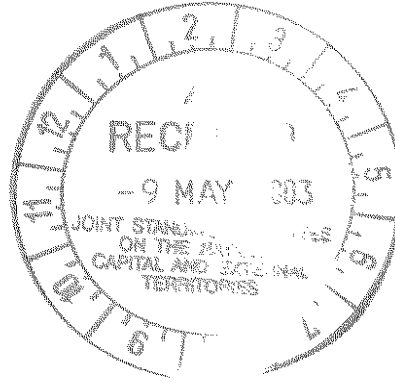


SUBMISSION 53



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9 May 2003

Mr Quinton Clements
Inquiry Secretary
Joint Standing Committee on the National Capital and External Territories
Parliament House
Canberra ACT 2600



Dear Mr Clements

Establishing credit union facilities in the Indian Ocean Territories

Please find below APRA's response to the questions raised in regard to the establishment of a credit union in the Cocos (Keeling) islands (CKI).

Addressing the questions raised in your facsimile of 29 April 2003:

1. What are the requirements for setting up a credit union in the Indian Ocean Territories (IOTS)?

The establishment of a "credit union", or more correctly, an authorised deposit-taking institution (ADI), is subject to the requirements of the *Banking Act 1959*. By virtue of section 6(2) of the Banking Act, that Act applies to Australian territories unless the Treasurer makes a determination that it should not. APRA is not aware that any such determination has been made in regard to the Indian Ocean territories, or the Cocos (Keeling) islands specifically.

Detailed guidelines for the establishment of an ADI are available on the APRA website (www.apra.gov.au). This should be viewed in conjunction with the Prudential Standards that apply to ADIs, which are also available on our website. In particular, issues to be considered include:

- **Authorisation criteria for ADIs**

APRA will only authorise applicants with the capacity and the commitment to conduct banking business (a generic term covering taking of deposits and making advances) with integrity, prudence and competence on an ongoing basis.

It is expected that applicants be familiar with and comply with the prudential standards from the commencement of their banking operations.

- **Capital**

While no set amount of capital is required for an authority to carry on a banking business, APRA considers, for each application, on a case by case basis the scale the nature and

complexity of the operations as proposed in the applicant's business plan. It should be noted however, that APRA would require a start up credit union to hold significantly higher levels of capital until they have established themselves and shown the capacity to effectively and efficiently manage the risks associated with their banking business.

However, all locally-incorporated ADIs are required to maintain a minimum capital ratio of 8 per cent of risk weighted assets, calculated by dividing the ADI's eligible capital base by its total risk weighted assets.

Mutually owned ADIs are permitted to have start up capital made up entirely or mostly of Tier 2 capital. The lead time for these institutions to build up Tier 1 capital will be agreed with APRA on a case by case basis. Definitions of Tier 1 and Tier 2 capital can be found in the Prudential Standards.

- ***Management***

All locally- incorporated ADIs must have a board consisting of at least 5 directors, a majority of whom must be non-executive.

Directors and senior management of the proposed ADI must satisfy APRA that they are fit and proper to hold the relevant position. APRA will have regard to the experience and expertise of the person relative to the duties involved, demonstrated competence in banking business in the past and integrity in business activities.

- ***Risk management and internal control systems***

Applicants must satisfy APRA that their proposed risk management and internal control systems are adequate and appropriate for monitoring and limiting risk exposures in relation to operations from the commencement of the ADIs banking operations. This will include the maintenance of policies and procedures for monitoring and managing credit risk, liquidity risk operational risk and market risk.

- ***Information and accounting systems***

Applicants must satisfy APRA that the proposed banking, information and accounting systems are adequate for maintaining up to date records of all transactions and commitments undertaken by an ADI. The systems must be capable of producing all required statutory and prudential information in an accurate and timely manner from the commencement of their banking operations.

- ***Audit arrangements***

Both internal and external audit arrangements must in place from the outset. Requirements are set out in the prudential standards but include matters such as observation of APRA's prudential standards and reliability of information supplied to APRA.

The above comments are only an indication of the broad requirements, and prospective applicants should refer to APRA website for details of the legislation, the Prudential Standards and other matters relating to seeking approval and to operating a credit union.

2. What are the obstacles if any, to setting up a credit union in the IOTS?

Other than having to comply from the outset with the requirements noted above, which is not a complete list of requirements, establishing an ADI from start up requires considerable initial capital outlays.

Establishing physical facilities, having adequate computer systems, service providers and staff will involve considerable cost. Attracting experienced staff to CKI may add to this cost.

Most credit unions use bureau services for the provision of IT and communication infrastructures; indeed it is becoming common for ADIs to outsource other business activities including documentation and other administrative matters. It is considered by these ADIs that it is more cost effective to outsource than to provide these functions in-house. Applicants must satisfy APRA that any proposed outsourcing arrangements do not result in unacceptable risks and comply with APRA prudential standards.

Referring to the Hansard of the Committee meeting held 13 March 2003 at NCET 138, evidence provided to the committee states a "very serious deficit in the business sector is that we cannot lease heavy equipment....we cannot get cash flow loans, bridging loans or any of the other business facilities...".

Credit unions traditional products are personal loans, residential mortgage lending and some very limited business lending (usually supported by a residential mortgage). The types of financial facilities that appear to be required of the proposed ADI are not the types of facilities usually offered by a credit union. Indeed the skill sets required of ADI lending staff to assess cash flow lending and other business type facilities are not those usually found in credit unions. It is APRA's opinion that a small credit union would probably not meet the business requirements envisaged.

Another matter to consider would be the sustainability of the credit union. Given the size of the population and the apparent level of unemployment, it is doubtful that sufficient mass could be achieved to make establishing a credit union a viable option without a degree of subsidization.

Encouraging an existing credit union (or other ADI) to establish a branch in the CKI may also be a difficult task. APRA has been advised that the Credit Union Foundation, an affiliate of CUSCAL, have also looked at the feasibility of establishing a credit union. At least three feasibility studies of varying intensity have been conducted since 1998.

Findings from these studies have included:

- The requirement for a subordinated debt grant of at least \$175,000, un-serviced for 10 years.
- Projected membership of only 320 with total assets of \$1.1 million
- Problems with land ownership that could preclude mortgage-secured lending
- Population of only 620 people.

3. What assistance might the Commonwealth be able to offer to offset any obstacles to setting up a credit union facility on CKI?

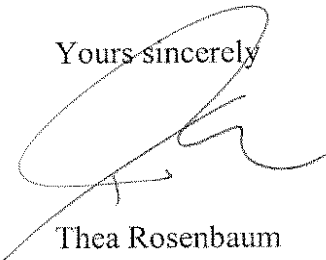
As indicated above, there is no legal impediment to establishing an ADI on the CKI, the obstacles in doing so are however substantial and the viability and sustainability of such an entity is questionable. The matter of what the Commonwealth can do to offset those obstacles is not a matter APRA can comment on.

4. What alternatives, if any, exist for providing credit union type facilities on CKI?

Again while this is a matter for the Commonwealth, an alternative may be that the Commonwealth Bank agency that currently operates on a limited basis on the CKI, may consider extending their hours of operation and facilities provided (although we are not aware of what financial facilities are currently offered). This may provide the facilities required while avoiding the costs of establishing a new ADI in the area.

If we can provide any further assistance in this matter please do not hesitate to contact either Paul Thompson (02) 9210 3327 or Ray McIntosh on (02) 9210 3035.

Yours sincerely



Thea Rosenbaum
Company Secretary