



INFORMATION PAPER

ADI licensing: Restricted ADI Framework

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Glossary

ADI	Authorised deposit-taking institution within the meaning in section 5 of the Banking Act.
ADI licence	Authorisation under section 9 of the Banking Act to conduct banking business, with or without conditions.
Adjusted assets	Adjusted assets are assets, within the meaning given in the Australian Accounting Standards, minus an amount equal to the value of regulatory adjustments the Restricted ADI is required to make to its capital under Attachment D to <i>Prudential Standard APS 111 Capital Adequacy: Measurement of Capital</i> (APS 111).
APRA	Australian Prudential Regulation Authority.
Banking Act	<i>Banking Act 1959</i> .
Banking business	Banking business is defined in section 5 of the Banking Act.
CET1	Common Equity Tier 1 has the meaning in <i>Prudential Standard APS 001 Definitions</i> (APS 001)
FCS	The Financial Claims Scheme (FCS) is an Australian Government scheme that provides protection to deposits with ADIs and policies with general insurers in the unlikely event that one of these financial institutions fails. In the case of ADIs, the FCS only covers deposits in protected accounts held with institutions that are incorporated in Australia and recorded in Australian currency. The FCS can only be activated by the Australian Government. APRA is responsible for administering the scheme.
LCR	Liquidity Coverage Ratio has the meaning given in <i>Prudential Standard APS 210 Liquidity</i> (APS 210)
Licensing	Licensing refers to the process by which APRA grants an ADI licence to an institution.
MLH	Minimum liquid holdings, within the meaning given in APS 210.
NOHC	Non-operating holding company, has the meaning given in section 5 of the Banking Act.
PPF	Purchased payment facility, within the meaning given in section 7 of the <i>Payment Systems (Regulation) Act 1998</i> .
Protected account	Has the meaning in section 5 of the Banking Act.

Prudential framework	Prudential framework refers to the legislation, including prudential standards and associated guidance material, which applies to the prudential regulation of ADIs.
Prudential requirements	Includes requirements imposed by the Banking Act, prudential standards made under the Banking Act, reporting standards made under the <i>Financial Sector (Collection of Data) Act 2001</i> , conditions on the ADI's authorisation and any other requirements imposed by APRA in writing.
Resolution reserve	A reserve to cover potential APRA costs of resolving a restricted ADI which may, as a last resort, include administration of the FCS if activated by the Australian Government.
Restricted ADI	An ADI that holds a Restricted ADI licence.
Restricted ADI licence	Authorisation under section 9 of the Banking Act to conduct banking business for a limited period with specific requirements and restrictions.
Restricted phase	The period in which a Restricted ADI holds a Restricted ADI licence.
Stored value	The balance of funds represented on purchased payment facility (PPF) devices or PPF accounts held by beneficiaries for the purpose of making payments.

Executive summary

The Australian Prudential Regulation Authority (APRA) is an independent statutory authority established for the purposes of prudential supervision of financial institutions and for promoting financial system stability in Australia. APRA is responsible for, in particular, protecting the interests of depositors, insurance policyholders and most superannuation fund members¹ – collectively referred to as APRA's beneficiaries. Protecting the financial interests of these beneficiaries lies at the centre of APRA's mission.

Financial institutions that take customer deposits occupy a unique position of trust within the community. The financial safety of these institutions is key to the financial stability and economic well-being of the community and, as a result, these institutions are subject to higher standards than many other sectors of the economy. This includes higher entry standards, such as legislation which requires an institution that wishes to conduct banking business to apply to APRA for a licence authorising it to conduct banking business under the *Banking Act 1959* (the Banking Act). An institution which has been granted a licence under the Banking Act by APRA is referred to as an Authorised Deposit-taking Institution (ADI).

The process of granting an ADI licence is intended to help ensure that a new entrant will be able to honour the financial promises it makes to depositors under all reasonable circumstances. A licence is granted where an applicant is assessed as being able to meet the standards set out in the prudential framework.

In undertaking its role, APRA seeks to not unduly hinder other desired objectives of promoting efficiency, competition, contestability and competitive neutrality in the financial system. In licensing new entrants to the prudentially-regulated segments of the financial system, APRA aims to achieve an appropriate balance between financial safety and these other considerations.

Achieving an ADI licence requires significant resources and capabilities, for this reason there are two routes available to become an ADI: the direct route and the restricted route.

- The **direct route** allows applicants to conduct their intended banking business from the granting of the licence. The applicant must demonstrate it meets the prudential framework and be ready to commence banking business.
- The **restricted route** provides eligible applicants with a restricted licence for a maximum of two years before they must meet the prudential framework in full. It allows them to conduct limited banking business while developing their capabilities and resources, facilitating entry into the banking sector while not materially lessening entry standards that serve as important protections for the Australian community. If it is unable to meet the requirements of the prudential framework within two years, the holder of a restricted licence would need to exit the banking industry.

¹ APRA does not supervise self-managed superannuation funds as these are regulated by the Australian Taxation Office.

The granting of a Restricted ADI licence will represent a tangible milestone for applicants at an earlier stage of the licensing process than would otherwise be the case. This can assist Restricted ADIs in seeking the investment required to develop capabilities and resources in order to meet the full prudential framework and be ready to commence banking business. As such, the restricted route plays a role in facilitating entry into the banking industry, potentially enhancing competition and outcomes for the Australian public.

This Information Paper sets out APRA's Restricted ADI framework. This includes guidelines for eligibility, minimum and ongoing requirements for Restricted ADIs, application of the prudential framework and allowable business during the restricted phase. It also provides an explanation of what applicants can expect when entering into and progressing through the licensing process and APRA's expectations at each stage. This provides a general guide for those interested in the Restricted ADI framework. For each Restricted ADI additional requirements may also be applied by APRA in relation to the particular circumstances.

Chapter 1 - ADI licensing routes

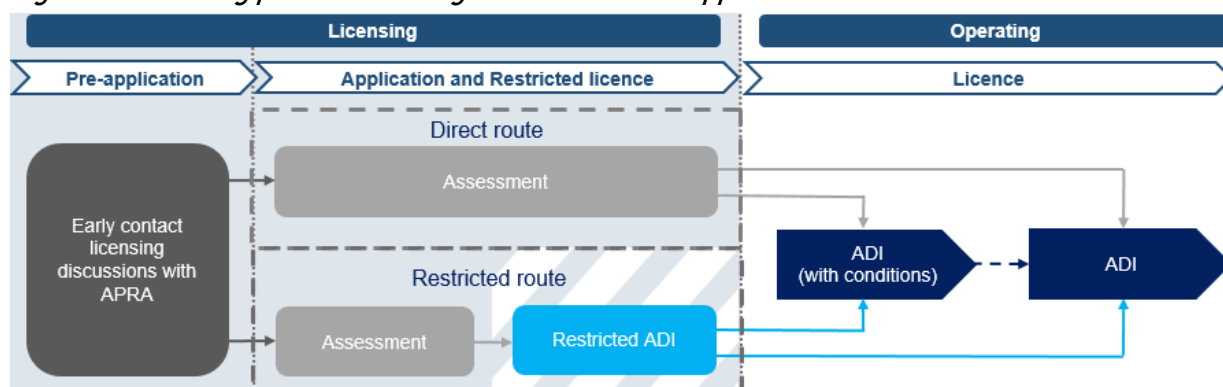
This chapter discusses the licensing routes that are available to applicants wishing to become an ADI. The route that is suitable for a particular applicant will depend on its particular circumstances. Potential applicants should discuss with APRA the most suitable route for their proposition, taking into account the guidance below.

APRA offers two distinct licensing routes: a direct route and a restricted route.

- The **direct route** allows applicants to conduct their intended banking business from the granting of the licence. The applicant must demonstrate it meets the prudential framework and be ready to commence banking business.
- The **restricted route** provides eligible applicants with a restricted licence for a maximum of two years before they must meet the prudential framework in full. It allows them to conduct limited banking business while developing their capabilities and resources, facilitating entry into the banking sector.

Regardless of the route taken, applicants will receive ongoing guidance from and engagement with APRA during the entirety of the licensing process.

Figure 1: Licensing process showing the two different application routes



1.1. Direct route

The direct route is suited to applicants that have the resources and capabilities to establish an ADI. It is also the route suited to those who wish to pursue a more complex, higher risk or larger scale business model from the outset.

Under this route, potential applicants would start developing operational capabilities ahead of submitting an application to APRA. The applicant would then need to complete preparations for the operation of their business and demonstrate that it meets the prudential framework prior to being granted a licence.

This route enables institutions to begin actively conducting banking business as soon as they are granted an ADI licence. This licence may be granted either with or without conditions.

ADI licence

An ADI licence may be granted for institutions that wish to operate across a broad range of segments of the market and offer a wide range of banking services. During the licensing assessment the institution would be required to demonstrate it meets all aspects of the prudential framework for the full range of services it will be offering.

ADI licence with conditions

In granting a licence under the Banking Act, APRA can impose conditions in relation to any prudential matter. Examples include:

- A foreign ADI that has conditions which limit its acceptance of deposits and other funds from Australian retail customers.
- An ADI that has conditions which limit it to solely conduct business in one market segment, such as retail banking or commercial banking. In these cases, during the licensing process the institution may demonstrate it meets the ADI prudential framework in regards to that particular segment. However, should the institution want to expand its business model at a later point, it would need to demonstrate to APRA that it has the capabilities to operate more broadly. At this point the licence conditions may be altered or removed.

