Chapter 10

CONSUMER AND PRIVACY REGULATION

10.1 Consumer Regulation - Trends and Issues

As outlined earlier in this Submission, competitive pressures arising from deregulation have led to considerable changes in the relationship between financial institutions and their customers. In banking, there has been extensive product innovation, while technology has contributed to a proliferation in the ways customers can access services, putting pressure on banks to lower their cost structures through a range of actions, such as branch rationalisation. Banks are unbundling their product lines where there was previously cross-subsidisation and begun charging for services which had previously been free or provided at below cost.

To many customers previously accustomed to loan rationing and limited competition, this has been confusing and difficult to handle. The highly competitive environment, with wide choice and access, has led to demands for greater disclosure and other, more prescriptive, regulation. As a consequence, consumer protection has emerged as one of the more significant trends in regulation since the mid-1980s. Developments have included:

- The EFT Code of Conduct.
- The enactment of the Uniform Consumer Credit Code (with effect from 1 November 1996), which will be considerably stronger than the current Credit Acts in most States.
- The development, under considerable pressure from the Government, of Codes of Banking, Credit Union and Building Society Practice.
- An expanded role for the Australian Payments System Council and the Council of Financial Supervisors to monitor and report on compliance with these Codes.
- An Inquiry into credit card pricing, and annual monitoring on the effects of the deregulation of credit card fees and interest rates, with the prospect of a further review at the end of three years.
- An Inquiry into fees and charges on retail transaction accounts.
- The establishment by the banks of the Australian Banking Ombudsman Scheme as a way of addressing consumer issues in the wake of deregulation. This has been followed by other alternative dispute resolution schemes, for example, for the life and general insurance industries.

Following financial market deregulation, other countries such as the UK and the US have also experienced the trend to greater consumer protection regulation. But what is of particular concern in Australia is that much of the consumer regulation has been highly prescriptive with little regard for the costs or longer term implications for consumers. As a consequence, it is not at all clear that consumers have experienced net benefits from this intervention.

A major reason for this is that the benefits of regulation are usually much easier to describe than the costs, so that, as a result, the net benefit is over-stated. For example, regulation which requires extensive disclosure is perceived as benefiting consumers because they have access to much greater information than they did previously. However, little attention is given to whether consumers use all the information, how it affects the cost of production and dissemination (which are ultimately borne by consumers), or how it affects the incentive and scope for product innovation.

With considerations like these in mind, Westpac has proposed the principles outlined in chapter 5. Those which have particular relevance to consumer regulation include the need for:

- a *diversity of choice* for customers;
- the *quality of products and services* to be in keeping with changing customer needs;
- *costs* to be minimised;
- products to be offered on *fair terms and conditions*, with an emphasis on the quality of disclosure; and
- the protection of users to be balanced *with consumers' need to exercise care and judgement* in the acquisition of financial services.

10.2 Approach to Consumer Regulation

In Chapter 6, it was argued that regulation designed to protect consumers should be on a functional basis. It was recommended that responsibility for the regulation of financial practices and conduct should be drawn together in one agency, involving the creation of a financial practices regulator such as new Financial Practices Authority (FPA)[1]. The following functions would be transferred to the new body:

- the Australian Payments System Council (and through it the Reserve Bank) monitoring responsibilities for consumer issues, including industry Codes of Practice;
- the Insurance and Superannuation Commission's responsibilities for consumer issues, including industry Codes of Practice and the registration of insurance brokers;
- the responsibilities of State Governments for the Uniform Consumer Credit Code;
- the ASC's responsibilities for funds raising by funds managers and finance companies, and the licensing of financial advisers; and

[1] As discussed in Chapter 6, the FPA could take the form of a revamped ASC or ACCC, rather than a new body.

- consumer policy.

This approach would leave the ASC with corporations law, the determination of prospectus requirements and the conduct of exchange traded financial markets.

10.2.1 National versus uniform approach to consumer credit regulation

The Uniform Consumer Credit Code which commences on 1 November 1996 takes the form of separate but uniform State legislation and regulations. (A comparable approach is the Financial Institutions Scheme for the prudential regulation of credit unions and building societies.) A uniform approach differs from a national approach (eg. the regulation of banks under the Banking Act), where responsibility rests with the Commonwealth Government.

