

Guidelines on Authorisation of Specialist Credit Card Institutions

Overview

1. These guidelines are for prospective applicants seeking an authority to carry on credit card issuing and/or acquiring business in Australia as a “specialist credit card institution” (SCCI). Credit card issuing and acquiring activities in four-party credit card schemes designated on 11 April 2001 by the Reserve Bank of Australia under Section 11 of the *Payment Systems (Regulation) Act 1998* are “banking business”, as defined in Section 5 of the *Banking Act 1959* and regulation 4 of the *Banking Regulations 1966*.
2. SCCIs are a special class of authorised deposit-taking institutions (ADIs) that are authorised to perform a limited range of banking activities. (Note: Conditions will be imposed on the authority of an SCCI under paragraph 9(4)(a) of the Banking Act to this effect.) SCCIs may only perform credit card issuing and/or acquiring business and any other services related to credit card issuing and/or acquiring. SCCIs are not permitted to accept deposits (other than incidental credit balances on credit card accounts). Specifically, acquiring SCCIs are not allowed to maintain deposit accounts with their merchants and must separate funds awaiting settlement to merchants and any funds from merchants as performance bond in a trust account with an ADI authorised to accept deposits. Any subsidiary of an SCCI is allowed to perform only those activities related to credit card issuing and/or acquiring.
3. As ADIs, SCCIs are subject to the requirements of the Banking Act and any other Acts applicable to ADIs such as the *Financial Sector (Shareholdings) Act 1998*, the *Financial Sector (Transfers of Business) Act 1999* and the *Financial Sector (Collection of Data) Act 2001*. Regulations and prudential standards applicable to ADIs also apply to SCCIs to the same extent, unless provided otherwise by APRA.
4. Section 7 of the Banking Act stipulates that only bodies corporate can be authorised as ADIs in Australia. Prospective SCCI applicants may refer to the Australian Securities & Investments Commission (ASIC) website (<http://www.asic.gov.au>) for information with regard to the requirements and procedures for registration of a body corporate in Australia.
5. A body corporate seeking to become an SCCI in Australia should apply in writing to APRA, in accordance with Section 9 of the Banking Act.
6. APRA may refuse an application for authority to become an SCCI in Australia where an applicant is a subsidiary of a locally incorporated non-operating holding company (NOHC) that does not hold a NOHC authority under the Banking Act. Where relevant, an applicant should submit to APRA a written application by its NOHC for a NOHC authority under Section 11AA of the

Banking Act concurrently with its application for authority to carry on credit card issuing and/or acquiring business.

7. ADIs, foreign banking organisations and other foreign or domestic non-financial corporations may apply to establish wholly owned SCCI subsidiaries. Foreign credit card banks may also apply to operate as SCCI branches in Australia.

Use of Restricted Words and Expressions

8. An authority to act as an SCCI does not entitle the SCCI to call itself a “bank”. Applicants should note Section 66 of the Banking Act which restricts the use of certain words or expressions, without explicit APRA consent (refer Section 66 Guidelines available on the APRA website www.apra.gov.au).
9. An SCCI is entitled to use or assume the restricted expressions (determined by APRA under Section 66(5) of the Banking Act) “specialist credit card institution” and “SCCI” in relation to its financial business upon authorisation, pursuant to a class consent made by APRA under Section 66(1B) of the Banking Act. However, an SCCI is prohibited from representing that it is authorised to carry on the general business of taking deposits. Whenever an SCCI holds out to a member of the public that it is an “ADI” or “authorised deposit-taking institution” or in possession of a banking authority, it must qualify that with a clear statement that it is only authorised to carry on credit card issuing and/or acquiring business and is not authorised to carry on the general business of taking deposits.

Authorisation Criteria for SCCIs

10. Unless otherwise indicated, the authorisation criteria set out below are applicable to all SCCI applicants, whether intending to establish locally incorporated SCCIs or SCCI branches. These criteria represent the *minimum* requirements that an SCCI applicant will ordinarily need to meet for authorisation under the Banking Act and should not be taken as an exhaustive list. Depending on the circumstances, APRA may refuse an application on other prudential grounds not covered in these guidelines.
11. APRA will only authorise suitable applicants with the capacity and commitment to conduct credit card issuing and/or acquiring business with integrity, prudence and competence on a continuing basis.
12. APRA expects all SCCI applicants to be able to comply with its prudential requirements, as set out in the various ADI Prudential Standards, from the commencement of their credit card issuing and/or acquiring operations. (Note: Where appropriate, APRA may exempt a wholly owned SCCI from some of these requirements e.g. NOHC structure and consolidated supervision at parent company level where the SCCI is the only ADI in a non-financial or commercial

group, recognising that it does not engage in deposit-taking activities in the normal course of its operations.) Prospective SCCI applicants should familiarise themselves with these Prudential Standards which are available on the APRA website (www.apra.gov.au). It should be noted that higher prudential requirements may be set on a case-by-case basis, e.g. for newly authorised SCCIs in their formative years.