A licence condition may also be used for other prudential matters. For example it may be used to set limits on related party dealings to take account of aspects of a group's structure or risks arising through the business of related parties, that are not able to be resolved as part of the licensing process.

1.2. Restricted route

This route is suitable for institutions for which a Restricted ADI licence would enable them to develop the necessary resources and/or capabilities to pursue an ADI licence. It will allow the institution to conduct limited, lower risk banking business during its start-up phase.

The restricted route allows eligible applicants to be authorised at an earlier stage in the licensing assessment process than under the direct route. This can assist applicants in seeking the investment required to develop resources and capabilities, demonstrating progress made towards fully complying with the prudential framework. When granted, this licence enables the applicant to conduct a limited amount of business for up to two years while it seeks to demonstrate it meets the full prudential framework. If during this period it is unable to do this, the applicant would need to wind up its banking business and the licence would be revoked.

Applicants taking this route are offered the same pre-application engagement and guidance as the direct route but are able to submit a proportionately shorter application that focuses on key essential elements of the prudential framework. Provided the information submitted as part of the application is of the required quality, and APRA is satisfied that the applicant meets the minimum requirements and is capable of progressing to an ADI licence within the two year period, APRA will grant a Restricted ADI licence. This Restricted ADI licence will give the institution time to completely develop its capabilities and demonstrate it meets the full

prudential framework for an ADI licence. If APRA forms the view that the Restricted ADI is not able to demonstrate this within the permitted period or the ADI reaches the trigger points set out in its exit plan, the Restricted ADI must cease conducting banking business and will have its licence revoked.

1.3. Providers of purchased payment facilities

A provider of a purchased payment facility (PPF provider) that conducts banking business as defined in Regulation 6 of the *Banking Regulation 2016* is required to be authorised and supervised by APRA. APRA-authorised PPF providers are a class of ADIs with a limited licence. PPF providers are only permitted to conduct certain banking activities.

APRA-authorised PPF providers are subject to a specific prudential framework outlined in *Prudential Standard APS 610 Prudential Requirements for Providers of Purchased Payment Facilities*. There is no restricted route available for applicants wishing to operate as PPF providers, reflective of the fact the prudential framework is already substantially streamlined for PPF providers. Institutions that want to be authorised by APRA as a PPF provider must apply directly for an ADI licence to carry on PPF activities. More information on PPF providers and the licensing process is available on APRA's website and is not dealt with further in this paper.

Chapter 2 - ADI application and assessment

This chapter discusses the process for applying for an ADI licence and the guidance from and engagement with APRA that applicants will receive. It provides information that will assist in ensuring the application will be as complete as possible. This is important to make the licensing process as efficient as possible.

2.1. APRA Licensing

APRA's Licensing Unit is APRA's centralised licensing function and the point of contact for potential applicants to engage on all licensing matters from pre-application through to licence approval for all types of licence.

APRA strongly encourages all potential applicants to engage in pre-application discussions to ensure that they are clear on what they need to do to become an ADI. During the discussions, APRA will outline the licensing process, take the opportunity to gain a better understanding of the applicant's proposals and raise any evident material issues or concerns with the proposals which applicants might usefully address ahead of entering the licensing process. Early on in the pre-application phase, APRA will also discuss with the applicant which route to take to an ADI licence.

Regardless of the route taken, applicants will receive ongoing guidance from and engagement with APRA during the entirety of the licensing process. However, it is important to note that while APRA seeks to engage and offer guidance on the licensing process and APRA's prudential requirements, it is unable to offer consultation on wider aspects of a new entrant's business.

2.2. Pre-application — early contact with APRA

Discussions with potential applicants in the early stages of considering a licence application are highly beneficial, providing an opportunity for the potential applicant to ask questions and for APRA to clarify what the potential applicant will need to do to obtain a licence. It also assists the potential applicant in understanding APRA's expectations and the licensing process.

Early contact also enables APRA to gain an understanding of the potential applicant's proposals and raise any likely issues or concerns as soon as possible. This can inform whether or not the potential applicant proceeds to an application and its approach to developing its application. For example, early discussions with potential applicants have on occasions highlighted that the intended business does not need a prudential licence to proceed or that the intended structure of institutions in a group will need adjustment.

During early discussions APRA will agree with the potential applicant which route, restricted or direct, it will take to obtain an ADI licence.

2.2.1 Pre-application meetings

The pre-application meetings are intended to help applicants navigate the licensing process and ensure that their applications are as complete as possible. APRA has found that often two pre-application meetings are needed with additional meetings scheduled depending on whether applicants are applying via the restricted route or their proposals include innovative or complex features, such as untested IT systems.

Initial enquiry meeting

The initial meeting gives potential applicants an opportunity to discuss their plans with APRA and for APRA to understand the general proposal and give feedback. Where relevant APRA will also discuss the restricted route and start to assess whether this would be a licensing route that is open to the applicant. These meetings are often held at a formative stage of a potential applicant's planning.

Preparing for an initial enquiry discussion with APRA: What do applicants need to do?

In advance of the initial meeting, potential applicants should prepare a brief, high-level summary of their business proposition. As a minimum it should include:

- an explanation of why the applicant wants to be licensed as an ADI; and
- the potential applicant's initial business proposition and strategy, including high level information on its:
 - a. business plan – what products it will be offering, how it will offer them and its target market;
 - b. sources of funding – how it proposes to fund the business and whether it has any investors and/or funding in place;
 - c. owners and structure – details of proposed owners and the ownership / group structure, as far as these are known;
 - d. corporate governance – proposed structure, board, senior management and governance arrangements, as far as these are known; and
 - e. project plan - an overview and timeline of the plan to set up the ADI.

Feedback meeting

Once a potential applicant's plans have developed and it considers it will be in a position to submit an application in the short to medium term, it should submit its developed business plan to APRA for high-level review. This is a key step in the licensing process and allows APRA to determine whether there are any prudential issues associated with the proposals and to raise with the potential applicant any concerns that APRA may have. It also assists with the applicant submitting a good quality application which will add to the efficiency of the licensing process.

APRA will meet with the potential applicant to present high-level feedback and give the potential applicant the opportunity to ask questions or discuss any issues it may have. At the end of the meeting, APRA will provide feedback on the potential applicant's readiness to submit an application and discuss the actions the potential applicant will need to take if it wants to progress with its application. Following the meeting APRA will send formal feedback

to the potential applicant in a letter. Depending on the feedback given, the potential applicant may require additional pre-application feedback meetings prior to submitting its licence application.

Risk specialists meetings

Depending on the type of business which a potential applicant proposes to undertake, a meeting may be arranged with one or more of APRA's risk specialist teams.

As an example, where a potential applicant's proposed business involves innovative or particularly complex IT systems, APRA may arrange a meeting with APRA's IT specialists to focus on the applicant's IT systems (including any outsourcing agreements). The meeting would cover how the applicant expects to manage the risks associated with its IT systems (for example security, testing, software maintenance, and incident handling), how it plans to manage the operational risks associated with its use of third-party suppliers (if any) and its plans for monitoring and oversight of these arrangements.

Similarly, depending upon the underlying risks proposed in the potential applicant's business plan, APRA may arrange for the applicant to meet other risk teams such as APRA's liquidity, operational, credit or market risk teams.

Further meetings

It may be appropriate for the applicant to have further meetings with APRA, which will be determined on a case-by-case basis. For example, if an applicant will be taking the restricted route, APRA may arrange a separate meeting to fully discuss the Restricted ADI approach with the applicant.

2.3. Application

After the pre-application meetings, the applicant should be ready to submit its formal application to APRA.

2.3.1 Application fees

All applicants are required to pay an application fee at the time of submitting their application. This is usually after the applicant has received initial feedback from APRA on its pre-application documentation.

The fees for licence applications are available in the Licensing section of APRA's website. Application fees are reviewed on a regular basis with the fees determined on a cost recovery basis. APRA's application fees, along with other charges and levies, are published in the annual Cost Recovery Implementation Statement.

In instances where an applicant's organisational structure involves a Non-operating Holding Company (NOHC), APRA may require the NOHC to be licensed as an authorised NOHC. An authorised NOHC is subject to a licensing assessment and a separate application fee. However, APRA may review the NOHC application fee depending on the level of additional work required in assessing the NOHC application, where this is done concurrently with the ADI application.

For applicants who require an approval under the *Financial Sector (Shareholdings) Act 1998* (FSSA) for shareholding interests above the FSSA threshold, an application fee may also be applicable.

All application fees are non-refundable regardless of the outcome of the application or if a Restricted ADI does not progress to an ADI licence.

2.3.2 Supervisory levy

Once an applicant has been granted a Restricted ADI licence or an ADI licence, it will be subject to an annual supervisory levy that is used to fund APRA's operations. The annual supervisory levy is calculated based on a percentage of the institution's total assets as defined in APRA's reporting standards, subject to a minimum and maximum levy amount. The levy percentage is determined on an annual basis with the levy generally charged in July each year.

2.3.3 Application requirements for the restricted and direct routes

The table below provides a comparison between the application requirements for the restricted route and the direct route.² Once licensed, a Restricted ADI will also need to meet the requirements set out in Chapter 3.

