



Discussion Paper

Financial Claims Scheme for authorised deposit-taking institutions

6 January 2010

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Preamble

The purpose of this discussion paper is to seek comment from interested parties on the possible methods by which the Financial Claims Scheme in respect of an authorised deposit-taking institution could be implemented, if required.

In its capacity as administrator of the Scheme, APRA is considering the most cost-effective means by which the Scheme could be implemented.

This discussion paper provides an overview of how the Scheme is intended to work and the proposed steps that ADIs will be required to undertake to ensure that, in the event of the failure of an ADI, the Scheme can be implemented in a timely and effective manner.

The paper includes details on the:

proposed information to be provided on the nature of deposits and other protected accounts covered by the Scheme, aggregation of protected accounts and the provision of account-holder information to APRA; and

proposed mechanisms for making payments to account-holders of a failed ADI.

It is important that the Scheme is implemented in an efficient and cost-effective manner. The Scheme must balance the need to ensure account-holders' timely access to their funds and the stability of the financial system, against the cost of implementation, both for ADIs and for APRA.

The proposals outlined in this paper will involve operational challenges for the ADI industry. APRA therefore seeks the views of industry on these proposals, and the nature of technical and other issues that ADIs could encounter in meeting the proposed requirements.

APRA also seeks the views of other interested parties on the proposed arrangements set out in this paper.

Written submissions on these proposals should be forwarded not later than 12 March 2010 to:

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Glossary

ADI	Authorised deposit-taking institution under the <i>Banking Act 1959</i>
ATM	Automated teller machine
APRA	Australian Prudential Regulation Authority
APCA	Australian Payments Clearing Association
APCS	Australian Paper Clearing System
Banking Act	<i>Banking Act 1959</i>
Cheques Act	<i>Cheques Act 1986</i>
CSV	Comma-separated values
D2A	Direct to APRA
EAFD	Early Access Facility for Depositors
EFTPOS	Electronic funds transfer at point of sale
EOD	End of day
FCS	Financial Claims Scheme (also referred to as the Scheme)
FCS limit	The maximum amount payable to an account-holder with a declared ADI in accordance with s16AG of the <i>Banking Act 1959</i> .
FTP	File Transfer Protocol
IT	Information technology
RBA	Reserve Bank of Australia
Regulations	<i>Banking Regulations 1966</i>
RTGS	Real-time gross settlement

Chapter 1 – Overview of the Financial Claims Scheme¹

Introduction

Commonwealth legislation was enacted on 16 October 2008 to implement the Financial Claims Scheme (FCS). The FCS is designed to protect account-holders² of an insolvent authorised deposit-taking institution (ADI) from any loss on their deposits, and to provide them with timely access to those deposits, up to the maximum amount payable under the FCS (FCS limit). The FCS is a 'closed resolution' scheme, meaning that it will not apply to an ADI in distress that continues to conduct new and existing business under a private sector or government support arrangement. APRA is responsible for the administration of the FCS.

Currently, under the Government deposit guarantee arrangements, the maximum amount payable under the FCS is \$1 million per account-holder per ADI. Nearer the expiration of the guarantee (currently October 2011), the Government will review the FCS deposit limit.

Under the *Banking Act 1959* (Banking Act), the Treasurer may invoke the FCS when APRA has applied for a failed ADI to be wound up (after first placing the ADI into statutory management). This could occur where the ADI is insolvent or otherwise unlikely to be able to meet its obligations to depositors as they fall due.

It is expected that the FCS will only be invoked when other remedies for resolving the ADI's financial difficulties, such as transferring some or all of the liabilities to another ADI, or recapitalising the ADI with or without public assistance, are unavailable or not justified on financial system stability grounds.

Bank failures in Australia are rare and generally only involve a single institution. Against this background, APRA is cognisant of the need to balance the objectives of the Scheme against the potential cost to industry of putting in place the necessary framework to facilitate its effective operation should it be activated. In designing the FCS framework, APRA is seeking to ensure that costs associated with implementing the FCS are minimised to the extent practical. However, while cost is an important consideration, it is equally important that ADIs are able to deliver reliable, complete and accurate data in the required format to APRA in a timely manner.

As part of the FCS arrangements, the Government has made a standing appropriation for funds to be available for FCS purposes. From October 2011, the appropriation is for a maximum amount of \$20 billion for payouts to account-holders at any one time and \$100 million for expenses relating to the administration of the FCS. The former amount would be used to pay account-holders in the first instance, with this amount to be repaid to the Government from the liquidation of the ADI. Under the legislation, APRA also has the power to borrow, with the consent of the Minister for Finance and Deregulation, for FCS purposes.

Payments made under the FCS are covered by the depositor preference provisions in the Banking Act, such that the assets in Australia of the ADI in winding up must first be applied to repay amounts paid under the FCS.³ If the assets of the ADI are insufficient to meet the amounts paid under the FCS (including expenses incurred in administering the FCS), an industry levy may be imposed to cover any shortfall.

The target repayment time is not defined in the legislation. APRA's intention is to provide account-holders with access to their deposits up to the FCS limit as soon as possible following the declaration of the FCS.

1 The Financial Claims Scheme (FCS) for ADIs is also known as the Early Access Facility for Depositors (EAFD). It is the EAFD that is the focus of this paper. All references to the FCS in this discussion paper are to be read as referring to the EAFD.

2 The definition of account-holder is set out on page 8 of this paper.

3 For details of priority for application of assets in the event of an ADI being unable to meet its obligations refer to s13A(3) of the Banking Act

Chapter 2 – FCS data requirements

General matters

The purpose of the FCS, and therefore of the proposed data requirements, is to facilitate timely access to deposits held with a failed ADI. Regardless of the payment option applied, the information from ADIs needed to facilitate payments will be broadly similar.

