Submission to the Wallis Inquiry

from Rand Merchant Bank Limited (South Africa)

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A Executive summary of recommendations

This submission concentrates on policy relating to the ownership structure of foreign banks that wish to be licensed as a bank in Australia.

Its recommendations are as follows:

1. Amend provisions of Banks (Shareholdings) Act as it relates to diversity of ownership.

2. Extend the policy of allowing a holding company to own a bank and/or insurance company.

3. Create a fairer level playing field by licensing those who conduct bank business.

4. Extend the concept of the current wholesale orientated "branch banking licence" by creating a new "wholesale banking licence" that allows appropriate Australian incorporated institutions to conduct such banking business under RBA supervision.

B Recommendations

1 Amend provisions of Banks (Shareholdings) Act as it relates to diversity of ownership

The current provisions of the Banks (Shareholdings) Act 1972 imply that a diversified shareholding in a bank is preferred.

Under the Act approval is required to hold 10% or more of the shares and there is a prohibition on holding 15 percent or more without the approval of the Governor-General, which approval is only given if satisfied that it is in the national interest to do so.

Dispersal of shareholdings in a bank that is not wholly owned by an overseas bank is seen as minimising the risk of it being operated in a manner that could compromise the bank's prudential standards, through serving the interests of one or a few large shareholdings.

Also, it is argued by the Reserve Bank (RBA) that a diversified shareholding would allow capital to be raised more quickly and easily in times of need.

We question whether this preferred shareholding diversification stance stands this test (that is a widely diverse shareholding - public company status or a direct spread of shareholders each with less than 10% of the capital - will ensure capital can be raised from shareholders in times of stress).

For example, when Westpac wanted to raise capital in 1992, 90% of the rights issue was not taken up by existing shareholders, but left with the underwriters. Clearly, the diverse shareholding did not assist Westpac on that occasion to raise capital.

Another disadvantage of this philosophy (divergence of shareholding) is that when urgent action is required to raise capital, the process is likely to be protracted and any shares issued are likely to be at a significant discount of the current share price.

This increases the servicing cost to the bank for the long term, as the same dividends are likely to be paid on the existing and (lower priced) new rights issue shares once they are fully paid.

On the other hand, a concentration of shareholding (eg with another bank owning 20% or 25% of the shares) has a number of benefits. In our opinion, this includes easier access to capital from a "reputable source", since the dominant shareholder bank will wish to preserve its reputation and is unlikely to walk away from its investment.

Any such concerns about one shareholder or group having undue influence on the bank could be overcome through restricting the proportion of votes or directors the shareholder has on the bank board. Director restrictions are already provided for in the RBA's prudential statement (B1 - Ownership and Control of Banks) while voting restrictions have also been put in place in certain situations for banks operating in Australia.

In addition, the banking licence could provide restrictions on the extent of any exposure that a bank may have to any potentially dominant shareholder. In practice the RBA already imposes limits on the exposure a subsidiary bank may have to its parent.

2 Extend the policy of allowing a holding company to own a bank and/or insurance company

At present, Australian policy in relation to insurance companies owning banks is as expressed in May 1990, following the government's rejection of the proposed ANZ/National Mutual integration.

That is, insurance companies would be allowed to own banks providing the insurance company:

- agrees to convert from a mutual status to one where it is owned by shareholders (thus the investment in the bank is from shareholders' funds, not statutory funds)
- is of sufficient financial strength
- accepts and agrees to supervision from the RBA of its activities in relation to prudential matters relating to its bank subsidiary

We consider this represents a reasonable policy, although it is not, in our opinion, widely known in the financial services community.

This policy does, in effect, allow a bank to be owned by a holding company that is engaged in the financial services community.

The present RBA reluctance to authorise banks that are owned by non bank holding companies is inhibiting Australia's competition policy, particularly since other countries allow banks to operate where those banks are owned by holding companies.

We consider it appropriate that this policy be widened to allow a pure holding company to control, through share ownership, a basic range of financial institutions eg a bank, insurance company, fund manager etc.

We consider it is appropriate that the holding company be subject to prudential oversight.

The directors of a broadly based financial services group (that is including banking, insurance and funds management) owned through a holding company structure would be particularly careful to ensure each part of the group was operating within prudential guidelines. The directors would not wish any breach to occur in one section of the business, for fear it could cross contaminate other parts of the group, to the detriment of the whole. Thus they would take steps to ensure adequate capital was available as needed.

In practice we believe the concerns of the regulators could be overcome through a number of simply administered requirements, in particular

- setting for such a bank within this group a higher capital adequacy limit than the 8% minimum currently required (we understand the Bank of England adopts this approach)

- requiring certain directors of the holding company to sit on the bank's board of directors, to maximise the benefits of understanding and coordination of the bank's business

- introduction of regulations requiring the bank and its holding company to supply to the RBA such consolidated group information as the RBA requires to understand the overall risk profile of the group's business (such power being already available to European banking supervisors under the EEC Second Consolidated Supervision Directive, 1992)

These requirements could be incorporated into the conditions in the banking or ISC approval licence and we recommend they be introduced as elements of Australia's bank supervisory policy.

3 Create a fairer level playing field by defining banking business and licensing those who conduct it

At present, there is not a level playing field in Australia for the conduct of aspects of banking business.