The licensing threshold for an ADI licence is not lower for applicants that apply via the restricted route; all of the requirements will need to be met for an ADI licence regardless of the route taken to the ADI licence, with Restricted ADIs having two years to meet the full prudential framework.

Table 1: Comparison between application information requirements for restricted and direct routes

Licence assessment area	Restricted application requirements	Direct application requirements
Business plan	Fully developed.	Fully developed.
Group structure	Final structure with the Restricted ADI or a NOHC at the head of the Australian Group.	Final structure with the ADI or a NOHC at the head of the Australian Group.

² While the requirements for applying directly for an ADI licence with conditions are the same as an application for an ADI licence, the applicant may only need to meet requirements in relation to its proposed limited business model. As such the requirements may be proportionately less than for an ADI licence.

Licence assessment area	Restricted application requirements	Direct application requirements
Board and management	<ul style="list-style-type: none"> • High-level structure. • Key personnel in place with senior roles critical to operations as a Restricted ADI identified and ready to be recruited. • Able to demonstrate meets the requirements of the Banking Executive Accountability Regime. 	<ul style="list-style-type: none"> • Majority independent Board and committees in place. • All key senior management identified. • Able to demonstrate meets requirements of <i>CPS 510 Governance</i>. • Able to demonstrate meets the requirements of the Banking Executive Accountability Regime.
Fit and proper	Fully developed – able to demonstrate meets requirements of <i>CPS 520 Fit and Proper</i> .	Fully developed – able to demonstrate meets requirements of CPS 520 Fit and Proper.
Capital	<ul style="list-style-type: none"> • Required to maintain, at all times, the higher of \$3 million plus resolution reserve (typically set at \$1 million); or 20 per cent of adjusted assets. • Capital management plan proportionate to the activities during the restricted phase. • Able to demonstrate sufficient access to additional capital so as not to breach the capital requirements during the restricted phase. 	<ul style="list-style-type: none"> • Required to maintain, at all times, a prudential capital requirement (PCR) and capital buffers as set by APRA in accordance with <i>APS 110 Capital Adequacy</i>. • Finalised ICAAP. • Able to demonstrate meets requirements of all capital related prudential standards.
Liquidity	<ul style="list-style-type: none"> • Required to maintain, at all times, a Minimum Liquid Holdings (MLH) at the higher of 20 per cent of liabilities; or the value of protected accounts and stored value at risk (if applicable) plus an amount equal to the resolution reserve. • High-level liquidity risk appetite and funding strategy covering liquidity requirements during the restricted phase. • Able to demonstrate sufficient financial resources so as not to breach the liquidity requirements during the restricted phase. 	<ul style="list-style-type: none"> • Required to maintain, at all times, MLH as set by APRA or Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) in accordance with <i>APS 210 Liquidity</i>. • Able to demonstrate meets requirements of <i>APS 210 Liquidity</i>.
Risk governance	<ul style="list-style-type: none"> • Developed sufficiently to be able to monitor material risks. • Able to demonstrate meets requirements of <i>CPS 220 Risk Management</i> proportionate to its expected activities during the restricted phase. 	Fully developed - able to demonstrate meets requirements of <i>CPS 220 Risk Management</i> and all other relevant standards.

Licence assessment area	Restricted application requirements	Direct application requirements
Material outsourcing arrangements	Not required unless material outsourcing arrangements impact on the strategic plans during the restricted phase – development should be planned.	Fully developed – able to demonstrate meets requirements of <i>CPS 231 Outsourcing</i> .
IT infrastructure and systems	<ul style="list-style-type: none"> • Outline of technology strategy and implementation roadmap. • Details of products, services and service providers selected/under consideration. • Testing strategy to ensure systems are fit for purpose. 	Fully developed – able to demonstrate IT infrastructure and systems meet the requirements of relevant prudential standards (such as CPS 231 and 232) and have regard to the expectations of practice guides and information papers.
FCS systems and reporting	Not required prior to Restricted ADI licence but must demonstrate prior to accepting protected accounts that requirements of <i>APS 910 Financial Claims Scheme</i> are met.	Fully developed – able to demonstrate meets requirements of <i>APS 910 Financial Claims Scheme</i> .
Strategy to ADI licence	Fully developed.	N/A
Exit plan	Fully developed.	N/A
Recovery plan	Draft elements – may form part of the exit plan and/or scenario planning in the business plan.	Finalised.
Business continuity plan	Restricted ADI must demonstrate will meet customer obligations in the event of a disruption – may form part of the exit plan and/or scenario planning in the business plan.	Fully developed – able to demonstrate meets requirements of <i>CPS 232 Business Continuity Management</i> .
Additional policies and procedures	Not required but development should be planned.	Fully developed - able to demonstrate meets requirements of relevant prudential standards.
Other approvals i.e. AFSL, FSSA	Relevant approvals must be obtained before commencement of operations.	Relevant approvals must be obtained before commencement of operations.

2.4. When can an institution call itself a 'bank'?

Under section 66 of the Banking Act a financial business may not use certain restricted terms, including 'bank', 'banker', 'banking' and 'ADI' in Australia unless it has been granted consent or an exemption by APRA³.

The purpose of restricting terms is to assure the public that a financial business using words like bank, building society, credit union or authorised deposit-taking institution is in fact authorised to carry on banking business. The intent is to limit the use of restricted terms by financial businesses that are not ADIs to very rare and unusual circumstances. The restriction also applies to words of similar meaning to the restricted terms (whether or not in English), and combinations with other words, letters or symbols (e.g. 'neobank').

A financial business is a business that consists of, includes or relates (in whole or in part) to the provision of financial services. If a financial business uses a restricted term without consent or an exemption from APRA, it is committing an offence and, if convicted, the court may impose a fine in respect of each day the business was in violation.

Applicants and potential applicants

Applicants can start the licensing process as 'Applicant Ltd', and can request that APRA provide a letter confirming that a company name containing a restricted term can be reserved with ASIC e.g. 'Applicant Bank Ltd'.

APRA understands that applicants, especially start-ups, may need to approach investors and start marketing their business ahead of being granted a licence, which can be difficult to do when the applicant is not permitted to use restricted terms. APRA will generally not object to applicants making certain factual statements, which use restricted terms, once the licensing process has begun, provided the statements are not misleading and it is made clear with prominent disclosure that the institution has not yet been granted a banking authority.

Where APRA becomes aware of an applicant or potential applicant making misleading statements using restricted terms (e.g., on its website or social media), APRA may seek an order under section 65A of the Banking Act restraining the making of such statements, and requiring other corrective action.

Misleading or inappropriate use of restricted terms will be looked at unfavourably by APRA when assessing a licence application. Applicants can check their proposed use of restricted terms with APRA if they are unsure whether the use would be misleading.

While some potential applicants may not yet be carrying on a financial business, they should follow these guidelines in marketing their business or dealing with investors to avoid breaching section 66 or other laws.

³ Or where a statutory exception applies, e.g. the Reserve Bank of Australia is permitted to use restricted terms without consent or approval from APRA

Restricted ADIs and ADIs

Once APRA has granted the applicant a licence it can use certain restricted terms⁴ in reference to its business and will be able to register a previously reserved company name with ASIC and call itself by that name, e.g. 'Applicant Bank Ltd'.

Restricted ADIs, although able to use restricted terms in reference to their business, will still need to make certain disclosures to make it clear to consumers that they are operating on a restricted licence, refer to section 5.9 for more information on the specific disclosure requirements.

Related entities of an ADI or Restricted ADI may use restricted terms in relation to the financial business carried on by the licenced institution, provided the terms are not used in a misleading way and it is clear the related entity does not have a licence.

2.5. Assessment

2.5.1 What happens when an application is submitted?

Once an application is received, APRA will review the information and start to assess the application against the requirements. APRA will review the information provided in the application and may request additional information, hold meetings with the applicant and review aspects of its operations onsite.

During the assessment phase, an applicant will be assigned a lead contact from APRA's Licensing Unit who will remain in contact with the applicant throughout the licensing process. Each applicant will also have a responsible supervisor involved in the assessment to ensure the transition to ongoing APRA supervision will be smooth once licensed. This responsible supervisor will generally be the supervisor of the applicant once a licence is granted.

2.5.2 What will APRA assess?

In assessing the application, APRA will seek to understand the risks the applicant's business will face and its capabilities in addressing those risks. APRA will need to be confident that if the applicant is granted a licence it will:

- be financially sound;
- manage its risks effectively;
- meet fit and proper expectations;
- have a sound risk culture;
- satisfy prudential requirements; and
- not pose a risk to the safety of depositors' funds or the stability of the financial system.

Proposed new institutions differ widely in their potential impact on the financial system and complexity. Consistent with APRA's risk-based approach, the depth of APRA's assessment

⁴ Restricted ADIs and ADIs are able to use the restricted terms 'ADI', 'bank', 'banker' and 'banking' without approval from APRA. However if they wish to use the restricted terms 'building society', 'credit union', 'credit society' or 'credit co-operative' in relation their business they must apply to APRA for approval.

through the licensing process will be proportionate to the risks within the applicant institution. For example an applicant with significant plans to undertake lending will be subject to a more in depth credit risk management assessment.

2.5.3 Timeframe

The timeframe to obtaining a licence varies, depending on the quality of the application, the complexity of the proposed arrangements, how clearly an applicant meets the requirements and how responsive the applicant is to APRA's requests throughout the assessment phase. It will also depend on the number of existing applicants in the licensing process.

