An Update on the Transfer of Banking Assets for Mutual ADIs

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1. Introduction[2]

In view of the ongoing consolidation occurring in the customer-owned banking (**COB**) sector it is timely to revisit an alternative which is special to the financial sector and extremely useful to effect a transfer of banking assets to authorised deposit-taking institutions (**ADIs**) in the COB sector (**Mutual ADIs**).

In a series of surveys that the Customer Owned Banking Association carried out for several years from 2011 merger and acquisitions were identified as the main opportunities in the COB sector for Mutual ADIs to grow their business. Mergers and acquisitions have long been a common feature of the COB sector with the number of participants reducing from 810 in the 1970s to 85. In more recent times between 2006 and 2016 there were 84 mergers of one form or another.

As a result of this continuous trend we are now seeing fewer but larger Mutual ADIs and overall sector growth. However there are still many smaller Mutual ADIs having less than a median asset size of $422 million in 2016 and further consolidation will be no surprise.

The *Financial Sector (Business Transfer and Group Restructure) Act 1999* (Cth) (**Transfer Act**) is a very important and useful piece of legislation for the financial sector which facilitates the transfer of certain businesses between ADIs (or as between life [or general] insurers) by providing a statutory mechanism by which all the assets and liabilities of a transferring body can become the assets and liabilities of the receiving body without the need for separate transfer for each asset and liability. This is a very significant benefit for ADIs when considering buying or selling assets.

This paper outlines the framework of the Transfer Act and touches on the key practical issues that need to be addressed to effect a sale or purchase of any banking assets and/or liabilities under the Transfer Act.[3]

A couple of points to note are:

- This paper only considers voluntary transfers of business. We do not consider any compulsory transfers of business under the Transfer Act (which may occur where an ADI is in financial distress) or any restructure relating to establishing a non-operating holding company.

[1] The author would like to acknowledge the contribution of Cassian Ho, Lawyer, Ash St. for his assistance in producing this article.

[2] Various statistics relating to the COB sector are sourced from material provided by GRC Solutions Pty Limited which acquired the compliance and training business of the Customer Owned Banking Association in 2017.

[3] Please note that this paper is a general overview of the regulatory environment under the Transfer Act and is not tailored to any particular circumstances.

- For ease of reference we will only refer to ADIs in this paper although the position of life [and general insurance] companies will be essentially the same.

2. Voluntary Transfer of Business

Under section 10 of the Transfer Act, two ADIs may apply in writing in the prescribed form to the Australian Prudential Regulatory Authority (**APRA**) for approval of a transfer of business from one entity (**transferring ADI**) to the other (**receiving ADI**).

Each State and Territory in Australia has enacted complementary legislation under section 14 of the Transfer Act to give effect to the certificate of transfer and the voluntary transfer of business provisions.[4]

A point to note here however is that the efficacy of the Transfer Act is questionable in relation to assets and liabilities located in any foreign jurisdiction or agreements which are governed by a foreign law. In such cases any transfer should be individually effected by a transfer or novation arrangement for certainty. We would not expect this to be a significant issue for Mutual ADIs generally.

There are also a number of other issues that should be noted. These are:

- The transfer has to be between 2 ADIs. This can include a transfer between a Mutual ADI and an ADI which is not a mutual. If the transferring body is a Mutual ADI then it is most likely that the demutilisation process provided for in the Mutual ADI's constitution will then come into play and will need to be effected.
- The transfer can include the transfer of business that is not regulated business (that is, it is not the ADI's banking business). It is possible therefore that the transfer of an ADI's business can include non banking business.
- A transfer may be for the whole or the partial business of an ADI. If it relates to a partial business only it cannot only relate to business that is not regulated business.

3. Preliminary issues

If an ADI is contemplating a transfer of business there are a number of issues that should be initially considered. Whilst a number of issues are the same as for any transfer of non ADI business, the following in particular should be noted:

(a) The constitution of the ADI should be viewed to check whether there are any restrictions on the transfer of business. In the case of a Mutual ADI in particular it needs to be checked whether a proposed transfer will trigger a demutualization process.

(b) The ADIs should closely liaise with APRA in relation to any transfer of business throughout the process. In particular they should meet with APRA informally to discuss the proposed transfer and before any formal application is made under the Transfer Act. This process is also encouraged by APRA.

