
TREASURY LAWS AMENDMENT (NON-ADI LENDER RULES) BILL 2017

EXPOSURE DRAFT EXPLANATORY MATERIALS

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

| <i>Abbreviation</i> | <i>Definition</i> |
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| ADIs | Authorised Deposit-taking Institutions |
| APRA | Australian Prudential Regulation Authority |
| APRA Act | <i>Australian Prudential Regulation Authority Act 1998</i> |
| ASIC | Australian Securities and Investments Commission |
| FSCODA | <i>Financial Sector (Collection of Data) Act 2001</i> |
| non-ADI lenders | Entities that engage in the provision of finance that are not Authorised Deposit-taking Institutions |
| CFR | Council of Financial Regulators (APRA, ASIC, Treasury and the RBA) |
| RBA | Reserve Bank of Australia |

Chapter 1

Promoting financial stability

Outline of chapter

1.1 This Bill will promote financial stability through strengthening the Australian Prudential Regulation Authority's (APRA) ability to respond to developments in non-ADI lending that pose a risk to financial stability.

Context of amendments

1.2 Under the *Banking Act 1959* (Banking Act), a body corporate that wishes to carry on 'banking business' in Australia may only do so if APRA has granted an authority to the body corporate for the purpose of carrying on that business. Once authorised by APRA, the body corporate is an authorised deposit-taking institution (ADI) and is subject to APRA's prudential requirements and ongoing supervision.

1.3 There are other entities who, like ADIs, provide finance for various purposes within Australia, but are not considered to be conducting 'banking business' as they do not take deposits. Given there are no depositors to protect, these entities are not required to be licensed as ADIs and prudentially regulated by APRA. These non-ADI lenders currently only have to report data to APRA in certain circumstances.

1.4 However, the protection of depositors is only one component of APRA's regulatory responsibilities. When APRA makes Prudential Standards under the Banking Act, APRA is also expected to have regard to the stability of the Australian financial system.

1.5 Under current law, APRA has significant powers with which to address the financial stability risks posed by the lending activities of ADIs. For example, concerns in recent years about residential mortgage lending have led APRA to take specific prudential actions to reinforce sound residential mortgage lending practices by ADIs.

1.6 APRA currently has no such ability with respect to non-ADI lenders. This gap potentially undermines APRA's ability to promote

financial stability, as lending practices that APRA has curtailed or prohibited for ADIs may continue to be pursued by non-ADI lenders.

1.7 To address this gap, APRA will be given new rule making powers which apply to non-ADI lenders. These new powers will allow APRA to make rules relating to the lending activities of non-ADI lenders, where APRA has identified material risks of instability in the Australian financial system.

1.8 These powers are narrow when compared to APRA's powers over ADIs. This is an appropriate outcome, given there are no depositors to protect in non-ADI lenders. When exercising these powers, APRA will have to consider efficiency, competition, contestability and competitive neutrality consistent with section 8 of the *Australian Prudential Regulation Authority Act 1998* (APRA Act).

1.9 A separate but related issue is APRA's ability to collect data from registrable corporations under *Financial Sector (Collection of Data) Act 2001* (FSCODA). The current definition of registrable corporation in section 7 of the FSCODA has limited APRA's ability to collect data, as corporations which engage in material lending activity are occasionally technically not required to register. This has inhibited the ability of APRA and the Council of Financial Regulators (CFR) to properly monitor the financial stability implications of the non-ADI lender sector.

1.10 APRA's ability to collect data from non-ADI lenders will be improved by an alteration of the definition of registrable corporations in FSCODA. The new definition will seek to capture entities who engage in material lending activity, irrespective of whether it is their primary business.

Summary of new law

1.11 A new power will be provided to APRA to make rules with respect to lending finance by non-ADI lenders, for the purpose of addressing financial stability risks. APRA will also be provided a power to issue directions to a non-ADI lender, in the case that it has, or is likely to, contravene a rule. Appropriate directions powers and penalties will also be introduced for a non-ADI lender that does, or fails to do, an act that results in the contravention of a direction from APRA.

1.12 It is important to note that these powers do not equate to ongoing regulation by APRA of non-ADI lenders. APRA will not prudentially regulate and supervise non-ADI lenders as it does ADIs.