Capital

13. No set minimum dollar amount of capital is required for an authority to carry on credit card issuing and/or acquiring business. APRA will assess the adequacy of start-up capital for an SCCI applicant on a case-by-case basis, based on the nature and scale of the operations as proposed in the business plan. Foreign credit card banks proposing to operate as SCCI branches are not required to maintain endowed capital in Australia.
14. SCCIs will also be subject to on-going capital requirements. SCCI applicants must satisfy APRA that they are able to comply with the Capital Adequacy Standards for ADIs on an on-going basis from the commencement of their credit card issuing and/or acquiring operations. Given their specialised nature which may concentrate certain types of risks, locally incorporated SCCIs will normally be subject to a minimum capital ratio of 15 per cent (or minimum dollar capital whichever is higher), although this may be varied by APRA depending on the risk profile of the applicant. In addition, newly established SCCIs may also be subject to a higher minimum capital requirement in their formative years, depending on the risk profile of the proposed operations. APRA expects foreign credit card banks to meet comparable capital adequacy standards, which must be consistent in all substantial respects with the Basel Capital Adequacy Framework, as required by their home country supervisors.

Ownership

15. Ownership in locally incorporated SCCIs is governed by the Financial Sector (Shareholdings) Act (“the FSSA”). The FSSA limits shareholdings of an individual shareholder or a group of associated shareholders in an SCCI, whether held directly or through another entity or entities, to 15 per cent of the SCCI’s voting shares. The Treasurer, or in some cases APRA under delegated authority from the Treasurer, may approve a higher shareholding limit for specific institutions on national interest grounds.
16. SCCI applicants wishing to obtain an approval for a higher shareholding limit under the FSSA must submit with their application an explanation and supporting evidence of how this would serve the public interest.
17. All substantial shareholders of an SCCI applicant are required to demonstrate to APRA that they are well-established and financially sound entities of standing and substance. In the case of a wholly owned SCCI, the substantial shareholders

of the parent company must also satisfy APRA of their financial soundness and substance. APRA requires all substantial shareholders of an SCCI to be able to demonstrate that their involvement in the SCCI will be a long-term commitment and that they will be able to contribute additional capital, if required.

Management

18. SCCI applicants must satisfy the requirements set out in the (draft) ADI Prudential Standard on “Board Composition”. Specifically:
 - (a) all locally incorporated SCCIs must have a Board with at least 5 directors, a majority of whom (including the Chairman of the Board) must be non-executives i.e. they must not be executives of the SCCI, its parent corporation or any member of the corporate group to which the SCCI belongs. (Note: Where appropriate, APRA may consider granting an exception to an SCCI applicant with respect to the minimum directorship requirement on a case-by-case basis. Essentially, the applicant concerned will need to satisfy APRA that the small Board would be capable of managing the institution’s business in a prudent manner.) However, non-executive directors of the parent may sit on the Board of the subsidiary SCCI as non-executive directors. Non-executive directors of the SCCI should have at least proportionate representation on all Board committees. Other than a wholly owned subsidiary SCCI, individual shareholders (or any group of associated shareholders) of an SCCI should have broadly proportionate representation on the Board, based on their shareholdings. As a guide, holdings under 15 per cent of an SCCI’s voting shares should have a representation of no more than one on a Board of six or less, and no more than two on a Board of seven or more. Holdings over 15 per cent may have greater representation but not more than is broadly proportionate to the relevant shareholding.
 - (b) in the case of a foreign bank-owned subsidiary SCCI, non-executive directors (including the Chairman) of the Board could be executives of the foreign bank parent. However, at least two directors must be Australian residents, one of whom must be a non-executive.
19. Directors and senior management of the proposed SCCI must satisfy APRA that they are fit and proper to hold the relevant position. APRA may consult other regulators (domestic and overseas) regarding the suitability of personnel for the proposed SCCI. Where necessary, applicants should provide APRA with the authority to seek details in this regard.
20. In reaching its view on the fitness or propriety of any director or manager, APRA will have regard to factors such as:
 - (a) the experience and expertise of the person relative to the duties involved;

- (b) demonstrated competence in business in the past and/or in the conduct of current duties;
- (c) integrity in business activities; and
- (d) reputation within the business and financial community.

