



## Financial Sector Legislation Amendment (Restructures) Bill 2007

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## Financial Sector Legislation Amendment (Restructures) Bill 2007

**Date introduced:** 24 May 2007

**House:** House of Representatives

**Portfolio:** Treasury

**Commencement:** The Act commences on Royal Assent. Schedules 1 and 3 (excluding consequential amendments to the *Income Tax Assessment Act 1997* in Schedule 3) commence on Royal Assent. Schedule 2 and items 10-23 of Schedule 3 commence on 1 July 2007.

### Purpose

The purpose of the Bill is to remove regulatory impediments to financial conglomerates changing to a non-operating holding company (NOHC) structure.

### Background

#### Company group structures

Financial conglomerates are a dominant feature of Australia's financial system.<sup>1</sup> Like other corporate groups, financial conglomerates operate through certain company group structures. Corporate group structures give rise to various regulatory issues such as inter-group liability, or the extent to which other companies in the group should be liable for the debts of other companies in the group. The recent controversy surrounding the James Hardie Group was an example where issues of this kind were relevant.

For present purposes, corporate groups can be described as consisting of parent or holding companies and their subsidiaries.<sup>2</sup> Individual companies in a corporate group are generally not liable for the debts of other companies in the group but there are exceptions to this rule. Holding companies can be liable for the debts of their subsidiaries in the circumstances outlined in Part 5.7B of the *Corporations Act 2001*.

Prior to the Wallis review into Australia's finance system, corporate groups containing banks were required by the Reserve Bank of Australia to operate with the bank as the holding company. Many submissions to the Wallis review argued that financial conglomerates should be allowed to establish non-operating holding companies, with banks allowed to be subsidiaries of the holding company. An example is the submission of the Westpac Banking Corporation, which included:

Banks should be permitted to establish non-operating holding companies, and to become subsidiaries of the parent holding company.<sup>3</sup>

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One effect of this would be to increase the degree of separation between banks and other operating companies in a group, and thereby lessen the risk that the bank would be held liable for debts of a subsidiary. Another effect might be, as noted in the Explanatory Memorandum, to relieve other entities in the group of any formal obligation to support a 'distressed affiliate'.<sup>4</sup>

The Westpac submission to the Wallis review, and others, drew upon previous work of the Council of Financial Supervisors.<sup>5</sup> The Council expressed the view that:

Prudential concerns about contagion, conflicts of interest and transparency might be alleviated to some extent under a financial holding company, as opposed to parent/subsidiary, structure. This could arise from the perception of greater 'separateness' of the different activities undertaken by the conglomerate.<sup>6</sup>

These arguments apparently persuaded the Wallis Review. Its recommendations included:

Recommendation 49: Non-operating holding companies should be permitted subject to certain requirements.

Subject to a financial conglomerate meeting prudential requirements, the APRC should permit adoption of a non-operating holding company structure. The structure must satisfy the APRC in the areas of capital, management, adequacy of firewalls, reporting of intra-group activities and independent board representation on subsidiary entities.<sup>7</sup>

As part of its response to the Wallis Review, the Government agreed to facilitate the use of non-operating holding companies in financial conglomerate structures. As noted in the Explanatory Memorandum to the Bill, however, no major Australian financial group containing an ADI (authorised deposit taking institution) has chosen to adopt a NOHC structure.<sup>8</sup>

The rationale for the Bill appears to be the perception that the failure of groups to take up the adoption of the NOHC structure is due to regulatory impediments, including requirements of the Corporations Act, and tax consequences. This Bill attempts to alleviate those impediments.

## Financial implications

The Explanatory Memorandum states that the financial impact will be 'minimal'.<sup>9</sup> However, it also notes that the amendments made by Schedule 2 to the capital gains tax provisions in the *Income Tax Assessment Act* are designed to remove tax impediments that prevent financial groups containing ADIs from restructuring. There is no specific information provided on what the effect might be on tax revenues if the relevant major Australian financial groups adopt NOHC structures as a result of such amendments.<sup>10</sup>

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## Main Provisions

### Schedule 1 – Restructure relief: corporations law aspects

Amendments to the *Financial Sector (Transfers of Business) Act 1999*

**Item 14** inserts **new Part 4A–Restructures** into the *Financial Sector (Transfers of Business) Act 1999* (FSTBA). The Part deals with proposals by an ADI, general insurer or life insurer (called ‘the operating body’) for a restructure arrangement under Part 5.1 of the *Corporations Act 2001*, that would make the operating body a subsidiary of a non-operating holding company.<sup>11</sup>

**Proposed section 36B** provides for the operating body to apply to the Minister for a ‘restructure approval’. These approvals include a ‘restructure instrument’. The instrument gives relief to the operating body, the NOHC and related bodies corporate, from requirements of the Corporations Act as specified in the instrument.

