Australian Competition & Consumer Commission

Second Submission to the Financial System Inquiry

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- **involves the minimum necessary intervention;**

- **promotes competition;**
- **promotes competitive neutrality;**
- **provides inexpensive and speedy consumer remedies;**
- **promotes consistency;**
- **maximises consumer welfare;**
- **is durable;**
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- **a larger co-regulatory body responsible for transaction regulation, dispute resolution and market conduct; and**

- **continued application of the consumer protection provisions of the Trade Practices Act.**

EXECUTIVE SUMMARY

National Competition Policy (Chapter 1)

The Financial System Inquiry chaired by Mr Stan Wallis is charged with providing a stocktake of the results arising from the financial deregulation of the Australian financial system since the early 1980s, analysing the forces likely to drive further change, and making recommendations on future regulatory arrangements for financial services.

The Inquiry comes at a time when financial services providers in Australia, as with other sectors of the economy, have been grappling with deregulation, the effect of changes to Australia's national competition policy, pressure from governments and changes in consumer behaviour and expectations.

The outcomes that the ACCC would like to see emerging from the Inquiry cover both competition and consumer protection matters.

The ACCC would like the Inquiry to continue the "Hilmerisation" of the financial services sector by promoting regulatory arrangements which are competitively neutral, consistent and flexible. In particular, all regulation and laws affecting the financial services sector which restrict competition, or have the potential to do so, should be reviewed or repealed unless justified. In addition the Commission considers that the Hilmer reforms, national competition policy and the Trade

Practices Act all have important roles to play in the future regulation of the financial services sector.

The “Hilmerisation” process can best be achieved by taking an economy-wide approach to ensuring that anti-competitive restrictions are removed unless some clear public benefit is shown, and by putting in place mechanisms to test for these claimed public benefits.

The ACCC and Competition Policy (Chapter 2)

Part IV of the TPA contains the Restrictive Trade Practices provisions including section 50, the mergers provision.

In assessing a merger the ACCC takes a case by case approach and its merger enquiry process is fact intensive and based on extensive marketplace enquiries.

The ACCC has looked at relatively few bank mergers over the past five years. Of these, it was the Westpac Banking Corporation acquisition of Challenge Bank Ltd in September 1995 which received most attention.

In that matter the Commission regarded the market as being that for retail banking services in a State, in that case Western Australia. The Commission identified the importance of regional banks in providing competition in banking and as a strong source of innovation.

In the Westpac/Challenge matter the Commission said that it would scrutinise any major trading bank acquisitions of regional banks very carefully. The Commission also said that in any State with only one major regional bank it would be especially concerned that such an acquisition would be likely to substantially lessen competition. The Commission said that it would therefore need highly persuasive evidence to be convinced otherwise. The Commission said that in States with more than one substantial regional bank it would examine any major trading bank acquisition very closely in any event.

The Commission's approach to mergers in the financial services sector is that they should be approached on a case by case basis. This enables it to take account of the particular transaction involved and also of any changes in the surrounding circumstances at the time that the merger is to take place. The Commission has particularly emphasised this point in relation to banking mergers so that it can take account of any relevant structural changes affecting the sector that may have a bearing on its assessment of the state of competition.

The Commission has noted the impact of new technology on the design and delivery of financial products and services. It has been keeping up with developments in remote banking and in the design and delivery of new products, as well as the emergence of new providers.

In relation to possible future mergers, the ACCC has noted general claims being made about cost savings and efficiencies to be achieved from mergers between the major banks. These claims, especially those about increased efficiencies, have never been fully tested and they would be subject to thorough enquiry by the Commission in the course of such a merger.

Taking a wider view of banking and financial services, the Commission has also identified some banking and other legislation which may potentially have anti-competitive effects. The Commission recommends that this legislation be amended or repealed so as to remove its anti-competitive effects on the market.

Merger Investigations and the Authorisation Process (Chapter 3)

This Chapter draws heavily on the ACCC Revised Merger Guidelines, released in July 1996, and explains the concentration thresholds, dimensions of the market, importance of other factors in a merger investigation, and the remedies available to the ACCC. The Chapter also covers the authorisation process in Part VII of the TPA.

Section 50 prohibits mergers or acquisitions which would, or would be likely to, result in a substantial lessening of competition in a substantial market for goods and services. (Although if some other public benefit exists, the merger or acquisition can be authorised by the ACCC, section 88 TPA).

At the administrative level there is a five stage process of review which takes account of the statutory merger factors and structures them in such a way that at each step mergers which would not substantially lessen competition are cleared from further investigation. As the merger investigation moves through the five stages the complexity (and cost) of the information required from the parties and others escalates. The process is designed to achieve compliance at the lowest cost to the parties and to the Commission.

The five steps are:

(1) **Market Definition**

(2) **Concentration Thresholds**

(3) **Imports**

(4) **Entry Barriers**

(5) **Other Factors**

Mergers are assessed by the ACCC against the merger factors listed in section 50(3) of the Trade Practices Act.

Authorisation is available under the TPA for a range of conduct which would otherwise be prohibited because of its anti-competitive effects. Authorisation is applied for to the Commission with a right of appeal against a Commission decision to the Australian Competition Tribunal.

Significant authorisation matters in financial services have been the authorisation of two of the payments system clearing arrangements and authorisations relating to the Australian Stock Exchange.

Consumer Protection in Financial Services (Chapter 4)

At a broad level the problems that consumers face in purchasing financial services and products are similar to those that they face in other markets. They include problems of market failure and other constraints arising from particular market conditions:

- imperfect competition (eg, abuse of market power);
- externalities (eg, institutional failure);
- information imperfections and asymmetries (eg, misleading or deceptive conduct);
- transaction costs and contestability (eg, termination fees);
- barriers to access (eg, cost of services); and
- unconscionable conduct and harassment.

Some of these are more acute in financial markets than is the case elsewhere, and this can lead to consumers being placed at greater risk. Specific problems arise because of the large value of some transactions, the infrequency of certain purchases, the complexity of many financial products, high switching costs for some products and the centrality of financial products for an individual's participation in modern society.

In particular, information imperfections and asymmetries between buyers and sellers can be very pronounced in financial markets, leaving consumers open to the potential for exploitation through misleading or deceptive conduct.

A range of mechanisms exist to address consumer protection problems in the financial sector, involving both rule making and non-rule making solutions.

Rule making solutions range from government rules based on legislation and regulation to industry-based rules such as codes of practice and consumer charters. In this sector, the Commission favours a mix of government and industry rules.

With regard to government rules, the Trade Practices Act (TPA) is the most important piece of consumer protection legislation. The TPA provides effective and comprehensive protection to consumers in all Australian markets. The universal application of the TPA is paramount to underwriting consumer protection in the financial sector, and the Commission would be strongly opposed to any proposal that the sector be exempted from the operation of any part of the TPA.

With regard to industry-based rules, the Commission considers that codes of conduct/practice as an extremely effective and market-sensitive mechanism for delivering the detail of consumer protection rules, provided that they are appropriately framed, administered and monitored.

Non-rule making solutions are also invaluable in this sector. They can encompass such mechanisms as industry complaints handling and dispute resolution schemes, industry, government and consumer education campaigns, and information brokerage services.

In the Australian financial services sector, particular success with non-rule making solutions has been achieved through industry-based dispute resolution schemes. These schemes can provide effective, speedy, accessible, fair and cost-effective means of redress for consumers, and the Commission considers that such schemes should be responsible for dealing with the bulk of consumer complaints.

However, there currently exists gaps in coverage, inconsistencies between schemes, overlap and duplication in some areas, an inability to deal with systemic/persistent problems and difficulties for consumers in identifying which scheme applies in a given case. The Commission believes that the addition of an umbrella body overseeing the schemes could facilitate the elimination of these limitations.

The ACCC and Consumer Protection in Financial Services (Chapter 5)

In addition to its competition responsibilities on the supply-side of Australian markets, the Commission has significant consumer protection responsibilities relating to demand-side issues. Most importantly, the ACCC is responsible for ensuring compliance with the consumer protection provisions of the Trade Practices Act, most of which are found in Part V of the TPA.

Of these provisions, section 52, which prohibits misleading or deceptive conduct, is probably the most important provision with regard to financial services.

Given the extent of information asymmetries in financial markets and the high value of many transactions, the administration of section 52 by the ACCC is vital to the Commission’s work in protecting consumers of financial services. It is by abusing the information gaps faced by consumers that sub-standard and fraudulent operators exploit consumers and draw business away from reputable and ethical suppliers of financial services. The administration of section 52 by the ACCC not only protects consumers but assists business by sanctioning providers whose conduct is unethical.

In carrying out its role of protecting Australian consumers, the Commission’s activities in the financial services sector, as in other sectors of the economy, are designed to achieve the most strategic and effective outcomes with the resources allocated. The strategies employed to achieve these outcomes are as follows:

- enforcement of the TPA in line with the “pyramid of enforcement”;
- assisting industry to improve the trading environment through self- and co-regulatory initiatives;

- assisting industry to comply with the TPA through compliance education activities; and
- identification of systemic problems and effective solutions through market studies and consumer protection research.

The consumer protection activities of the ACCC (and former TPC) have been an important catalyst for identifying and implementing improvements to many of the markets for financial services and products. Some examples include the life insurance, consumer guarantees, consumer credit insurance, and retail electronic funds transfer markets. In respect of each of these markets, the Commission was involved in a strategic manner and in a number of ways. If the Commission is to continue to provide strategic solutions for protecting consumers of financial services, it is vital that it is not burdened with administering day to day aspects of regulation in the sector.

Universal competition and consumer protection legislation must be administered by an economy-wide enforcement agency. To this end, the administration of Part V of the TPA with regard to financial services should remain with the Commission and should not be transferred to an industry- or sector-specific regulator. The importance of this has been acknowledged in the Hilmer reform process through the establishment of the ACCC as an economy-wide trade practices regulator.

The continued application of Part V of the TPA is necessary to underwrite and support consumer protection in the financial services sector, to provide universal application of the Act, to avoid capture and maintain consumer confidence, and to avoid gaps in coverage emerging on the fringes of the sector.