Risk Management and Internal Control Systems

21. SCCI applicants must satisfy APRA that their proposed (or existing) risk management and internal control systems are adequate and appropriate for monitoring and limiting risk exposures arising from their credit card issuing and/or acquiring business from the commencement of their operations. This includes, in particular, the maintenance of adequate and appropriate policies and procedures for monitoring and managing:
 - (a) credit risk (including credit risk arising from merchant chargebacks) such as underwriting standards for cardholders and merchants, policy on large exposures and dealings with related entities (e.g. self-acquiring), and policy on monitoring asset quality (e.g. loan classification and provisioning policy) – refer Prudential Standards on “Risk Management of Credit Card Activities”, “Large Exposures”, “Associations with Related Entities” and “Credit Quality”;
 - (b) liquidity risk (refer Prudential Standards on “Risk Management of Credit Card Activities” and “Liquidity”); and
 - (c) operational risk such as fraud or systems failure (refer Prudential Standards on “Risk Management of Credit Card Activities” and “Outsourcing”).
22. SCCI applicants that are subsidiaries of a parent company must demonstrate that arrangements for reporting to parent companies are adequate.
23. In assessing whether the policies and procedures proposed for managing and controlling risk are adequate and appropriate for the applicant’s operations, APRA will take account of the nature and scale of the operations, the volume of transactions undertaken and the proposed organisational structure as set out in the business plan.

Information and Accounting Systems

24. SCCI applicants must satisfy APRA that their proposed (or existing) information and accounting systems are adequate for maintaining up-to-date records of all transactions and commitments undertaken by the SCCI, so as to keep management continuously and accurately informed of the SCCI’s condition and the risks to which it is exposed. Applicants are required to demonstrate to APRA that the proposed systems will be capable of producing all required statutory and

prudential information (including those required under the Financial Sector (Collection of Data) Act) in an accurate and timely manner from the commencement of their credit card issuing and/or acquiring operations. (Note: Relevant ADI reporting forms and standards are available on the APRA website www.apra.gov.au.)

25. In assessing the overall adequacy of the proposed information and accounting systems, APRA will have regard to the integrity and security of the systems, including associated backup facilities and disaster recovery arrangements. Any proposed (or existing) outsourcing of data processing (and any other back office) functions must satisfy APRA's outsourcing requirements (refer Prudential Standard on "Outsourcing").

External and Internal Audit Arrangements

26. SCCI applicants must demonstrate to APRA that arrangements have been established with external auditors in accordance with the requirements set out in the Prudential Standard on "Audit and Related Arrangements for Prudential Reporting". This includes, in particular, arrangements for an external auditor to report annually to APRA on:
 - (a) the SCCI's observance of APRA's prudential standards and requirements;
 - (b) the SCCI's compliance with statutory banking requirements and the conditions on the SCCI authority (including restrictions on deposit-taking activities);
 - (c) the reliability of information supplied to APRA for prudential supervision purposes;
 - (d) any other matters agreed between the SCCI, its external auditor and APRA under the tripartite arrangements.
27. SCCI applicants are also required to satisfy APRA that the proposed (or existing) internal audit arrangements (including establishment and composition of an audit committee) are in accordance with the requirements set out in the Prudential Standard on "Audit and Related Arrangements for Prudential Reporting".

Supervision by Home Supervisor

28. Foreign banking organisations wishing to establish an SCCI operation in Australia must have received consent from their home supervisor.
29. Foreign bank applicants must satisfy APRA that they are subject to adequate prudential supervision in their home country. In considering the standard of supervision exercised by the home supervisor, APRA will have regard to the Core Principles of Banking Supervision promulgated by the Basel Committee on

Banking Supervision. This includes whether the home supervisor supervises the foreign banking organisation on a consolidated basis in accordance with the principles contained in the Basel Concordat, and is prepared to co-operate (in terms of the Concordat) with APRA in the supervision of the SCCI in Australia.

Dual Operation

30. Where an ADI has dual authorisation to operate as an ordinary ADI and to conduct its credit card business in a subsidiary SCCI, each operation is required to conduct its business in Australia in a way which recognises, and makes clear to others, its separate authorisation.
31. The ADI and its subsidiary SCCI will need to have:
 - (a) separate books of accounts;
 - (b) separate statistical (including prudential) reporting to APRA;
 - (c) separate internal control systems for monitoring and managing risks (including systems for controlling credit, liquidity and operational risk); and
 - (d) as part of the control systems, separate systems of delegations (although these could comprise the same people in some cases).