While uniform regulation is certainly a lot better than the fragmented approach which has been adopted in the past to the regulation of consumer credit, there are a number of reasons why the new Code will adversely affect efficiency. In particular, it will reduce flexibility for credit providers and increase costs for consumers.

A uniform State-based approach which relies on agreement among States and Territories is inevitably less flexible than a national scheme under the Commonwealth's auspices. While uniformity should not be lightly discarded, having taken so long to achieve, the fact that so many governments have to reach agreement will inevitably make it far more difficult to ensure that the regulation of credit providers will adapt readily to the changing competitive market place. Several examples can be given of the sort of problems which are likely to arise:

- Some indication of the likely difficulty of reaching agreement among the States on issues which will arise from time to time is provided by their inability to agree on a quite simple issue: the cross-vesting of civil penalties which may be imposed under the Code where an application is made by a credit provider in recognition of a breach of a 'key requirement' under the Code. These penalties can be up to $500,000. Western Australia is concerned that it will not get its share of these penalties because most credit providers will make application in the eastern States.

- Legislative change will also be a major problem. Given the protracted gestation of the Uniform Consumer Credit Code, there is no reason to expect that amendments to it will be easy to secure. A relevant example is the Financial Institutions Scheme, which is also a State-based uniform scheme of regulation. Under this scheme, credit unions and building societies have at times found it very difficult to secure changes to the legislation they consider desirable even where most State Governments have been in support.

- There is little scope for flexibility under the Code, to take account of special circumstances. Unanimous agreement is required before exemptions can be made to the requirements of the Code. Thus, for example, financial institutions are likely to find the Code an impediment to mergers. If each party to a merger runs different internal systems for securing compliance to the very complex requirements of the Code, they will - in the absence of an exemption - need to run them in parallel to ensure full compliance while they integrate their operations. This will make it far more difficult to achieve integration efficiently.

Westpac has already experienced an example of the inflexibility which can be expected in future. Earlier this year, it sold its Challenge Bank business in Victoria to the Bank of Melbourne. With the Code to commence from 1 November, however, the Bank of Melbourne indicated it would be unable to ensure compliance with the Code. Westpac sought an exemption but, although the Victorian Government agreed, it has had difficulty securing the agreement of several other States. With a national approach this clearly would not have been a problem.

- There is scope for tribunals in different states to make inconsistent decisions on similar matters, for example, where consumers apply for relief under their contracts. While the Code outlines matters which may be considered by the Court when determining whether a contract is unjust and should be reopened, this includes "the public interest", which is clearly open to widely different interpretation.

Consumer credit is a national business in which there are significant international players, such as Amex, MasterCard, Visa, Citibank, GE Capital and the like. It will become even more international as consumer finance is available on the Internet. It is clearly no longer a State-based business, and leaving responsibility for its regulation at this level risks impairing the ability of Australian financial institutions to compete in what will increasingly become a global market.

With the changes expected in the market place over the next few years, including competition on the Internet, this lack of flexibility and adaptability will pose major problems. It is a compelling reason why responsibility for the Code should be transferred to the Commonwealth:

- Only one Government would then make decisions on when and what changes are necessary.

- Only one regulator implements the legislation and promotes compliance.

Achievement of uniformity has involved some compromise among the States and Territories. The new Code is therefore halfway towards a national approach. Now would be the right time to go the whole way, before disagreement among the States on issues arising out of the application of the Code makes this more difficult to achieve.

The need for the financial system to be adaptable to regulation in a climate of rapid change has been emphasised elsewhere in this submission. Considerations such as the above point to the uniform nature of the Consumer Credit Code as a prime reason why it is likely to give rise to major problems of adaptability in future.

Recommendation 10.1: **A national approach should be adopted to the regulation of consumer credit to ensure that it adapts with the market over time. Responsibility should be transferred from the States to the Commonwealth, with a separately constituted financial practices regulator having responsibility for its administration.**

10.2.2 Major inefficiencies with the Uniform Consumer Credit Code

The purpose of this section is to highlight how the Code fails the principles which should govern regulation and weakens the efficiency of credit providers in meeting the needs of their customers. Westpac does not propose that the Committee should address all the matters which are a cause for concern with the Uniform Consumer Credit Code, many of which raise complex technical or legal issues.