As a guide, it could take APRA from three to 18 months to assess an application. The time taken to grant a Restricted ADI licence is likely to be faster than the time for an ADI licence, reflecting the proportionately shorter application requirements. However, it is not expected that the total time to obtain a full ADI licence would be quicker for ADIs applying under the restricted route.

Pre-application meetings will allow APRA to discuss timeframes that are likely for each applicant. It will also assist ensure better prepared applications when entering the licensing process which will assist with timing.

Chapter 3 - Restricted ADI route

The Restricted ADI licence route allows an institution to gain a licence at an earlier point in the licensing process, enabling it to conduct limited business while developing its capabilities towards fully meeting the prudential framework. Restricted ADIs must have both a credible plan to fully meet the prudential framework within a maximum of two years, and a credible exit plan that can be executed if needed.

This chapter discusses who is eligible for the Restricted ADI licence route, the requirements and restrictions that apply to Restricted ADIs, and what happens during the Restricted ADI phase, including transitioning to an ADI licence.

3.1. Eligibility

The Restricted ADI licence is intended to facilitate entry into the banking system for applicants that require time to develop resources and capabilities before progressing to an ADI licence and that would otherwise not be able to enter the market. Where an institution has significant resources and capabilities, or is proposing a higher risk business model, it would be expected to apply directly for an ADI licence.

Applicants that are part of an existing ADI or foreign bank are unlikely to be eligible for the restricted route as these applicants are expected to have sufficient resources and capabilities to apply directly for an ADI licence. These eligibility guidelines appropriately balance APRA's objectives of enhancing competition and efficiency in the banking industry, while maintaining high levels of financial safety and financial system stability and a broadly competitively neutral regulatory framework. Institutions that are not eligible for the restricted route may apply directly for an ADI licence via the direct route. The level of engagement and guidance provided by APRA will be the same for either route.

3.1.1 Principles based approach

APRA has adopted a principles based approach to the eligibility guidelines for the restricted route given the potential for innovative new business models to emerge. Potential applicants should speak to APRA about the most appropriate licensing route for their business, taking into consideration the principles and guidance set out below.

Capabilities

Capabilities are likely to be reflected in the type, size and maturity of an institution's existing business (if any). However there may be other circumstances where a Restricted ADI licence is appropriate, for example if the institution has no existing banking business capabilities. Such circumstances can be discussed with APRA.

Resources

APRA would expect applicants using the restricted route to be at the smaller end of the banking industry, lessening the risk of a negative impact on any level playing field considerations. As an indicative guide, APRA does not expect institutions applying for a

Restricted ADI licence to have a balance sheet greater than \$100 million, which would equate to approximately \$20 million of equity under the Restricted ADI minimum capital requirements (see section 3.3). As such, institutions which have balance sheet assets greater than \$100 million; have more than \$20 million of equity; and/or have parent institutions that have an ability to invest equity of more than \$20 million in establishing an ADI subsidiary, would typically be expected to apply via the direct route.

Limited business

The restricted route is targeted at applicants that require time to develop their resources and capabilities. APRA expects Restricted ADIs to be conducting limited business during the restricted phase and would not expect Restricted ADIs to grow significantly beyond the \$100 million asset size guidance. This reflects that the restricted phase is intended for entities to develop their capabilities towards achieving an ADI licence, while acknowledging that some applicants may have pre-existing business that they wish to continue during the restricted phase. Restricted ADIs can also release new products within the limits of the asset threshold, but must comply with APRA's disclosure requirements so that customers clearly know that they are dealing with a Restricted ADI (see sections 3.3.2 and 3.3.7).

Lower risk business

Potential applicants should plan on conducting lower risk business during the restricted phase. Those proposing a higher risk business plan are unlikely to be eligible for the restricted route. This could include complex product offerings, reliance on a niche market, or higher reputational risk. Examples would include businesses with a high exposure to market risk, funding of a concentrated portfolio, or funding of speculative activity such as a property development.

Table 2 provides examples of likely eligibility for the restricted route for a range of different potential banking entrants. To be eligible, the applicant would typically have to demonstrate that it was of an appropriate size, has limited banking experience and is conducting lower risk business.

Table 2: Examples of likely eligibility for the Restricted ADI licensing route

	New start-up	Small Non-ADI SME lender	Commercial business	Large Non-ADI mortgage lender	Insurer	Existing bank	Large tech firm
Asset size \$ million	5	10	100	500	1,000	1,000	1,000
Years of operation	0	5	10	10	30	30	5
Business proposition	Digital bank	Deposit funded lending	Deposit funded commercial business	Deposit funded lending	New digital bank sub	New digital bank sub	Digital bank
Appropriate Size	✓	✓	✓	✗	✗	✗	✗
Limited Banking experience	✓	✓	✓	✗	✓	✗	✓
Lower risk business	✓	✓	✗	✓	✓	✓	✓
Eligible	✓	✓	✗	✗	✗	✗	✗

3.2. Restricted ADI phase

An important part of the restricted route is the expectation that a Restricted ADI will progress to an ADI licence (see section 3.4). As such a Restricted ADI will have a maximum two year period in which it is allowed to operate as a Restricted ADI. There is no minimum time limit and APRA encourages Restricted ADIs to transition to an ADI licence as early as possible.

The set time period has several benefits: this includes certainty, transparency and facilitation of exits if needed as well as mitigating risk of an uneven playing field with competitors. Notwithstanding these factors, APRA may, in exceptional circumstances, be prepared to extend the restricted period. All Restricted ADIs will be in regular contact with APRA and significant issues of this nature will be addressed individually where required.

3.3. Requirements

The following section details the requirements that an institution will need to meet both in applying to be a Restricted ADI and once they have been granted a Restricted ADI licence.

3.3.1 Capital

A Restricted ADI will at all times need a minimum capital of the higher of: \$3 million plus a resolution reserve; or 20 per cent of adjusted assets.

The resolution reserve is typically set at \$1 million, representing the likely costs of APRA resolving the entity which may, as a last resort, include administration of the FCS if activated by the Australian Government. The actual costs for the business to exit the banking industry may be higher and applicants should consider this when setting their capital targets and operating levels. APRA retains discretion to increase the size of the resolution reserve if a Restricted ADI is deemed particularly complex to resolve.

These minimum capital requirements would apply to a Restricted ADI at Level 1, and where applicable, Level 2.⁵

Capital for the restricted phase must meet the definition of Common Equity Tier 1 Capital set out in *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital* (APS 111).

Mutually owned ADIs are currently permitted to have start-up capital made up entirely or mostly of capital which meets the definition of Tier 2 Capital in *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital* (APS 111). The timeframe for these institutions to build up Tier 1 Capital is agreed with APRA on a case-by case basis. A mutually owned Restricted ADI will also be permitted to meet its capital requirements through qualifying Tier 2 Capital.

3.3.2 Not actively conducting business

Restricted ADIs should not grow significantly beyond a \$100 million balance sheet, consistent with the eligibility guidelines. Restricted ADI applicants' business plans and financial projections should reflect this at the time of application, as should their operations during the restricted phase.

Within this limit, Restricted ADIs can continue to offer to the general public existing products (such as, for example, pre-paid cards or personal loans) that were established before the entity became a Restricted ADI as it is expected that the Restricted ADI will already have in place adequate resources and capabilities to manage the risks associated with these products.⁶

Restricted ADIs will also be able to offer new lower risk banking business products, including deposit products to a limited number of customers. Customers offered a new product during the restricted phase are expected to consist of staff of the Restricted ADI, family and friends of

⁵ Level 1 and level 2 are as defined in *Prudential Standard APS 001 Definitions*.

⁶ Applicants will be required to demonstrate adequate controls for existing products as part of the Restricted ADI licensing assessment.

staff, and a small number of early adopters who have expressed an interest in being involved in the start-up phase of the Restricted ADI. Other members of the general public should not be able to apply for a new release product from a Restricted ADI,

The Restricted ADI must comply with APRA's disclosure requirements so that customers clearly know that they are dealing with a Restricted ADI. All customers who acquire a new or existing product from the Restricted ADI (regardless of their relationship to the Restricted ADI), should be provided with a Restricted ADI disclosure statement explaining the risks of transacting with the Restricted ADI. (see section 5.9).

A Restricted ADI can actively market its business and its new release products to the general public in order to develop a wait-list of customers who can be offered products once the restricted ADI obtains its ADI licence. The Restricted ADI must make clear that those customers will not be eligible to apply for the product until it has gained its ADI licence.

By not actively conducting new banking business, a Restricted ADI can focus its attention on demonstrating its readiness to meet the requirements of the full prudential framework and transition to an ADI licence as soon as possible.

3.3.3 Liquidity

A Minimum Liquidity Holdings (MLH) requirement equal to the higher of:

- a) 20 per cent of liabilities⁷; or
- b) the total value of protected accounts plus an amount equal to the resolution reserve; or
- c) for Restricted ADIs which are holders of stored value⁸ (e.g. pre-paid cards), 100 per cent of the stored value at risk, plus the total value of protected accounts, plus an amount equal to the resolution reserve

will be required to be held at all times. The MLH should comprise of liquid assets which are free from encumbrances as defined by the MLH approach in Attachment B to *Prudential Standard APS 210 Liquidity* (APS 210).

The resolution reserve is the reserve referred to under capital in 3.3.1.