In order to ensure the effective operation of the FCS and to provide account-holders of an ADI with timely access to their FCS-protected deposits, it will be necessary for ADIs to be able to generate and provide APRA with the requisite deposit data. Pursuant to the Banking Act, the Treasurer has declared a list of deposit products that are covered by the FCS (refer to Attachment A). These include standard deposit accounts (e.g. term deposits, cheque accounts and other at-call accounts) and a range of other deposit products.

In particular, to ensure timely payment to account-holders, it is necessary that an ADI be able to identify each of its account-holders and to determine their deposit balances, based on end-of-day (EOD) values in their protected accounts (including accrued interest, but net of charges and fees) on the day the FCS is declared.

Given that FCS payments are subject to a cap on the maximum amount payable to any one account-holder, each ADI will need to ensure that its information technology (IT) systems are capable of identifying each account-holder of the ADI and aggregating the balances in all protected accounts held by each account-holder. It will also be necessary for an ADI to be able to provide relevant account-holder information at short notice to APRA. APRA, as administrator of the FCS, will take all necessary steps to ensure the prompt payment of deposits held in protected accounts up to the FCS limit, in the event of the Scheme being activated.

The FCS limit applies on a per account-holder, per-ADI basis – not on an account basis. Therefore, for the purposes of the FCS, APRA intends to require ADIs to produce deposit data on an aggregated basis for each account-holder based on the list of deposit products declared by the Treasurer. Given the limit, ADIs will need to configure their IT systems in order to provide information to APRA, or to a party designated by APRA, on protected account balances. For the FCS to be effective, aggregated deposit data will be required within a short timeframe – desirably within 48 hours – after the decision to activate the FCS for the ADI in question. The data will need to be in an electronic format that can be readily accessed and used by APRA or by a party designated by APRA.

Protected accounts

A protected account is defined in the Banking Act⁴ to be an account or covered financial product that is kept by an account-holder (whether alone or jointly with one or more account-holders) with an ADI and either:

- (a) is an account that is prescribed by the Banking Regulations 1966 (Regulations) for the purposes of paragraph 5(4) of the Banking Act (refer to Attachment A); or
- (b) is an account, or covered financial product, that is kept under an agreement between the account-holder and the ADI requiring the ADI to pay the account-holder, on demand by the account-holder or at a time agreed by them, the net credit balance of the account or covered financial product at the time of the demand or the agreed time (as appropriate).

⁴ Subject to subsections 5(5), 5(6) and 5(7) of the Banking Act.

For prescribed accounts,⁵ which are special accounts not intended for immediate payment, FCS payments to account-holders will be made by way of crediting the funds to the same or similar type of account at another ADI, rather than paying the funds direct to the account-holder. However, any amounts held in prescribed accounts must be included in the calculation of aggregate deposit balances within the FCS limit. In order to give effect to this, prescribed accounts will need to be identified by an ADI and a sub-aggregated balance will need to be provided for each account-holder. This would require an ADI to flag all such accounts as prescribed accounts for reporting to APRA.

Definition of account-holder⁶

For the purposes of the FCS, an account-holder means an entity, whether resident in Australia or outside Australia. This includes an individual, a body corporate, a body politic, a partnership, any other unincorporated association or body of persons, a trust, a superannuation fund or an approved deposit fund for the purposes of the *Income Tax Assessment Act 1997*. There is no statutory restriction on who may be a protected account-holder.

Denomination of account

The current Commonwealth deposit guarantee arrangements apply to protected accounts in any currency. However, upon expiry of these arrangements in October 2011, only those accounts denominated in Australian dollars will be covered by the FCS.

General matters

It is intended that ADIs will establish and maintain the capacity to submit the required aggregated account-holder information to APRA within a specified time period. The required data would need to be delivered within 48 hours of the request for the data being made to an ADI. In order to periodically test an ADI's capacity to do this, it is intended that ADIs will be required to provide these data to APRA at periodic intervals (proposed to be annually) and that APRA would conduct occasional random testing to simulate a situation where the FCS is declared. More frequent testing may be needed in situations where APRA has reasonable cause to believe that the data being provided by an ADI is not complete or accurate, or where the ADI has previously been unable to deliver the data in the required format within 48 hours.

Subject to industry consultation, APRA intends to introduce the deposit aggregation and reporting requirements around the middle of 2010, but with a transition period applying before the reporting requirements are to be fully enforced. During the transition period, APRA would engage with ADIs to monitor their progress in implementing system changes to facilitate FCS data collection and transmission. APRA proposes a transition period of at least 12 months for most ADIs, but with the scope for a longer period if APRA considers it appropriate.

APRA understands that some ADIs will need to make IT system changes to be able to identify individual account-holders and produce aggregated data in the form proposed. APRA therefore seeks the views of industry about how long it will take to implement these changes.

APRA seeks the views of industry on the proposal to require an ADI to provide the required FCS information to APRA within 48 hours of the request for the information. APRA also seeks the views of industry on the proposed frequency of testing of FCS data provided to APRA (i.e. annually in most cases and with the scope for random testing).

⁵ Prescribed accounts are those prescribed in the Regulations. Currently, prescribed accounts are retirement savings accounts, farm management deposits and first home saver accounts.

⁶ Refer to section 5 of the Banking Act.

Account-holder identification

For the purposes of calculating the amount to be paid to an individual account-holder up to the FCS limit, a mechanism is required for identifying individual account-holders and the accounts held by them. This mechanism is important in ensuring that an account-holder with multiple protected accounts does not receive payments exceeding the FCS limit.

Although all ADIs have some form of customer identification, these systems do not necessarily link all deposit accounts. For example, some ADIs use an 'opt-in' approach which enables account-holders to establish an account without identifying themselves, or being identified, as an existing customer. Customer identification practices vary considerably across the ADI industry.

