Submission
Paper

APRA LICENSING DISCUSSION PAPER

A phased approach to authorising new entrants to the banking industry in Australia

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FEROCIA

Introduction

We are pleased to submit this response to APRA's discussion paper on the proposal to introduce a new phased approach to authorising new entrants to the banking industry.

We have provided brief responses to each of the questions raised by the paper.

We look forward to assisting in whatever way we can to continue the open dialogue with industry regulators and participants on the introduction of a restricted licence process for applicants seeking to become authorised deposit-taking institutions in Australia.

About Ferocia

Ferocia is a close-knit team of talented developers and designers making delightful software. We're driven by distilling complex problems into simple, elegant solutions that customers love.

We've been delivering software solutions within the Australian banking industry for more than six years, and we currently design, develop and operate the mobile and online banking platform for the fifth largest retail bank in Australia.

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Should APRA establish a phased approach to licensing applicants in the banking industry?

Yes — We support APRA in establishing a phased approach to licensing ADIs.

- We support APRA in the implementation of policy that lowers the barriers to entry for new banks in Australia and promotes competition within the Australian banking sector.
- We support APRA's proposal to introduce a phased approach for new entrants to demonstrate they have the systems, processes, products, procedures and wherewithal to be a responsible Australian financial institution (especially given the positive impact of regulatory change in supporting similar outcomes in overseas jurisdictions, such as the UK).

Do the proposals strike an appropriate balance between financial safety and considerations such as those relating to efficiency, competition, contestability and competitive neutrality?

Yes — From our perspective, the proposal appears to deliver an appropriate balance of APRA's stated considerations.

Are the proposed eligibility criteria appropriate for new entrants to the banking industry under a Restricted ADI licence?

Yes — The proposed eligibility criteria is appropriate, in our view.

- We agree that the restricted ADI process should be designed in such a way to support the increased use of technology to deliver banking services, providing there are no fixed rules enforced (to support flexibility for each organisation to develop technical competence and compliance their own way).
- We agree with the approach being tailored to provide new entrants with a suitable environment and timeframe to be able to adequately test and develop their products, systems and processes to demonstrate they can meet the regulatory requirements. We do not think this should be limited to their banking products and services, but should also importantly apply to their use of and adoption of technology to meet the requirements.
- It is not entirely clear from the paper what restrictions would be proposed for new entrants in terms of products and services. In our view, it does makes sense for organisations considering this route to market to focus on a restricted product and/or service offering during the early stages of their business development (to reduce complexity and develop appropriate processes and systems to meet the regulatory requirements). We would support the regulators not stipulating any particular product/service restrictions, but rather assessing applicants on merit and considering how those organisations have embedded this type of diligence into their business plan and/or ADI application.
- The capital requirements proposed (including reserves and wind-up costs) seem appropriate.

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- We do not think that the suggested capital adequacy requirements proposed are too high at 20%. The phased ADI process has a limited timeframe for each new entrant and, in our view, any new applicant should be prepared to meet the proposed capital adequacy requirements during this phase. It makes sense for the capital adequacy requirements to be higher than for established ADIs. An example cited during recent conversations included an established lender with $100m in current loans seeking a license to become an authorised deposit-taking institution. In our view, an organisation already operating at this scale should be able to raise funds or provide balance sheet assets to meet the proposed capital adequacy requirements. If they cannot, then perhaps they are not an appropriate candidate for the newly proposed phased approach to authorising new entrants. They may prefer to apply under the existing rules (which support a lower capital adequacy requirement).
- We support the approach to leverage the existing Financial Claims Scheme for record-keeping, and believe it makes sense to do so without creating specific constraints (i.e. supporting APRA's objectives of encouraging innovation and technology-based adherence with the rules).
- We believe the proposed limits for maximum single deposits ($250k) and aggregate deposits ($2m) are appropriate. When a new entrant is in a position to exceed these limits then perhaps they would also be ready to consider exiting the phased ADI program.

Is two years an appropriate time for an ADI to be allowed to operate in a restricted fashion without fully meeting the prudential framework? Is two years a sufficient period of time for a Restricted ADI to demonstrate it fully meets the prudential framework?

Yes — The proposed two year maximum timeframe for a restricted license to operate is appropriate, in our view.