The MLH when combined with the capital requirements, ensures that Restricted ADIs at all time have sufficient liquidity and capital to meet their financial obligations in a timely fashion, including covering the resolution reserve.

⁷ Liabilities as defined in Attachment B to *Prudential Standard APS 210 Liquidity* (APS 210).

⁸ as defined by the *Payment Systems (Regulation) Act 1998* and that make payments (as mentioned in paragraph 9(1)(c) of that Act) in relation to a PPF

3.3.4 Strategy to ADI Licence

A credible strategy which details the applicant's plan to meet the prudential framework within the restricted phase will be required as part of the application documentation.

The applicant must demonstrate to APRA how it will meet the prudential framework and transition to an ADI licence by the end of the restricted period. This document will demonstrate that the applicant understands the full requirements under which they will operate as an ADI.

The document will also be important for assessing progress against the institution's plan during the restricted phase and, should material delays occur, APRA may consider invoking the Restricted ADI's exit plan. Further guidance on APRA's expectation on what should be covered in the strategy to ADI licence is provided in Chapter 5.

3.3.5 Exit Plan

Should the Restricted ADI be unable to fully meet the prudential framework by the end of the restricted phase, it will be required to cease banking business. The Restricted ADI may also decide that its business model is not viable, or it may come under stress and as such may not progress to an ADI licence. APRA therefore requires applicants to have a credible exit plan identifying the avenues it would take to exit its banking business.

The primary focus of the exit plan should be to protect deposit-holders without reliance on the FCS and without impacting financial stability or requiring use of APRA's crisis management powers. The exit plan should link to the applicant's business plan, key risks, strategy to ADI licence, and risk management framework, ensuring that there are clear trigger points for management actions and exiting the banking industry. Further guidance on APRA's expectation on what should be covered in the exit plan is provided in Chapter 5.

Where an ADI has an exit strategy that is unusual or involves more complex arrangements, APRA will consider setting a higher resolution reserve requirement.

3.3.6 Deposit Limit

Part of APRA's mission is to ensure that, under all reasonable circumstances, financial promises made by ADIs are met.

Provisions under the Banking Act for the protection of depositors apply to all Australian ADIs, including Restricted ADIs and they are covered by the Australian Government Financial Claims Scheme. Given Restricted ADIs will not meet the prudential framework, restrictions on the amount of liabilities held in protected accounts will be in place during the restricted phase. Restricted ADIs will be subject to a deposit limit of \$2 million on the aggregate balance of all protected accounts and a deposit limit of \$250,000 on the aggregate balance of all protected accounts held by an individual account-holder.

All ADIs (including Restricted ADIs) need to make it very clear to customers where balances, and other funding liabilities, such as pre-paid cards, are not protected under the FCS. In addition, given the intention to ensure regulated institutions can meet their financial promises, and, reflective of the fact that Restricted ADIs will not fully meet the prudential framework, Restricted ADIs should not build up material balances in non-protected accounts, such as pre-

paid card accounts and foreign currency deposits, during the restricted phase on their own balance sheet.

3.3.7 Disclosure

It is important that all consumers who deal with a Restricted ADI understand that it is subject to restrictions on its licence. The Restricted ADI must therefore take all reasonable steps to ensure sufficient disclosures are made to this effect. Chapter 5 provides details on the minimum disclosures that a Restricted ADI must make. If APRA notifies the Restricted ADI that in APRA's view a disclosure made by the Restricted ADI is or may be misleading or incomplete, the Restricted ADI must promptly amend the disclosure and make corrective disclosures.

3.3.8 Reporting

Under the *Financial Sector (Collection of Data) Act 2001*, ADIs are required to provide APRA with data as outlined in the ADI reporting standards.⁹ APRA will exempt Restricted ADIs from the current suite of ADI reporting standards and in place apply a reporting standard for the Restricted ADI. This reporting standard will apply during the restricted phase. Subsequently, as an ADI, the standard range of ADI reporting standards will be applicable.

The Restricted ADI reporting standard is a common reporting form and set of instructions that Restricted ADIs are required to provide to APRA. However, APRA may request Restricted ADIs to also provide entity-specific information needed to assist APRA in assessing the Restricted ADI's business model as well as progress towards meeting the prudential framework. Chapter 5 provides an overview of the reporting requirements for Restricted ADIs.

3.4. What happens during the restricted phase?

During the restricted phase, Restricted ADIs are expected to be focused on developing their resources and capabilities to meet the full prudential requirements. This could include (but is not necessarily limited to) the following:

- fully capitalising the ADI;
- finalising senior management appointments and staff recruitment and training;
- finalising details of products, pricing and on-boarding arrangements;
- developing control functions such as risk and compliance;
- developing, testing and implementation of systems and IT infrastructure;
- completing policies and procedures; and
- finalising outsourcing arrangements.

The activities completed during the restricted phase will depend on the Restricted ADI and its business model.

⁹ The ADI reporting standards are available at <http://www.apra.gov.au/adi/ReportingFramework/Pages/reporting-forms-and-instructions-adis.aspx>

During the restricted phase, Restricted ADIs will be authorised under the Banking Act and must meet the prudential standards applicable to them (see Chapter 4), and the Banking Act, which includes, from 1 July 2019, the Banking Executive Accountability Regime (BEAR).

During the restricted phase, APRA will be assessing progress of the Restricted ADI towards meeting the full prudential requirements and will engage on an on-going basis with the institution. This will include reviewing documents and arranging meetings as required, for example with the risk specialist teams at appropriate stages in the development of the Restricted ADI's business. APRA will conduct formal reviews of progress against the Restricted ADI's strategy to ADI licence at least every six months during the restricted phase.

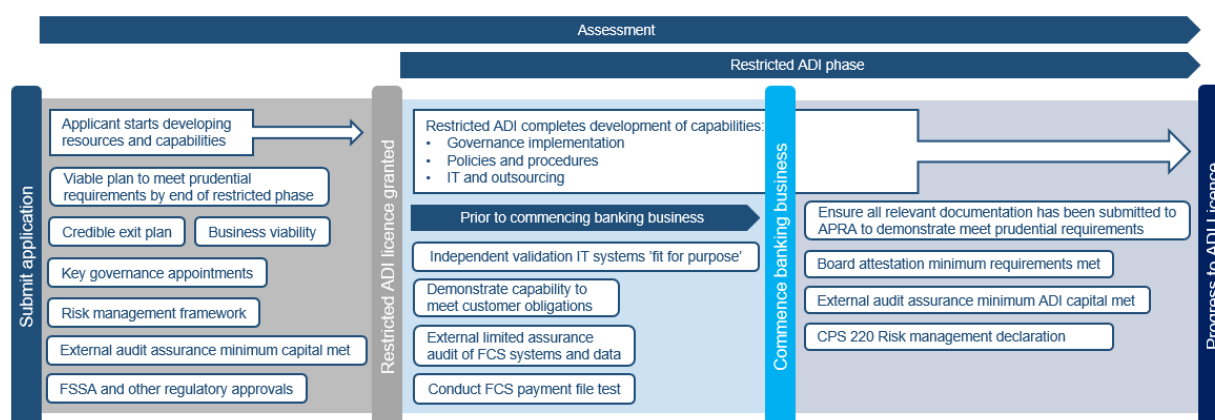
Prior to commencing banking business

While Restricted ADIs will not be required to meet the full prudential framework and are unlikely to have finalised and embedded risk management practices, as a Restricted ADI will benefit from the cover under the FCS it is important that prior to accepting deposits it has in place adequate systems and controls to be able to manage its customer obligations and provide APRA with the necessary information for the payment of depositors under the FCS, should it be required as a last resort. As such prior to accepting deposits, a Restricted ADI must:

- **IT** - have implemented its banking system with appropriate key controls in place to effectively manage security incidents and recover from a disruption. The banking system must be independently validated and fit for purpose. Refer to Chapter 5 for further guidance; and
- **FCS** – have engaged an auditor to undertake a limited assurance engagement of its Single Customer View (SCV) systems and data, and the systems used to generate and transmit FCS payment and reporting information and have performed a FCS payment file test with APRA and APRA's paying agent, the Reserve Bank of Australia.

Prior to conducting any lending, a Restricted ADI must have an adequate credit risk management framework to ensure that it can effectively manage its credit risk profile.

Figure 2 – Requirements of the different phases of the restricted route.



3.5. Ending the restricted phase

The restricted phase is for a maximum period of two years. The Restricted ADI will either progress to an ADI licence or exit the industry.

In situations where a Restricted ADI needs additional time past the two year limit, APRA may consider allowing more time to transition to an ADI licence. However, APRA expects that this would only occur in exceptional circumstances where APRA assesses that the Restricted ADI is able to transition to an ADI licence in a very short timeframe past the two year limit.

3.5.1 Progression to an ADI licence

When a Restricted ADI is satisfied that it meets the prudential framework, it should:

- ensure it has provided APRA with all relevant documentation to demonstrate it meets the full prudential requirements;
- submit a formal application to APRA, approved by the Board, requesting progression to an ADI;
- provide a risk management declaration as required by CPS 220;
- provide an attestation from the Board that it meets all prudential requirements; and
- provide external audit confirmation on its capital position.

This will start the formal assessment of progression to an ADI licence, based on an assessment of the Restricted ADI against the prudential framework in the same way that an institution applying via the direct entry route would be assessed.

Once APRA is satisfied that the Restricted ADI has met the prudential framework on a proportionate basis, APRA will approve the application. Depending on its business model, the ADI may have conditions on its licence.