APRA does not propose to require the adoption of a uniform customer identifier. Rather, each ADI would use its own systems and methods for identifying individual account-holders, subject to the requirement that each ADI must be able to uniquely identify each account-holder and each account-holder's aggregate deposit balance in order to ensure the integrity of the data produced for FCS purposes and to effect payments to account-holders of a failed ADI.

APRA seeks the views of industry on this approach.

Calculation of end-of-day deposit balances

In order to identify the deposit liabilities that will be covered by the FCS, for an ADI that has failed, it will be necessary for ADIs to be able to accurately calculate their EOD deposit balances. For further details on how this process is intended to work, refer to Attachment B to this discussion paper.

Account aggregation

For the purposes of aggregating deposit data, APRA envisages that a failed ADI would need to identify all protected accounts and associated balances plus accrued interest up to the date of the declaration of the FCS, net of any applicable fees and charges. The balance used for prompt access would be the 'available balance' (i.e. cleared funds) as at the time prompt access is made available. This would be funds available at that time for immediate cash withdrawal and not any 'unconfirmed balance', which includes cheques deposited but awaiting clearance. The payment of any remaining amounts up to the FCS limit would only be made once cleared funds have been obtained.

For account aggregation and payout purposes, all protected accounts for an account-holder are to be aggregated on a gross basis. There is to be no set-off of outstanding debt payable by an account-holder to the failed ADI for the purposes of calculating FCS balances. Recovery of any debt owed by an account-holder will be pursued in the liquidation process or in the process of transferring assets of the failed ADI to another party.

Section 16AF(2) of the Banking Act states that, where an account is held jointly by two or more account-holders with the declared ADI, each of the account-holders is entitled to an equal share of the account.

The Banking Act enables a flexible approach to be taken to aggregation requirements, including taking into account factors such as the dollar value of accounts and the nature of each account. The Banking Act therefore enables APRA to require ADIs to aggregate account balances in ways that differentiate between transaction/at-call accounts and term accounts, or through application of other criteria.

APRA is of the view that all protected accounts should be aggregated on a uniform basis, without differentiating between the maturity of deposits or other factors. This is the least complicated approach and is likely to be easier to administer and less costly for ADIs to comply with. A simple aggregation requirement should assist with the timely completion of the aggregation process. However, APRA proposes to require ADIs to separately provide aggregated balances for prescribed accounts on a per-account-holder basis.

Subject to industry consultation and the release of a draft reporting standard, APRA may provide further guidance on deposit aggregation. However, the broad principles on account aggregation are set out below.

General principles for account aggregation

1. All protected accounts attributable to each account-holder are to be aggregated for the purpose of establishing each account-holder's balance and for the purpose of applying FCS payments to each account-holder.
2. Account aggregation will include all protected accounts in a single account-holder's name, as well as any protected joint accounts, trust accounts, business accounts, prescribed accounts and all other protected accounts held by an account-holder, whether individually or jointly.
3. Sub-aggregation will be required for prescribed accounts, since all such accounts are to be transferred to a similar account at another ADI to preserve their status.
4. Joint accounts are to be split on a proportionate basis between all account-holders named on that account (e.g. for a joint account with four named account-holders, each account-holder would have one quarter of the total account balance included as part of its protected aggregated account balance).

5. In the case of business accounts, where the account is held in a business name, the balance will be treated as belonging to a single account-holder, being the person (including corporations, etc) named as the account holder. If a business account is held in multiple individual names (as may be the case with partnership accounts), the rules for joint accounts will apply.
6. As for joint accounts, any balance in partnership accounts would be shared proportionally among all persons named as the account-holders.

These guidelines on account aggregation are not intended to be exhaustive, but are intended to cover the key matters to which an ADI would need to have regard when aggregating deposits and the treatment of different account types.

APRA seeks the views of industry on whether the proposed aggregation guidelines are sufficient or whether additional guidance is required. It would be useful in this context if submissions could provide details of the matters where additional guidance would be considered necessary.

Proposed information to be collected

Format and method of data submission to APRA

Given the unique nature of the information collection for FCS purposes and the volume of data involved, submission via the 'Direct 2 APRA' (D2A) system is not practical. Rather, it is proposed that each ADI would electronically submit the relevant information to APRA as an encrypted data comma-separated values (CSV) file using File Transfer Protocol (FTP).

Proposed data collection

The type of information that APRA proposes to collect under the FCS is set out in Table 1.

Table 1: Proposed data items

1. Account-holder identifier		
1.1	Account-holder identifier	Unique identifier for each individual account-holder (if available)
2. Account-holder details		
2.1	Account-holder name	Full name of account-holder
2.2	Mailing address	Address details of the account-holder
2.3	Email address	If known
2.4	Contact telephone numbers	If known
3. Account details (to be provided for each protected account for each unique account-holder)		
3.1	Account(s) title	The name used on the account including surname, first name and middle name identifier. For companies/trusts and other entities – the relevant name of that entity/trust.
3.2	Account(s) number	The number given to the account by the ADI.
3.3	Product type	Identifies whether the account is a deposit or a prescribed account (Farm Management Deposits, Retirement Savings Accounts or First Home Saver Accounts).
3.4	Joint account-holder identifier	Only to be completed if account(s) is/are held in joint names.
3.5	Account(s) status	Active, open, closed, dormant.
4. Account balance		
4.1a	Account(s) balance – total (i.e. cleared and uncleared funds)	The amount held in the account at the end of the day (in accordance with EOD processes) on the day the FCS is invoked, including accrued interest, net of charges and fees where applicable.
4.1b	Account balance – cleared funds	The amount recorded at item 4.1a less any funds payable to the account-holder but not yet cleared (e.g. cheques drawn on another ADI but awaiting settlement).
4.2	Aggregate balance	The amount held in all protected accounts of the account-holder at the EOD on the day the FCS is invoked, including accrued interest, net of charges and fees where applicable. A sub-balance will be required in respect of any prescribed accounts held by a account-holder.
4.3	FCS protected amount	If the amount payable is less than the FCS limit then this will be the total held in all accounts; if the amount payable is greater than or equal to the FCS limit then it will be the FCS limit.
4.4	Amount above FCS cap	The difference between the amount held by the account-holder and the FCS limit, being the amount that the account-holder is entitled to seek from the liquidator outside the FCS process. For account-holders whose accounts are fully covered by the FCS, this field would read nil.