One over-riding point should be made at the outset: the Code has not been based on any rigorous assessment, public or private, of the need for consumer protection. Its development has flowed from claims by consumer advocates and State Consumer Affairs officers, based on anecdotal case studies, that particular problems need to be addressed. As such, the efficiency implications of the Code have not so much been the focus of attention. The implications for consumers have been viewed in terms of their obvious impact (eg. the level of disclosure and the ability to reopen contracts) but not their dynamic effects, as credit providers respond to the more onerous and prescriptive environment in a way which adversely affects consumers.

Recommendation 10.2: **In any review of the Uniform Consumer Credit Code after responsibility has been vested in the financial practices regulator, provision should be made to take account of the <u>full</u> costs and implications for consumers. Putting in place a requirement for Regulatory Impact Statements would be one way of bringing this about.**

Excessive emphasis on disclosure

Disclosure is often advanced as a meaningful alternative to prescriptive regulation. For example, the Campbell Committee observed the following:

> "While disclosure requirements do not always represent a complete alternative to other forms of regulation, in many instances such a trade-off may exist. The scope for this depends importantly on one's judgement about the ability of investors to look after themselves, however much information is available to them and however clearly and simply it is expressed.
>
> It should not be overlooked that disclosure requirements are another form of regulation, carrying not insignificant costs of compliance in many cases. The question is not necessarily one of increased information, but of how the quality of information can be improved so as to maximise its usefulness to (consumers), while minimising the costs to companies and financial intermediaries."[2]

Disclosure is at the core of any good scheme to protect consumers, as it ensures they have the scope to exercise informed consumer choice. However, it is the quality of information which is important, not the quantity. Too much information can be counter-productive, discouraging consumers from reading what they need to know to make the appropriate decision.

In this regard, consumer education will become increasingly important as credit facilities become more complex. All financial institutions offering such facilities and the new financial practices regulator should actively work to inform the public of their rights and responsibilities and how to derive greatest benefit from the financial services available to them.

The disclosure requirements imposed under the Code are deficient in two important respects:

2 *Report of the Australian Financial System Inquiry*, 1981, page 290

- They are onerous for banks and their length and complexity make them of limited value to customers[3]. The Code prescribes a range of information which must be provided in lengthy[4] pre-contractual disclosure statements. These include details of interest charges and repayments based on assumptions which may have little relevance to the circumstances of individual borrowers.

- Borrowers have no right to obtain a simpler statement and a credit provider supplying one will be in breach of the Code. (Nor can credit providers provide advice about a loan because of perceived conflicts of interest).

The value of such disclosure to consumers is open to question. Instead of obtaining helpful advice and a simple statement from a credit provider when seeking a loan, potential borrowers are provided with a lengthy and complex statement and have to work it out for themselves or seek independent legal or financial advice.

Inconsistency between emphasis on disclosure and right to reopen transactions

If potential borrowers are fully informed as a result of onerous disclosure requirements, it is inconsistent for them to have the right to reopen transactions because they are subsequently dissatisfied with some aspect of the contract and claim it to be “unjust”. The Code gives a Court considerable powers to vary the terms of a contract entered into in good faith by both parties, by granting relief from the contract.[5]

Westpac obviously does not support any contract which is “unjust”, but the subjective basis on which the assessment of this may be made is inequitable. This provision adds to the risk of lending and, as it is prudent for lenders to obtain a risk-related return on their lending, it means borrowers have to bear an additional, and otherwise unnecessary, cost.

Compliance costs

The cost of meeting the disclosure requirements under the Code are considerable. For instance, under the Code, disclosure includes any representation made by sales staff. Thus to secure compliance with the Code, it is particularly important that regular training and accreditation of sales staff be undertaken. Westpac’s intention is to provide such training every six months.

Another source of cost is keeping contracts up-to-date. Contracts are produced by operators trained in the use of computer-embedded codes or prompts. These codes require constant monitoring to reflect changes in products and markets.

