

4. Developments in the Financial System Architecture

The Financial Stability Board (FSB) and global standard-setting bodies have continued to progress work across a range of post-crisis reform areas. These include addressing 'too big to fail', as well as strengthening the regulatory framework for central counterparties (CCPs). These bodies have also been monitoring and, where necessary, responding to, potential new sources of risk to financial stability. This has included examining the implications of financial technology ('fintech') and the related issue of cyber security, and continuing work to reduce misconduct in the financial sector. Evaluating the effectiveness of post-crisis reforms also remains a key focus. The FSB recently released a new framework to guide such evaluations. Discussions continue at the Basel Committee on Banking Supervision (BCBS) to finalise remaining Basel III capital reforms, which are aimed at reducing the variability in banks' risk-weighted assets (RWAs).

Domestically, the Council of Financial Regulators (CFR) agencies have focused on strengthening and testing crisis management frameworks, ongoing implementation of international reforms, and reducing misconduct and enhancing the culture within financial institutions. The Australian Prudential Regulation Authority (APRA) has published proposals on counterparty credit risk and a prudential standard on margining for non-centrally cleared derivatives. A number of measures have been announced, or are under consideration, for better facilitating innovation in the financial sector.

International Regulatory Developments

Addressing 'too big to fail'

A key focus of the G20 post-crisis reforms has been to address the 'too-big-to-fail' problem – that is, mitigating the moral hazard and financial stability risks associated with institutions that are very large, perform critical functions or are highly interconnected with other parts of the financial system. One of the recent measures in this area is the FSB's total loss-absorbing capacity (TLAC) standard for global systemically important banks (G-SIBs). To comply with this standard, G-SIBs must hold certain TLAC-eligible liabilities that can be 'bailed in' during resolution. Implementation of this standard has progressed further, with the FSB reporting to the G20 in July that TLAC issuance strategies are now in place for almost all of the 30 G-SIBs identified by the FSB.

A related issue is how to ensure that, where a G-SIB operates in another jurisdiction as a subsidiary, host authorities have the confidence that there is sufficient loss-absorbing capacity available to that subsidiary. This is being achieved through 'internal TLAC', which is a mechanism for a subsidiary's losses to be absorbed by its parent G-SIB without the need for the subsidiary to enter into resolution. After consulting on internal TLAC earlier this year, the FSB issued final guiding principles in July. These provide guidance on the size and composition of the internal TLAC requirement, coordination between home and host authorities, and the trigger mechanism for internal TLAC.

More broadly, over recent years the FSB and standard-setting bodies have worked on improving resolution frameworks, in line with the FSB's *Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes)*. The FSB has regularly monitored global progress in implementing the *Key Attributes*, and in July the FSB published a stocktake of the resolvability of systemically important financial institutions (SIFIs). The stocktake found that the development of policies to help ensure that SIFIs can be resolved without wider disruption is largely complete. Despite this, the FSB reported that further work on implementation in some areas remains. In particular, implementing measures to address cross-border resolution issues will be a priority over the coming year. This includes the adoption of cross-border cooperation agreements between authorities, and 'resolution stay protocols' – which help prevent cross-border over-the-counter (OTC) derivatives contracts from being terminated disruptively in the event of a foreign counterparty entering resolution.

CCP recovery and resolution frameworks

Another major component of the post-crisis reforms was mandating the clearing of standardised OTC derivatives through CCPs, to reduce the scope for contagion in financial markets. As the use globally of central clearing has increased in derivatives markets, standard-setting bodies have pursued an international work plan to ensure that CCPs themselves do not become 'too big to fail', and that they are subject to strong regulatory requirements and supervisory oversight. Several key elements of the plan were finalised in July:

- The Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) published guidance to further strengthen CCP resilience in the area of

financial risk management. At the same time, these bodies issued revised guidance on recovery arrangements for financial market infrastructures (FMIs). The recovery guidance included a discussion of scenarios that may trigger the use of recovery tools and the characteristics of appropriate recovery tools in the context of such scenarios. The Bank will take both sets of guidance into account in its oversight of clearing and settlement facilities licensed to operate in Australia.