The ADI will then be subject to ongoing supervision by APRA's supervision area.

3.5.2 Exit from industry

There may be instances where Restricted ADIs will not proceed to an ADI licence and will therefore need to exit the industry. This could occur if the Restricted ADI decides that its business is not viable, where it does not wish to proceed to an ADI licence or where it breaches a trigger in its exit plan.

However, APRA could also initiate an exit if APRA considers that the Restricted ADI will not be successful in transitioning to an ADI licence. An APRA triggered exit could occur if the Restricted ADI is unable to demonstrate to APRA sufficient progress in its development of capabilities and resources to fully meet the requirements of the prudential framework on a proportionate basis within the two year restricted phase.

There could also be instances where the Restricted ADI has breached its licence requirements or comes under stress. In this instance APRA would assess the severity and likely continuation of the breach or stress to determine if the Restricted ADI should exit the industry.

Once an exit is triggered, the Restricted ADI would be required to exit the industry in an orderly manner with interests of depositors given the highest priority. When the Restricted ADI no longer has any deposits, APRA would revoke its licence.

Chapter 4 - Restricted ADI prudential standards

This chapter comprises of a guide, summarised in Table 3 (below) as to how APRA intends the Prudential Standards to apply to Restricted ADIs. APRA will discuss the specific application of the prudential standards with each applicant as they may differ depending on the proposed business model.

Table 3: Prudential Standards

Prudential Standard	Applies in Full	Modified	Not Applicable ¹⁰
APS 110 Capital Adequacy		✓	
APS 111 Capital Adequacy: Measurement of Capital		✓	
APS 112 Capital Adequacy: Standardised Approach to Credit Risk		✓	
APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk			✓
APS 114 Capital Adequacy: Standardised Approach to Operational Risk			✓
APS 115 Capital Adequacy: Advanced Measurement Approaches to Operational Risk			✓
APS 116 Capital Adequacy: Market Risk			✓
APS 117 Capital Adequacy: Interest Rate Risk in the Banking Book			✓
APS 120 Securitisation			✓
APS 180 Capital Adequacy: Counterparty Credit Risk			✓
APS 121 Covered Bonds			✓
APS 210 Liquidity		✓	
APS 220 Credit Quality		✓ ¹¹	

¹⁰ Depending on a Restricted ADI's business model, APRA may decide that a prudential standard is not applicable to the Restricted ADI.

¹¹ Restricted ADIs which intend to offer credit products during the restricted phase will be required to meet parts of APS 220 prior to extending credit. If a Restricted ADI is not intending to offer credit, APS 220 will not be applicable.

Prudential Standard	Applies in Full	Modified	Not Applicable ¹⁰
APS 221 Large Exposures		✓	
APS 222 Associations with Related Entities		✓	
CPS 226 Margining and risk mitigation for non-centrally cleared derivatives			✓
APS 310 Audit and Related Matters	✓		
APS 330 Public Disclosure			✓
CPS 220 Risk Management	✓		
CPS 231 Outsourcing		✓	
CPS 232 Business Continuity Management		✓	
CPS 510 Governance		✓	
CPS 520 Fit and Proper	✓		
APS 910 Financial Claims Scheme	✓		

APS 110 Capital Adequacy

A Restricted ADI is required to hold a minimum Prudential Capital Requirement of \$3 million plus resolution reserve (set at \$1 million unless otherwise notified by APRA) or 20 per cent of adjusted assets, whichever is higher.

A Restricted ADI is required to have a capital management plan which is proportionate to its size and complexity and its activities during the restricted phase.

APS 111 Capital Adequacy: Measurement of Capital

A Restricted ADI is required to hold its entire capital requirement as Common Equity Tier 1 Capital. A restricted ADI will be required to make all necessary regulatory adjustments to its capital under Attachment D to APS 111 from its CET1.

A mutually owned Restricted ADI is permitted to hold its capital as Tier 2 Capital, consistent with mutually owned ADIs being permitted to have start-up capital made up entirely or mostly of Tier 2 Capital. The timeframe for these institutions to build up Tier 1 Capital will be agreed with APRA on a case-by case basis.

APS 112 Capital Adequacy: Standardised Approach to Credit Risk

A Restricted ADI will calculate its Prudential Capital Requirement as a simple percentage of adjusted assets. The calculation of risk weight based capital under APS 112 will therefore not be applicable, unless otherwise notified by APRA.

The residential mortgage lending criteria detailed in Attachment D paragraphs 1-2 of APS 112 will apply to Restricted ADIs conducting mortgage business.

APS 114 Capital Adequacy: Standardised Approach to Operational Risk

A Restricted ADI will calculate its Prudential Capital Requirement as a simple percentage of adjusted assets. APS 114 will therefore not apply, unless otherwise notified by APRA.

APS 116 Capital Adequacy: Market Risk

A Restricted ADI will calculate its Prudential Capital Requirement as a simple percentage of adjusted assets. APS 116 will therefore not apply, unless otherwise notified by APRA.

APS 117 Capital Adequacy: Interest Rate Risk in the Banking Book

A Restricted ADI will calculate its Prudential Capital Requirement as a simple percentage of adjusted assets. APS 117 will therefore not apply, unless otherwise notified by APRA.

APS 120 Securitisation

A Restricted ADI is not permitted to undertake any securitisation business during the restricted phase as it is not considered to be a lower risk business. APS 120 will not therefore apply unless otherwise notified by APRA.

APS 121 Covered Bonds

A Restricted ADI is not permitted to issue covered bonds. APS 121 will not therefore apply unless otherwise notified by APRA.

APS 180 Capital Adequacy: Counterparty Credit Risk

A Restricted ADI will calculate its Prudential Capital Requirement as a simple percentage of total adjusted assets. APS 180 will therefore not apply, unless otherwise notified by APRA.

APS 210 Liquidity

A Restricted ADI will need to meet an MLH requirement of the higher of: 20 per cent of liabilities; or the total value of protected accounts plus 100 per cent of stored value at risk (if applicable) plus the resolution reserve of \$1 million (or higher as determined by APRA).

Liabilities and liquid holdings are defined in Attachment B of APS 210. Attachments A and C will not apply to a Restricted ADI.

A Restricted ADI must have a liquidity risk tolerance and a liquidity management strategy proportionate to its business model during the restricted phase.

APS 220 Credit Quality

A Restricted ADI which intends to offer credit products during the restricted phase must have an adequate credit risk management system prior to providing credit. The credit risk management system must include policies, procedures and systems for:

- accurate and complete measurement of credit exposure;
- sound and prudent processes to value collateral held to determine security coverage;
- prompt identification of potential problem facilities on a timely basis including provisioning for impaired facilities; and
- regular monitoring of portfolio credit quality.

A Restricted ADI will be exempt from complying with Attachments A, B, C and D of APS 220. A Restricted ADI is expected to adhere to the Australian Accounting Standards AASB 9 for recognition of impairment losses on financial assets.

If a Restricted ADI is not intending to offer any credit products during the restricted phase APS 220 will not apply.

APS 221 Large Exposures

The large exposure limits in APS 221 will apply to a Restricted ADI, however the limits will be measured against CET1 capital.

The prior consultation requirement for large exposures greater than 10 per cent of the Restricted ADI's CET1 capital will not apply. However, a Restricted ADI must provide notification to APRA no later than one business day after entering into a large exposure of greater than 10 per cent, including demonstration that the exposure has not resulted in excessive risk under all reasonable circumstances.

APS 222 Associations with Related Entities

The related entity exposure limits in APS 222 will apply to a Restricted ADI, however the limits will be measured against CET1 capital.

Unless otherwise notified by APRA, Attachment A will not apply as a Restricted ADI is not permitted to have any extended licence entities.

CPS 226 Margining and risk mitigation for non-centrally cleared derivatives

A Restricted ADI is not permitted to deal in derivatives. CPS 226 will therefore not apply unless otherwise notified by APRA.

APS 310 Audit and Related Matters

Restricted ADIs are expected to meet and continue to meet on an on-going basis the full requirements of APS 310. External auditors will be expected to provide assurance against a Restricted ADI's compliance with the applicable Restricted ADI reporting and prudential requirements.

APS 330 Public Disclosure

APS 330 will not apply to a Restricted ADI, instead it will need to meet specific disclosures that apply to Restricted ADIs.

CPS 220 Risk Management

A Restricted ADI will be expected to meet CPS 220 on a proportionate basis. The Restricted ADI will be expected to demonstrate that its risk management framework is appropriate and that it has adequate systems and controls in place to monitor and manage the risk it is exposed to during the Restricted ADI phase.

A Restricted ADI must maintain an exit plan and a strategy to ADI licence as part of its risk management framework.

Restricted ADIs will be exempt from the requirement for a comprehensive review of their risk management frameworks by operationally independent persons, however they will be expected to assess whether any amendments or review are necessary where a material change to the size, business mix or complexity of their operations is identified.

CPS 231 Outsourcing

A Restricted ADI must be able to demonstrate to APRA as a minimum that any outsourcing arrangements for material business activities that impact on the strategic plans during the restricted phase meet the requirements of CPS 231. A restricted ADI must also ensure it manages and monitors each outsourcing relationship at all times.