The costs of complying with the Code can be broken up into two groups: the initial costs of implementing the various requirements and the on-going compliance costs. Westpac estimates that it has incurred the following costs, set out in Table 10.1, in ensuring that it will comply with the Code when it commences on 1 November 1996.

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3 In the past, prospectus requirements for investors were widely criticised for much the same reasons. These have now been extensively modified and simplified, with the result that disclosure in prospectuses is now a lot more relevant to, and likely to be used by, investors.

4 The length will vary according to product options, with 24 pages being the average for a fairly straight forward loan.

5 This may involve relieving the debtor and any guarantor from payment of any amount, increasing the term of a contract, setting aside or altering an agreement made or mortgage given, releasing the security held by a credit provider, and so on.

Table 10.1
WESTPAC'S UCCC COSTS

Implementation costs	
• personnel - direct	$2,400,000[6]
• personnel - indirect	$2,000,000[7]
• legal	$2,300,000
• training - develop and implement	$2,600,000
• systems development	$4,500,000
• documentation	$2,500,000[8]
TOTAL	**$16,300,000**
On-going annual compliance costs:	
• managing compliance processes	$80,000
• competency testing	$300,000
• documentation	$2,000,000
• systems development	$500,000
TOTAL	**$2,880,000**

Of course, some of these costs would be incurred whatever regulatory regime was in place, as they are associated with good practice. Nevertheless, Westpac believes these costs are out of all proportion to the benefits of the Code to consumers.

This is all the more so, as these costs do not include the adverse impact of complex disclosure requirements on the ability of credit providers to communicate simply to potential customers the features and benefits of their products.

There are significant fixed costs involved in the initial implementation of the Code and in on-going compliance with it. These may be seen as a barrier to entry, and are likely to add significantly to the problems of existing smaller institutions. The overall cost burden may even lead to the failure of individual institutions if non-compliance results in significant penalties.

6 Includes the cost of the project team within Westpac which has worked on compliance over the past three years.

7 Includes the cost of others within the Bank, eg. various product and process managers, who have been involved periodically in the project where their interests are involved..

8 Includes updating forms and brochures, amending or rewriting policies and procedures manuals and developing new forms and contracts.

Impact of the Code on consumer choice

The UCCC may act as a disincentive to credit providers to innovate. More innovative products are likely to require more complex disclosure, carrying greater risk of errors and thus penalties. Substantially greater disclosure, beyond what is needed to exercise informed consumer choice, is likely to be accompanied by less diversity of choice and higher cost products for consumers. Some examples where innovation in product features will be inhibited are as follows:

- *Deferred repayment (honeymoon) loans* - The Code prohibits a credit provider from charging an exit penalty which exceeds the costs it incurs if a customer breaks a contract and transfers their loan to another provider once the higher repayments begin. As the provider only makes the loan on the basis that the discount will be offset by future repayments at the full interest rate, this removes any incentive to make such loans, even though there is a customer demand.

- *Pre-paid interest loans* - Credit providers are not permitted to debit accounts with unearned interest and thus offer these loans, although they can accept early payments.

- *Business market products* - In their efforts to respond in a flexible manner to customer needs, banks have often provided business market products to individuals. Potential beneficiaries include sole traders with no commercial banking business but whose personal business relationship makes it attractive to provide them with innovative packages that encompass finance for personal and business purposes.

  An example is a 'share' farmer who knows that he is going to be well paid in due course and wants an advance for a holiday and to fix his tractor. He will no longer be able to obtain a more flexible business loan as this would involve extending to business loans the much more onerous terms and conditions which apply to consumer loans. Banks also risk incurring a significant penalty if an error occurs.

Uniform Consumer Credit Code: Conclusion

The Code fails to achieve a reasonable balance between user protection and efficiency objectives. In combining disclosure, prescriptive requirements and onerous penalties, the Uniform Consumer Credit Code is the antithesis of the regulatory outcomes this Inquiry is seeking to achieve. It leaves little scope for consumers to exercise care and judgement in a meaningful way, impairs the efficiency of credit providers, raises the cost of finance to consumers and reduces the range of choice and quality of products available to them. As a consequence, consumers are not better off as a result of the Code.