New Technologies, Consumer Protection and the Delivery of Financial Services (Chapter 6)

Recent developments in telecommunications and computing technology are likely to bring significant changes to the way in which financial services are delivered. These new service delivery and transactions mechanisms are able to incorporate a range of new technologies - existing electronic cards; cash/stored value/smart cards; ATM, booth and post office banking; telephone banking; and on-line banking through personal computers.

For service delivery organisations, new technologies can present opportunities to simultaneously reduce costs and enhance client service. For consumers also, new technologies provide greater opportunities.

However, these new forms of electronic banking also pose a multitude of threats and challenges for consumer protection. Broadly speaking these consumer issues relate to:

- liability for loss, errors and unauthorised transactions;
- security of transactions and payment details;
- protection and usage of data (privacy concerns);

- transactions records and audit trails;
- pricing and costs;
- dispute resolution;
- barriers to access;
- increased information problems; and
- protection of consumer rights in virtual and global marketplaces.

These concerns will need to be considered and satisfactorily resolved as these new technologies are introduced.

Apart from technical developments, solutions can be expected to come from both industry-based initiatives such as codes of practice and regulatory responses from government and public sector agencies.

To assist with the development of solutions, an adequate consumer protection framework is needed. The key dynamic characteristics of such a framework include flexibility, durability, competitive neutrality and minimum necessary regulatory intervention.

The current system does not generally embody these characteristics, and is therefore not particularly well suited to coping with change of the type posed by electronic banking. The inconsistencies imposed by its rigid and fragmented structure have lead to variations in such important areas as the content and coverage of codes of conduct, external complaints handling bodies and the allocation of liability across delivery mechanisms. A new consumer protection framework that does embody these key characteristics is described in Chapter 8.

Quite apart from the challenges posed by electronic banking in the Australian context, the development and increased use of open on-line computer systems like the Internet for the purchase of financial services and products raise a range of altogether more difficult and less tractable problems. Chief amongst these is enforcement of consumer protection rules in virtual (and anonymous) marketplaces, and the jurisdictional problems raised by the global nature of systems like the Internet.

At this time, it is difficult to predict the extent to which the Internet will be used to market, sell and purchase financial products within and across borders. While some banking, insurance and financial products from abroad are being offered in cyberspace at present, it seems that for the immediate future the Internet will serve more as a sophisticated marketing tool. Transactions would then be taking place through more familiar channels like retail branches, telephone and mail.

There are many uncertainties and obstacles to overcome before cyberspace replaces existing mechanisms for delivering financial services, and cyberbanks threaten the market of existing financial services providers.

The vexing issues raised by the possibility of mass commerce on the Internet are, however, already confronting national regulatory agencies across the globe and solutions are being sought. The ACCC, in common with other regulatory agencies in Australia and overseas, is examining the enforcement difficulties posed by the Internet and seeking workable solutions at a range of levels and in varying forms.

The Existing Regulatory Structure for Consumer Protection and Options for Reform (Chapter 7)

While the Commission regards a number of the features of the existing regulatory structure as workable and effective, it is concerned that the fragmented and rigid nature of the current regulatory arrangements creates some significant problems. Key amongst these problems are those of inadequate coverage, duplication, lack of competitive neutrality, lack of flexibility, high costs and the regulatory burden imposed on industry.

A further factor to consider is that, over time, there is likely to be a migration of responsibility for credit and financial legislation from States and Territories to Commonwealth control.

The Commission believes that the key features of a more effective and desirable regulatory structure would include the following:

- minimum necessary intervention - intervention is costly both for businesses and government;
- promotion of competition;

- competitive neutrality - no one business type should be subject to lesser amounts of regulation, or differing rules, than another business type providing the same outcome for consumers;
- provides inexpensive and speedy consumer remedies;
- consistency;
- maximising consumer welfare;
- durability - the structure should remain stable in the face of industry changes and other changes;
- flexibility - the structure should be able to adjust to accommodate changes in industry and changes in technology;
- simplicity; and
- provision of an effective mechanism for addressing market problems.

These features should be kept at the forefront in any assessment of options for reforming the consumer protection structures in the Australian financial services sector.

One of the better known options that has been canvassed is that of an essentially self-regulatory structure. Another is that of a large sector-wide government regulator. When these two options are examined against the features of an effective regulatory structure they are both found to have significant deficiencies.

A third option, preferred by the Commission, is to rely on sector-wide industry co-regulation for consumer protection, with targeted checks and balances to ensure that the scheme is working effectively. This model, as proposed by the Commission in Chapter 8, is found to be the option which is best aligned to the key features of a more effective and desirable regulatory structure.

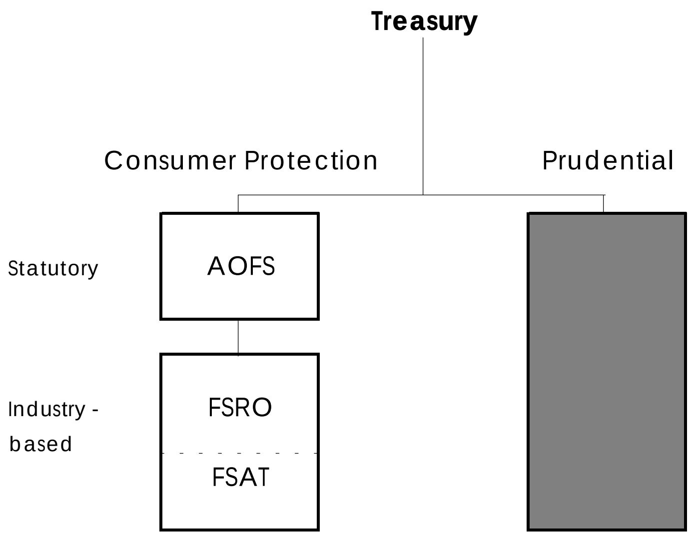
Regulatory Structure (Chapter 8)

The ACCC has a clear interest in the regulatory arrangements which may result from the Inquiry's recommendations. There are three general principles necessary for an effective regulatory scheme - competitive neutrality, consistency and flexibility, and the ACCC would wish to see these incorporated into any regulatory arrangements recommended by the Inquiry.

The ACCC notes the importance to consumer welfare of the regulatory arrangements relating to prudential supervision. The Commission does not claim to have expertise in this area but it does see pro-competitive advantages in consolidating some aspects of prudential supervision under one regime. The Commission's view is that incorporating the AFIC institutions - building societies, credit unions and friendly societies - with banks under a single prudential supervision regime would be a step towards opening up the advantages and benefits of prudential regulation without threatening the integrity and stability of the system.

Regulatory arrangements for consumer protection need to address market failures and require certain attributes - in addition to competitive neutrality, flexibility and consistency - to be effective. These other attributes of an effective consumer protection regulatory scheme are discussed in Chapters 4 to 7.

The ACCC recommends the development of a new scheme of co-regulation. This would involve existing industry schemes being harmonised and standardised under an umbrella body responsible for all facets of the provision of financial services. The industry-based component of the scheme would be responsible for accreditation, compliance, complaints handling and public education, and would be subject to oversight and audit by a small independent statutory body within the Treasury portfolio. The statutory body would be responsible for setting policy in the financial services sector, carrying out or commissioning audits of the activities of the industry-based component, and conducting compliance inspections. A diagram of the proposed scheme appears below:



Parts of the scheme would be subject to authorisation by the ACCC under the Trade Practices Act.

The ACCC believes that such a scheme would leverage off the considerable effort and good faith shown by industry. It would also incorporate an appropriate level of audit and oversight so as to ensure that a high level of consumer protection is achieved with minimum government intervention.

CHAPTER 1

NATIONAL COMPETITION POLICY

The Financial System Inquiry

The Financial System Inquiry chaired by Mr Stan Wallis is charged with:

- providing a stocktake of the results arising from the financial deregulation of the Australian financial system since the early 1980’s.
- analysing the forces likely to drive further change, including:
  - technological and marketing advances;
  - international competition and integration of financial markets;
  - domestic competition in all its forms;
  - consumer needs and demands.
- making recommendations on the regulatory arrangements and other matters affecting the operation of the financial system (including prudential and other regulations made by the Reserve Bank and other bodies) as will:
  - best promote the most efficient and cost effective service for users, consistent with financial market stability, prudence, integrity and fairness;
  - ensure that financial system providers are well placed to develop technology, services and markets and that the financial system regulatory regime is adaptable to such innovation;

- provide the best means for funding the direct cost of regulation;
- establish a consistent regulatory framework for similar financial functions, products or services which are offered by differing types of institutions.

Recommendations will be made on the nature of the regulatory arrangements that will best ensure an efficient, responsive, competitive and flexible financial system to underpin stronger economic performance consistent with financial stability, prudence, integrity and fairness.

The Inquiry comes at a time when financial services providers in Australia, as with other sectors of the economy, have been grappling with deregulation, the effect of changes to Australia's national competition policy, pressure from governments and changes in consumer behaviour and expectations.

The outcomes that the ACCC would like to see emerging from the Inquiry cover both competition and consumer protection matters.

The ACCC would like the Inquiry to continue the "Hilmerisation" of the financial services sector and it has identified a number of areas where impediments to competition could be removed. The Commission considers that the Hilmer reforms, national competition policy and the Trade Practices Act all have important roles to play in the future regulation of the financial services sector.

The Hilmer Committee

On 21-22 November 1991, at a Premiers and Chief Ministers Meeting in Adelaide, Australian governments formulated a set of agreed principles for a National Competition Policy[1]:

(a) No participant in the market should be able to engage in anti-competitive conduct against the public interest;

(b) As far as possible, universal and uniformly applied rules of market conduct should apply to all market participants regardless of the form of business ownership;

(c) Conduct with anti-competitive potential said to be in the public interest should be assessed by an appropriate transparent assessment process, with provision for review, to demonstrate the nature and incidence of the public costs and benefits claimed;

(d) Any changes in coverage or nature of competition policy should be consistent with, and support, the general thrust of reforms:

(i) to develop an open, integrated domestic market for goods and services by removing unnecessary barriers to trade and competition; and

[1] Communique of Premiers and Chief Ministers Meeting, Adelaide, 22 November 1991

(ii) in recognition of the increasingly national operation of markets, to reduce complexity and administrative duplication.

The meeting also agreed that an independent review of the Trade Practices Act should be carried out to determine its capacity to secure a national competition policy and to identify alternative models for regulating market behaviour.