- The FSB published guidance on incorporating the *Key Attributes* in CCP resolution frameworks. The guidance sets out: the powers that resolution authorities should have to maintain the continuity of critical CCP functions; details on the use of loss allocation tools; and the steps authorities should take to establish crisis management groups for relevant CCPs and develop resolution plans. The Bank and other CFR agencies are working to develop an Australian resolution regime for CCPs and FMIs more generally.
- The BCBS, CPMI, FSB and IOSCO published an analysis of CCP interdependencies. The aim of this analysis was to develop an understanding of the connections between CCPs, clearing participants and other financial entities that provide critical financial services to CCPs. The report, based on data from 26 CCPs globally (including the two domestic CCPs operated by the Australian Securities Exchange (ASX)) found that some clearing participants are also important providers of critical services to CCPs, which could lead to operational difficulties at a CCP if one or more of these clearing participants defaulted. Further work will be conducted on this topic over the coming year.

In June, the FSB published a review of OTC derivatives market reforms. It found that

the implementation of most reforms is now well progressed. However, in some cases implementation has taken longer than originally intended due to the scale and complexity of the reforms and other challenges, such as the need to establish new FMI or upgrade existing FMI to meet new standards. As part of the increasing focus on evaluating the effectiveness of reforms, in July the FSB and relevant standard-setting bodies commenced a study of the effect of the reforms on incentives to centrally clear OTC derivatives. A final report is due in late 2018.

Shadow banking

In July, the FSB reported to the G20 that examples of shadow banking activity, which it previously labelled as ‘toxic’ (such as subprime residential mortgage-backed securities and collateralised debt obligations), had declined substantially since the crisis. Accordingly, the types of shadow banking that contributed to the financial crisis are no longer considered to be a key financial stability concern. Nonetheless, the asset management sector remains an area of focus. As detailed in the FSB’s 2016 *Global Shadow Banking Monitoring Report* published in May, investment funds are large in certain jurisdictions and many have inherent structural vulnerabilities, especially leverage and the risk of a redemption run.

IOSCO released a consultation paper in July that seeks to operationalise earlier FSB policy recommendations to address the mismatch between the relative illiquidity of certain fund investments and the ease of redemption in open-ended funds. Future IOSCO work will focus on developing consistent and risk-based measures of leverage in funds. This will facilitate more meaningful monitoring of leverage for financial stability purposes and better capture, for example, the use of ‘synthetic leverage’ and the effects of netting and hedging.

Building resilient financial institutions

Much of the work aimed at building resilient financial institutions, namely the Basel III capital and liquidity reforms, has been completed. However, as discussed in the previous *Review*, the BCBS is yet to finalise the remaining Basel III capital reforms. These are intended to reduce the variability in banks’ RWAs, and more generally to increase the simplicity, comparability and risk sensitivity of the Basel capital framework. The BCBS originally planned to finalise these reforms by the end of 2016, but discussions are still ongoing to reach an agreement. Areas yet to be finalised include:

- reforms to the ‘standardised’ and ‘internal ratings-based’ approaches to credit risk, which determine capital risk weights based on a fixed standard and banks’ own models, respectively
- the ‘output floor’, which places a limit on the benefit a bank derives from using its own models to estimate risk weights.

Separately, over the past six months, the BCBS has proposed revisions to other aspects of the Basel framework.

- In June, reforms to the standardised approach for market risk were announced. The changes will remove some of the more complex capital requirements as well as simplify calculations in other parts of the framework.
- In July, proposals were released setting out the criteria for identifying ‘simple, transparent and comparable’ (STC) short-term securitisations as well as additional guidance on their capital treatment. The criteria for identifying STC short-term securitisations build on earlier BCBS-IOSCO principles for STC securitisations. The new criteria are designed to help the parties to such transactions

conduct due diligence and evaluate the risks of a particular securitisation. According to the BCBS, STC short-term securitisations warrant reduced capital requirements due to increased confidence in their performance. Accordingly, the BCBS is proposing to apply preferential capital treatment for banks acting as investors in, or as sponsors of, STC short-term securitisations.

In July, the International Association of Insurance Supervisors (IAIS) released 'version 1.0' of the Insurance Capital Standard (ICS) for extended field testing. This is another key step by the IAIS in its development over recent years of a risk-based global capital standard for the insurance sector. All internationally active insurance groups will be included in the test and there will be supervisory consequences for groups that do not meet the ICS requirements. Implementation of the final version of the standard is expected to take place in 2019.