***Recommendation 10.3*: In any review of the Code (after responsibility has been vested in the new financial practices regulator), the following broad reforms should be made:**

- **Restrictions imposed under the Code should balance the need to protect consumers with that of ensuring credit providers can respond flexibly and efficiently to customer needs.**

- **Regulatory impact statements should be used to ensure that:**

- regulation under the Code achieves an appropriate balance between user protection and efficiency and equity considerations, and
- the Code evolves in a way which enables credit providers to adapt to the changing market place.

- **Disclosure requirements should have regard for broader efficiency implications, including the costs of compliance.**
- **Disclosure should emphasise the need for consumers to exercise care and judgement in choosing financial services and assist in this through clear and simple disclosure requirements.**
- **Where a contract is reopened because it appears to be unjust, relief should only be provided where it can be shown that there has been an intention to deceive a consumer or where a consumer has been significantly and adversely affected as a result of action by a credit provider.**

In future, consumer finance will become increasingly available on the Internet and other commercial networks, with the funds being sourced from overseas credit providers. Other providers will not be subject to the same requirements or perhaps any requirements at all. While "caveat emptor" will obviously apply in these circumstances, Australian credit providers will be at a disadvantage in competing with overseas credit providers which have greater flexibility in meeting customer needs and can do so at lower cost.

10.3 Privacy

Financial services are essentially information services. As the technology of information collection, processing and communication has changed dramatically in recent years, making information more accessible and more useable, it is to be expected that privacy issues associated with the way information is used should have arisen. These issues cover a broad field, and this submission does not propose to cover these in detail. It does, however, examine areas of concern and suggests some broad principles for handling these in future.

10.3.1 Privacy and the management of customer information

As discussed in Chapter 4, financial institutions are essentially in the information business. Banks use information about their customers to manage the risks associated with lending. They use it in developing new financial instruments. Increasingly, information is being used to market financial services to customers using sophisticated data base marketing techniques. With the increasing availability of information, institutions which do not use information effectively will lose market share to others who do.

In keeping with its general duty of confidentiality, Westpac respects the privacy of customer information and has a long history of doing so. In section 12 of the Code of Banking Practice, banks have also committed to various limitations in the way customer information may be used. Nevertheless, it has been proposed that the Information Privacy Principles which apply to governments under the Privacy Act 1988 should be extended to the whole of the private sector, including financial institutions. This would increase the level of privacy protection by increasing the rights of customers to information and restricting the collection and use of information by financial institutions.

This proposal has its origin in the pressure being exerted by the European Union, including the prospect of trade sanctions, on other countries to follow its lead on privacy. There is, however, scope for some variation from the European approach.

The proposed Information Privacy Principles, while consistent with the European approach may adversely affect the provision of financial services. Westpac's main concerns about the proposals are as follows:

Use of information within financial institution groups

One of the proposed Information Privacy Principles may restrict the use of information to the purpose for which it was originally given. For example, this restriction would prevent information collected in connection with a term deposit being used to offer the term deposit customer a bank's funds management product, although the latter may better meet the consumer's need. This restriction may therefore affect the capacity of banks and financial institutions to use customer information to analyse customer needs, develop innovative products, and offer those products to customers most likely to need them.

Westpac believes that, subject to customers having the right to withhold their agreement, information collected from them in one part of a bank group should be able to be used elsewhere within the group to market other products and services and for other purposes to which customers may consent. This would cover information flows between banks and their financial services and finance company subsidiary operations.

Using information in this way to target customers who are more likely to be interested in a specific product is less costly than other, less focused forms of marketing, and should not be prohibited. This is essential if the financial system is to be efficient, low cost and responsive to customer needs.

***Recommendation 10.4*: Subject to the customer not objecting, financial institutions should be permitted to use information within the group for purposes related to the activities of the group, so as to enhance the efficiency of their marketing activities and their ability to meet customers' needs more effectively.**

Customer access to information

Another of the proposed Information Privacy Principles would extend current arrangements for access by customers to all information held about a person by a financial institution. This would enable customers to seek all manner of information, not just on their own banking business, but for other purposes.