An Independent Committee of Inquiry chaired by Professor F G Hilmer, the “Hilmer Committee”, was commissioned to undertake that review. In relation to regulatory arrangements the Hilmer Review said that such arrangements should be competitively neutral, consistent and flexible.

The Hilmer Committee recommended that a national competition policy cover six main elements. Apart from the competitive conduct rules under the Trade Practices Act, the Committee made recommendations regarding regulatory restrictions to competition; structural reform to public monopolies; access to essential facilities; monopoly pricing; and competitive neutrality.

1. The Committee reviewed the provisions of the Trade Practices Act in some detail and found them in the most part to be operating satisfactorily, to be broadly consistent with overseas approaches, and to be appropriate for application to areas previously excluded without the need for substantial revision. The thrust of the Committee’s recommendations were to fill unjustified gaps in the

application of the Act in a way that promotes a nationally consistent legal framework for business.

2. The Committee held that the greatest impediment to enhanced competition in certain areas of the economy are restrictions imposed by government regulation. The Committee recommended the adoption of principles aimed at ensuring regulation and statutes do not impede competition unless the restriction can be supported on the grounds of the public interest.

   Areas of regulation recommended to be adjusted include regulatory barriers to market entry; barriers creating monopolies such as public utilities and government sanctioned utilities; restrictions that operate by reference to standards or qualifications; restrictions that operate by reference to the number of producers or products; barriers that operate against interstate providers of goods or services; and barriers that operate against foreign goods or service providers.

3. Another area of reform recommended by the Committee is in relation to public monopolies. The committee recommended a mechanism for the pro-competitive structural reform of public monopolies form part of the national competition policy.

   Before competition is introduced to a sector traditionally supplied by a public monopoly, it is important to separate regulatory powers from the incumbent, so that conflicts of interest do not arise. In addition, where appropriate, separation of potentially competitive activities should take place to achieve the greatest competitive outcome. Already there is progress being made in the implementation of the Committee's recommendations in areas such as electricity and rail.

4. The Hilmer Committee also made recommendations for the implementation of an access regime (contained in the new Part IIIA of the TPA). This would allow firms to be given access to certain types of infrastructure which cannot be duplicated economically, known as 'essential facilities', on fair and reasonable terms. The National Competition Council plays an important part in determining whether access rights to particular essential facilities, such as the electricity transmission grid, pipelines and railway tracks, should be created and, if so, under what terms and conditions. The Australian Competition Tribunal provides an appellate jurisdiction to applicants seeking access rights.

5. The Committee made recommendations on changes to the prices oversight mechanism. That is, a national competition policy should include a carefully targeted prices monitoring and surveillance process to apply to markets where the conditions for effective competition are absent - such as where firms have a legislated or natural monopoly or the market is otherwise poorly contestable. In such instances firms may be able to charge prices above efficient levels, and this "monopoly pricing" is detrimental to consumers.

A firm could only be subject to the prices oversight mechanism without its consent if the National Competition Council had recommended declaration after a public inquiry into competitive conditions in the market and the firm was found to have substantial market power in a substantial market in Australia.

The Committee recommended that powers be limited to prices oversight and monitoring, with no provision for price control.

6. The Hilmer Committee also recognised the need for firms to compete on a neutral footing, and in many circumstances government business enterprises experienced unfair competitive positions over private firms. The Committee recommended that the Australian governments adopt a set of principles aimed at ensuring that government business enterprises (GBE's) do not have a competitive advantage over private sector firms.

   In that respect, government business enterprises should compete against other firms in their traditional markets subject to measures that effectively neutralise any net competitive advantage flowing merely from their public ownership.

The implementation of the reforms resulting from the Hilmer Review has resulted in the exposure of Australian business at all levels to competition policy. This "Hilmerisation" process is being achieved by taking an economy-wide approach to ensuring that anti-competitive restrictions are removed unless some clear public benefit is shown and by putting in place mechanisms to test for these claimed public benefits.

The extension of the coverage of the TPA to unincorporated enterprises and the removal of the shield of the crown has provided the economy-wide application that the Hilmer Committee was seeking in its recommendations. It acknowledges the changing nature of the Australian economy towards a single national market and the trends towards globalisation. The Inquiry has the opportunity to ensure the application of the reform process which began with the Hilmer Committee is successfully implemented throughout the financial services sector.

The Hilmer Committee sought the creation of a national competition policy in which the Commonwealth, State and Territory governments in Australia co-operated to ensure that universal and uniformly applied rules of market conduct applied to all market participants. The Hilmer Committee said:

> ... the objective of protecting a competitive process [is] the most appropriate for the competition conduct rules of a national competition policy. The rules themselves should not be aimed at favouring particular sectors of our society.[2]
>
> ... the general desirability of permitting competition is so well established that those who wish to restrict or inhibit competition should bear the burden of demonstrating why that is justified in the public interest.[3]

[2] Hilmer Report p 26

> ... the general conduct rules of a national competition policy should, in principle, apply to all business activity in Australia, with the exemptions for any particular conduct only permitted when a clear public benefit has been demonstrated through an appropriate and transparent process. Indeed, this much has already been agreed by Australian governments.[4]

In determining how to implement its proposed reforms the Hilmer Committee made important judgments on two key issues. The first was whether the regulators of competition policy would be industry-specific or generalist, and the second was what role the Commonwealth, State and Territory governments would play.

On the first point the Hilmer Committee said that industry-specific regulators are at greater risk of capture by the industry they regulate and an industry-specific approach would tend to fragment the application of competition policy which in turn could lead to inconsistency of application as between different industries. It was because of these concerns that the Hilmer Committee recommended that an economy-wide regulator be established.

On the role of the Commonwealth, State and Territory governments, the Hilmer Committee's recommendations led to the establishment of the Australian Competition and Consumer Commission. In addition, a National Competition

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[3] Hilmer Report p 18

[4] Hilmer Report p xxiv

Council was established jointly by Australian governments to provide a high level of advice and analysis of competition policy.

Many of the recommendations of the Hilmer Review have been put in place and others, such as the expiry of many State and Territory legislated exemptions from the TPA, are scheduled to come in over the next few years.

Section 50 of the Trade Practices Act, the mergers test, is an important element of competition policy in Australia. The change in the test from dominance to a substantial lessening of competition (which took effect from 21 January 1993) was consistent with the wider review of competition policy and industry regulation commenced by Australian governments in the early 1990's. Its application is an integral part of achieving micro-economic reform in Australia and maintaining the benefits of that reform.

Hilmer and Financial Services

In assessing the regulatory arrangements affecting the operation of the financial services sector, it is important to consider the significant progress made through the Hilmer reforms in competition policy on an economy-wide basis. The concerns raised by the Hilmer Committee in relation to industry-specific regulators and competition policy remain strong arguments for the retention of a national approach to competition policy.

The wide range of institutions and products in the financial services sector, and the potential for the blurring of boundaries between financial services and the electronics and telecommunications sectors, may lead to the creation of grey areas. These already exist with regard to the provision of a financial product or service ancillary to another purchase such as, say, a car loan. A specific financial services sector regulator may not be able to effectively cover these grey areas.

In a recent speech, Mr D R Argus, Managing Director and Chief Executive Officer of National Australia Bank, argued that "today any company with a sophisticated technology and communications platform and a broad customer base can successfully deliver a financial service. Computer software and postal service companies are a few examples."[5] Mr Argus has also nominated companies such as Microsoft, IBM, AT&T, British Telecom, Telstra, General Motors, General Electric, Mastercard and Visa as competitors of National Australia Bank.[6] While this situation may not be fully realised yet, developments in technology are providing the basis for future expansion in the delivery of financial services.

The convergence between finance and telecommunications highlights the concerns of the Hilmer Committee that national competition policy should be capable of adjusting to changes occurring in composite sectors.

[5] Speech to Trans-Tasman Business Association 4 April 1996.

[6] Interview Weekend Australian 25 May 1996, page 56.

There is a high degree of risk that a specific financial services sector regulator administering competition policy independently of the Hilmer reforms would not have the capacity or expertise to regulate effectively and meet the needs of a changing environment.

Flexibility is a key element to an effective regulatory regime. Given the dramatic changes in the provision of financial services in recent years and the predicted changes to come, the regulatory structure of the financial services sector should be adaptable to the changing nature of the products and services supplied. A major factor in achieving an effective regulatory regime will be to harness the market disciplining power of open competition through the promotion of the competition principles. The adoption and promotion of the competition principles by the Inquiry will greatly boost the "Hilmerisation" of the financial system.

Recommendation 1

The Commission recommends that the Inquiry endorse the extension of the competition principles agreed to nationally by all Australian governments, as appropriate, to the financial services sector.

CHAPTER 2

COMPETITION POLICY AND THE ACCC

The Trade Practices Act 1974 (Cth) is one of the principal pieces of legislation for implementing the changes resulting from the National Competition Policy. Part IV of the TPA contains the Restrictive Trade Practices provisions including section 50, the mergers provision.

Section 50 prohibits mergers or acquisitions which would or would be likely to result in a substantial lessening of competition in a substantial market for goods and services (Although if some other public benefit exists, the merger or acquisition can be authorised by the ACCC, section 88 TPA). Section 50 is one of the most important provisions for ensuring competitive markets because it seeks to prevent market concentrations rising to such a level that firms in a market can exercise market power. A merger which produces very high levels of concentration threatens to diminish competition by enhancing market power or facilitating its exercise.

Section 50 - The Merger Factors

Section 50(3) provides a list of ‘merger factors’ which the Commission considers when making an assessment of whether a merger or acquisition would, or would be likely to, substantially lessen competition. This section provides a brief overview of what factors an ACCC merger enquiry looks at. The process is dealt with in greater detail in Chapter 3 and the Revised Merger Guidelines attached at Appendix A.

At the administrative level there is a five stage process of review which takes account of the statutory merger factors and structures them in such a way that at each step mergers which would not substantially lessen competition are cleared from further investigation. As the merger investigation moves through the five stages the complexity (and cost) of the information required from the parties and others escalates. The process is designed to achieve compliance at the lowest cost to the parties and to the Commission. The five steps are:

Market Definition:

In defining the market consideration is given to each of the following factors:

- demand-side;
- supply-side;
- product market;
- geographic market;
- functional market; and
- time dimension.

