks. Disclosures are already in place in relation to retail products offered by RFCs. For the reasons set out in the RIS, APRA believes stronger disclosure must be accompanied by other mechanisms in relation to retail products.

b. APRA has not proposed any restrictions on wholesale investors, thus they would be able to continue to invest in at-call products regardless of the proposed changes to the RFC exemption order.

Impact Analysis

The RIS discusses the expected impacts of the policy options, but provides no analysis. According to *The Australian Government Guide to Regulation,* it is a requirement that the RIS assesses the likely net benefit of each option, and recommends the option with the greatest net benefit. A good start to providing suitable analysis would be to address the following.

Directly affected businesses

16. The RIS should explain how significant the impacts will be on those entities who offer at-call deposits and offer B-Pay and cash withdrawal facilities. For example:
    a. What portion of total liabilities is accounted for by at-call accounts?
    b. How many of the affected entities offer B-Pay and cash withdrawal facilities?
    c. How important are at-call accounts and B-Pay and cash withdrawal facilities to the commercial practices of these entities?
    d. How difficult will it be for affected RFCs to change their business model to account for the new regulations?
    e. Is it likely that any businesses will close?
    f. How will the restriction of at-call accounts affect the issuance of other products or services (i.e. margin lending)?
    g. What are the opportunity costs of receiving funding through term accounts compared to at-call accounts? This will include the cost of providing a higher rate of return for retail investors moving from at-call to term accounts.

APRA’s response

APRA has addressed these points in the updated RIS, and to avoid duplication has not responded further here. Please refer to pages 12-14 of the RIS.

RFC sector and the economy

17. The RIS should provide a strategic analysis of the impacts of the proposal on the RFC sector and the economy more generally. For example:
    a. How will the changes affect prices (i.e. rates of return) and availability of products/services?
    b. How will the changes impact competition?
    c. Will the changes impact distribution between larger and smaller RFCs? For example, will larger entities accrue a larger market share?
    d. Will the changes impact distribution between RFCs and ADIs? For example, will ADIs accrue a larger market share?
    e. How will the *'spectrum of risk' be* affected? What are the consequences of this?

APRA's response

Please refer to pages 14-15 of the RIS.

Investors

18. The RIS should provide a more nuanced breakdown of how different types of investors will be affected. For example
    a. How will the impacts on wholesale and retail investors differ?
    b. What are the costs and benefits of the proposal for those investors who are already informed?

APRA's response

a. Given these proposals only impact on retail product offerings, not wholesale products or investors, APRA anticipates wholesale investors will be unaffected. For retail investors certain products that are bank-like may no longer be offered by RFCs.

b. APRA has covered this matter under the costs and benefits for investors.

19. The RIS asserts that investors will benefit from greater transparency and clarity around the nature of the entity and the type of products they are investing in.
    However, our understanding is that the proposal seeks to 'protect' investors by removing the choice to invest in the at-call products of RFCs. The RIS should provide more depth to the explanation of how investors will become better informed. For example:
    a. How important is marketing material to investors when making an investment decision?
    b. In the context of the extensive disclosure requirements that already exist, how would this marginal change to marketing material influence the decision of an otherwise uninformed investor?
    c. Why is it necessary to restrict consumer choice, instead of improving disclosure requirements?

APRA's response

As outlined on page 9 of the RIS, a central prudential issue is the distinction between ADIs and unregulated RFCs. The protection referred to comes from the prudential framework, including the relevant legislation that applies to ADIs, rather than through disclosure.

It is further noted that updating disclosure requirements to ensure they remain current and reflect relevant prudential disclosures is important, but in addition, and as noted on p.8 'APRA's proposed approach is a recognition that strengthening disclosure requirements will not itself be sufficient to achieve its regulatory objectives' and noting 'the proposals seek to limit the type of fundraising activities of RFCs, and, in so doing, minimise any confusion on the part of retail investors as to whether an entity in which they are investing is prudentially regulated and supervised'.

The limitations of relying on disclosure alone have been detailed in earlier answers above.

20. The RIS states that *"APRA's proposals do not seek to prevent RFCs from offering products to retail investors"*. This statement contradicts the fact that the preferred option will prevent RFCs from offering at-call products to retail investors. The RIS should address this apparent contradiction.

APRA's response

APRA has reworded this section providing additional information to more accurately reflect the intention of its proposals (please refer to page 8 of the RIS).

Regulatory cost estimates

21. The costs that have been estimated currently relate to outward facing matters, such as updating prospectus' and market materials. As discussed between our offices, costs resulting from changes to business models (such as referred to at page 11) need to be estimated. For example, we note that Westlawn submitted that they would need to rationalise staff, and, to our understanding, Bell Potter has already outsourced its at-call accounts. These are the types of changes that should be costed.

APRA's response

Further relevant information has been included in the RIS regarding regulatory cost estimates.

22. The RIS also notes that there may be costs to consumers who currently have transaction accounts for which regulatory cost estimates should also be provided.

APRA's response

APRA has included information on these matters in the RIS. Please refer to page 15 of the RIS.

Conclusion

23. The RIS recommends implementing option 2. However, the RIS has not demonstrated that this option will deliver the greatest net benefit to the community. To be consistent with best practice the RlS must do this. In practice this would involve addressing all of the issues outlined in this letter and noting any uncertainties where relevant.

APRA's response

By providing additional information and explanation, APRA considers that all issues raised have been appropriately addressed and that a sound case has been made for the preferred option.

Implementation and Review

24. The RIS should outline what review processes are in place to measure the extent to which the changes will lead to reduced maturity mismatch problems and enhanced investor comprehension of the market.

APRA's response

APRA's proposals are not intended to address any potential maturity mismatch problems among RFCs and, consistent with normal practice, APRA will not be monitoring entities for which it does not have regulatory responsibility. APRA does not actively monitor conditions that attach to the exemption order but would take action if it came to APRA's attention that entities were operating in breach of conditions. APRA would review the operation of conditions should a problem be brought to its attention.

25. The RIS should refer to compliance with the *Australian Government Guide to Regulation* rather than the previous Handbook.

APRA's response

The RIS has been updated accordingly.