ADIs will also be expected to have the capacity to provide APRA with account-holder identification data upon request, including any data used by the ADI to verify the identity of the account-holder. This will not be included in the data to be transmitted to APRA on a regular basis, but would be subject to annual audit.

In addition to the account-holder specific information, an ADI would be required to provide a total payout figure for funds protected for payment under the FCS. This figure would be used to determine the appropriation that would be required to fund all protected account-holder balances under the FCS. APRA also proposes to require each ADI to provide the additional aggregated data totals below. This would be a summary of the data set provided to APRA and would include, at a minimum:

- the aggregate deposit balance of all deposits held by the ADI;
- the aggregate amount of uncleared funds;
- the aggregate deposit balance for all FCS protected account balances; and
- the aggregate deposit balance for all FCS prescribed accounts.

The reporting requirements will be set out in a reporting standard. APRA intends to issue a draft reporting standard in the first half of 2010 for consultation with industry.

Frequency and submission of data

APRA proposes that all ADIs would be required to submit FCS deposit data on an annual basis. The timing for reporting would be staggered across the ADI industry. ADIs will be expected to submit the required data within 48 hours of being requested to do so. The exact nature and form of the testing would be decided by APRA in consultation with the industry. While APRA would provide information to ADIs about the nature and timing of any such testing it is generally expected that an ADI would be in a position to be able to produce and submit the data at reasonably short notice, as would be the case in the event of activation of the FCS.

Audit of FCS data

In order to ensure the accuracy, completeness and integrity of an ADI's FCS data, APRA is proposing that periodic external audit of both the data collected and the systems used to produce the data will be required. This audit would be undertaken by an ADI's appointed auditor⁷ at the ADI's expense.

The level of testing in audit terms would most likely entail reasonable assurance review⁸ by the auditor. APRA would also seek assurance as to the efficacy of controls over the data aggregation, production and reconciliation of data to source systems.

APRA will provide further details on the proposed audit requirements when it releases its draft reporting standard.

CEO attestation

As part of the implementation of the FCS, APRA proposes that the CEO of an ADI be required to provide an attestation to the effect that the ADI has taken all necessary steps to ensure that it is compliant with FCS reporting requirements, including that the ADI is able to:

- identify each unique account-holder;
- aggregate protected accounts for each unique account-holder; and
- provide the data required by APRA within the timeframes set out in the reporting requirements.

APRA is aware that the pre-positioning required for prompt access to deposits involves IT and operational challenges. APRA wishes to ensure that pre-positioning requirements strike an appropriate balance between achieving FCS objectives and keeping compliance costs at reasonable levels. In particular, APRA seeks the views of industry on:

- the processes that ADIs have already employed in order to aggregate deposits for the purposes of the Government guarantee on large deposits;

⁷ An appointed auditor is the auditor appointed in accordance with *Prudential Standard APS 310 Audit and Related Matters*.

⁸ As defined in accordance with the *Framework for Assurance Engagements* issued by the Australian Accounting Standards Board.

- the existing capacity of ADIs to identify aggregate deposit balances for each account-holder;
- the extent to which existing anti-money laundering and counter-terrorism financing requirements concerning customer identification might assist in providing a systematic basis for identifying and aggregating customer accounts;
- the practicality of requiring ADIs to provide details that would allow APRA to authenticate the identity of an account-holder. This would be necessary where APRA sought to require an account-holder to identify themselves when telephoning a call centre, or when using a website. In such a case, an account-holder would be given the option of selecting their preferred means of FCS payment – for example, to have their funds transferred to an account at another ADI, or otherwise effecting a payment method that required identification of the account-holder;
- the nature of IT systems changes that ADIs anticipate may be required to provide aggregated EOD deposit data to APRA within 48 hours of the FCS declaration, and the anticipated costs associated with required IT systems changes;
- the likely cost of requiring external audit of FCS data including the ADI's systems and controls for producing and transmitting that data; and
- the timeframe required to enable an ADI to establish pre-positioning functionality.

Chapter 3 – Proposed payout process under the FCS

The Banking Act and Regulations do not prescribe the method by which account-holders are to be paid out under the FCS. The legislation was designed to give APRA the ability to determine the most appropriate payment method on a case-by-case basis, taking into account the particular circumstances of a failed ADI.

APRA has assessed the cost-effectiveness of facilitating FCS payments, including assessment based on:

- speed of payout;
- administrative costs (for APRA, the failed ADI, the paying agent and any designated recipient ADI);
- risks to the safe payout of deposits;
- ease of process for account-holders;
- operational risks;
- impact on the financial system, including confidence; and
- credibility and compatibility with international practice.

Regardless of the particular payment option chosen, APRA will, as part of the ongoing administration of the FCS, establish mechanisms to inform depositors about the FCS and associated matters. In the event of the FCS being activated, timely provision of information through web-based means and a call centre to deal with account-holder enquiries will be established. APRA is developing contingency arrangements for public communications and the handling of account-holder queries that can be quickly invoked should the need arise. As part of the communications process, APRA would ensure that account-holders are made aware of the need for them to re-establish payment arrangements (including direct credits and debits) with another ADI.

The remainder of this chapter provides details of how APRA anticipates the payment of FCS balances to account-holders of a failed ADI would occur where the ADI is withdrawn completely from the payments system and payments are not made via the ADI's own payment channels. APRA seeks the views of industry and other interested parties on this proposal.