Concentration Thresholds

If market shares are below certain levels the Commission does not further investigate the merger.

There is no presumption that because a firm's market share is above a certain threshold it is necessarily considered to be anti-competitive. The reverse is true: below certain market shares the Commission does not investigate mergers.

Imports

If comparable competitive imports exceed ten percent over a period of three years the Commission does not investigate a merger.

Entry Barriers

If entry barriers are low the Commission does not object to mergers.

Other Factors

If a merger is still under consideration after the steps above have been taken, the Commission then engages in more detailed competitive analysis.

The possibility of anti-competitive conduct occurring still exists and Part IV of the TPA contains provisions to remedy such conduct. However, experience has indicated that preventing the creation of anti-competitive market structures is superior to other forms of action in achieving fair, open and competitive markets. The TPA provisions dealing with other forms of anti-competitive conduct were discussed in the ACCC's first submission to the Inquiry and in Appendix 3 to that brief.

The Commission takes a case by case market-oriented approach to merger matters and will look at all of the available information in the context of the merger proposal before it. The Commission will not assess hypothetical mergers and if it forms the view that a particular, real, merger may be in breach of section 50 then it must next decide what remedy is most appropriate and what evidence is required to obtain it.

In the majority of cases, parties approach the Commission prior to a merger or acquisition being undertaken so that any difficulties which the ACCC may have with it can be addressed. Trade practices lawyers and other professional advisors are well aware of ACCC methodology and merger negotiations between firms are often subject to completion only if they are not opposed by the ACCC. In any case where the ACCC has indicated that it would be likely to oppose a merger, there is almost always a further approach from the parties in an attempt to identify and redress ACCC concerns. If this cannot be done to the ACCC's satisfaction then there are some options open to the parties:

Discontinue. On occasion parties proposing to merge will, when faced with the prospect of ACCC opposition, abandon their plans. This has occurred in financial services as well as other industries.

Provide undertakings under section 87B to overcome ACCC concerns. In financial services, especially in banking, such an undertaking might be to sell off a specified number of bank branches in a particular area. This is an approach which has been used in the United States in order to overcome Department of Justice concerns about bank mergers. The Commission recognises that this particular type of solution might be more difficult to achieve in the smaller Australian market. The

Commission would look at any solution proposed to it in good faith to asses whether the solution overcame its concerns about a merger or acquisition resulting in a substantial lessening of competition. The Commission prefers “structural” undertakings, eg, divestiture, to “behavioural” undertakings, eg, a commitment not to increase prices.

Seek authorisation. The parties may seek to have a merger or acquisition which substantially lessens competition authorised. The authorisation process is described in Chapter 3. It was also covered in the ACCC’s first submission to the Inquiry.

Proceed with the merger. The Commission would then be likely to seek injunctive relief pursuant to section 80 of the TPA to enjoin the parties from proceeding with the merger. In such cases the parties have a right of appeal to the full Federal Court.

Since 21 January 1993, when the mergers test was changed to a substantial lessening of competition, there have been three occasions where the ACCC has sought interlocutory injunctive relief to enjoin the parties from proceeding with a merger or acquisition where the matter raised competition concerns[7].

[7] These are dealt with at page 2, note 1, of the Revised Merger Guidelines.

Recommendation 2

The Commission recommends that the Trade Practices Act, including section 50, continue to apply to all financial services providers.

Bank Mergers

The Westpac/Challenge Matter

In the Westpac Banking Corporation acquisition of Challenge Bank Limited in September 1995, the then Trade Practices Commission (now the ACCC) identified the product dimension of the market as the cluster or bundle of services provided by banks to their retail customers. The Commission determined that there were no close substitutes for the cluster or bundle which were available to customers. In doing so the Commission had regard to the technical characteristics of the goods and services, the perceptions of customers and users and the relative importance of the goods and services to the customer or user.

It was clear on an assessment of all these factors that no close substitute for the product, that is, the cluster or bundle of goods and services, provided by banks existed.

The cluster of services considered by the Commission included: loans, both home mortgages and consumer credit products; deposits, especially at call but also including term deposits; and payments, especially cheques, ATM and EFTPOS access, as well as credit or debit cards.

The Commission also identified that consumers did not generally create their own bundle of services using disparate suppliers. This was a further indication that close substitutes did not exist.

The importance of branches to retail customers, identified by the Martin Committee, crossed both the product dimension and the geographic dimension of the market definition.

The Martin Committee said:

> Industry representatives acknowledged that the costs of establishing a large branch network are a significant barrier to entry. These costs were cited by foreign banks as being one of the major reasons for their failure to make an impact in the retail banking sector.[8]

An article in the Australian Banking Law Bulletin noted:

> The existence of such an extensive network of branches (as is possessed by the incumbent banks) has undoubtedly made it more difficult for a new competitor to establish itself as, without undertaking a takeover, such a competitor faced the prospect of establishing a network of uneconomic branches and an extended and expensive price war to obtain market share.[9]

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[8] House of Representatives Standing Committee on Finance and Public Administration (The Martin Committee), A Pocket Full of Change, November 1991, Canberra, AGPS, p 144.

[9] D. Moore "Has The Competition Goal Of Deregulation Been Fully Recognised?" (1995) 10 Australian Banking Law Bulletin 57

The availability of over-the-counter (OTC) transactions was part of the cluster of services offered by banks. It was also a significant factor in the geographic dimension because of the high level of OTC business transacted by retail customers. A 1996 Ernst & Young report on technology in banking[10] reported that in 1995 in Australia 46% of retail banking was transacted in branches. The Commission also received information from one regional bank which indicated that up to 50% of its active customers did not make any use of electronic banking facilities transacting all their business through branches.

The reliance on OTC transactions indicated that retail customers did not have reasonable or practical access to banks which did not have an extensive branch network in their home State or Territory.

In the Westpac/Challenge matter the Commission formed the view that there were significant barriers to entry into banking in Australia. An extensive branch network, referred to above, for the provision of services has been identified as being important to the success of a mainstream full service bank. Opinions vary as to how long a branch network will continue to be important. Some in the financial services sector have said that branch networks will continue to be very important to banks until there has been a generational change where younger more computer-literate

[10] Creating the Value Network 1996, Fifth Annual Special Report on Technology in Banking, Ernst & Young LLP and American Bankers Association, p84.

customers replace older customers accustomed to using their passbooks in a branch.

Even for customers who made use of electronic banking for the majority of their banking requirements there were impediments to making use of interstate banking facilities. These obstacles to using interstate facilities included the need to open an account in person, as it is still not possible to open an account electronically, and the procedural requirements of the Financial Transaction Reports Act 1988 (Cth). The introduction of charges for the use of ATM's can also affect the viability of operating an account through an interstate bank given that fees for transactions conducted through ATM's not owned by the account holder's own bank generally attract higher fees.

The Commission's market enquiries made it clear that retail banking customers did not have ready access to interstate banks for their day to day banking needs and needed to have access to banks which operated extensively within their own State. The information cited earlier on the level of OTC transactions reinforces this point.

Also of significance in determining that the relevant market was regional rather than national was the fact that ANZ has chosen to retain the separate Town & Country brand in Western Australia. Town & Country is a subsidiary of ANZ which operates under the ANZ banking authority but the head of Town & Country, unlike his colleagues in other States, is referred to as the Managing Director rather than simply as a manager. ANZ operates 31 Town & Country-badged branches in Western Australia.

Since its acquisition of Challenge Bank, Westpac has retained the Challenge brand in Western Australia. Westpac has also recently announced the reorganisation of its management structure on regional (more or less State-based), as opposed to product-based, lines.

The Westpac/Challenge merger, which was not opposed by the Commission, resulted in what might be considered by some to be a narrow definition of the market. However it was defined in this way because that is how the market was at that time. The Commission did not say, and was not of the view, that the market for retail banking services in Australia was uncompetitive. Indeed it did not oppose the proposed merger but it was clear from the enquiries conducted in that matter that it was the regional banks which made the market competitive. The Commission believed that, left to themselves, the four major banks were less likely to compete vigorously and the position of the regional banks as competitive spurs needed to be recognised and preserved. This was the reason for the Commission's comments in the Westpac/Challenge matter that it would require at least one strong regional bank in each State.[11]

[11] A copy of the Commission's media release in the Westpac/Challenge matter was attached to the ACCC first submission to the Inquiry.

Despite predictions of virtual banking, Internet banking, mobile banking, banking without banks, banking through telecoms and the increasing globalisation of banking, the evidence before the Commission showed that ordinary retail customers, who stood to be most affected by a merger, used full service banks with a local presence (through branches, ATMs and EFTPOS). A high proportion of customers used a branch to conduct their banking business and the business they transacted with the bank involved a bundle of services being provided to the customer. No other type of institution provided the same range of services with the same level of accessibility. The Commission was not saying that it doubted that virtual banking and the rest might be significant factors in the supply of financial services. The Commission's position was simply that these things did not yet have such an impact on consumer behaviour as to shape the market definition in retail banking.

Globalisation has also been identified as having changed the face of banking in Australia. For corporates, the ACCC has no difficulty in believing that this is the case. Indeed the major corporates can raise funds in any number of ways including bypassing the banks completely. The Commission accepts that dis-intermediation is a significant factor in that sector of banking and finance. However, the Commission has not yet seen any evidence of the impact of globalisation on the supply of day to day banking services to retail customers in Australia.

Banking and Other Legislation

It would appear that Australia's banks are being shielded from the effects of global competition. The Banks (Shareholding) Act 1972 (Cth) and the Foreign Acquisitions and Takeovers Act 1975 (Cth) could be significant impediments to international competition. Both these Acts can be used to block acquisitions of Australian banks by foreign financial institutions and claims about international competition ring rather hollow while such protection for banks exists.

The Banks (Shareholding) Act goes further and can limit an acquisition of an Australian bank by another Australian person or entity. The ACCC questions whether such restrictions are justifiable.

There is also section 63 of the Banking Act 1959 (Cth) which requires that the Treasurer's consent (which will not be unreasonably withheld) be given for an amalgamation, reconstruction or partnership between banks. There is a risk that the Treasurer's consent could be withheld for competition reasons when competition considerations should properly be left to section 50 of the TPA. The ACCC believes that the Inquiry as part of its role in undertaking a review of anti-competitive legislation should determine whether these restrictions are warranted.

