

The Dentons logo is presented in a white, arrow-shaped box pointing to the right, set against a dark purple background. The word "DENTONS" is written in a bold, white, sans-serif font.

DENTONS

Banking and financial services

Grow | Protect | Operate | Finance

2024

Banking and financial services

1. Australia's financial system

The Australian financial system consists of commercial banks, retail banks and investment banks.

The Australian Government has in place a 'four pillars' policy and will reject any merger between the four major banks. This is long-standing policy rather than formal regulation, but it reflects the broad political unpopularity of bank mergers.

Regulation

Australia's banking regulation is split mainly between the Australian Prudential Regulation Authority

(APRA) and the Australian Securities and Investments Commission (ASIC). APRA is responsible for the licensing and prudential supervision of Authorised Deposit-Taking Institutions (ADIs). These include banks, building societies, credit unions, friendly societies and participants in certain credit card schemes and certain purchaser payment facilities. ASIC is responsible for financial services licensing that applies both to banks and others offering credit and financial services, including those providers who are not banks.

Foreign banks

Foreign banks may operate either through an authorised branch or an authorised locally-incorporated subsidiary. Subsidiaries can normally engage in the full range of banking business in Australia, but branches are normally subject to restrictions (including a prohibition on engaging in retail banking).

Anti-Money Laundering and Counter-Terrorism Financing Act (AML/CTF Act)

The AML/CTF Act imposes certain obligations on 'reporting entities', such as businesses operating in the financial services sector. The obligations include implementing an AML/CTF Act compliance program, which involves verifying the identity of clients before a 'designated service' is provided.

Ongoing customer due diligence is also required to protect against money laundering or the financing of terrorism.

The AML/CTF Act also requires a reporting entity to advise the Australian Transaction Reports and Analysis Centre (AUSTRAC) of suspicious matters and cash transactions of more than A\$10,000.

It also regulates entering into transactions with residents of prescribed foreign countries.

2. Borrowing from a bank in Australia

Secured or not?

Lending can be secured or unsecured. Unsecured lending is likely to be restricted to the highest of institutional credits and may result in pricing that is higher than a bank would offer for a secured loan.

Unsecured lending may be made available on the basis of a negative pledge from the borrower and possibly other members of the borrower group.

Secured lenders have priority for payment on the borrower's insolvency.

Types of security and finance documents

For the majority of commercial borrowing, Australian banks use letters of offer prepared on bank standard paper, mostly produced by the lender itself but sometimes by the lender's external lawyers.

Loans will be regularly available on both floating and fixed rates (the floating rate is far more common).

Facilities in Australia will often be documented as bill facilities or cash advances.

Pricing is on the basis of individual bank published lending rates or on screen rates. In Australia, the most common screen rate used is the Reuters BBSY rate. Sometimes the rate set by reference banks will apply.

When borrowing in Australia, security is likely to include one or more of the following:

- Guarantees
- Real estate mortgages
- General security interests

3. What is the ranking of security?

Australia has a system under which secured creditors (i.e., creditors who hold a security interest over assets as security for the payment of money or the performance of obligations) rank ahead of unsecured creditors.

The ranking of security is quite complex and changes if a company is placed into liquidation (i.e., being wound up as insolvent).

How is security taken?

There are three principal ways security is taken:

- By operation of law (eg, a warehouseman's or repairer's lien over goods).
- By a security interest which should be registered on the Personal Property Securities Register (PPSR). Importantly, anyone who parts with possession of property other than real estate may have their title to that property defeated if they do not register a security interest on the PPSR. For example, a landlord under a finance lease needs to register that interest on the PPSR.
- By mortgages over real estate. Real estate mortgages will generally extend to any improvements (fixtures) on the land and are not subject to the PPSR regime.

Financial assistance issues

An issue that arises in acquisition financing is financial assistance. The Corporations Act restricts a company from giving financial assistance to a person to acquire shares in the company or its holding company. Financial assistance includes giving a guarantee or security.

Recourse

Secured lending can be recourse or non-recourse to the borrower. This means that in some cases, the lender will only be able to enforce its rights against the asset being provided as security. This mostly happens only for sophisticated borrowers, where the asset is of high quality and the facility is not highly geared.

Hedging

For property and project lending, Australian banks will often require that a significant part of the debt be subject to interest rate hedging (in the case of floating rate financing). This can be up to 50% or more of the facility.

Interest withholding tax

Interest payments out of Australia generally attract interest withholding tax. The rate of tax is 10% of the gross amount of the interest payment.