Payout via methods external to the failed ADI

In any payout situation, the ADI would be closed to all new business and transactions on existing business from the time that the decision is made to declare the FCS. In a situation where FCS payments are made by means that are external to the failed ADI's payment channels, all payments systems would be closed to the ADI concurrent with the activation of the FCS. The ADI would then calculate its EOD balances as at the date of declaration of the FCS.

APRA would activate mechanisms to notify account-holders of the ADI that FCS balances will be available for payment, and to advise the methods for effecting payment and what account-holders would need to do to receive payment of a protected account balance.

While the means of notification would take into account the depositor base of the ADI in question, APRA intends that notification would include the operation of a call centre to assist affected account-holders, use of the APRA website or an affiliated FCS website with details for account-holders, and any other notification mechanisms as considered appropriate, including via mail or email.

If practicable, account-holders would be given the opportunity to select the most suitable payout means for their purposes. This allows flexibility for account-holders to receive payment and allows a combination of payout mechanisms to be used as best suited to each individual account-holder. In particular, it would allow account-holders to choose whether to receive payment by cheque or by electronic transfer to an account at another bank nominated by them.

However, providing a range of payout options to account-holders will have implications for the timeliness and efficiency of the payout process. It could take many days or weeks to obtain account-holders' preferred payout method. In addition, if account-holders were given the option of receiving their funds by way of electronic transfer to nominated accounts at other ADIs, APRA would need to obtain account-holder identification information from the failed ADI to verify the account-holder's identity before transferring the funds. This would add to the cost and complexity of payout and slow down the payout process.

APRA would therefore consider the nature of the options it thinks appropriate on a case-by case basis, with a view to striking a balance between facilitating a relatively prompt payout, minimising the risk of fraud and giving account-holders some scope to select their preferred payment method.

Proposed standard payout method

APRA proposes that the 'default' means of payout would be by way of cheque drawn on the RBA and mailed to account-holders, where the failed ADI holds a valid mailing address for the account-holder. The default payment method would be supplemented by providing quick access to cash via the branch network of the failed ADI or through cashable cheques or pre-paid cards. This option provides a relatively simple and cost-effective means of payout and draws on established payment system technology.

However, any payment involving posting cheques to account-holders creates a risk of cheques being mailed to incorrect addresses, being stolen or subject to fraudulent use. Also, payment by cheque does not necessarily achieve prompt payout. In the case of account-holders without a transaction account at another ADI, it could mean that deposits are not able to be accessed for several days while an account-holder establishes new deposit accounts. APRA proposes options for alternative payout for those who indicate that that is their preference, together with prompt cash access arrangements.

APRA proposes that account-holders would be advised (via a secure website established by APRA or via email or letter) of their eligible FCS payout amount and the basis of its calculation. They would also be advised that the default payment method would be by cheque drawn on the RBA and mailed to their address. Account-holders would be advised that, if they do not wish to receive payment in that form, they would need to indicate, within a specified period, their preferred payout option. Subject to the above, they would be able to do this via a call centre or website established by APRA for this purpose.

The alternative payout options would be for an account-holder to:

- collect a cheque from a designated branch of the failed ADI within a specified period of time; or
- nominate an account at another ADI into which their funds are to be credited.

Prescribed accounts

Deposits held in prescribed accounts (farm management deposits, first home saver accounts and retirements savings accounts) would be transferred to like accounts at another ADI. These accounts would be included as part of an account-holder's FCS balance, but payment would only occur through preservation of the amount by transfer to a like account at another ADI. Payment of balances in prescribed accounts by cash or cash equivalents will not be an option. Account-holders would be advised (via website, email or letter) of the amount in their prescribed account, the details of the account (being of the same or similar nature) at another ADI into which the funds would be transferred and the process they would need to follow to activate the account at that ADI.

Access to cash

Some account-holders are likely to need prompt access to cash in order to meet day-to-day expenses. Account-holders would be advised of the options available to them to obtain prompt access to a proportion of their deposits (e.g. up to \$2,000 per account holder). The options would include the following:

- allowing access to limited cash through the branch network of the failed ADI (where APRA and the liquidator are satisfied that the operational and logistical risks of opening branches for this purpose are manageable);
- providing account-holders with cashable cheques drawn on the RBA, either mailed to them or made available via the branch network. Subject to the agreement of other ADIs, cheques would be cashable at any ADI upon the account-holder providing requisite identification; or

- providing account-holders with pre-paid cards to a specified value (accessible via a PIN), either mailed to them (with the PIN posted separately) or made available for collection through the branch network. The cards would be provided by a third party engaged by APRA for this purpose. The account-holder would need to activate the card and would then access the funds via the card until those funds were exhausted.

Benefits and costs of proposed standard payout method

The main benefits of the proposed standard payout method are that:

- it provides for a standard “default” means of payment by cheque drawn on the RBA, using secure cheque technology that is regularly used and proven to be reliable. Payment by cheque is likely to be an acceptable method of payment for many account-holders;
- mailing cheques to account-holders is more likely to facilitate relatively quick access for account-holders as most other payout options require accurate data on account-holder identification, BSB and account details at other ADIs;
- it allows account-holders who do not wish to receive a cheque mailed to them an alternative means of accessing their funds – e.g. electronic transfer or collection of a cheque at a branch;
- any risks associated with cheque payments would be reduced to the extent that account-holders are able to specify a nominated account into which funds are to be credited; and
- it provides relatively quick access to cash (up to a limit) by way of cashable cheque, pre-paid cards or payment of cash through a branch of the failed ADI.