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[4] *Financial Sector Reform (New South Wales) Act 1999* (NSW), *Financial Sector Reform (Victoria) Act 1999* (VIC), *Financial Sector Reform (Queensland) Act 1999* (QLD), *Financial Sector (Transfer of Business) Act 1999* (SA), *Acts Amendment and Repeal (Financial Sector Reform) Act 1999* (WA), *Financial Sector Reform (Tasmania) Act 1999* (TAS), *Financial Sector Reform (Northern Territory) Act 1999* (NT) and *Financial Sector Reform (ACT) Act 1999* (ACT).

(c) The board of directors of the ADIs will need to consider and agree to any such transfer of business. The normal directors' duties will apply and in particular the directors will need to consider the benefits to its members for any particular transfer to proceed.

(d) The board of directors of the ADIs will need to consider and agree who will remain or become a director of the merged ADI following the transfer. In addition the identity of the senior executive management team that will manage the merged ADI will need to be agreed. The importance of this cannot be underestimated and can lead to significant difficulties if it is not dealt with upfront.

(e) Proponents should consider whether it will be necessary to contact other relevant regulatory authorities as necessary, such as the Australian Securities and Investments Commission (**ASIC**), the Australian Taxation office (**ATO**), Australian Competition and Consumer Commission (**ACCC**) and/or the Foreign Investment Review Board (**FIRB**).

(f) The stamp duty implications of any transfer will need to be considered and particularly where any land or goodwill is to be transferred. Whilst there are some exceptions that may be available and the transfer of loans and securities is generally no longer problematic, as a general comment any transfer of assets and liabilities situated in Queensland, Western Australia and the Northern Territory in particular need to be carefully considered.

4. Application to APRA

The form of the application for a voluntary transfer approval is prescribed for in the *Financial Sector (Business Transfer and Group Restructure) Determination No. 2 of 2017* (Cth) (**Transfer Rules**).

There are 3 letters that must be provided and which are endorsed by the board of directors of both the transferring ADI and the receiving ADI.

The first letter is a joint letter from the ADIs which sets out various information in relation to the transferring ADI and the receiving ADI including the proposed method of adoption of the transfer of business. There is a recommended "usual way of adoption" of a transfer which provides for a special resolution of members at a general meeting. In relation to a Mutual ADI, the usual way of adoption will be preferred and an information document will need to be prepared for the members to consider for voting purposes. In addition the letter sets out the various approvals that are sought in relation to the transfer.

APRA will liaise with Treasury where approvals are required under section 63 of the *Banking Act 1959 and the Financial Sector (Shareholdings) Act 1998*. APRA will also consult with the ATO, the ACCC, ASIC and if necessary, the FIRB.

The second letter is from the receiving ADI and sets out various matters in relation to the proposed transfer including the receiving ADI's business plan and the purchase price.

The third letter is a joint letter which is the application to APRA to approve the transfer under section 11 of the Transfer Act. This is provided after the transferring ADI and the receiving ADI have adopted the transfer.

Further details of the 3 letters and certain other information requirements are set out in the Schedule.

5. APRA Approval of the Voluntary Transfer

APRA *must* approve a transfer of business under section 11 of the Transfer Act as long as APRA considers that:

(a) the application is in the prescribed form and relates to a regulated business;

(b) the transfer is adequately adopted by the transferring and receiving ADI;

(c) the transfer should be approved having regard to the interests of the depositors of each body as a group, the interests of the financial sector as a whole and any other matter that APRA considers relevant;

(d) the Minister has consented to the transfer.

APRA may consult with various bodies such as the Reserve Bank of Australia in making decisions to approve a transfer and if it is to approve a transfer, it must consult with the ACCC, ASIC and the ATO unless any of those agencies notify APRA that it does not wish to be consulted. A voluntary transfer may also require approval by the Minister unless the Minister has determined that his or her consent is not required.

APRA may impose conditions on the transferring or receiving ADI which may need to be complied with prior to, or after, the issue of a Certificate of Transfer by APRA. It is critical that the transferring and receiving ADIs maintain close liaison with APRA throughout the process and that if any conditions are to be imposed by APRA that they are able to be considered beforehand to the extent possible and are acceptable.

If APRA:

(a) has made a voluntary transfer approval;

(b) considers all pre-conditions imposed by the approval have been complied with;

(c) in the case of a partial transfer, has been provided the relevant information; and

(d) is not aware of any reason why the transfer should not go ahead,

APRA must issue a Certificate of Transfer.

The Certificate of Transfer when it comes into force will result in the receiving ADI becoming the successor in law of the transferring ADI to the extent of the transfer. The result of this is that all the assets liabilities the subject of transfer, wherever they are located, are automatically transferred to the receiving ADI.