Risks and reforms beyond the post-crisis agenda

As the post-crisis reforms are implemented, increasing emphasis is being placed on evaluating whether they have met their intended objectives, and on identifying any material unintended consequences. In July, and following a consultation process, the FSB published a framework to guide such evaluations. The framework outlines the types of evaluation that could be undertaken, the techniques that could be employed, and the analytical issues that may be encountered. The FSB will be responsible for selecting and prioritising the policy evaluation proposals submitted by its members. In line with the FSB's prioritisation, the standard-setting body that issued the relevant standard will conduct the evaluation. Where possible, evaluations should build on existing implementation monitoring and assessment frameworks and be conducted with input from external stakeholders,

including academics and industry. At its October meeting, the FSB Plenary agreed that the FSB, in coordination with relevant standard-setting bodies, should undertake an evaluation of the effects of reforms on financial intermediation. This will be the second evaluation under the FSB's framework (the first being a review of the incentives for central clearing of OTC derivatives noted above).

These evaluation studies will complement the FSB's annual report to G20 Leaders on the implementation and effects of reforms. In July, the FSB's third such annual report suggested that the post-crisis reforms have increased resilience, consistent with the conclusions of previous annual reports. The latest report noted that reforms to OTC derivatives markets have had a meaningful impact on mitigating systemic risk. It also noted that the policies implemented to address shadow banking risks have been effective, with no new shadow banking risks that warrant additional regulatory action. The report pointed out some possible consequences of the reforms that merit ongoing attention. For instance, there is some evidence of reduced liquidity in certain markets, although the report largely attributed these changes to other factors, such as a decline in banks' risk appetite, historically low interest rates and unconventional monetary policy, as well as an increase in electronic trading. The report noted that these changes require ongoing analysis and may be assessed under the FSB's new evaluation framework.

In addition to the evaluation of existing reforms, international bodies continue to monitor emerging risks. In May, the FSB and the Committee on the Global Financial System (CGFS) of the Bank for International Settlements (BIS) published a report on fintech credit. The report noted that fintech lending activity may help diversify economies' credit channels and reduce the risk of a credit contraction if bank

lending is interrupted. However, regulators should remain mindful that competitive pressure from fintech firms may encourage greater risk-taking by banks and erode lending standards.

In June, the FSB published a report outlining the regulatory and supervisory issues raised by fintech. Echoing the FSB-CGFS report, the FSB study found that fintech can help diversify the sources of credit in an economy, as well as increase efficiency and competition. However, the FSB noted that it could introduce or increase procyclicality, cyber risk and operational risk from third-party service providers. While fintech activity is still very small in most countries, the report also noted that issues such as contagion (where distress in a fintech entity could be transmitted to other institutions or sectors, for example, through direct exposures) may emerge as fintech activities increase in size. Also, where fintech expands into critical areas, such as FMIs or core banking systems, it is important that risks are identified and managed effectively.

In August, the BCBS issued a consultation document on the sound practices banks and bank supervisors can adopt to respond to the new risks and opportunities presented by fintech. The BCBS made several recommendations, including that banks and bank supervisors should ensure the safety and stability of the banking system without inhibiting beneficial financial sector innovation. Other recommendations include that:

- banks, as well as new fintech entrants, should manage operational, cyber and compliance risks effectively
- bank regulators should enhance cooperation both domestically (with authorities responsible for fintech regulation) and with foreign authorities, given the potential global growth of fintech companies.

Cyber risk in the financial sector has been another area of international focus recently. The FSB has undertaken a stocktake of existing publicly available regulations, guidance and supervisory practices with the aim of identifying effective practices. In a progress report to the G20 in July, the FSB noted that all member jurisdictions have released regulations or guidance that address cybersecurity for at least part of the financial sector. The FSB will deliver the stocktake to the G20 in October.

Over recent years, the FSB together with relevant bodies, has been progressing a work plan to reduce the risk of misconduct in the financial sector. A key aspect of this work has been the development of the Global Code of Conduct for wholesale foreign exchange markets, which was launched in May. The Code was developed under the auspices of the BIS and in partnership with industry, and sets out global principles of good practice in the foreign exchange market. Adherence to the Code should help to restore confidence in, and promote the effective functioning of, the wholesale foreign exchange market.