Comparison of key features of new law and current law

| <i>New law</i> | <i>Current law</i> |
|---|---|
| The Banking Act will be amended to include new definitions of non-ADI lender, non-ADI lender rule and lending finance at subsection 5(1). | Non-ADI lenders are not currently defined in the Banking Act. |
| New Part IIB will be inserted into the Banking Act to further define non-ADI lenders and create a power for APRA to make rules and issue directions with respect to non-ADI lenders. | No equivalent in the current law. |
| Section 38C will be inserted into the Banking Act to provide APRA with the ability to make non-ADI lender rules. New section 38C is broadly modelled on section 11AF of the Banking Act to provide internal consistency within the Act. | No equivalent in the current law. |
| Section 38E will be inserted into the Banking Act providing APRA with the power to issue directions in certain circumstances. New section 38E is broadly modelled on section 11CA of the Banking Act to provide internal consistency within the Act. | No equivalent in the current law. |
| Section 38F creates an offence should a non-ADI lender contravene a direction provided to it under section 38E. New section 38F is broadly modelled on section 11CG of the Banking Act to provide internal consistency within the Act. | No equivalent in the current law. |
| Further consequential amendments will be made to the Banking Act to ensure the changes made by this Schedule are carried through the Act. | No equivalent in the current law. |
| Consequential amendments to the <i>Financial Sector (Collection of Data) Act 2001</i> (FSCODA) to broaden APRA's ability to gather data from all relevant non-ADI lenders. | The FSCODA currently enables APRA to collect limited data from certain non-ADI lenders. |

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| <p>As a result of these amendments, corporations whose business activities in Australia include the provision of finance, or have been identified as a class of corporations specified in a determination made by APRA, will become registrable corporations for the purposes of the FSCODA.</p> <p>This will widen the class of registrable corporations under the FSCODA and will ensure that all non-ADI lenders, within specified parameters, are captured by these amendments.</p> <p>Corporations which are not considered to be registrable corporations for the purposes of the FSCODA will include those corporations: whose sum of assets in Australia, consisting of debts due to the corporation resulting from transactions entered into in the course of the provision of finance by the corporation, does not exceed \$50,000,000 (or any greater or lesser amount as prescribed by regulations); and whose sum of the values of the principal amounts outstanding on loans or other financing, as entered into in a financial year, does not exceed \$50,000,000 (or any other amount as prescribed by regulations).</p> | <p>Currently, the scope of registrable corporations is significantly narrower.</p> <p>Under the current law a corporation is a registrable corporation if it satisfies any of these three tests:</p> <p>First, the sole or principal activities of a corporation must relate to the provision of finance by the corporation.</p> <p>Secondly, the sum of the values of the assets of the corporation consisting of the debts due to the corporation which exist as a result of the provision of finance by the corporation exceed 50% or any greater or lesser percentage, as prescribed by regulations.</p> <p>Finally, if a corporation engages in the provisions of finance, whether as its sole or principal business in Australia, and the debts due to the corporation exceed \$25,000,000 or any greater or lesser amount as prescribed by regulations, then the corporation will be a registrable corporation.</p> |
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Detailed explanation of new law

1.13 Schedule 1 creates new definitions in the Banking Act to clarify the application of the provisions relating to non-ADI lenders.

1.14 Non-ADI lenders are defined by reference to the concept of registrable corporations contained in section 7 of the FSCODA. This ensures that corporations which are engaged in the provision of finance, lending of money and origination of loans or other financing are captured by the new regime. While APRA does not have regulatory responsibility for non-ADI lenders, these changes will ensure that APRA is able to make rules relating to the lending activities of non-ADI lenders. The role of non-ADI lenders in the mortgage and personal finance markets has been identified as a potential risk to financial stability in these markets and

enabling APRA to monitor non-ADI lending practices will enhance the overall stability of the financial system. *[Item 1, subsection 5(1) and item 2, Part IIB, Division 1, section 38B of the Banking Act]*

1.15 In order to ensure that the activities of non-ADI lenders are appropriately captured under this new regime, further definitions have been added to the Banking Act including 'lending finance'. This definition makes it clear that conduct of a non-ADI lender relating to lending finance including the lending of money, with or without security or any other activities which either directly or indirectly result in the funding or originating of loans or other financing, which has the ability to cause or promote instability in the financial system, will be captured by this regime. These changes give APRA authority to make rules concerning the lending activities of non-ADI lenders where those activities may materially affect financial stability. *[Item 1, subsection 5(1) of the Banking Act]*