APRA must not approve a transfer of business if it considers that the transfer should not be approved having regard to the provisions of any other legislation prescribed under or referred to in the Transfer Act or the Transfer Rules, which includes the Banking Act and the Competition and Consumer Act.

Conclusion

The Transfer Act is a very convenient and efficient means for Mutual ADIs to transfer regulated businesses between themselves. We fully expect that the Transfer Act will continue to prove to be a popular and convenient method for Mutual ADIs in connection with any further consolidation of the COB sector involving transfer of business.

Schedule

The application to APRA must be in the form prescribed by the Transfer Rules and contain or be accompanied by the information required by the Transfer Rules.

1. (**Joint Letter to APRA**): There must be a first joint letter to APRA signed by the CEO of each of the transferring body and receiving ADIs. The first joint letter must contain:
    a. the names, ABN (or ARBN) of the transferring and receiving bodies;
    b. the proposed date of the transfer of business;
    c. whether the proposed transfer is total or partial (and if the transfer is partial, a description of the assets and liabilities proposed to be transferred);
    d. a statement specifying the mechanism for determining things in relation to the transfer of business, including whether taxation liabilities will be transferred;
    e. the proposed method of adoption of the transfer of business, and why it is appropriate for the particular transfer. The recommended "prescribed method" of adopting the transfer is through a special resolution of members at a general meeting;
    f. draft information documents to be distributed to members for voting purposes, which are required to describe the proposed transfer of business comprehensively including as to particulars of financials, any independent advice received, disclose interests that any officers may have, incentives given to any stakeholder, particulars of arrangements to allow interested parties to raise questions or be heard, recommendations by the board in relation to the transfer, whether the transfer triggers Part 5 of Schedule 4 of the *Corporations Act* (in relation to demutualisations), and all other information which is material to the making of a decision by a member (and any other information that APRA specifies in writing must be included).
    g. details of any other regulatory approvals that may be required for the transfer;
    h. details of how the bodies propose to take into the account the interests of policy owners, depositors, creditors and other investors; and
    i. any legal documentation relating to the proposal.

    If there is to be a partial transfer the first letter must include a written statement –the Section 19 Statement- that lists in detail the assets and liabilities to be transferred and APRA has to be satisfied that this has been agreed to by the transferring and receiving ADIs.

    The transferring and receiving ADIs, or both, may provide APRA at the same time as the first letter, a written statement –the Section 20 Statement- specifying a mechanism for determining things that are to happen or are taken to be the case in relation to the assets and liabilities to be transferred or the transfer of the business to be effected. APRA may approve the Section 20 Statement before it issues a Certificate of Transfer if it is satisfied that the Section 20 Statement has been agreed and the matters specified are appropriate. Whilst the provisions of an approved Section 20 Statement may override other legislation, there are certain provisions or legislation that it cannot override and APRA may also require full disclosure and members' meetings if members' rights are affected.

2. (**Letter from the receiving body**). The second letter is from the receiving ADI to APRA signed by its CEO, which contains the following information:
    a. the indicative purchase price;
    b. details of how the transfer will be funded and the impact of the transaction on the receiving body's solvency, capital ratios and profit levels;
    c. explanation of due diligence or actuarial valuation process to be undertaken;
    d. details of business plans including strategy, likely changes to naming, activities and scale of the receiving body's operations;
    e. draft integration plans, and details of the transfer's likely impact on product lines, distribution and branch networks, and staffing;
    f. description of the proposed organisational and managerial structure post-transfer, and proposed changes to the board of directors of the entity;
    g. details of risk management systems applying to the transferred business;
    h. a written assurance from the Board of Directors as to the above matters; and
    i. if the receiving body is foreign owned or incorporated outside of Australia, advice from the home supervisor as to whether it consents to the transfer.
3. (**Second Joint Letter to APRA**): After the transferring and receiving ADIs have adopted the transfer of business (but before APRA approves the transfer), the third letter must be sent which is a joint letter to APRA signed by the CEOs of each of the ADIs. The third letter must:
    (a) contain evidence of the adoption of the transfer by each of the ADIs;
    (b) attach copies of all regulatory approvals necessary for the transfer.

DISCLAIMER: This communication is intended to provide commentary and general information only. It is not intended to be a comprehensive review of all aspects of the matter referred to. It should not be relied upon as legal advice as to specific issues or transactions.

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