The costs and risks of the proposed payout method are that:

- to the extent that payment is made by cheque mailed to an account-holder, there is a risk of cheques going to incorrect addresses, or of theft or fraud. This risk can be reduced by verifying addresses with account-holders and giving them the option to nominate an alternative payment option. However, this adds to the complications of payout and reduces the speed of payout. It will also be necessary for the failed ADI to provide APRA with customer identification information in order to further minimise the risk of fraud; and
- as with any call centre arrangement, and despite all reasonable efforts to make the call centre arrangements efficient, some account-holders may find the process less than ideal. This has the potential to weaken the credibility of this option.

Unclaimed amounts

For account-holders who are not contactable or who fail to nominate or initiate payout arrangements by a particular date, APRA would take steps to contact them at their nominated contact address or other means as appropriate. If account-holders cannot be contacted after what is considered to be a reasonable period of time, APRA would transfer their moneys to the Commonwealth as ‘unclaimed moneys’. The legislation covering such moneys would apply and account-holders would then need to recover these amounts through normal claims processes.

Additional payment option – transferring funds to new accounts

In addition to the above payment methods, APRA is considering the efficacy of an alternative payment option which may be useful for account-holders without a transaction account at another ADI. This would involve APRA opening an account in an account-holder’s name at a designated ADI and transferring the funds from the account-holder’s account at the failed ADI to the new account. Account-holders would be provided with the account details and advised of the process to be followed to activate the account.

In the event that the FCS is invoked, the selected recipient ADI would be provided with electronic data identifying account-holders. It is expected that the deposit accounts established at the recipient ADI would be at-call accounts with basic transaction capacity, regardless of the type of account the account-holder held with the failed ADI. The exception would be special purpose accounts.

The recipient ADI would be provided with electronic data to enable it to credit funds to each new account. The recipient ADI's Exchange Settlement Account at the Reserve Bank of Australia (RBA) would be credited with an funds to enable the ADI to credit the protected funds to each account-holder's account. This amount would be drawn from an FCS special purpose account established at the RBA and administered by APRA.

Any costs incurred by the recipient ADI in establishing the new deposit accounts and communicating with account-holders to activate new accounts would be reimbursed from the FCS special purpose account.

This payment option has some important benefits, including the ability to provide a relatively quick means of providing access to account-holders' funds in situations where account-holders do not have transaction accounts with another ADI. It also avoids the risks associated with cheque payout. However, APRA is mindful that this option also entails costs and risks. In particular, depending on the number of account-holders involved, it could take a considerable period of time to establish new accounts at another ADI. This option could also cause account-holders and others to assume that the recipient ADI is necessarily safer than any other ADI, which would not, in fact, necessarily be the case. It would also require periodic tendering to establish one or more recipient ADIs, which would entail considerable administrative costs.

APRA seeks the views of industry on the proposed payout mechanisms and the extent to which these are considered practical and feasible. APRA invites industry feedback on the feasibility, costs, risks and perceived benefits of the payment options discussed above.

APRA also seeks the views of industry as to which forms of payout would best meet the needs of account-holders and on issues relating to the trade-offs between speed of payout and providing account-holders with options for payout.

Alternative payment option – via the ADI's own payment channels

A potential alternative payout approach involves making payments to account-holders via an ADI's own payment channels – such as automated teller machines (ATMs) and Electronic Funds Transfer at Point of Sale (EFTPOS) (e.g. cash up to a limit of \$2,000), or telephone and internet banking and direct credits (for remaining FCS amounts).

Under this approach, the ADI would be withdrawn from the payments system for the determination of EOD positions and then re-entered into the payments system for a limited period for the sole purpose of enabling FCS payments to be made. On this basis, only outward payments would be permitted via the ADI's payment channels and only up to the FCS limit. Once FCS payments had been completed, the ADI would be terminated from the payments system.

This option may be suitable in cases where APRA is satisfied that the ADI has the operational capacity to operate its payment channels in a reliable and secure manner. It would also require the ADI in question to have the capacity to apply limits on cash payment channels, such as ATMs and EFTPOS, that are consistent with the proposed \$2,000 cash payout limit and to have the capacity to apply limits on other payment channels (e.g. internet channels, telephone banking and direct credits) for the remaining balance up to the FCS limit on an aggregated basis.

Using an ADI's own payment channels has a number of potential advantages:

- it provides the quickest means of allowing account-holders to access cash up to a defined limit;
- it provides account-holders with the ability to use existing payment channels to transfer funds up to the FCS limit into a transaction account at another ADI of their choice; and

- it reduces delays in payment and data transmission complications by avoiding the need to transmit account-holder data to another paying agent (such as the RBA or a designated ADI).

APRA notes that deposit guarantee scheme administrators in some other countries, including in Europe, either use or are considering using a failed deposit-taker's payment channels to facilitate payout for the kinds of reasons referred to above.

However, APRA notes that there are some risks and challenges associated with using a failed ADI's payment channels to make payments. These include:

- given the ADI would be insolvent, there might be failings in its operational risk management arrangements and IT systems could limit or prevent the use of the ADI's own systems. (However, this is a matter that APRA would take into account when assessing the payment options; it would only use this option if it were confident that the failed ADI's systems could be used safely and reliably);
- using the ADI's own payment channels would require certainty that the ADI has robust systems, controls and staff in place to oversee the payout process. In some situations, it could be difficult to retain sufficient staff of requisite competence and experience to administer the payout process. Some systems-related issues could also arise. For example, it is not clear that ADI IT systems are capable of enforcing a uniform \$2,000 customer withdrawal limit, as opposed to an individual account limit, without IT pre-positioning. If this option were implemented, it is likely that considerable oversight by APRA, and parties appointed by APRA, would be required; and

- providing cash payments via ATMs could create logistical risks associated with stocking ATMs with sufficient cash to meet higher-than-normal withdrawals. The extent of this risk depends in part on the size of the failed ADI, its geographic concentration and the extent to which withdrawals can be made via other ADIs' ATMs (where, in the latter case, explicit assurance would be provided to other ADIs that any such withdrawals would be settled in full via the FCS process).