Recommendation 3

The Commission recommends that the foreign ownership restrictions in the Foreign Acquisitions and Takeovers Act 1975 (Cth), in so far as they apply to financial services providers, be removed.

Recommendation 4

The Commission recommends that the shareholding restrictions contained in the Banks (Shareholding) Act 1972 be removed.

Recommendation 5

The Commission recommends that the section 63 of the Banking Act 1959 (Cth) be amended to make it explicit that the Treasurer’s consent shall not be withheld on competition grounds.

There is a significant amount of State and Territory legislation which favours banks to the exclusion of building societies and credit unions. Typically this legislation requires that certain types of bodies - Government departments, local government authorities, persons required to hold trust accounts - hold or operate bank accounts. Such provisions restrict the ability of building societies and credit unions to compete against the banks for this business.

Recommendation 6

The Commission recommends that the Inquiry endorse the review of all legislation, regulation and trade practices in the financial services sector which are anti-competitive and against the public interest.

The ACCC understands that submissions from the building society and credit union representative bodies are likely to canvass this issue in detail and the ACCC does not propose to do so here. However, the ACCC does support efforts to remove unwarranted discrimination in State and Territory legislation which, subject to appropriate prudential requirements, restricts building societies and credit unions from competing equally with banks. The ACCC notes that New South Wales has recently passed legislation to remove discriminatory provisions from its legislation. Such an enactment may serve as a model for other States and Territories.

Recommendation 7

The Commission recommends that, subject to prudential requirements, building societies and credit unions be enabled to compete equally with banks and that discriminatory legislation that provides no clear public benefit be reviewed.

Technological Change

The ACCC has kept up with developing technologies, and has been assessing the likelihood of foreign financial institutions offering goods and services to Australian retail customers. The Commission is also aware of the prospect for significant changes to customer behaviour which may result from the introduction of new technologies. However, the Commission still does not have credible evidence of a significant uptake of new technologies or of major changes to customer behaviour that would lead us to accept that Australian retail customers use a global network to do the grocery shopping or pay the electricity bill.

Over an extensive series of informal talks between the ACCC and financial services providers, analysts and advisors, the general view seemed to be that changes in the pattern of customer usage of branches and electronic facilities would be evolutionary not revolutionary and would come in over the medium to long term. Some analysts said that the change to high levels of use of electronic banking could be extremely slow in coming and that the banks had little control over the pace of that change.

If the pace of change is relatively slow, then the need to establish a significant branch network which offered convenience and accessibility for customers is, and will remain, a barrier to new entry for some time to come. The Commission is also aware that banks are being advised to retain strong branch networks which, through redesign and re-configuration, can be a strong competitive advantage in offering customer accessibility.[12]

[12] Mr Stuart James, State Bank of NSW, presentation to Banking without Banks Conference, 28-29 February 1996, Sydney; Ms Molly Rice, John Ryan International, presentation to Banking without

Besides the branch network, a new entrant also needs to establish or get access to electronic banking facilities, in particular ATM's and EFTPOS.

Using the manner of usage of a product by the consumer as one reference point in determining market definition the Commission arrived at a market definition of retail banking services in a State. The existence of other institutions which provided one or two services out of the bundle was not enough to broaden the relevant market to include NBFI's because customers did not use them in the same way, or to the same extent, that they used banks.

In reaching this decision, the Commission was not making any judgement about the likelihood or desirability of significant changes occurring in relation to the provision of financial services. It was saying that banks, and the services they provide, had sufficiently distinctive characteristics that, at the time of the proposed acquisition of Challenge Bank by Westpac, it warranted identifying a separate State-based retail banking market.

However, neither the market nor the ACCC have stood still. Since the Commission's consideration of the Westpac/Challenge matter there have been a number of developments in the provision of financial services which could potentially impact on the way in which the Commission defines the market in the future.

Banks Conference, 28-29 February 1996; "Branch banking is not a dinosaur", Mendonca and

There has been a marked increase in home lending by non-bank institutions as well as increases in remote (telephone, PC and Internet) banking. Australia Post now offers giroPost for some eight institutions, credit unions plan to increase the number of credit cards they issue, and plans are well advanced to allow one card access to all Australian ATM's. Credit unions are also engaged in a program to offer services to rural and remote area residents where a bank branch has closed down. Stored value cards (smart cards or electronic purses) are being trialed in several different locations and the Federal Government has announced its plans to allow banks, building societies, credit unions and life offices to offer Retirement Savings Accounts.

Alternative Analysis

Besides the impact which these changes, and others not canvassed here, might have on how the market is defined, the Commission also has open to it the option to change the method of analysis it uses in banking and financial services matters. The alternative method open to the ACCC, the multi-product firm analysis, was canvassed in the ACCC first submission to the Inquiry. The Commission would consider recent developments in any merger proposal which was put to it. In doing so it would continue to assess each matter on a case by case basis looking at the prevailing circumstances at the time of the proposed merger or acquisition.

Nakache, McKinsey Quarterly, 1996, Number 1, p 136.

Banking in Transition

Australia's banks have only recently emerged from a long period of what amounted to an officially sanctioned cartel. The controls on interest rates and on the activities of banks meant that credit was rationed and the low level of competition that did exist between the banks was mostly non-price competition.

The ACCC has grave concerns that an industry only deregulated in the past ten or twelve years is seeking to engage in mergers which will create high levels of concentration and will also take out smaller regional banks which the evidence indicates have been innovative, efficient, customer focused and a positive force for competition.

Overseas experience has shown that regulators are likely to face pressure from participants who have recently emerged from long periods of close regulation into deregulated markets to be allowed to merge. While some of this merger activity is beneficial it is also clear that it can lead to the undoing of the competitive gains achieved by deregulation.

The prospect of the members of what was effectively a cartel, newly unrestrained, moving directly to do this does not sit easily with the ACCC's responsibilities under the TPA. Nor does it bode well for the level of choice, price and service which will be available to retail customers in the future. The recent calls for the rules on bank mergers to be changed or relaxed to allow the creation of some larger banks in

Australia, which it is said will make them more competitive internationally, are of concern to the ACCC. Such calls go directly against the principles of Australia's National Competition Policy which, as noted in Chapter 1, is predicated on economy-wide application.

Attempts to sway the Inquiry in favour of making recommendations which might compromise the effectiveness of the National Competition Policy are, with respect, an inappropriate response to changes in the marketplace brought about by deregulation and the implementation of the Hilmer reforms.

The argument that Australians should bear the burden of anti-competitive structures at home because this may make some few institutions more competitive on the world stage is entirely unsatisfactory. There is indeed strong economic evidence which debunks the idea that such an arrangement would lead to international competitiveness.[13]

There have been claims by some bankers that bank mergers not only offer opportunities for considerably enhancing the efficiency of their operations but that mergers are the only way this can be achieved. The ACCC has concerns about both these claims.

[13] Michael E. Porter The Competitive Advantage of Nations, 1990, MacMillan, London.

First, the claims to increased efficiency come about from rationalising branch numbers and reducing the number of staff. The ACCC does not question that cost savings can be achieved by closing branches and by shedding excess staff. However, the efficiency gains to be achieved from these moves are in the way of short run cost savings which do not necessarily indicate any improvement in internal efficiency of the merging banks as regards long run costs.[14]

The ACCC has not done a complete analysis of the efficiency gains to be made from bank mergers and claims to enhanced efficiencies have not been tested by the ACCC in the course of either a merger investigation or as a result of an authorisation application. As a general view the Commission believes that such claims should form part of an application for authorisation.

As to the second claim, the Commission does not accept that merger is the only method open to banks to achieve efficiencies. The Commission is naturally reluctant about telling industry how it should be structured, except to the extent necessary to ensure compliance with the legislation it is responsible for administering, but it does see that it is important to ensure market diversity.

There is evidence that scale and scope economies for different banking services and products may appear or disappear at different levels of scale. Cheque

[14] See G. Walker Estimation of Economies of Scale for Australian Banking with Labour as a Quasi-Fixed Input Paper presented to Australian Institute of Bankers Banking and Finance Conference, July 1995 and G. Walker Banking on Size: Australian Evidence The Australian Banker, June 1995, p113.

processing is an example of a process which can be delivered most cheaply at high scale, including scales in excess of any individual Australian bank. Other bank services and products, some types of transaction services for example, appear not to present any economies of scale. Different levels at which scale economies or diseconomies occur helps to explain why banks or financial services providers of markedly different sizes can be successful and profitable.

The fact that the financial services sector is fragmented in terms of the size and scope of participants does not necessarily indicate that the sector is inefficient. This situation can be indicative of it being competitive because it delivers to consumers a wide choice in types of banking product, and in terms of price, service and level of quality available. This level of diversity in the market helps maintain pressure on all participants to perform or perish. An uncritical acceptance of assertions about efficiency gains may lead to this pressure being removed at a time when banks and other financial services providers need a push from ‘red hot’ competition to ensure improvements in efficiency, performance and consumer benefits.

Mergers may also prevent the development of more efficient market structures. This could occur where a merged entity achieves sufficient scale of operations to continue to conduct in-house a process such as, say, mortgage processing, loan administration or payments clearing, which could be undertaken far more efficiently by an outsourced contractor. Indeed some of the other firms which banks have identified as potential rivals - telecommunications companies, IT companies - are considered by many analysts, advisors and others as more likely to become service partners with the banks rather than head to head rivals in the provision of financial services. This means that telecoms and IT companies would serve as deliverers of financial services but banks and other financial institutions would be the content providers. Strategic alliances and joint ventures of this type could prove to be pro-competitive and efficiency enhancing by allowing banks to concentrate on those areas where they have expertise and a competitive advantage.

The evidence of efficiency gains from banks mergers is at best equivocal. At a minimum, banks have not yet substantiated their claims about efficiencies and a clear distinction must be drawn between short run cost savings and long run efficiency gains. If claims of efficiencies from banking mergers are put to the ACCC in a bank merger matter they will be rigorously tested. As Coopers & Lybrand have recently noted, banks must substantiate the claims they are making about the benefits mergers will bring.[15]

The issue of to whom benefits realised from mergers, if there are any, will accrue also needs to be addressed. The importance of this will depend on whether merger parties were seeking authorisation or were putting claims of enhanced efficiency forward to show that the merged entity would, through these efficiencies, be more competitive. In either case the types of efficiencies claimed are important in considering the matter. In the case of authorisations the benefits from the merger must include public benefits.