Foreign banks can establish a merchant bank subsidiary (whether guaranteed or not) that, without a banking licence, can carry out all aspects of banking (including raising retail type deposits, if a prospectus is issued).

As policy is presently administered such entities are not subject to any prudential supervision by the RBA (apart from foreign exchange limits).

Licensed banks (whether incorporated locally or as branches), building societies and credit unions, are subject to the costs and requirements of prudential supervision, including matters such as reserve asset requirements (PAR, NCD) large exposure limits. Licensed banks, (and to a much lesser extent building societies and credit unions) carry on business similar to many merchant banks.

Although it has been argued that the requirements of (retail) depositor protection justify prudential supervision/costs, this argument is weakened since, under the current regime, licensed branches of foreign banks are subject to such supervision/costs but depositors are not covered by the depositor protection provisions of the Banking Act.

In essence we recommend that all entities carrying out banking business (which should be properly defined by the government/Reserve Bank) should require bank licenses and be subject to formal supervision. This step would, in our opinion, create a more level playing field in a competitive sense and improve the scope of supervision in Australia.

4 Extend the concept of the current wholesale orientated "branch banking licence" by creating a new "wholesale banking licence" that allows appropriate Australian incorporated institutions to conduct such banking business under RBA supervision.

The RBA is very conscious of its depositor protection responsibilities under the Banking Act, and its prudential supervisory stance is geared partly with this in mind.

However, many financial institutions choose to operate in the wholesale market, and have no wish to expand into the retail end.

Current policy allows foreign banks to establish licensed branches in Australia that are restricted to "wholesale" business, as defined, and who depositors are not subject to the depositor protection benefits of the Banking Act.

We consider it is a logical step to extend the concept of the current wholesale orientated branch banking licence by creating a new "wholesale banking licence" that allows appropriate locally incorporated institutions to conduct such business.

This extension of policy would enhance competition in the Australian market and allow institutions conducting such banking business to be regulated.

At present the RBA does not allow Australian banks to generally guarantee their subsidiary operating either in Australia or overseas. Depositor protection considerations are amongst as the reasoning cited.

One of the additional benefits of adopting a "wholesale banking licence" concept, where depositors are not subject to depositor protection provisions of the Banking Act, would be to allow the RBA to adopt a policy of allowing "wholesale banks" to issue guarantees to subsidiaries onshore and offshore to allow them to compete more effectively in the wholesale market.

Obviously appropriate criteria have to be developed for issuing such wholesale licences.

For foreign entities that wish to establish in Australia as wholesale banks, we consider the criteria for the entity to be eligible for a wholesale banking licence should be:

- the parent is established in its home country as a banking and financial services group,

- it is regulated by a recognised supervisor,

- there is a minimum level of shareholders funds in Australia and appropriate RBA supervisory requirements.

The object of this recommendations is not to lower standards of entry but to recognise the reality that entities are currently conducting banking business in Australia in an unsupervised manner. We consider this solution will provide Australia with more competition and a more fully regulated environment.

In addition, the concept of a wholesale bank being able to issue guarantees to its subsidiaries offshore will also enhance Australia's position in the globlisation of financial markets.

C Opportunities for Australia through the licensing in Australia of South African Banks

Rand Merchant Bank Limited of South Africa (RMBSA) is a bank licensed by the South African Reserve Bank and thus regulated by the South African Registrar of Banks.

The assets of RMBSA and its subsidiaries at 30 June 1996 exceeded A$2 billion.

RMBSA is itself wholly owned by Momentum Life Assurers Limited (Momentum), the sixth largest insurance company in South Africa.

In turn, Momentum is majority owned by RMB Holdings Limited, a financial services conglomerate, quoted on the Johannesburg stockmarket with a capitalisation of A$1.5 billion.

The most significant shareholding in RMB Holdings is one of 20% held by a retail bank, NBS Bank.

RMBSA has operated in Australia for a number of years through 100% ownership of the Australian Gilt Securities Group (AGS). This group has included one of the largest of the seven Official Authorised Dealers (Australian Gilt Discount Limited).

As the Committee is aware, effective 9 August 1996 the Reserve Bank of Australia withdrew accreditation of the Official Dealers.

As evidence of its ongoing commitment to Australia, RMBSA is arranging to fully guarantee the operation of AGS and is renaming it RMB Australia Limited to reflect the closer relationship.

RMBSA aim has been to upgrade its presence in Australia by establishing a licensed branch banking presence to enable:

(i) siting of its Asia pacific regional headquarters in Sydney; and

(ii) development here of an Offshore Banking Unit (OBU).

RMBSA held discussions with the RBA with a view to obtaining a branch banking licence.

The RBA has currently put the progress of our application on hold. The RBA is of the view that RMBSA's ownership structure does not fit neatly into current policy guidelines.

Other South African banks have a variety of holding company structures that also do not conform to current RBA policy. These structures, however, have not prevented some of them establishing themselves as banks in the UK and other reputable jurisdictions.

Current RBA policy would inhibit the development of direct banking relationships between Australia and South Africa.

This submission has sought to offer recommendations to effect policy changes in Australia that would allow increased competition balanced by adequate prudential supervision.

D Further contact

If so required we would welcome the opportunity to appear before the Inquiry to clarify or discuss any aspect of the contents of this submission.

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