APRA seeks the views of industry on the risks and benefits of this option and what types of assurances would be required in order to implement this option.

Chapter 4 – Next steps

APRA will consider comments from submissions and will take these into account in the design of the FCS reporting requirements. It is intended that a draft reporting standard will be developed and released for consultation in the first half of 2010, and finalised in the latter half of the year.

At this stage, APRA anticipates that implementation of the final form of the matters set out in this discussion paper for FCS purposes would begin later in 2010 with a transition period of at least 12 months before the FCS reporting requirements become fully enforceable. During this period, APRA would engage with ADIs to ensure that they develop the systems required to meet the FCS reporting requirements.

Chapter 5 – Request for cost-benefit analysis information

To improve the quality of regulation, the Australian Government requires all proposals to undergo a preliminary assessment to establish whether it is likely that there will be business compliance costs associated with the proposal. In order to perform a cost-benefit analysis, APRA welcomes information from interested parties. As part of the consultation process, APRA requests respondents to provide an assessment of the impact of the proposed changes and, specifically, any marginal compliance costs ADIs are likely to face.

Given that APRA's proposed requirements will impose some compliance costs, respondents may also indicate whether there are any other regulations relating to the FCS implementation that should be improved or removed to reduce compliance costs. In doing so, please explain what they are and why they need to be improved or removed.

Respondents are requested to use the Business Cost Calculator (BCC) to estimate costs to ensure that the data supplied to APRA can be aggregated and used in an industry-wide assessment. APRA would appreciate being provided with the input to the BCC as well as the final result. The BCC can be accessed at www.finance.gov.au/obpr/bcc/index.html.

Attachment A – Treasurer’s Declaration of Covered Financial Products

COMMONWEALTH OF AUSTRALIA

Banking Act 1959

DECLARATION OF COVERED FINANCIAL PRODUCTS

I, WAYNE MAXWELL SWAN, Treasurer, pursuant to subsection 5(8) of the *Banking Act 1959* DECLARE that the financial products specified below are ***covered financial products***.

- (a) Saving accounts
- (b) Call accounts
- (c) Term deposits
- (d) Current accounts
- (e) Cheque accounts
- (f) Debit card accounts
- (g) Transactions accounts
- (h) Personal basic account
- (i) Cash management accounts
- (j) Farm management deposits
- (k) Pensioner deeming accounts
- (l) Mortgage offset accounts, either 100 per cent or partial offset, that are separate deposit accounts
- (m) Trustee accounts
- (n) Retirement Savings Accounts
- (o) First home saver accounts that are deposit accounts
- (p) Other deposit accounts that meet the following conditions:
 - (i) the terms applicable to the deposit do not permit the amount from time to time standing to the credit of the facility to be reduced otherwise than as a result of one or more of the following:
 - a withdrawal, transfer or debit on the instruction of, or by authority of, the depositor, not being on account of entry fees, exit fees or charges for the

management of the funds (but this does not exclude charges for the maintenance of the facility itself);

- a payment of charges or duties on deposits into, or withdrawals from, the facility that are payable under a law of the Commonwealth or of a State or Territory;
- a payment that a law of the Commonwealth, or of a State or Territory, requires to be made out of the facility;
- a payment that an order of a court requires to be made out of the facility;
- the exercise of a right to combine accounts;
- the correction of an error; and

(ii) any return to be generated for the depositor on the amount from time to time standing to the credit of the deposit is an amount that is set out in, or that is calculated by reference to a rate or rates that are set out in, the governing terms.

Dated: 27 October 2008

Wayne Swan

Treasurer

Attachment B – Calculation of EOD balances

Calculation of EOD deposit balances

The amount repayable to the holder of a protected account under the FCS is based on the EOD aggregate deposit balance on the day the FCS is declared. EOD deposit balances will generally include cleared and uncleared funds. Payments under the FCS would be made on the basis of deposit balances comprising cleared funds. Any uncleared funds in deposit balances on the day the FCS is declared would need to clear before being eligible for payment.

To calculate the EOD aggregate balance, a statutory manager or liquidator of a failed ADI would withdraw the ADI from the payments system as soon as a decision has been made to implement the FCS. It would be necessary to ensure the correct posting to accounts of all unsettled⁹ payments exchanged between the failed ADI and other ADIs on the day of the failure. These payments could include direct entry credits, cheques and EFTPOS transactions. The statutory manager or liquidator of the failed ADI would also need to take into account accrued interest, net of any accrued fees.

Treatment of unsettled payments

At present, the way in which an ADI is required to treat unsettled payments, in terms of posting to accounts, is governed by a range of factors including legislation, industry regulations, contractual arrangements with account holders and general insolvency law. The current arrangements also assume that there is time to arrive at a final position in relation to how various payments are treated and final EOD balances are calculated. With the introduction of the FCS, greater clarity will be required in relation to the treatment of unsettled payments exchanged between a failed ADI and other ADIs in terms of posting to accounts.