CPS 232 Business Continuity Management

APRA expects the Restricted ADI to meet customer obligations in the event of a disruption. As a minimum, the Restricted ADI must demonstrate it has considered its exposure to, and has developed response plans for, plausible disruption scenarios to its business operations which are commensurate with the nature, size and complexity of its operations. This may be incorporated in scenario analyses or exit plans.

CPS 510 Governance

CPS 510 will generally apply to Restricted ADIs. However, acknowledging that some Restricted ADIs may be using the restricted phase to finalise executive appointments and staff recruitment, certain concessions will be made to specific requirements:

- instead of a majority of independent directors, Restricted ADI Boards will require:
 - a) a minimum of two independent directors at all times;
 - b) one independent director to be eligible and present to vote at all board meetings.
- a Restricted ADI will not be required to have established board committees. The responsibilities of these committees under CPS 510 will be responsibilities of the Board, with the exception of the remuneration committee whose responsibilities will be the responsibilities of the non-executive directors; and
- a Restricted ADI will not be required to have in place a policy for Board renewal or procedures for assessing Board performance.

CPS 520 Fit and Proper

Restricted ADIs are expected to meet, and continue to meet on an on-going basis, the full requirements of CPS 520 Fit and Proper.

APS 910 Financial Claims Scheme

Prior to commencing deposit taking activities, Restricted ADIs will be required to meet the requirements of APS 910.

APRA will use its powers under paragraph 29 of APS 910 to require Restricted ADIs to engage an auditor to undertake a limited assurance engagement of its Single Customer View (SCV) systems and data, and the systems used to generate and transmit FCS payment and reporting information prior to commencing deposit taking activities. Restricted ADIs will also be asked to conduct an FCS payment file test with APRA and APRA's paying agent, the Reserve Bank of Australia, prior to commencing deposit taking activities.

Providing the systems are fit for purpose, the SCV systems used by the Restricted ADI do not necessarily have to be the final systems it intends to use as an ADI, i.e. a Restricted ADI may use a less complex system during the restricted phase, while it completes the build of its final operating system.

Chapter 5 - Restricted ADI application guidance

The information provided below constitutes a guide to the supporting information APRA expects to be submitted as part of an application for a Restricted ADI licence. While the information is presented as a set of specific documents, it may suit an applicant for certain information to be presented in a different manner. Further, this list is not exhaustive and potential applicants should discuss with APRA the specific requirements for their application which may differ depending on the proposed business model.

- The application documents should be largely final ahead of submitting to APRA. If an applicant has not finalised some of the required documentation when it submits its application it should provide draft copies and indicate when the finalised supporting information will be provided. If information submitted as part of an application changes whilst APRA is still considering the application, institutions should inform APRA as soon as possible.
- Restricted ADIs will be required to submit further supporting information prior to progressing to an ADI licence. Details of the supporting information required for an ADI licence can be found in the ADI authorisation guidelines on the APRA website.

5.1. Business Plan

The applicant's description of its proposed business is an important part of the overall application and integral to APRA's decision making. The amount of detail submitted should be proportionate to the scale and complexity of the proposed business and to the risks associated with the proposed business.

The applicant should submit its business plan which as a minimum must:

- set out the rationale for applying to become an ADI;
- provide details of products, delivery channels and target market, including all the regulated and unregulated business that it intends to carry out;
- demonstrate the ongoing viability of its business proposal, including its competitive advantage and referring to appropriate supporting material and market research;
- demonstrate that the business will run in a prudent manner, including setting out the capital and liquidity strategy and the proposed funding model;
- include financial projections for at least five years, with scenario analysis setting out upside and downside cases;
- identify all the likely business and regulatory risk factors and explain how it will monitor and control these risks;
- clearly identify proposed owners and controllers and the proposed corporate structure.
- demonstrate that it will have the skills, competence and governance arrangements appropriate to managing a banking business, including setting out the proposed organisational structure, Board (including Board committees), senior management and governance arrangements;
- indicate the proposed resourcing of roles critical to operation during the restricted ADI phase and any further roles to be filled ahead of obtaining an ADI licence;

- outsourcing - details of planned key outsourcing arrangements (as far as they are known); and
- provide details on planned IT infrastructure and systems.

5.2. Strategy to ADI licence

APRA needs to have confidence that the applicant has credible plans to progress to an ADI licence within two years. Applicants will be required to provide their strategy to progress to an ADI licence as part of the application process and provide regular updates against the strategy during the restricted phase. The strategy to ADI licence should be sufficient for APRA to understand the key activities and dependencies, including for each key activity the milestones and timescales (including time for regulator assessment work), for the applicant to successfully meet the full prudential requirements.

Strategies to ADI licence should:

- detail all the necessary actions that need to be completed in order for the entity to meet the full prudential requirements;
- give expected timings on when actions will be completed;
- detail key dependencies such as capital raisings and IT infrastructure and systems;
- link with the applicant's business plan; and
- be documented in such a way that both APRA and the entity can track the applicant's progress against the plan on an on-going basis.

5.3. Exit Plan

Before granting a Restricted ADI licence, APRA needs confidence that the applicant has a credible exit plan that demonstrates it will be able to protect depositors without reliance on activation of the FCS by the Australian Government and without impacting financial system stability or requiring the use of APRA's crisis management powers. If the applicant does not progress to an ADI licence, or it breaches the triggers set out in its exit plan, it will need to exit from APRA regulated business.

An exit plan should:

- be tailored to the institution's specific business model;
- contain a robust framework of qualitative and quantitative triggers;
- include a cascading range of trigger points, including those required in the applicant's capital and liquidity management plans), triggers relating to the strategy to ADI licence and flow and stock measures;
- include a menu of credible options both for recovery and exit. Exit options should give consideration to time critical situations, with the purpose of protecting depositors without the need for activation of the FCS;
- be action orientated, covering governance, escalation and implementation procedures. It should be clear how the plan would be effected so it can be implemented quickly and effectively and how issues would be escalated and actioned depending on the trigger; and
- include a communication strategy detailing the method and timeframe for communicating with relevant parties, e.g. APRA, ASIC, customers and investors.

5.4. Capital

An applicant must be able to demonstrate that its capital resources will be sufficient to meet its Prudential Capital Requirement both at authorisation and on an ongoing basis. Applicants should provide their capital management plan which should cover at a minimum:

- the applicant's strategy for maintaining capital resources over time, for example, by outlining its capital needs for supporting the degree of risks involved in its business, how the required level of capital is to be met, and the means available for sourcing additional capital where required; and
- actions and procedures for monitoring that the applicant meets minimum capital adequacy requirements, including setting trigger ratios to alert management to, and initiate actions to avert, potential breaches to the minimum capital required by APRA.

Ahead of the granting of a Restricted ADI Licence, an applicant must provide confirmation from its external auditor on its capital position.

5.5. Liquidity

At all times Restricted ADIs must maintain an MLH of either 20 per cent of liabilities or the value of protected accounts plus stored value at risk (if applicable) and resolution reserve (typically set at \$1 million), whichever is higher. This is to ensure that there is no significant risk that its deposit liabilities cannot be met as they fall due. Applicants should be able to demonstrate how they will meet their liquidity requirements on an ongoing basis. Applicants should provide their liquidity management plan which should cover:

- the applicant's strategy for maintaining liquidity resources over time, as well as the means available for sourcing additional liquidity where required;
- actions and procedures for monitoring the applicant's compliance with minimum liquidity requirements, including setting trigger ratios to alert management to, and initiate actions to avert, potential breaches to the minimum liquidity required by APRA; and
- The applicant's strategy for managing a retail deposit run, including measures to repay retail depositors as soon as practicable.

5.6. Governance

5.6.1 Owners and Controllers

APRA needs to understand who owns and controls the applicant and the relationships the applicant might have with other individuals or institutions.

Applicants will need to provide a group structure chart showing the ownership structure of the applicant as well as any subsidiaries (of the proposed ADI and its parent) and any related companies. The chart should include details of related entities business and any proposed linkages with the applicant (e.g. outsourcing/insourcing arrangements).

Group Structure and Non-Operating Holding Companies

The protections provided under the Banking Act, are predicated on APRA regulating the parent entity of ADI groups, either as the ADI operating company or an APRA-regulated Non-Operating Holding Company (NOHC). Section 9 of the Banking Act explicitly allows APRA to make the authority to carry out banking business conditional on a body corporate of which the ADI is a subsidiary being an authorised NOHC. This reflects the importance of this structure in facilitating access to important powers under the Banking Act. In times of stress, in particular, it is essential that APRA has access to flexible, timely and robust powers. When dealing with groups, it is often not sufficient to apply powers to the ADI alone. Critical services (such as information technology, financial positions or essential staff) may be located in other group entities and contagion effects can occur within groups. APRA needs to be able to move swiftly to safeguard the critical operations of these entities.

Ownership of ADIs is governed by the *Financial Sector (Shareholdings) Act 1998* (FSSA) which limits shareholdings of an individual shareholder, or group of associated shareholders, to a defined percentage of the ADI's voting power. Shareholders who hold a stake in excess of the FSSA limit are considered to have an unacceptable shareholding. A higher percentage limit may be approved by the Treasurer subject to criteria set out in the FSSA. Owners with a shareholding that exceeds the FSSA threshold will need to submit an FSSA application with their licence application for approval to exceed the FSSA shareholding limit. If the application is within APRA's delegation, APRA will make a decision on the increased shareholding limit as part of the licensing assessment. Otherwise APRA will provide advice to the Treasurer, who will make the final decision.