This might include information such as how a pricing decision is made on a particular loan. Such information would be open to misuse eg. it may be passed to competitors. There are established legal processes for obtaining information where there is a specific need eg. it may be subpoenaed by a Court. It should not simply be available on request.

Westpac therefore believes that right of access should not be extended so that it interferes with market sensitive or commercial proprietary information or the confidentiality of information held by financial institutions on their own behalf or on behalf of others.

Recommendation 10.5: **Customers should not have access to market sensitive or commercial proprietary information or confidential information held by financial institutions on their own behalf or on behalf of others. Customer access should be limited to a bank's holding of information on the customer's address, occupation, marital status, age, gender, accounts with the Bank and balances and statements relating to those accounts.**[9]

Legislative jurisdiction

While the Privacy Act is a Federal Act, there is still ample scope for the States and Territories to take different legislative approaches to the implementation of privacy principles, and still be consistent with European trends.

Recommendation 10.6**: The Commonwealth Government should seek to ensure that a national approach is adopted in relation to the implementation of laws relating to the privacy of financial information.**

Administrative costs

Westpac is concerned that a prescriptive approach to privacy (eg. where institutions are required to seek the consent of individual customers to use information for purposes other than that for which the information was collected) may result in considerable logistical difficulties and administrative costs, and make such an outcome impractical. As such costs would need to be recovered, this could have significant implications for the cost of providing services to customers or make it impractical to offer potentially valuable services to them.

Recommendation 10.7**: Regulatory impact statements should be used to ensure that:**

- **any amendment to privacy regulation achieves an appropriate balance between the need to protect the privacy of customers and the ability of financial institutions to offer beneficial services to them; and**

- **the Privacy Act evolves in a way which enables financial institutions to adapt to the changing market place.**

[9] This is consistent with Section 12.4 of the Code of Banking Practice.

10.3.2 Positive credit reporting

Currently credit reporting is restricted to negative reporting relating to delinquencies. The Privacy Act prevents banks from reporting good credit behaviour (positive credit reporting) to credit reference agencies such as the Credit Reference Association of Australia (CRAA). This is a good example of how a concern to protect consumers disadvantages consumers and can have significantly adverse efficiency implications.

Positive credit reporting is widely used in the US and Canada and, increasingly, in the UK. It is not inconsistent with the Information Privacy Principles discussed earlier. Typically, information provided to credit bureaux includes the type of account, balance currently outstanding, arrears (if any) and current status (30, 60, 90 days, etc.). This practice contributes to greater competition by enabling consumers with a good record of meeting their commitments to obtain finance more readily from other institutions with whom they don't have a "track record". As noted above, banks use information to manage the risks associated with lending. The more information a credit provider has on the financial commitments and performance of a potential customer, the greater is its ability to assess the risk of extending credit to them.

Negative credit reporting provides information on credit which is already "in collection", that is, where repayments are already 90 days in arrears. Thus there is a delay in obtaining the information on delinquencies. With positive credit reporting, the information comprises all details of a customer's commitments, perhaps from different institutions, is up to date and enables credit providers to undertake repayment trend analysis, on the basis of which they can more readily predict customer behaviour.

In the absence of positive credit reporting, the outcome is thus quite imperfect. On the one hand, some customers are denied access to finance who, in reality, should be able to obtain it, as banks err on the side of caution in using their quantitative credit scoring assessments. On the other hand, the pressures of competition mean that credit providers provide loans to some customers who would not obtain loans if more or earlier information on their commitments and repayment performance were available.

Thus, the absence of positive credit reporting contributes to dissatisfaction by customers who are unable to obtain loans, to over-commitment by other customers, to more bad debts for credit providers, and because of the greater risks involved, to higher costs generally for all borrowers.

In response to concerns expressed in the UK by the Data Protection Registrar, a study was undertaken in 1994 on the value to credit assessment of positive credit reporting. This study covered three credit card issuers, which together account for about half the cards on issue in the UK, and a credit reference agency. This showed that a reduction in serious credit card arrears of between 5% and 11% could be achieved with positive credit reporting.