[15] Coopers & Lybrand On Banking an occasional paper for bankers, April 1996.

Changes in branch structure - in numbers, location and design - are also indicative of a change in the way banking will be done. The ACCC is looking at what these changes mean, in particular whether it means that the bundle of services identified in Westpac/Challenge has begun to unravel. If this is so then the other financial institutions which offer retail transaction accounts (RTAs) - building societies and credit unions - might properly be considered close substitutes for banks and so come within the market definition.

If the ACCC were to adopt such an approach the same merger enquiry considerations outlined at the beginning of this Chapter, and in Chapter 3, would continue to apply in this slightly expanded market. The Commission would pay close attention to gathering evidence that indicated whether or not building society and credit union RTAs were close substitutes to those offered by banks. For these to be included when assessing a merger between two banks, the ACCC would need in the particular case to be satisfied that building society and credit union RTAs offered a comparable level of accessibility, flexibility, price and risk to those provided by the parties to a proposed merger. The Commission would also need to be satisfied that consumers used non-banks RTAs as a close substitute for those offered by banks.

It is important to note that to date banks have not tested the merger provisions or the authorisation provisions of the TPA. Many of the claims made about the benefits of mergers among banks are precisely the sort of matters which would need to be tested by the merger enquiry process or as part of an application for authorisation. There is no basis for changing untested provisions of the Trade Practices Act.

Other Mergers involving Banks and Non-bank Institutions

While the Westpac/Challenge matter is the one where the Commission most clearly stated its position on bank mergers it is not the only bank merger or acquisition which it has examined.

The Commission was kept informed of developments which were occurring in relation to the Commonwealth Bank of Australia's acquisition of the State Bank of Victoria in January 1991. This acquisition occurred when the dominance test applied to section 50 matters. The Commission did not oppose this acquisition.

The Commission examined but did not oppose the acquisition of the State Bank of NSW by Colonial Mutual Life in January 1995. Market enquiries at the time indicated that the two entities operated in separate markets and there were no cross-holdings or other interests which caused competition concerns.

In August 1995 the Commission examined the Advance Bank acquisition of BankSA. This matter was the subject of extensive discussions with the relevant parties as well as market enquiries. The Commission did not oppose this acquisition. St George Bank had also expressed an interest in merging with BankSA. The Commission indicated that it did not have competition concerns about this matter either.

The Commission examined the acquisition of BankWest by Bank of Scotland in September 1995 and also indicated that it would not oppose that acquisition.

The Commission examined National Australia Bank's acquisition of 6.8% of St George Bank, which became public in March 1996. That partial acquisition did not cause the Commission any competition concerns. NAB's subsequent acquisition of an interest in Metway Bank through the purchase of preference shares and ordinary shares did not raise competition concerns for the Commission.

The Commission examined the proposal for St George to merge with Metway Bank in March 1996. This matter did not raise competition concerns for the ACCC and would not have been opposed.

The St George/Metway proposal was superseded by a Queensland Government sponsored deal for the merger of Suncorp Insurance and Finance, Metway Bank and Queensland Industry Development Corporation (QIDC) to create a major Queensland-based financial services institution. The Bank of Queensland was invited to join the deal but declined. The ACCC also examined this matter but does not intend to oppose it.

On the broader issue of mergers which might take place between banks and other financial institutions, particularly insurance companies, the ACCC has relatively few concerns. The Commission did not oppose the Colonial Mutual Life acquisition of

State Bank of NSW in January 1995 nor has it opposed the proposed amalgamation of Metway Bank, Suncorp Insurance and Finance and QIDC currently underway in Queensland. Prior to these the Commission had no objection to the proposed ANZ/National Mutual venture in 1990 although this was considered under the dominance test prior to the amendment of section 50.

If the so-called ‘Six Pillars’ doctrine which the then Treasurer, Mr P J Keating, used in May 1990 to rule out mergers between any of the major banks and the two largest insurance companies, was to be changed the Commission would apply the same merger enquiry procedures as it does to any other matter.

As a provisional view the Commission would tend to consider that insurance companies and banks operate in different markets. Such a view would be thoroughly tested as part of the Commission’s response to any such merger proposal which might be put to it, but the Commission would not expect that competition concerns sufficient to warrant opposing a major bank/insurance company merger would arise. The Commission believes that it would be appropriate to remove the prohibition on the merger of banks and insurance companies and allow such matters to be dealt with under the appropriate provisions of the Trade Practices Act.

Recommendation 8

The Commission recommends that mergers between banks and insurance companies should only be subject to the Trade Practices Act and prudential requirements.

CHAPTER 3

ACCC MERGER INVESTIGATIONS AND THE AUTHORISATION PROCESS

Mergers and the Trade Practices Act

Mergers in the financial services sector are of particular importance to the Commission, as well as to the Inquiry. Merger analysis is a complex, detailed process that needs particular focus to be effective. Analysis of a merger proposal requires consideration of the specific market characteristics to assess its legal and economic effects and to determine what remedies or other action might be appropriate.

As much as mergers in the financial services sector are of importance to the Commission and the Inquiry they are also of interest to financial services providers as well as the community more generally. In order to provide for commercial certainty the ACCC has published merger guidelines to provide both business and the community with sufficient guidance to readily determine whether a particular merger is likely to exceed its concentration thresholds. Mergers and acquisitions which exceed the concentration thresholds will be subject to more detailed scrutiny.

The provisions of the Trade Practices Act relevant to mergers include:

- mergers and acquisitions - s.50;
- extraterritorial operation - s.5(1);
- overseas share acquisitions - s.50A;
- anti-competitive agreements - s.45;
- definition of acquisition of shares or assets - s.4(4);
- market definition - s.4E;
- lessening of competition includes preventing or hindering - s.4G;
- power to grant authorisations - s.88;
- determination of an application for authorisation - s.90;
- application to Australian Competition Tribunal for Review - s.101;
- injunctions - s.80;
- divestiture and setting aside acquisitions - s.81;
- pecuniary penalties - s.76; and
- enforceable undertakings - s.87B.

The Commission's merger analysis is a fact intensive and market-oriented approach based on the general competition policy position of the Trade Practices Act. The merger review process outlined by the ACCC in its July 1996 release of the Revised Merger Guidelines, details the extent of the intensity, thoroughness and detail of the

ACCC's investigatory process in determining whether a proposed merger/acquisition is in breach of section 50 of the Trade Practices Act.

The Guidelines outline the Commission's policy for the administration and enforcement of those provisions of the Act that deal with mergers. They include detailed discussion of the statutory factors to be taken into account under section 50(3) of the Act in determining whether an acquisition substantially lessens competition.

The importance of merger investigation work for the Commission can be shown from the breadth of effort given to reviewing mergers in the recent years after the test was changed to one of a substantial lessening of competition in 1993. Before 1993, section 50 assessed acquisitions under the dominance test. Only a subset of mergers which were likely to lessen competition substantially were prohibited, that is those that gave rise to dominance or increased dominance in a substantial market.

Dominance occurs where there is only one large firm in an industry and it is free from effective competitors. An example is where in an industry with four players who each had 25% of the market share, a set of mergers occurred following which two 50% players remained. There would be no dominance because two big firms remained. The increased concentration could, however, be associated with a substantial lessening of competition if there were few or no imports and high barriers to entry. In such circumstances anti-competitive co-ordinated pricing behaviour could, for example, be facilitated.

Since 21 January 1993, the Commission has based its investigatory process on section 50(1)-(2) of the Act which provides:

> "(1) A corporation must not directly or indirectly:
>
> (a) acquire shares in the capital of a body corporate; or
>
> (b) acquire any assets of a person;
>
> if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.
>
> (2) A person must not directly or indirectly:
>
> (a) acquire shares in the capital of a corporation; or
>
> (b) acquire any assets of a corporation;
>
> if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market."

Merger analysis is a dynamic process of information gathering and examination of the appropriate issues to determine the competitive effects of changes to market structure. The Commission has developed a comprehensive approach to merger investigations under the substantial lessening of competition criteria, as outlined in the Revised Merger Guidelines. Such a process cannot be completed effectively without the devotion of sufficient resources, expertise and market research to arrive at an accurate decision.

The Merger Factors

In evaluating whether a merger is likely to have the effect of substantially lessening competition in a substantial market, section 50(3) of the Trade Practices Act requires regard to be had to a non-exhaustive list of 'merger factors':

a) the actual and potential level of import competition in the market;

b) the height of barriers to entry to the market;

c) the level of concentration in the market;

d) the degree of countervailing power in the market;

e) the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins;

f) the extent to which substitutes are available in the market, or are likely to be available in the market;

g) the dynamic characteristics of the market, including growth, innovation and product differentiation;

h) the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor; and

i) the nature and extent of vertical integration in the market.

The Explanatory Memorandum to the Trade Practices Legislation Amendment Bill 1992 makes it clear that the list of factors in section 50(3) is non-exhaustive:

> This is not an exhaustive list, and some of the factors are interrelated ... In considering a proposed acquisition, regard is to be had to the factors specified in the list, but of course there may be other factors that would need to be taken into account in any particular case, and the weight to be given to any factor, whether included in the list or otherwise found to be relevant, has to be determined in the context of the facts of the case.

In analysing the likely effect of a merger or acquisition, the Commission has organised the statutory factors into a five stage evaluation process. The process is designed to give clear signals to the business community, wherever possible, as to the Commission's likely attitude to potential mergers. The Commission will only conclude that a merger or acquisition will result, or be likely to result, in a substantial lessening of competition in a substantial market after consideration of all the statutory merger factors and any other relevant issues.

Market Definition

The first step is to define the relevant market, in its product, functional, geographic and time dimensions. From a legal perspective, the Act requires that the assessment of substantial lessening of competition or substantial degree of market power be related to a market. Delineation of the relevant market from an economic view, helps to focus the analysis of competition effects. It is a necessary prerequisite for the calculation of market shares and identification of other market characteristics, such as the height of barriers to entry.

Section 4E of the Trade Practices Act provides that the term 'market':

> includes in a market for those goods and services and other goods and services that are substitutable for, or otherwise competitive with, the first mentioned goods or services.