1.16 The Banking Act will be amended to provide APRA with powers to make rules for non-ADI lenders. The new rule making powers will extend and enhance APRA's ability to promote the stability of the financial system. These rules close a gap which may occur when APRA restricts the lending activities of ADIs, but is unable to affect the activities of non-ADI lenders. *[Item 2, Part IIB, Division 2 of the Banking Act]*

1.17 The rule making powers for non-ADI lenders include the ability to impose different requirements to be complied with by all non-ADI lenders or by a specified class of non-ADI lenders or by one or more specified non-ADI lenders. This will provide APRA with the flexibility to make rules that focus on the particular area of the non-ADI lender industry that is engaging in practices which threaten the stability of the financial system. *[Item 2, subsections 38C(1) (2) and (3) of the Banking Act]*

1.18 APRA will have the ability to exercise powers and discretions under rules made by it, including but not limited to discretions to approve, impose, adjust or exclude specific requirements in relation to one or more specified non-ADI lenders. Rules made by APRA under this provision may be varied or revoked from time to time, as determined by APRA and must be made in writing. *[Item 2, subsections 38C(4), (5) and (6) of the Banking Act]*

1.19 Where rules apply to a class or classes of non-ADI lenders, the rules will be legislative instruments. *[Item 2, Division 2, subsection 38C(1) and subsection 38C(12) of the Banking Act]*

1.20 However, APRA's new rule making powers for non-ADI lenders are not intended to relate to lending matters which are properly the responsibility of the Australian Securities and Investments Commission (ASIC), such as responsible lending obligations. APRA is required to

consult with ASIC before making any non-ADI lender rules, to ensure that any such rules are targeted appropriately, cognisant of any interaction with the various regulatory regimes for which ASIC is responsible. This acknowledges the role ASIC has in regulating non-ADI lenders that hold either an Australian financial services license or a credit license as granted by ASIC. It will ensure that the work of APRA and ASIC in this area is consistent. *[Item 2, subsection 38C(9) of the Banking Act]*

1.21 In addition to the power to make rules with respect to non-ADI lenders, APRA may give a body corporate that is a non-ADI lender a direction if APRA has reason to believe that the non-ADI lender has contravened, or is likely to contravene, a rule made under Part IIB of the Banking Act. This directions power provides APRA with the ability to seek compliance with the whole or part of a relevant rule as well as directing that a non-ADI lender do, or refrain from doing, anything in respect of finance lending, as defined in section 5(1) of the Banking Act. *[Item 2, section 38E of the Banking Act]*

1.22 Part IV of the Banking Act will apply to decisions made by APRA in relation to individual non-ADI lenders under this new Part IIB of the Banking Act. This will provide non-ADI lenders with the ability to seek reconsideration or review of APRA decisions in the same manner ADIs can seek review or reconsideration of certain actions taken by APRA under the Banking Act. *[Item 2, subsection 38C(14) and 38E(9) of the Banking Act]*

1.23 An offence provision will be inserted into Part IIB of the Banking Act to apply where a non-ADI lender, or an officer of a non-ADI lender does, or fails to do, an act which results in contravention of the direction given under section 38E. In the case of contravention of section 38E, penalties will apply for non-compliance. *[Item 2, section 38F of the Banking Act]*

1.24 Further consequential amendments are made to the Banking Act to ensure internal consistency upon the introduction of these new provisions. *[Items 3 and 4, subparagraph 65A(1)(a)(i) and paragraph 65A(4)(a) of the Banking Act]*

Consequential amendments

1.25 Schedule 2 provides consequential amendments to the FSCODA to ensure that it applies to non-ADI lenders, as regulated in new Part IIB of the Banking Act. These amendments include updates to the definition of registrable corporations which widens the class of corporations which must be registered under the FSCODA. By widening the class of corporations FSCODA applies to, these amendments will ensure that non-

ADI lenders are included for the purposes of registering under the FSCODA, which will enable collection of information relevant to the exercise of APRA's new powers under Part IIB of the Banking Act. *[Items 1 and 2, subsection 7(1) and paragraphs 7(1)(a), (b) and (c) of the Financial Sector (Collection of Data) Act 2001]*

1.26 In addition, APRA will have a power to make a determination in writing to specify a corporation, or a class of corporations, for the purposes of the FSCODA. Such a determination will enable any corporations which are not captured by the widening of the class of registrable corporations in section 7 of the FSCODA to be specified by APRA. Full coverage of the non-ADI lender market is the intended consequence of these amendments. *[Item 3, subsection 7(1A) of the Financial Sector (Collection of Data) Act 2001]*