Information Required to be Submitted on Application

32. A list of information and supporting documents required to be submitted by an SCCI applicant on application for an authority to carry on the banking business of credit card issuing and/or acquiring in Australia is set out in Attachment A.
33. APRA may seek such additional information from an applicant as is necessary to assess the application.

Application Procedures

Preliminary Consultation

34. Prospective SCCI applicants are encouraged to contact APRA at an early stage to discuss their plans prior to submitting a formal application. This assists APRA in identifying any matters which might adversely impact on the proposal and to advise on the format and content required of an application. APRA will review drafts of an application through various stages of its development.

Submission of Application

35. Two copies of the final application, including all the required information and supporting documents set out in the Attachment (as appropriate) should be submitted to APRA.

Processing and Notification

36. All applications will be promptly processed. However, the time required to process an application will depend on the particular circumstances of each application, including the completeness of information and documents submitted to APRA by the applicant.
37. An authority may be granted to take effect on delivery or from some nominated date.

Supporting Information Required for an Application to Establish a Specialist Credit Card Institution (SCCI)

1. Ownership, Board and Management

- (a) Name of the proposed SCCI.
- (b) A brief history of the applicant and an outline of the existing operations of any related entities in Australia.

For foreign credit card banks establishing SCCI branches in Australia, include information necessary to demonstrate the applicant's financial standing. This should include balance sheet, profit and loss and off-balance sheet data for the foreign bank itself, and where applicable for its holding company, for the last three years (plus any available current year's data) and information on impaired loans and capital ratios.

- (c) Proposed initial capital (authorised, paid-up, classes of shares, etc). (Note: This requirement is inapplicable to foreign credit card banks establishing SCCI branches in Australia.)
- (d) Names of substantial shareholders (direct and ultimate) and their respective shareholdings.
- (e) An undertaking by substantial shareholders to provide additional capital, if required, and that their investment in the SCCI represents a long-term commitment. (Note: This requirement is inapplicable to foreign credit card banks establishing SCCI branches in Australia.)
- (f) Board structure, including names of directors, their principal business associations and curriculum vitae.

For foreign credit card banks establishing SCCI branches in Australia, names of directors (including their principal business associations) and senior management.

- (g) An outline of the proposed organisational framework, with names of senior management, their responsibilities and curriculum vitae.

For foreign credit card banks establishing SCCI branches in Australia, an outline of the proposed branch framework (including names of the senior management of the Australian branch, their responsibilities and curriculum vitae) and the proposed reporting lines from the local branch to head office.

2. Three-Year Business Plan

The business plan submitted should incorporate the goals or milestones of the first three years of operations of the SCCI. The plan should include:

Structure of Business

- (a) An outline of the current and proposed activities and the scale of operations.
- (b) Details of proposed borrowing and lending (for issuers) to be undertaken.
- (c) Details of proposed off-balance sheet activities and their relevance to credit card activities.
- (d) For issuers, current and targeted cardholder demographic composition.
- (e) For acquirers, a list of existing merchants and details of the targeted client base.
- (f) The location of head office and any envisaged network of other offices or operation centres and the timeframe over which the network will be established.
- (g) A description of operations and technology.
- (h) An estimate of total staff complement envisaged.
- (i) Descriptions of any marketing or similar alliances with third parties.
- (j) The proposed date for commencement of operations.

Financial Data

- (k) The most recent audited financial statements.
- (l) The size and composition of loan portfolio, if any (including for example number of cardholders' accounts, details of delinquencies and provisions made).
- (m) Projections (including sensitivity analysis covering expected, up-side and down-side scenarios) of the following:
 - (i) detailed balance sheet, cashflow and earnings (including assumptions used);
 - (ii) key financial and prudential ratios (e.g. capital ratios, liquidity ratios, prescribed provisioning amounts, etc) for the proposed SCCI; and

- (iii) key financial and prudential ratios for the proposed SCCI and its subsidiaries (if any) on a consolidated basis.