- The proposed two year timeframe is more than is currently available in other jurisdictions (such as one year in the UK)
- We believe two years is sufficient time for a start-up business to develop and meet the initial and ongoing requirements APRA has proposed in the discussion paper.
- One further consideration in the Australian market is the ability of new applicants to raise sufficient capital. Traditionally it has been difficult to raise millions of dollars in capital for start-ups in Australia. So, start-ups may want to seek funds internationally (which may take longer) and/or raise sufficient funds prior to starting the proposed two year restricted license period. It may also be possible to cater for a capital review period (or similar) within the proposed phased ADI structure. Ultimately capital is a responsibility for the applying entity, but whatever considerations APRA settles on it may also be beneficial to consider them in the context of the capital markets in Australia (compared to other jurisdictions) in order to ensure that the Australian market not only remains robust, but also supports and fosters innovation (and, in our view, access to sufficient capital will play an important role in achieving that outcome).

Are the proposed minimum requirements appropriate for potential new entrants to the banking industry? Are there alternative requirements APRA should consider?

Yes — Based on our understanding and experience, the proposed minimum requirements appear to be appropriate for new entrants.

Yes — There are potentially some additional requirements APRA may wish to consider, such as:

Use of technology

- One of the stated objectives was to engender support for the increased use of technology amongst new applicants. To help achieve this outcome, APRA may want to consider some minimum technology requirements, or perhaps some “use of technology guidelines” would add value to the proposed process and assist new applicants in better understanding how they can meet this objective.
- We would not support fixed rules or constraints with regards to the use of technology. However, if one objective is to encourage, support, and/or increase the use of technology in delivering banking services then specifically calling that out (and not assuming technology is embedded in each requirement) or perhaps providing some associated examples/guidelines may be a useful tool for APRA in assessing potential applicants and their propensity to move the industry forward (and not simply provide a traditional alternative to the existing saturated market).

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Use of cloud services

- APRA may want to consider specifically calling out cloud services as an example (in the policies and procedures section), which could encourage applicants to ensure they have appropriate, robust and secure plans for hosting their technology services (either in-house where a formidable technology competence would be required, versus outsourcing to one of the major cloud service providers in Australia — where the technical competence can reside elsewhere, but the architecture, security controls and risk management are still required in-house).

Business plan considerations

- The business plan section appears to cover many of the key elements to assist in satisfying APRA that the applicant is serious, capable and a suitable candidate for a restricted ADI.
- Perhaps other areas of interest for APRA to consider including in this section would be the applicants plans for customer acquisition (on-boarding/switching) and the applicants plans for customer support. These specific areas may also present an opportunity for APRA and/or restricted ADI applicants to demonstrate support in encouraging and/or increasing the use of technology within the Australian banking industry.

Are the proposals appropriate in the context of the last resort protection afforded to depositors under the Financial Claims Scheme?

Yes — The last resort protection proposal to leverage the FCS is appropriate, in our view.

Are the proposed licence restrictions appropriate for an ADI on a Restricted ADI licence? Are there alternative or other restrictions APRA should consider?

Yes — Broadly speaking, based on our understanding and experience, the proposed restrictions appear appropriate for new entrants.

- Some further clarification may be required with regards to balancing APRA's intention for new ADI's to not actively conduct business with the general public during the restricted licensing phase, and involvement of early adopters through consent in order to adequately test processes, systems, security, products and services, etc.
- In our view, the proposed aggregate deposit cap sufficiently manages the scale (broad public usage) during the earlier stages of financial product/service testing during the restricted license phase.
- By way of illustration and experience, in the past we have adopted a "staff only" program (internal alpha testing, with appropriate consent), followed by a "family and friends" stage (private alpha testing, with appropriate consent), prior to engaging "public expressions of interest" in a public beta launch scenario (also requiring appropriate consent until generally available to the public).
- This approach is consistent with best practices adopted within the software industry in general (particularly in overseas markets) and would be expected to broadly align with the timeframe APRA have proposed for the restricted license process to operate.
- Note: In our experience, we would generally not associate broad-based public marketing designed to solicit interest (for example) as "public usage" or "conducting business with the general public". Perhaps most relevant to these new entrants looking to develop early awareness, APRA may also wish to review how new applicants propose to operate public marketing and engagement as part of their business and/or launch plans. For example, these types of activities might usually be executed in parallel to financial product/service testing during the restricted license phase (with appropriate consideration for financial services regulation relating to the promotion of present and future financial products).