**Proposed section 36C** requires the Minister to issue a restructure approval if satisfied of certain things including:

- the restructure arrangement would improve the operating body’s ability to meet its prudential requirements
- the approval would be in the interests of the depositors or policy owners of the operating body and of the financial sector as a whole

**Proposed section 36D** gives the Minister a discretion to consult, in making a decision on a restructure approval, with the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC), or any other person or body of the Ministers choosing.

**Proposed section 36E** allows the Minister to impose various conditions in a restructure approval.

**Proposed section 36G** provides for ‘restructure instruments’. The Minister may specify in the instrument that certain bodies and persons are given relief from compliance with the requirements of Division 1 of Part 2J.1 or Part 2J.2, as well as section 254T of the Corporations Act (these relate to restrictions in share capital; self-acquisition and control of shares; and the requirement that dividends may only be paid from profits). Restructure instruments are not ‘legislative instruments’ and so will not be subject to the disallowance and other provisions of the *Legislative Instruments Act 2003*.

**Proposed section 36K** allows the Minister to amend restructure instruments.

**Proposed section 36M** provides for ‘internal transfer certificates’. Where the Minister has issued a restructure approval, APRA may issue an internal transfer certificate if satisfied that the terms of the transfer is appropriate for giving effect to the restructure arrangement

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referred to in the approval. The certificate must clearly outline the transferring and receiving bodies and identify which assets and liabilities are being transferred.

**Proposed section 36P** allows APRA to amend internal transfer certificates, but only where the relevant restructure instrument has not yet come into force.

**Proposed section 36R** provides that the legal effect of an internal transfer certificate is that the nominated assets are transferred without the need for any transfer, conveyance or assignment.

## Schedule 2—Restructure relief: taxation aspects

Amendments to the *Income Tax Assessment Act 1997*

The Explanatory Memorandum summarises the effect of the amendments this way:

The amendments remove tax impediments that prevent financial groups containing ADIs from restructuring for prudential reasons by:

- disregarding certain preference shares issued by an ADI or an extended licensed entity member, for the purposes of determining whether the ADI or extended licensed entity member is a wholly-owned subsidiary of a consolidated group headed by a non-operating holding company;
- ensuring that certain dividends paid by the non-operating holding company are frankable if those dividends would have been frankable had they been paid by the ADI prior to the ADI restructure; and
- ensuring that shareholders in the original company (either an ADI or an extended licensed entity member) who exchange their shares for shares in the non-operating holding company can obtain a CGT roll-over if certain preference shares remain issued by the ADI and some foreign holders of shares do not receive shares in the non-operating holding company.<sup>12</sup>

## Concluding comments

The Government took the decision, some time ago, to allow financial conglomerates to operate through a NOHC structure. This Bill addresses the fact that few conglomerates have adopted that structure, by removing some of the regulatory impediments consequent upon choosing that course.

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## Endnotes

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1. Commonwealth of Australia, Financial System Inquiry, Final Report, (Wallis Review), March 1997, p. 344.
2. For some purposes the definition is broader.
3. Westpac submission to Wallis Review, Executive Summary, p. 10.
4. Explanatory Memorandum, Financial Sector Legislation Amendment (Restructures) Bill 2007, p. 2
5. The Council of Financial Supervisors was established by the Commonwealth Government in 1992, following a recommendation of the inquiry into banking and deregulation by the House of Representatives Standing Committee on Finance and Public Administration – better known as the Martin Committee after its then-chairman. Its basic rationale was – and remains – to improve communication and co-ordination among the main agencies responsible for regulation and prudential supervision in the financial system. These are, in no particular order, the Reserve Bank, the Insurance and Superannuation Commission, the Australian Financial Institutions Commission and the Australian Securities Commission.  
[http://www.rba.gov.au/PublicationsAndResearch/Bulletin/bu\\_oct95/bu\\_1095\\_4.pdf](http://www.rba.gov.au/PublicationsAndResearch/Bulletin/bu_oct95/bu_1095_4.pdf)  
accessed 1 June 2007.
6. Council of Financial Supervisors, Annual Report 1995, p. 30.
7. Commonwealth of Australia, Financial System Inquiry, Final Report, (Wallis Review), March 1997, p. 49.
8. Explanatory Memorandum, p. 3.
9. *ibid.* p. 4.
10. *ibid.*, p. 3.
11. New section 36A.
12. Explanatory Memorandum, p. 17.

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