3. Systems and Controls

- (a) Details of the risk management systems and procedures to be used to control and monitor risks in relation to the operations of the SCCI (and its subsidiaries), including:
 - (i) credit underwriting and scoring policies;
 - (ii) credit policy on loans to shareholders, directors and associated interests;
 - (iii) large exposures policy;
 - (iv) policy on measuring, reporting and monitoring credit quality across credit card accounts and provisioning policy for doubtful loans;
 - (v) merchant screening policy (including subsequent ongoing review procedures) and chargebacks risk management policy;
 - (vi) policy on dealings with related entities (e.g. self-acquiring);
 - (vii) liquidity management policy; and
 - (viii) policies and procedures for control of operational risk (e.g. systems failure and fraud monitoring).
- (b) Description of information and accounting systems (including a list of internal reports generated for risk management purposes).
- (c) Description of information security policies, procedures and systems controls.
- (d) Evidence that, from the commencement of operations, information and other systems will be capable of producing all required statutory and prudential returns in an accurate and timely manner.
- (e) Description of any existing or proposed material outsourcing arrangements.
- (f) Description of business continuity (including disaster recovery and system reliability) arrangements.
- (g) Description of the audit program covering internal controls and systems.

4. Subsidiaries

- (a) Details of existing or proposed subsidiaries and associates, the nature and scale of their business, and their proposed business relationship with the proposed SCCI.
- (b) Any plans to transfer assets from subsidiaries and associates to the proposed SCCI.

5. Other

- (a) For locally incorporated SCCI applicants:
 - (i) Certificate of incorporation of the corporate vehicle to hold the SCCI authority (refer Section 10 of the Banking Act).
 - (ii) Certified copies of Memorandum and Articles of Association (refer Section 10 of the Banking Act).
 - (iii) External auditor's certificates verifying the level of capital and, where applicable, capital ratios of the applicant.
- (b) For foreign credit card banks establishing SCCI branches in Australia:
 - (i) A copy of the certificate of incorporation of the foreign bank applicant (refer Section 10 of the Banking Act) and its authorisation to conduct banking business in its home country.
 - (ii) Certified copies of Memorandum and Articles of Association (refer Section 10 of the Banking Act).
 - (iii) An outline of the supervisory arrangements to which the foreign bank is subject to in its home country.
 - (iv) A statement from the applicant's home supervisor:
 - consenting to the application to establish a branch in Australia;
 - confirming that the applicant is of good financial standing;
 - confirming that the applicant is supervised on a consolidated basis in accordance with the principles contained in the Basel Concordat; and
 - agreeing to co-operate in the supervision of the proposed branch, in terms of the Basel Concordat.
 - (v) An undertaking by the applicant to keep APRA informed of any significant developments adversely affecting its financial soundness

and/or reputation globally, and to provide promptly to APRA copies of its published financial accounts and any significant media releases (with translations where appropriate).

6. Additional Information Requirements for Wholly Owned SCCI Applicants

- (a) The parent company (intermediate and ultimate) of an SCCI applicant should provide:
 - (i) a brief history and an outline of its operations, substantial shareholders (direct and ultimate) and directors (including principal business associations);
 - (ii) balance sheet, profit and loss and off-balance sheet data for the last three years (plus any available current year's data), and in the case of ADI or foreign bank parents, information on impaired loans and capital ratios;
 - (iii) an outline of the proposed reporting arrangements from the subsidiary SCCI to the parent company;
 - (iv) an undertaking to co-operate in the supervision of the proposed subsidiary SCCI, including the provision of information required by APRA to supervise the proposed subsidiary SCCI;
 - (v) an undertaking to keep APRA informed of any significant developments adversely affecting its financial soundness and/or reputation, and to provide promptly to APRA copies of its published financial accounts and any significant media releases (with translations where appropriate); and
 - (vi) if the parent company is a financial institution, an outline of the supervisory arrangements to which it is subject in its home country.
- (b) Foreign bank parents of SCCI applicants should provide APRA with a statement from their home supervisor confirming that:
 - (i) the foreign bank parent is of good financial standing and has the supervisor's consent to establish an SCCI subsidiary in Australia;
 - (ii) it supervises the parent bank and its subsidiaries on a consolidated basis in accordance with the principles contained in the Basel Concordat; and
 - (iii) it is willing to co-operate in the supervision of the proposed subsidiary in terms of the Concordat.

7. Prudential Supervision by APRA

- (a) A written undertaking by the applicant to:
 - (i) adhere to APRA's prudential requirements at all times;
 - (ii) consult APRA and be guided by it on prudential matters and in respect of new business initiatives; and
 - (iii) provide APRA with any information which it may require for the prudential supervision of the proposed SCCI (and its subsidiaries).
- (b) An acknowledgement by the applicant that APRA may discuss the applicant's conduct and status with its parent and, where applicable, its parent's supervisor(s).

For foreign credit card banks establishing SCCI branches in Australia, an acknowledgement by the applicant that APRA may discuss the conduct of the branch with its head office and its home supervisor(s).

- (c) Evidence that arrangements have been established for the prospective SCCI's external auditors to report to APRA.