1.27 Where such determinations apply to a class or classes of corporations, the determinations will be legislative instruments. *[Item 3, subsection 7(1C) of the Financial Sector (Collection of Data) Act 2001]*

1.28 However, where the determination applies only to a particular corporation rather than a class of corporations (or classes thereof), the determination is not a legislative instrument for the purposes of the *Legislation Act 2003*. Subsection 7(1B) is included to provide clarity as to which type of determination will be a legislative instrument. *[Item 3, subsection 7(1B) of the Financial Sector (Collection of Data) Act 2001]*

1.29 Certain classes of corporation are excluded from the definition of registrable corporations under the FSCODA. As a result of these changes to the Banking Act and FSCODA, a further class of entities will be specifically excluded from being characterised as registrable corporations.

1.30 In particular, new subsection 7(2A) will clarify that where a corporation has assets, consisting of debts due as a result of the provision of finance, and principal amounts outstanding on loans or other financing, which do not exceed \$50,000,000 or any greater or lesser amount as prescribed by regulations, such a corporation is not a registrable corporation for the purposes of the FSCODA. This provision is designed to ensure that corporations with a stock of debt on their books, and a flow of debt through their books, which does not exceed \$50,000,000, will not be registrable corporations for the purposes of the FSCODA. *[Item 6, subsection 7(2A) of the Financial Sector (Collection of Data) Act 2001]*

1.31 The calculation of the value of loans or other financing is to be done on a financial year basis. So in determining whether a corporation is a registrable corporation, if that corporation had less than \$50,000,000 in loans outstanding on 30 June in the relevant year and less than \$50,000,000 in assets consisting of debts due to the corporation as a result

of transactions entered into in the course of provision of finance, that corporation is not a registrable corporation for the purposes of the FSCODA. *[Item 6, subsection 7(2A) of the Financial Sector (Collection of Data) Act 2001]*

1.32 In addition to the specified classes of corporations which are not included as registrable corporations by operation of subsection 7(2A) of the FSCODA, APRA is provided with a power to make determinations specifying a class or classes of corporations. Such determinations are legislative instruments for the purposes of the *Legislation Act 2001*. However, subsection 7(2C) clarifies that a determination applying to a specific corporation or corporations will not be a legislative instrument. *[Item 6, subsections 7(2B), (2C) and (2D) of the Financial Sector (Collection of Data) Act 2001]*

1.33 Section 31 of the FSCODA will be amended to provide that a determination by APRA not to exempt an organisation taken under paragraphs 7(1A)(a) and 7(2B)(a) (which are not legislative instruments) are reviewable decisions. *[Item 8, section 31 of the Financial Sector (Collection of Data) Act 2001]*

1.34 Section 32 of the FSCODA will be updated to reflect the definition of provision of finance to clarify that it includes the carrying out of activities, whether directly or indirectly, that result in the funding or originating of loans or other financing. This addition ensures the internal consistency within the FSCODA and carries through the concept of provision of finance which is central to the definition of non-ADI. Additionally, it is intended to capture corporations that provide finance indirectly, such as through interposed corporations or trusts. *[Item 9, paragraph 32(1)(aa) of the Financial Sector (Collection of Data) Act 2001]*

1.35 The provision of finance for the sole purpose of intra-group activities between related corporations has been specifically excluded from the definition of provision of finance. The intention is to specifically exclude corporations that provide finance via intra-group activities in amounts which otherwise render the corporation as a registrable corporation under the FSCODA. *[Item 10, paragraph 32(1A) (b) of the Financial Sector (Collection of Data) Act 2001]*

1.36 Similarly, the provision of financial advice is specifically excluded from the operation of the new provisions. It is not intended that entities whose activities are limited to the provision of financial advice would be covered by the non-ADI lender regime. *[Item 10, paragraph 32(1A) (a) of the Financial Sector (Collection of Data) Act 2001]*

1.37 Other consequential amendments have been made to the FSCODA to ensure consistency with these amendments. *[Items 4, 5, and 7 paragraphs 7(2)(h), 7(2)(i) and subsection 7(3) of the Financial Sector (Collection of Data) Act 2001]*

Application and transitional provisions

1.38 The provisions of this Bill apply from the date of Royal Assent.