The Restricted ADI applicant should, as part of its application, provide details on its shareholders with stakes in excess of the FSSA limit. As a minimum the applicant should provide details of the shareholders long-term commitment to the applicant, their financial standing, their ability to provide future capital and their fitness and propriety.

Shareholders with stakes in excess of the FSSA limit should submit their own applications for approval under the FSSA to APRA. Ideally these should be submitted at the same time the application for a Restricted ADI licence is submitted.

5.6.2 Corporate Structure

The structure chart should tell APRA about the applicant's Board and management, i.e. the key officers and directors and their responsibilities within the structure of the institution. It should clearly show:

- the names of significant staff (e.g. directors, chief executive, managers);
- the function(s) for each individual; and
- direct reporting lines into the board including board committees, where applicable.

Board

Restricted ADIs will need to meet the requirements for the composition and functioning of the Board in CPS 510 Governance as modified under the Restricted ADI framework.

Applicants should submit their Board charter and details on the experience of each of its appointed directors, their rationale in making the appointments and their assessment of the combined skills of the Board (skills gap analysis). Applicants should also provide details of the proposed Board committees and, if known, which directors will chair/be members of the committees.

Management

Applicants should provide a proposed committee and management structure chart (with reporting lines) and describe how these arrangements will operate in practice. They should also provide detail on the experience of the management team in relation to the planned business.

Remuneration

Applicants should provide a copy of their final remuneration policy which should be consistent with the requirements of CPS 510 Governance and should take into account any requirements under the Banking Executive Accountability Regime.

5.6.3 Fit and Proper

Applicants must satisfy APRA that they have policies in place to ensure that persons who hold key positions within the proposed Restricted ADI are fit and proper, in accordance with Prudential Standard APS 520 Fit and Proper.

Applicants should provide their Board approved Fit and Proper Policy and the assessments conducted in accordance with the policy on persons holding key positions. Where key persons are hired during the licensing assessment and restricted phase, the applicant should provide fit and proper assessments of those individuals to APRA as soon as possible.

Banking Executive Accountability Regime

Applicants must satisfy APRA that they are able to meet the requirements of BEAR such as providing accountability statements for each accountable person and the applicant's accountability map.

5.7. Risk Management

Applicants must satisfy APRA that their proposed (or existing) risk management and internal control systems are adequate and appropriate for the risks the applicant will be exposed to during the restricted phase. Applicants should provide copies of their Risk Appetite Statement and Risk Management Strategy. These documents should be focused on the risks to the applicant's business during the restricted phase. Updated versions of these documents focusing on the risk to the applicant as an ADI will need to be provided to APRA prior to transitioning to an ADI licence.

5.7.1 Policies and Procedures

Applicants will need to satisfy APRA that they have appropriate policies and procedures in place in regards to the material risks they will be exposed to during the restricted phase. Applicants can discuss their specific business proposition with APRA and agree which policies will need to be finalised prior to a Restricted ADI licence being granted.

5.7.2 Internal and External Audit Arrangements

Applicants must be able to demonstrate to APRA that arrangements have been established with external auditors in line with *APS 310 Audit and related matters* and that the proposed (or existing) internal audit arrangements meet the requirements of *CPS 510 Governance*.

Applicants should provide details of their engagement with external auditors and their internal audit plan for the restricted phase.

5.8. Information Technology

Applicants should provide a description of IT systems to be employed across the proposed business, identifying whether these are existing proven systems (indicating the amount of changes needed to accommodate the proposed business) or new systems in development.

Where applicants are planning to use shared computing services, such as public cloud arrangements, APRA will seek to ensure that the applicant's proposed risk management and mitigation techniques are sufficiently strong to support these arrangements, particularly where disruption would have an extreme impact on the entity or its customers. APRA will define specific requirements with each applicant which seek to ensure that risk management and mitigation techniques are sufficiently matured by the time an unrestricted licence is granted.

The following documentation is indicative of what will be required at the relevant stages of the licensing process.

Restricted-ADI Application

- Technology strategy and implementation roadmap
- Products, services and service providers selected/under consideration
- Testing strategy to ensure systems are fit for purpose (e.g. systems maintain fair and true records for financial obligations, systems calculate interest accurately etc.)

Prior to commencing restricted banking business

- Overview of key controls in place to detect, prevent and respond to security incidents in order to maintain confidentiality, integrity and availability of information assets (hardware, software and data)
- Overview of key controls in place to recover information assets in response to a range of scenarios (e.g. service provider outage, local outage and application outage). In particular, APRA expects the Restricted ADI to maintain the capability to meet customer obligations in the event of a disruption (including disruptions at the service provider or failure of the service provider itself)
- Independent validation of design and operating effectiveness of above key controls
- Independent validation that systems are 'fit for purpose' (e.g. systems maintain fair and true records for financial obligations, systems calculate interest accurately etc.)
- For material service provision, formally documented arrangements that comply with CPS231

Prior to full ADI licence

- APRA expects that a restricted ADI can demonstrate it meets the prudential framework and has operational controls. This includes demonstration of effective management of IT risks and: ability to meet: *Prudential Standards CPS 231 Outsourcing, CPS 232 Business Continuity Management and Prudential Standard CPS 234 Information Security*¹². Restricted ADIs should also have regards to the expectations of: *Prudential Practice Guides CPG 231 Outsourcing, CPG 234 Management of Security Risk in Information and Information Technology and CPG 235 Managing Data Risk*; and Information Paper on *Outsourcing involving Shared Computer Service (including Cloud)*.

5.9. Disclosure

It is important that consumers know who they are dealing with and understand how dealing with a Restricted ADI may be different to an ADI. APRA requires that Restricted ADIs take all reasonable steps to ensure that it is clear to all customers and potential customers that they are operating under a restricted licence and do not yet meet the full prudential framework.

This includes making disclosures on all promotional and marketing material, whether in paper form, electronic form or website or social media based content. This disclosure must:

- prominently display a statement that the Restricted ADI is operating under a time-limited and restricted licence; and
- provide details of where further information is available.

Restricted ADIs must make the following further information available to the public:

- an explanation in plain language of the restrictions on its licence, and how the restrictions impact customers;
- the date by which the Restricted ADI must either convert to an ADI or exit the banking industry (i.e. the date two years after the granting of its Restricted ADI licence);

¹² CPS 234 is due to be finalised in Q4 2018, and come into effect on 1 July 2019.

- any other information regarding the Restricted ADI's status that is relevant to customers considering acquiring an existing product from the Restricted ADI or customers who are considering signing up for a new wait listed product which will be available when the Restricted ADI obtains its ADI licence.

Prior to entering into a customer relationship with a Restricted ADI, a customer must be provided with a disclosure statement. The statement must be prominently displayed and written in plain language and must disclose at a minimum, the matters determined by APRA.

Restricted ADIs must comply with all consumer protection measures required by the Australian Securities and Investments Commission (ASIC), including the requirement to give a Product Disclosure Statement (PDS) (unless an exemption applies). The Restricted ADI disclosure statement may be included as part of these measures provided it is prominently displayed. For example, if a PDS is required to be given for a particular product, information about the restrictions on the ADI authorisation may be information that is required to be included, as it is information that might reasonably be expected to have a material influence on a consumer's decision about whether to acquire the product. The Restricted ADI disclosure statement could be included in the PDS to meet both the Restricted ADI disclosure requirements and the content requirements for the PDS.

All staff, representatives and employees of the Restricted ADI must be reasonably trained about the restrictions applicable to the Restricted ADI and the conditions under which it operates, including the conditions on its authorisation.

Where a Restricted ADI is offering pre-paid cards, it needs to make clear to customers that these are not protected under the FCS.

Applicants should provide samples of their disclosure statements as part of their application.

5.10. Reporting

A Restricted ADI will be required to report to APRA on a monthly basis to assist APRA in assessing its compliance with the Restricted ADI prudential requirements and its progress towards fully meeting the prudential framework.

The minimum reporting requirements for a Restricted ADI includes:

- Shareholders – the top five ultimate shareholders and associates, and their percentage ownership;
- Capital – the amount of share equity, retained profits, reserves and regulatory deductions;
- Liquidity – holdings of MLH, including the composition of MLH as per Attachment B of APS 210;
- Deposit reporting – number and amount of protected accounts and non-protected accounts broken down to different buckets;
- Assets – cash, other liquid holdings, loans (broken down to different categories), investments, fixed assets and intangible assets;
- Liabilities – deposits (broken down to different categories), short term borrowings, long term borrowings, provisions, hybrid capital/securities;
- Impaired assets and past due loans;

- Off-balance sheet information such as lending commitments;
- Large and related party exposures;
- Profit and Loss statement – interest income, fee income, other income, interest expense, personnel expenses, director expenses, IT expenses, charges for bad or doubtful debts and depreciation; and
- Reporting against forecasted profit and loss and balance sheet metrics.

The reporting requirements will be made on a Level 1 and, if applicable, Level 2 consolidated basis to be submitted within 10 days after month end. Depending on the Restricted ADI's business model, APRA may also request any entity-specific information from time to time.

The information must be provided to APRA in electronic form by a method notified by APRA in writing.

Once the Restricted ADI transitions to an ADI licence, it will be required to report the full suite of ADI reporting forms to APRA. However APRA encourages Restricted ADIs to commence reporting the full suite of reporting forms as soon as they are able to do so.



 **APRA**