Section 4E was introduced in 1977 following a recommendation of the Swanson Committee that the definition of a market should:

> ... require that, in the determination of a 'market' for practical purposes, regard shall be had to substitute products which have a reasonable interchangeability of use and which have high cross-elasticity of demand, i.e. where a small decrease in the price of a particular product would cause a significant quantum of demand for a similar product to switch to the product in question.

When defining the market, the Commission assesses which products are close substitutes for each other and what sources of supply are available to meet the demand for those products (eg, local, national or overseas producers, or producers of other products who may be able to supply the relevant product). Market definition requires an assessment of competition at product, geographic and functional levels. The Commission will also take account of the changing nature of competition over time.

The Commission conducts this examination by interviewing businesses, and other market participants, which may be involved in supplying products to the merged firm, competing with it or buying products from it. In some major merger cases this has entailed the Commission interviewing as many as 50 to 100 market participants, to get their first hand assessment on the operation of the market. The

Westpac/Challenge matter involved an extensive analysis of financial sector participants, the Commission contacted or heard from 86 parties, to establish the definition of the relevant market.

The Commission's approach to market definition is based on widely accepted economic principles, which have been adopted by Australian Courts and the Australian Competition Tribunal (formerly the Trade Practices Tribunal). The Commission's approach is also consistent with that adopted by overseas competition regulators such as the US Department of Justice, the UK Monopolies and Mergers Commission and the European Commission’s Competition Directorate.

The process of market definition can be viewed as establishing that area of product, functional and geographic space within which a hypothetical current and future profit-maximising monopolist would impose a small but significant non-transitory increase in price (SSNIP) above the level that would prevail had the merger not taken place. This is the standard used in both the US and Canadian merger guidelines, except the latter only refers to a present monopolist, which would appear to incorporate potential entrants into the market.

The process of establishing the market boundaries starts with the product, geographic and functional area of supply covered by the merged firm. It is then extended in its product, geographic and functional dimensions to include all those sources, and potential sources, of close substitutes which would otherwise make it non profit-maximising for the hypothetical monopolist to impose a SSNIP or otherwise exercise a significant degree of market power.

If consumers would switch their demand to close substitutes and/or firms would switch their production to supply the customers of the merged firm, it will not be profit-maximising for the hypothetical monopolist to impose a SSNIP and the relevant market needs to be expanded to include these sources of substitute products. Note that it is the collective effect of substitution which determines what is in or out of the relevant market. A number of substitution possibilities, each of which is insufficient alone to defeat a SSNIP, may collectively have that effect.

In order to establish the relevant market for a proposed merger, the Commission is concerned to establish the potential sources of competitive, that is close, substitutes for the product(s) of the merging parties. Following the practice of the Tribunal and the Australian Courts, the Commission will consider substitution possibilities on both the demand and supply side when identifying the competitive constraints which delineate the relevant market.

On the demand-side, the Commission will examine which goods or services consumers consider to be close substitutes for the merged firm's product and which geographic sources of supply they consider to be substitutable. If cross-price elasticity of demand is high, such that in the event of a significant price rise, or equivalent exercise of market power, by the merged firm, consumers would switch to purchasing these alternatives to the extent of defeating such a price rise, these products and sources of supply will be included in the relevant market.

On the supply-side, the Commission will consider which suppliers could, without significant investment, switch their production and/or distribution facilities to supply a substitute product to that supplied by the merged firm, or switch from supplying another geographic area to that supplied by the merged firm. If cross-price elasticity of supply is high, such that in the event of a significant price rise, or equivalent exercise of market power, by the merged firm, these suppliers would switch their supply to the extent of defeating the price rise, these suppliers will be included in the relevant market.

Delineation of the relevant geographic market involves the identification of the area or areas over which the merged firm and its rivals currently supply, or could supply, the relevant product and to which consumers can practically turn. Starting with the geographic area supplied by the merged firm, each geographic market is gradually expanded to incorporate sources of supply to which consumers would turn, and firms which supply, or would supply, the relevant product into that area in the event of a significant price rise, or equivalent exercise of market power, by the merged firm.

Delineation of the relevant functional market requires identification of the functional level(s) at which the merged firm will operate and close substitution possibilities, either product and/or geographic, at another functional level (not *between* functional levels) which would constrain the merged firm from imposing a significant increase in price, or equivalent exercise of market power.

In those few cases where market definition is critical, views as to what is the correct market definition may sometimes differ and merger parties may disagree with the Commission's assessment. The process of market definition will in some industries give rise to the conclusion that the market is of a particular character, eg regional, whereas in another quite different industry the conclusion may be that it is a national market. This does not mean there is necessarily any inconsistency.

Concentration Thresholds

Merger factor (c) requires the Commission to consider the level of concentration in the market. Market concentration refers to the number and size of participants in the market. The thresholds used in the merger guidelines are aimed at minimising cost, particularly where mergers are not likely to raise any competition problems. That is, a merger that falls below the thresholds is considered unlikely to substantially lessen competition in breach of section 50. Where mergers do exceed the threshold, the Commission will give detailed consideration to the competition effects of the merger.

The Commission's two thresholds, one to deal with the situation of unilateral market power (similar to the concept of single firm dominance) and the other to deal with the situation of concentrated markets, where there may be combined or oligopoly market power, were set so that the Commission would not look at mergers where:

- unilateral market power: the merged firm had less than 40% of the market; and
- combined market power: the four largest firms had less than 75% or, where the four largest firms had more than 75%, the merged firm had less than 15%.

The Commission's thresholds are at higher levels of concentration than those used in overseas jurisdictions, such as the United States and Canada, where mergers at lower levels of concentration are investigated.

Imports and Barriers to Entry

Import competition and barriers to entry also play an important role in the determination of the competitive effects of a merger. If import competition, or the potential for import competition, is an effective constraint on the exercise of domestic market power, it is unlikely that the Commission will intervene in a merger. Since the mergers test was changed in 1993, the Commission has not opposed any merger where sustained, directly competitive imports account for more than 10% of the market. Since 1993, in some 30 matters or more, the role of imports has been either critical or highly relevant in the Commission not opposing a merger.

The height of barriers to entry to a market may be a substantial factor in assessing a merger. Even where a merger breaches the concentration threshold and import competition is not effective, if the market is characterised by low barriers to new entry, incumbent firms are likely to be constrained by the threat of potential competition to behave in a manner consistent with competitive market outcomes.

However, if the barriers to entry into a market are high, a merger exceeding the Commission's thresholds, in the absence of significant import competition, is likely to give rise to a substantial lessening of competition.

Barriers to entry can take a variety of forms that places a prospective entrant at a significant disadvantage compared with incumbent firms. They can include: sunk costs; legal or regulatory barriers; access to scarce resources enjoyed by incumbent firms; economies of scale and scope; and the threat of retaliatory action by incumbents.

Other Factors

The other factors listed under section 50(3) will also influence the Commission to varying degrees, depending on their importance to each merger matter. They are supplementary to the primary considerations of market definition, concentration, import competition and barriers to entry. Statutory factors considering the dynamic characteristics of a market and the removal of a vigorous and effective competitor may play important roles in establishing the competitive effects of a merger.

The statutory list is non-exhaustive of the factors the Commission may take into account in determining the competitive effects of each individual merger. It is not possible for the Commission to foresee every possible factor which may be of relevance in particular market circumstances.

Remedies

Where the Commission concludes that a merger may have the effect of a substantial lessening of competition in a market, the Commission will advise the parties of its view. The Commission has the power under section 80, to seek a permanent injunction to restrain an anti-competitive merger. A private litigant cannot seek an injunction to restrain a proposed merger.

The Commission may also, in appropriate circumstances, accept undertakings pursuant to section 87B.   So far the Commission has accepted undertakings from parties to ensure that the merger will not proceed until the Commission has had the opportunity to make appropriate inquiries; or to resolve matters where the proposed merger is likely to contravene the Act.

The Commission is likely to look favourably on proposed undertakings which are able to address structural issues in the relevant markets. Structural solutions provide an ongoing basis for the operation of competitive markets. The regulatory costs are one-off rather than a permanent burden. For example, divestiture of particular divisions of the merged company may remove competitive concerns from the merger, while leaving the merger an attractive proposition for the parties. The Commission accepted undertakings in the Village-Austereo merger which resulted in the divestiture of certain capital city radio stations, in order to maintain competition in those markets.

Another example is the Ampol/Caltex merger. The Commission's inquiries into the proposed merger involved an intensive development of contacts and consultations within the petroleum industry. The Commission contacted over fifty related organisations and associations in gathering information on the proposed merger between Ampol and Caltex. In particular, the other major oil companies provided their views, automobile associations and other petroleum product user representatives such as the National Farmers Federation were also approached.

In addition, retailers, wholesalers, distributors and importers of petroleum products were contacted as well as the various government departments with experience in the petroleum industry. An economic expert also provided analysis of the merger's effect on competition.

After examining the proposed merger of Caltex and Ampol, the Commission reached the conclusion that it would have the effect of substantially lessening competition in various petroleum markets. The parties to the proposed merger offered, and the Commission accepted, undertakings which provided a structural underpinning for independent operators to continue to play a competitive role in petrol markets, undermining any attempts to coordinate pricing between the majors.

An alternative course of action for parties, if appropriate, is to seek authorisation for the merger under section 88. Authorisation is considered later in this Chapter.

The Commission and the Tribunal have long considered that the more efficient utilisation of the resources of the Australian economy which may be achieved through mergers will be of substantial benefit to the community as a whole. Accordingly, efficiency considerations are of importance in assessing the extent to which there may be an overall public benefit from a merger. In making an evaluation, the Commission has to weigh the analysis of both public benefit and public detriment.

If parties choose to proceed a merger which the Commission has concluded to be in breach of section 50 they may face stern penalties, up to a maximum of $10 million for a body corporate.

The policy of merger analysis is pro-active, rather than reactive. The Commission's intensive merger examinations are aimed at preventing the evolution of anti-competitive market structures.

It also needs to be kept in mind that the Commission's mergers policy is pre-emptive of its enforcement role. The penalties associated with a breach of section 50 signify the importance placed upon the maintenance of competitive market structures. The emphasis on the need for efficient and competitive markets for the development of the Australian economy is highlighted by the penalty provisions against any attempts to breach those provisions.