The intended process for determining EOD positions is as follows:

1. the ADI would be placed in statutory management. Then, once APRA and the statutory manager were satisfied that the ADI is insolvent, APRA would apply to the Court for the ADI to be wound up. Depending on how account-holders are to be paid out, the ADI would either be suspended from the payments system and then reinstated for a limited period to facilitate payment to account-holders (if the ADI's own systems were used for payment), or terminated from the payments system, with APRA appointing a paying agent, such as the RBA or a designated ADI, to pay out FCS deposit balances to account-holders. In either case, the standard Australian Payments Clearing Association (APCA) failure-to-settle procedures would be applied in each payment system in which the ADI was a participant;
2. APCA rules distinguish between direct participants and indirect participants. The former assume responsibility for settlement of payments obligations drawn on indirect participants as well as their own settlement obligations. In the event that an indirect participant fails, its representative direct participant remains responsible for settling the indirect participant's obligations. In these circumstances, credits posted to customer accounts at a solvent ADI, and associated debits posted to customer accounts at the failed ADI, would stand even where the indirect participant had not settled for the resultant obligations with its representative direct participant (subject to the legitimate reversal of direct credits and the possibility of direct debits being dishonoured by the failed ADI). Also, some ADIs are direct participants in one or more APCA payment systems while participating indirectly in others. Accordingly, the treatment of customer accounts may vary by payment instrument;

⁹ Settlement refers to the extinguishment of obligations arising between payments system participants (including ADIs) using Exchange Settlement Accounts at the RBA.

3. for a failure by a direct participant:
- APCA's Australian Paper Clearing System (APCS) has been determined to be "a recognised settlement system" under the *Cheques Act 1986* (Cheques Act) by the RBA. The effect of this is that all cheques drawn on a failed ADI and not settled prior to the ADI's failure are taken to be dishonoured. Accordingly, for the purpose of calculating an EOD balance, any debits posted to an account by a failed ADI in connection with unsettled cheques would need to be reversed. Similarly, credit entries made by other ADIs to an account arising from unsettled cheques drawn on the failed ADI would also need to be reversed (note that the dishonour of cheques drawn on a failed ADI could also apply in the event of failure of an indirect participant);
 - cheques drawn on an ADI (other than the failed ADI) and deposited into accounts at a failed ADI prior to the commencement of statutory management remain obligations due to the failed ADI by that ADI. When calculating the EOD aggregate deposit balance, the failed ADI would need to ensure that credits associated with these cheques were posted to accounts as they normally would be. However, these deposits would remain subject to the standard APCS rules on cleared funds (i.e. cheques drawn on an ADI, and deposited at the failed ADI, could be dishonoured by an ADI if, for example, the drawer had insufficient funds in their account). As a result, EOD aggregate deposit balances provided to APRA by a failed ADI would need to distinguish between 'cleared' and 'uncleared' funds. FCS payments to account-holders would only be made in respect of cleared funds;
 - legislation similar to the Cheques Act does not exist in respect of other payments instruments. Treatment of accounts in respect of non-cheque payments instruments may be influenced by non-APCA contractual requirements (e.g. BPAY, Cashcard, Visa, Mastercard, AMEX and Diners Club). To the extent that contractual requirements are either silent, or allow discretion to be exercised, ADIs will need to adopt uniform accounting treatments in dealing with a failed ADI;
 - against this background, APRA's understanding is that the exchange of all direct entry credit and debit files would cease from the time that an ADI is withdrawn from the payments system. Specifically, for files that had been exchanged prior to the ADI's withdrawal:
 - unsettled direct entry credit files received from a failed ADI would be returned to the failed ADI if they had not already been posted to accounts at another ADI. Unsettled direct entry credits that had been posted to accounts at other ADIs would stand. To ensure consistent treatment between accounts at a failed ADI and other ADIs, the failed ADI would need to explicitly identify which of its files had been processed by other ADIs and which had not. In implementing the FCS, a consistent treatment for all unsettled direct entry credit files may be required because of the need to quickly arrive at a final EOD aggregated deposit balance for FCS protected accounts;
 - direct entry debit files that had not been settled by a failed ADI would be treated as if they had not been exchanged or dishonoured (and any account postings would be reversed by an ADI as well as the failed ADI). ADIs may need to check their capacity to reverse provisional credits in terms of any contractual arrangements governing operation of accounts and general insolvency law; and

- all direct entry credit and debit files exchanged on the day of failure, which require settlement payment from another ADI to the failed ADI, would be processed as usual. As a result, the failed ADI would need to post incoming direct entry credit payments from other ADIs and include these transactions in its EOD aggregate deposit balance reported to APRA. The same would apply to direct debit files the failed ADI had exchanged with other ADIs.
- real-time gross settlement (RTGS) payments are settled at the time they are exchanged. As a result, RTGS payments exchanged between a failed ADI and another ADI are irrevocable and these transactions would need to be included in the EOD balance; and
- a failed ADI's ATM network and EFTPOS banking channels would be closed from the time that the ADI is withdrawn from the payments system. It is understood that unsettled ATM and EFTPOS transactions would not be revoked because of the real-time nature of these transactions. APRA would also instruct the statutory manager, or request the liquidator, to close the payments functions associated with a failed ADI's internet and telephone banking facilities.

Accrued interest and fees

Subsection 16AF(1) of the Banking Act states that an account-holder who has a 'protected account' with a 'net credit balance' with a declared ADI when the FCS is invoked is entitled to payment of:

- (a) that balance; and
- (b) the interest (if any) accrued, but not credited to the account-holder in connection with the protected account before the declaration time

increased or decreased in accordance with the regulations to take account of clearance, within the period prescribed by the regulations (five business days), of transactions connected with the protected account and entered into before the declaration time.

Net credit balance is defined in the Banking Act as:

- (a) the net credit balance, at a time, of an account means the excess of the balance of the account in credit in favour of the account-holder at that time over the amount (if any) of fees, charges and duties that are identified under the agreement under which the account is kept and are payable by the account-holder to the ADI at that time; and
- (b) the net credit balance, at a time, of a covered financial product that is not an account means the amount owed to the account-holder at that time under the terms of the agreement under which the covered financial product is kept.

APRA's view is that accrued interest would be paid at the relevant interest rate applicable to the deposit account in question, rather than a 'break rate' that might apply if an account-holder withdraws funds before a certain time or subject to other restrictions. This would require ADIs to maintain systems which accrue interest on an account basis at the contractual rate applicable to each account. APRA seeks the views of industry on this and any associated IT matters.



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