4. Personal property securities law

The Personal Property Securities Act (PPSA) applies to all security interests created in tangible and intangible personal property. The PPSA does not apply to real property or mining tenements.

The PPSA sets out the requirements for creating valid security interests, as well as comprehensive priority rules for competing security interests.

Under the PPSA there is a national register, the Personal Property Securities Register (PPSR), where security interests in personal property are registered. Persons acquiring (or otherwise dealing with a person in possession of) personal property can review the PPSR to confirm whether another party has a security interest in that property.

Interests recorded on the PPSR include:

- A general security interest granted to a financier over all the assets of a company
- A security interest over a particular asset
- Interests held by owners of assets where those assets are in the possession of third parties (e.g., leased equipment)

It also affects personal property provided under:

- Operating leases (other than short term leases such as car rentals)
- Finance leases
- Hire purchase agreements

- Sale agreements under which possession of goods is given to the purchaser before payment, and commercial consignments (or bailments)

Unless the owner of an asset takes the necessary steps under the PPSA to perfect the security interest created by these arrangements, it will not have a first ranking claim to that personal property, on the insolvency of its counterpart.

5. How do you protect yourself under the PPSA?

You must perfect your security interest by registration on the PPSR to protect your priority position in personal property, to avoid personal property being sold free of your security interest, and to maintain its enforceability.

Laws for financial services providers

A person who carries on a financial services business in Australia is generally required to hold an Australian Financial Services Licence (AFSL). In certain, limited circumstances, a company does not have to be licensed where they have been appointed as an authorised representative of another AFSL holder, or where an exemption is available.

A person will be carrying on a financial services business in Australia if they engage in conduct that is intended (or likely) to induce people in Australia to use their financial services. It makes no difference whether the person carrying on the business is located in Australia or anywhere else in the world.

Generally, a person will be providing a financial service if they:

- Provide financial product advice
- Deal in a financial product (i.e., issue or trade in financial products)
- Operate a registered managed investment scheme
- Facilitate non-cash payments.

Examples of how this may apply to a foreign entity include:

- A foreign company issuing securities, shares, stocks, deposits, debentures, bonds
- A foreign company facilitating or processing payments

- Managed investment scheme interests or insurance products to people in Australia
- A foreign company holding securities, shares, stocks, debentures, bonds or managed investment scheme products in a custodial arrangement or on trust for people in Australia
- A foreign company entering into a swap, forward transaction or other derivative contract regarding currency, commodities, metals, rates and indexes with people in Australia

Exemptions that may apply include relief for foreign financial services providers who are regulated

by regimes which are comparable to Australia's regulatory framework (e.g., US Securities and Exchange Commission, UK Financial Services Authority, Hong Kong Securities and Futures Commission and the Monetary Authority of Singapore).

One-off transactions are not likely to be caught by the requirement to hold an AFSL, but advice should be obtained. Higher standards apply to a financial services provider to retail clients, compared to wholesale clients (who are sophisticated and professional investors).

Who needs to hold an AFSL?

Only the person providing the financial service needs an AFSL.

Licensees may appoint authorised representatives to act under their licence, however the licensee will generally be responsible for all acts of its authorised representatives.

ASIC issues AFSLs and has significant criteria to meet, including financial, staffing and other resourcing. Obtaining a licence is not a simple exercise and licence holders will have obligations placed on them once the licence is issued.

Failure to comply with financial services laws

There are serious consequences for failing to comply with financial services laws. These can include fines, jail, banning orders and/or, in certain circumstances, the right for clients to rescind agreements.

6. Consumer credit laws

Generally speaking, anyone who wishes to make loans or provide credit assistance (i.e., act as a broker or arrange loans for borrowers) individuals or strata corporations for personal, domestic or household purposes, or for investment in residential property, must hold an ASIC regulated Australian Credit Licence (ACL), or be a Credit Representative of the holder of an ACL. There are some exceptions to this general statement (i.e., the provision of short term credit).

They must also comply with the rules set out in the National Consumer Credit Protection Act and the National Credit Code.

7. Anti-Money Laundering and Counter-Terrorism Financing Act

Through strong regulation, and enhanced intelligence capabilities, AUSTRAC collects and analyses financial reports and information to generate financial intelligence. This vital information about potential criminals and criminal activity contributes to Australia's national security and law enforcement investigations.

The Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (AML/CTF Act) and the Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No. 1) (AML/CTF Rules) Australian government legislation that regulates AUSTRAC's functions.

Who needs to comply with the AML/CTF Regime?

AUSTRAC is the Australian Government agency responsible for detecting, deterring and disrupting criminal abuse of the financial system to protect the community from serious and organised crime.



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