Westpac believes that if positive credit reporting were permitted, there would be significant benefits for the efficiency of the financial system and for consumers by encouraging competition, reducing the level of consumer over-commitment, increasing the availability of funds for borrowers who wish to shop around and, by reducing the incidence of bad debts, lowering the costs of consumer finance generally.

The absence of positive credit reporting means that good customers are having to subsidise those who are not. Modelling by CRAA suggests that, relaxation of the current Privacy Act restrictions on the recording of positive credit information could result in cost savings equivalent to a 1% reduction in consumer credit interest rates. This translates to a saving for consumers of $130 million annually.

***Recommendation 10.8*: The Privacy Act should be amended to allow positive credit reporting.**

Westpac recognises that this recommendation may generate fears about privacy, as it extends the range of consumer credit information currently provided to CRAA. However, it also notes that such information is widely exchanged overseas, apparently without causing major privacy concerns. It is important that there should be close consultation with privacy and consumer representatives to ensure that their concerns are fully taken into account before the Act is amended.

10.3.3 Stored value cards

There has been considerable publicity in the past year about the privacy implications of stored value (or smart) cards.[10] The cards are not in widespread use, so there is little information available on the abuses which may occur, but some interest groups allege that, unless action is taken, there will be no protection or control over the collection, use, access or security of personal information contained on such cards. Among the unsubstantiated assertions are the following:

- Service providers - such as Transcard, Quicklink and Mondex - and merchants may obtain access to customer transaction information so they can track purchases and build a profile of a consumer’s purchasing habits.

- Different transaction information (eg. financial and medical information) may be linked on the one card allowing access by unintended or unknown parties.

- Smart card data trails may be exploited by government agencies.

- “Function creep” may occur where, at the outset there are a minimum number of functions and transactions are anonymous but functionality and data collection increase as consumers become more comfortable with the system.

Various trials of stored value cards have been under way for some months and these are investigating not only the feasibility of these cards, but also the privacy and other consumer implications. MasterCard International is currently conducting a study in Australia of privacy issues in general and privacy as it relates to payment cards, including smart cards. This study is being conducted in consultation with privacy regulators and consumer advocates to develop an accurate picture of consumers’ perceptions of privacy.

Users of cards issued by supervised institutions, such as banks, are already assured a high level of protection under codes of practice (eg., the Code of Banking Practice), under the Privacy Act and at common law. Personal information cannot be passed to third parties without the customer’s consent and this is equally as true of smart cards as of any other aspect of a customer’s relationship with a bank.

[10] At least 7 separate studies have been undertaken on the privacy aspects of stored value cards in the past twelve months or are currently under way. All but one of these have been driven by privacy, human rights or consumer advocates.

While privacy issues need to be considered carefully with any new technology, including stored value cards, there is simply no substance to existing concerns. For example, with the trials in which Westpac is participating, the information being collected is similar to that collected in respect of EFTPOS transactions. Nor is there scope for service providers or other third parties to monitor the purchasing habits of consumers who use a smart card, as no record of the items purchased is collected.

Stored value cards represent a new generation technology which has the potential to deliver significant efficiency benefits for the community. It is therefore important that this potential not be curbed by inappropriate regulation. With privacy, human rights and consumer groups actively identifying all the problems which they believe may occur, there is a strong risk of excessive regulation of stored value cards. This must be avoided.

Recommendation 10.9**: The key elements on which any privacy regulation relating to stored value cards should be based include the following:**

- **Before any new regulation is introduced over and above that available at common law, under the Privacy Act, and under the Code of Banking (and building society and credit union) Practice, a demonstrated need must be established.**
- **To secure public confidence in the terms on which information is collected and in any use to which it may be put, only licensed deposit-taking institutions should be permitted to issue general purpose stored value cards, as these institutions have proven and reliable standards regarding customer confidentiality[11].**
- **Regulatory impact statements should be used to ensure that any regulation achieves an appropriate balance between the need to protect the privacy of customers and efficiency considerations.**
- **Any additional regulation required should be provided in the EFT Code of Conduct rather than in legislation, as the Code provides greater flexibility to change the requirements if the need arises.**

[11] Other institutions would still be permitted to issue special purpose pre-paid stored value cards, such as Telstra's phonecard.