Misconduct risk is also being addressed by enhancing the integrity of major interest rate benchmarks, following past instances of manipulation. In particular, over recent years regulators have been working with benchmark administrators and market participants to strengthen the key interbank offered rates, including the bank bill swap rate (BBSW) in Australia. A recent focus has been the sustainability of benchmarks. The UK Financial Conduct Authority (FCA) recently expressed concern that wholesale funding markets are not sufficiently active for the London Interbank Offered Rate (LIBOR) – a set of key interest rate benchmarks for several major currencies including the US dollar and British pound – to be based on transactions. Banks on the LIBOR

panel are also reluctant to continue making submissions based on 'expert judgment'. To manage the risk of an unplanned cessation of LIBOR, the FCA has obtained agreement from the panel banks to voluntarily sustain LIBOR until 2021; beyond that, the FCA anticipates that it will no longer be necessary to persuade, or compel, banks to make submissions to LIBOR. Therefore, market participants and regulators must now focus on the transition to alternative benchmarks.

In the United States, a committee convened by the Federal Reserve Bank of New York proposed alternative reference rates to LIBOR that better reflect actual transactions. And in September, the European Central Bank stated that in coming years it will publish a new unsecured overnight interest rate based entirely on transactions, to complement existing benchmarks.

Domestically, the Australian regulators are currently working with market participants to strengthen BBSW. Importantly, for BBSW there are enough transactions in the local bank bill market each day relative to the size of the Australian financial system to calculate a robust benchmark, which is not the case for LIBOR. The ASX (the administrator of BBSW) is developing a new methodology that would measure BBSW directly from transactions. In October, the ASX issued guidance on the trading of bank bills during the 'rate set window' and on how these trades should be reported to the ASX to support the timely calculation of BBSW. The Australian regulators have also been working on a new regulatory framework for benchmarks, which should help to provide more certainty to market participants. A bill was recently introduced into parliament that would establish the regulatory framework, and the Australian Securities and Investments Commission (ASIC) has consulted with market participants about how the regulatory regime would be implemented.

More generally, in its July progress report to the G20, the FSB reviewed a number of other measures taken by international bodies relating to misconduct issues.

- In May, the FSB released a stocktake of efforts to strengthen governance frameworks. Drawing on these findings, the FSB plans to develop a toolkit for supervisors and firms to help strengthen financial institutions' governance in relation to culture, employees with a history of misconduct, and the responsibilities of the board and senior management.
- The FSB's *Principles for Sound Compensation Practices* and their associated *Implementation Standards* have now been substantively implemented for banks in all FSB member jurisdictions. These were developed to align compensation in the financial industry with prudent risk-taking. In June, the FSB issued for consultation supplementary guidance to the principles and standards. Once finalised, the guidance will provide information for firms and authorities on how compensation practices and tools (such as 'clawback' – the repayment of remuneration after it has been paid) can be used to reduce misconduct risk and address misconduct incidents.
- In June, IOSCO published a report on the regulatory approaches and tools used to prevent misconduct in wholesale markets. The report identified tools that are particularly important for minimising misconduct risk given the characteristics of wholesale markets; they are often opaque, increasingly automated, exhibit conflicts of interest and are dominated by organisationally complex market participants. Some of the tools discussed include whistleblower protection, supervisor liability, and information sharing to identify 'bad apples' and suspicious trades.

The FSB and other international bodies are continuing their work on assessing and addressing the decline in correspondent banking (due to 'de-risking'). In addition to adverse effects on financial inclusion, the concern is that the decline in the number of correspondent banking relationships may affect the ability to send and receive international payments, or may drive some payment flows to less regulated channels. In July, the FSB published its third progress report on this initiative, along with a separate update on the decline in correspondent banking, based on an FSB survey of banks in nearly 50 jurisdictions, including Australia. Similar to the experience of banks in peer countries, Australian banks reported a modest fall in the number of correspondent banking relationships, with more pronounced declines taking place in regions such as Africa and the Caribbean as well as in several Pacific island economies.

In a related development, the BCBS finalised revisions to its *Sound management of risks related to money laundering and financing of terrorism* guidelines in June. The revisions recognise that not all correspondent banking relationships bear the same level of risk. Accordingly, extra guidance is provided to banks on the application of a risk-based approach to managing relationships by including an updated list of risk indicators that correspondent banks should consider in their assessment of money laundering and financing of terrorism risks.