Are there other refinements to the licensing process APRA should consider?

Possibly — There are various complimentary industry initiatives and/or services/guidelines that APRA may wish to consider in terms of those initiatives coinciding and co-existing with the introduction of the proposed restricted licensing process, such as:

Cloud hosted services

- Supporting innovation — APRA's public stance on cloud services will be very important to help foster innovation in the industry and provide an environment conducive to launching new digital banks in Australia (in addition to the importance cloud has for incumbents). Since 2015 we've seen major global cloud service providers launch in the Australian marketplace and containerisation become the technical standard (supporting software controlled infrastructure as a service).
- Organisational capability — Whether or not a regulated entity uses cloud services should be a decision for them to make, so long as the use of cloud services does not compromise security, data, compliance, privacy and other relevant regulatory obligations and guidelines. Supporting the use of the major cloud service providers could reduce the reliance APRA would have on the capability, capacity and competence of new ADI registrants (and existing ADI's for that matter) — potentially reducing the risk of failure (or at least improving the odds of success) for new entrants.
- Industry engagement — The major cloud service providers in Australia seem to have an appetite for offering compliant solutions and toolsets to the regulated financial services industry. APRA may want to consider engaging with the major providers in Australia to develop industry standards and/or maintain oversight of regulated entities using such cloud services (rather than overseeing each individual ADI themselves in regards to scores or even hundreds of on-premises, shared and cloud-based infrastructure teams, services, toolsets, etc).

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- Specialist expertise — APRA may also wish to consider whether hosted infrastructure offered by dedicated and specialist cloud service providers is more secure and more up-to-date than individual on-premise solutions (in our experience, this is often the case — certainly amongst the market leaders such as Amazon, Google, IBM and Microsoft for example).
- Timing — It's unlikely any new entrant would not be using cloud services, so updated shared services guidelines within the same timeframe as the introduction of the new restricted ADI's may also be advantageous for APRA in delivering on the objective of supporting increased use of technology amongst new ADI applicants.

Ease of switching

- The ABA's better banking initiative has considered account switching as part of their mandate in 2017, and in 2018 the NPP will launch with plans to introduce improved portability for customers. The question remains...will that be soon enough?
- The UK introduced industry wide switching services for transaction accounts back in 2013, the availability of which has helped support the rapidly growing new digital banking entrants in the UK.
- Ultimately, switching banks in Australia should be as easy (or easier) than switching any digital service (including at least incoming, outgoing and recurring payments, balance transfer, and closing accounts). Value added services and other products could be supported in later stages — but at least being able to move transactional accounts automatically should be an important consideration for all ARPA regulated ADIs (not just new entrants).
- With over 55m reported customers of ADIs in Australia, every new ADI will need to be able to switch customers from the incumbents in order to have a positive and enduring impact on the industry.

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- With around 80% market share amongst the four pillar banks, the industry risk is low but the potential upside in terms of competition and adoption of new technologies is enormous. There's no disadvantage for existing ADIs, they would benefit from automated switching as well, they would simply need to deliver comparable products and services — customers would make the choice.
- As such, APRA may wish to consider including the requirement for new ADI applicants to include in their business plans and/or submissions how they intend to achieve simplified and/or automated switching — because without it they will be limited to non-bank customers only (of which there are limited numbers in Australia). Potential innovation amongst new applicants may also assist in driving industry adoption of new technology to support this broader industry initiative.

Open access to data

- In support of the proposed addition of the restricted ADI license pathway, and given the recent inquiry into open banking in Australia and plans for the introduction of open banking in the UK in 2018, it would make sense for open banking to be supported by all ARPA regulated ADIs in Australia (not just new entrants).
- APRA may therefore wish to consider, for any new ADIs issued in Australia during 2018 and beyond (restricted or otherwise), the requirement for participation/contribution (or similar) to the open data access guidelines and/or policy (as they are being agreed and implemented).
- Something along these lines would at a minimum educate new applicants on upcoming requirements/expectations for regulated financial institutions in Australia to support open data access standards, and would also assist APRA in delivering on the objective of supporting increased use of technology amongst new ADI applicants.

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