Domestic Regulatory Developments

Council of Financial Regulators

The CFR is a non-statutory body whose role is to contribute to the efficiency and effectiveness of financial regulation and to promote stability of the Australian financial system. The CFR provides the primary mechanism for coordination

between financial regulatory agencies, both on ongoing policy matters and in response to financial disruption, such as occurred during the 2008 financial crisis. Its membership comprises the Reserve Bank (which chairs the CFR), APRA, ASIC and the Australian Treasury. It meets quarterly, or more frequently when required. Over the past year, the CFR met in December, March, June and September, focusing on crisis management and resolution frameworks for banks and FMI, housing lending, competition, cyber security and distributed ledger technology (DLT). At the June meeting, the CFR convened with a broader group of agencies with an interest in regulation of the financial sector and the CFR will continue to engage with these agencies in the future.

A key role of the CFR is to ensure Australian agencies are jointly prepared for any financial disruption and to coordinate the response in such an event. In this context, CFR agencies have continued work in two important areas that affect agencies' ability to deal with a distressed bank – crisis management powers and the level and structure of loss-absorbing capacity.

In August, the government released draft legislation for consultation that would enhance APRA's crisis management powers. The draft legislation would align APRA's powers more closely with the FSB's *Key Attributes*. In particular, the new legislation provides APRA with:

- clear powers to set requirements for resolution planning and to ensure banks and insurers are better prepared for a crisis (for example, giving APRA the power to direct an entity to take actions to change its organisational structure so as to ensure that critical functions could continue if the firm needed to be resolved)
- an expanded set of crisis resolution powers that would allow APRA to act decisively to facilitate the orderly resolution of a distressed

bank or insurer (such as by enabling APRA to appoint a statutory manager to an authorised holding company and certain subsidiaries where necessary).

Development of an FMI crisis management framework is also underway. Drafting of legislation that will grant the relevant resolution authority crisis management powers to resolve a failing domestic FMI is expected to start later this year.

A second important workstream has been Australia's approach to implementing an appropriate loss-absorbing capacity framework for Australian banks. While none of the Australian banks are G-SIBs bound by the FSB's TLAC standard, APRA continues to consider options for a loss-absorbing capacity framework, consistent with a government-endorsed recommendation by the Financial System Inquiry. The CFR has supported this work during 2017, discussing possible approaches and considering the implications of those approaches for Australia.

Crisis simulations are an important tool to both test the preparedness of the CFR to manage the failure of a financial institution and to identify areas that require further attention. In March, the CFR undertook an exercise to step through the range of decisions and actions that would need to be taken in the event that a major Australian bank became distressed. This domestically focused exercise was followed by a larger cross-border crisis simulation in September. The simulation involved all CFR agencies and their New Zealand counterparts under the auspices of the Trans-Tasman Council on Banking Supervision (TTBC). The TTBC has been working to strengthen the cross-border crisis management framework over a number of years, recognising the need for effective cooperation and coordination on crisis resolution. The September simulation was aimed at testing parts of that framework and identifying further

refinements to crisis management arrangements. Findings from both exercises will be incorporated in the work programs of the CFR and the TTBC in the period ahead.

In addition to crisis management, a key focus of the CFR over the past year has been vulnerabilities related to lending standards in the housing market and household indebtedness. The CFR has considered developments in the housing market and emerging risks at each of its meetings over the past year. Given concerns about trends in some types of housing lending in early 2017, it discussed the merits of various policy actions. APRA subsequently announced additional measures in March (see 'Household and Business Finances' chapter). The CFR continues to assess the effects of those measures and broader developments in housing markets.

The CFR has recently undertaken two competition-related workstreams, both in collaboration with the Australian Competition and Consumer Commission (ACCC).

- In early 2017, the CFR considered recommendations from the Review of the Four Major Banks conducted by the House of Representatives Standing Committee on Economics, along with other possible measures for improving competition in the banking sector.
- In September, it published guidance on competition in the settlement of cash equities in Australia, complementing existing guidance on competition in the clearing of cash equities. The policy framework also includes regulatory expectations for conduct in operating cash equity clearing and settlement services. These apply to a market structure in which the ASX remains a monopoly provider of cash equities clearing or settlement services. The CFR and ACCC will work with the government over the coming

year to develop and consult on legislative amendments to provide the relevant agencies with the powers necessary to fully implement the framework.

Other areas of focus of the CFR over the past year have been cyber security and DLT. A CFR working group has been exploring the regulatory approach to cyber security by CFR agencies. As part of this effort, the group has been working on a comprehensive stocktake of the cyber risk landscape in the financial sector, drawing on supervisory information and industry liaison, as well as information from cyber-focused bodies and programs such as the Australian Cyber Security Centre and the government's Cyber Security Strategy. Another working group has been reviewing regulatory gaps that may be relevant to the uptake of DLT and has identified a number of areas where regulation could be updated or clarified in order to promote financial innovation.

Where CFR discussions are relevant to other government agencies, the heads of those agencies are invited to join the meeting or those agencies are consulted. This has included the ACCC attending recent CFR discussions on competition matters. The CFR this year sought to put in place more formal arrangements with other regulators that have an interest in the financial sector. In June, a meeting was held between the CFR agencies, the ACCC, the Australian Taxation Office and the Australian Transaction Reports and Analysis Centre (AUSTRAC). Topics discussed included the activities of the CFR, the work of the Black Economy Taskforce and the Productivity Commission's inquiry into competition in the financial system. The respective chairmen of the Black Economy Taskforce and the Productivity Commission attended.

Other domestic regulatory developments

A number of other regulatory developments reflect the focus of the main international workstreams discussed earlier in this chapter.

In addition to its announcement on 'unquestionably strong' bank capital (discussed further in 'The Australian Financial System' chapter), APRA has continued its program of implementing internationally agreed BCBS reforms. In August, it released a discussion paper on the standardised approach for measuring counterparty credit risk. The discussion paper outlines a series of modifications to an earlier version of the framework, made in response to issues raised during consultation. Among other measures, APRA is proposing a simpler methodology for the measurement of counterparty credit risk exposures for authorised deposit-taking institutions (ADIs) with immaterial exposure to such risk.

APRA has also released the final version of its prudential standard on the margining requirements for non-centrally cleared derivatives. Margin is collateral exchanged to reduce both the counterparty credit risk posed by the default of a market participant and the potential contagion stemming from such a default. Under the standard, compliance with the margining requirements of foreign authorities listed in the standard – such as those in the European Union, Japan or United States – will satisfy APRA's margining requirements in some cases ('substituted compliance'). Substituted compliance is intended to alleviate the burden of foreign firms having to comply with the rules of multiple jurisdictions.

Another area of focus has been mitigating misconduct risk. CFR agencies continue to monitor and encourage improvements in the culture of banks and other financial institutions.

In particular, over recent years, APRA has heightened its supervisory focus on culture for all regulated entities. For ADIs as well as general and life insurers, this has emphasised the need for their boards to identify desired changes to risk culture and ensure steps are taken to address those changes. The importance of enhancing culture was highlighted by apparent deficiencies in anti-money laundering practices at the Commonwealth Bank of Australia that were recently revealed by AUSTRAC (discussed further in 'The Australian Financial System' chapter).

As noted above, global bodies have increased their focus on fintech (including DLT), and assessing its possible implications for financial stability. A key theme of these efforts is to balance the facilitation of fintech, given its potential benefits, with effectively managing any risks it poses. There have been a number of developments domestically regarding fintech:

- In the May federal budget, the government announced several new measures to facilitate the development of the fintech sector, such as reducing barriers for new entrants into the banking sector (see below). The government also stated that it would legislate an enhanced 'regulatory sandbox'. This will build on an existing licensing exemption by ASIC, allowing eligible fintech businesses to test certain services on a limited scale without an Australian financial services or credit licence. Firms operating under the sandbox arrangements remain subject to consumer protection and disclosure requirements.
- In August, APRA proposed revisions to its licensing framework for ADIs. Consistent with government policies noted above, these revisions aim to increase competition and innovation in the banking sector, by making it easier for new entrants (including fintech firms) to navigate the ADI licensing process.

APRA's proposals would introduce a phased approach to ADI authorisation and would allow eligible firms to obtain a 'Restricted ADI' licence, so that they can begin limited operations without yet fully meeting APRA's prudential standards. The Restricted ADI licence would be granted for up to two years. So as not to compromise financial stability, APRA expects these ADIs to conduct banking business on only a small scale during this time, with explicit limits applying to deposits covered by the Financial Claims Scheme. Within the two years, the ADI would be expected to build up the capabilities and resources to fully meet prudential requirements and progress to a full ADI licence, or to exit the banking industry in an orderly manner. ✎