Information Gathering Powers

The ACCC possesses extensive powers for the gathering of information to carry out its enforcement role. Although rarely necessary in merger analysis, the Commission also has at its disposal the investigatory tool set out under section 155 of the Trade Practices Act. Under that section, the Commission has the power to make statutory demands for information where it has the requisite “reason to believe” that the information relates to a matter that constitutes, or may constitute, a contravention of the Act.

If the Commission had reason to believe that a merger was likely to substantially lessen competition and therefore contravene section 50 of the Act, it could issue a notice pursuant to section 155 to obtain information relating to the proposed merger. However, the Commission prefers a more co-operative approach in investigations of merger matters, and there is little need for the use of the information gathering powers under section 155, although it remains a reserve power. Perhaps merely the existence of such a power is sufficient incentive for co-operation in such situations.

An example of the detailed process of analysis that may accompany a proposed merger is the recent Wattyl/Taubmans paint matter. In April 1995, the owner of Taubmans Industries Ltd sought bids for the paint manufacturing operations in Australia. In July 1995, Wattyl advised the Commission of its interest in acquiring the Australian assets offered for sale. The Commission formed a preliminary view that there was a strong prospect that the proposed acquisition would have the effect of substantially lessening competition in breach of section 50. The proposed acquisition was announced publicly in October 1995, and the Commission undertook extensive market inquiries.

The Commission's inquiries extended to the competitors of Wattyl and Taubmans, namely ICI/Dulux, and retailers and consumers of the various products. The Commission also retained an economic expert to assist in assessing the effects of the proposed merger. The Commission contacted over 60 organisations and associations inviting them to provide information and express their views on the proposed merger.

After this investigation into the proposed acquisition, the Commission was able to decide on the competitive effects of the merger. On 6 December 1995, the Commission concluded that the proposed acquisition would be likely to breach section 50.

Wattyl indicated a preference for a Federal Court determination rather than seeking authorisation. Wattyl and Taubmans signed a contract for the purchase and sale of Taubmans' Australian business on 16 December 1995. The Commission initiated proceedings seeking an interlocutory order on 11 March 1996 to restrain the acquisition, this was not challenged. The parties lodged an application for authorisation on 3 April 1996.

After an extensive evaluation of the public benefits and detriments associated with the proposed acquisition, the Commission denied the application for authorisation by the parties. The parties lodged an application to the Australian Competition Tribunal to review the authorisation application, however prior to the hearing Taubmans was sold to an overseas bidder.

The process for determining the competitive effects of a merger under the Trade Practices Act is a well developed and complex procedure. The determination of the competitive effects of bank mergers is no exception to the process of profound evaluation of the factors that need to be taken into account. The Westpac/Challenge merger highlights the application of the Act.

The US Department of Justice's analytical framework for merger assessment in all industries, including banking, is contained within their 1992 Horizontal Merger Guidelines. The Guidelines' methodology requires a thorough examination and analysis of the facts and market conditions in the specific markets at issue in the same way the ACCC approaches its gathering of information. The US approach is also a fact intensive strategy that goes well beyond traditional measures of market share and concentration. Like the ACCC's use of thresholds, market concentration analysis is a mere step in the development of an information dense assessment of a proposed merger.

The US approach sets five steps in the process of examining a proposed merger similar to those undertaken by the ACCC. Market definition in terms of geography and product, anti-competitive effects, barriers to entry and efficiencies are all factors used in the US to examine a merger.

The process of merger evaluation by the Australian Competition and Consumer Commission is a detailed, fact gathering, extensive analysis of the relevant considerations to determine whether a proposed merger is anti-competitive and likely to substantially lessen competition in breach of section 50 of the Trade Practices Act.

Recommendation 9

The Commission recommends the continued application of the 'substantial lessening of competition' test in section 50 of the TPA to all financial services providers.

Authorisations

The Trade Practices Act provides for an authorisation mechanism whereby conduct which would otherwise substantially lessen competition can be permitted because it results in public benefit. The authorisation process demonstrates that the scheme of the TPA is to provide public benefit and not merely to promote competition. And so, in the context of section 50 and mergers, authorisation can be used to grant immunity, on the grounds of public benefit, to acquisitions and mergers which would or might otherwise contravene section 50 of the Act.

Immunity from legal proceedings in respect of a breach of the Act can give a competitive advantage to the parties to the authorisation. They are therefore granted only where benefits to the public result from the conduct and the detriments resulting from the conduct, including the lessening of competition, are outweighed by those benefits.

Under section 88 of the Act the ACCC has the power to grant authorisation for:

- anti-competitive agreements, including price fixing agreements (s. 45);
- covenants affecting competition (s. 45B);
- primary and secondary boycotts (ss. 45 and 45D);
- anti-competitive exclusive dealing (s. 47);
- exclusive dealing involving third line forcing (ss 47(6) and (7));
- resale price maintenance (s. 48); and
- mergers leading to or likely to lead to substantial lessening of competition (s. 50).

Authorisation is not available for misuse of market power (s. 46).

Authorisation does not take effect until granted by the ACCC.

In assessing applications for authorisation the ACCC must assess the public benefits and anti-competitive aspects of the arrangements or conduct. Should the public benefits outweigh the anti-competitive aspects the ACCC may grant authorisation.

The onus is on the applicant to show that the appropriate test is satisfied.

After considering the application the ACCC prepares a draft determination, normally within four months of receipt of the application. Any interested party dissatisfied with the draft can request a conference. Conferences are informal, without lawyers or other advisors present, and they allow all interested parties and the ACCC to discuss the operation and effect of the application. After the conference the ACCC reconsiders the application and publishes its final determination, usually within 30 days.

In the absence of a request for a conference or submissions opposing the draft, the ACCC promptly publishes its final determination.

Merger Authorisations

Authorisation applications for mergers are covered by additional specific legislative requirements. The ACCC must make a decision on such applications within 30 days of receiving them (plus any time taken by the applicant to provide additional information sought by the ACCC). The TPA provides for the ACCC to extend the period to 45 days in complex matters.

Authorisation is deemed to be granted if the ACCC does not make a decision within whichever time frame applies. Authorisation may be granted conditionally and/or may be granted subject to statutory undertakings provided by the applicant.

Parties proposing a merger should be aware that they cannot seek authorisation for an acquisition which has already occurred.

The Commission cannot initiate the process. The acquirer must lodge the application. While the Commission may suggest an authorisation application should be lodged, the decision on whether or not to do so ultimately lies with the parties.

In making its assessment the ACCC considers all potential public benefits from the proposed merger.

Section 90(9) provides that the Commission shall not grant authorisation

> unless it is satisfied in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place.

The Commission is specifically required by the Act to regard as public benefits:

- a significant increase in the real value of exports; or

- significant import substitution.

It must also take into account all other relevant matters that relate to the international competitiveness of Australian industry.

Merger and acquisition arrangements cannot be overturned once they have been granted authorisation.

The ACCC has the power to review and revoke existing authorisations under section 91(4) if:

- there has been a material change of circumstances affecting competition or public benefits in the areas covered;
- parties to the authorisation have not complied with conditions imposed by the Commission; or
- the authorisation was granted on the basis of information that was materially false or misleading.

If the ACCC revokes an authorisation it may issue another authorisation on different terms, conditions or time limits, if this is appropriate. Applications for review of ACCC determinations may be made to the Australian Competition Tribunal. In the case of mergers, the Tribunal must make a decision within 60 days except in special or complex circumstances.

In relation to the provision of financial services, the ACCC and the TPC before it have granted a large number of authorisations. These include a series of authorisations in relation to the payments system, two of which have so far been granted.

Authorisations relating to the Payments System

Another issue of relevance to competition in the financial services sector is access to the payments system. Over the years the TPC and now the ACCC has pressed the banks to liberalise access by non-bank financial institutions to the payments system. This is a continuing process in conjunction with the Australian Payments Clearing Association (APCA).

At its most simple a payments system is a mechanism provided by financial institutions to enable the transfer of financial assets. In Australia this is overseen by the APCA.

Under APCA, the payments system is being organised into four separate clearing systems covering paper transaction (mainly cheques), bulk electronic payments (such as salaries and welfare payments), consumer electronic payments (ATM and EFTPOS) and high value payments.

In September 1993 the then TPC granted authorisation for APCA's memorandum and articles of association as well as for the regulations and procedures of the paper clearing system. In October 1994 the Bulk Electronic Clearing System was granted authorisation.

The payments system operates for providers of payment services and participation is not limited to banks: Australian building societies and credit unions (through Special Service Providers) also participate. However non-bank financial institutions (NBFI's) participation in the paper clearing system is limited because they are prohibited from issuing cheques in their own name, and because they do not have settlement accounts for paper transactions with the Reserve Bank. The ACCC understands that amendments to the Cheques and Payment Orders Act allowing NBFI's to issue cheques in their own name will be reintroduced later this year.

APCA will soon be lodging an authorisation application in relation to the third clearing system, the Consumer Electronic Clearing System. The Commission has been advised that the authorisation application will cover ATM and EFTPOS only, and will not extend to credit cards (Mastercard, Visa and Bankcard). In addition, the authorisation application will relate only to the clearing and settlement of ATM and EFTPOS transactions between institutions, and will not cover arrangements relating to an institution's participation in the ATM or EFTPOS payment systems.

The components of the ATM and EFTPOS systems (terminals, switches and communications networks) are generally owned by individual industry participants. Access by other participants to these proprietary components is a matter for commercial negotiation. Participation in these systems will continue to depend upon the outcome of commercial negotiations.

Thus, any competition issues which may arise in obtaining access to the ATM, EFTPOS or credit cards systems will not be part of the APCA application for authorisation. These access arrangements have not been separately authorised by the Commission, and are therefore not exempt from action under the Trade Practices Act.

APCA also intends to apply for authorisation for its fourth clearing system, for high value payments, but this is pending the development of a Real Time Gross Settlement system by the Reserve Bank.

Issues of access to payments and clearing systems and the manner in which access is granted and/or controlled, particularly as it affects NBFI's, is of special importance for competition in the financial services sector. However, because authorisation applications are expected to come before the Commission, no recommendations will be put to the Inquiry in relation to the payments system or access to it.

Authorisations relating to Capital Markets

Another area of the financial services which the Commission has been involved in is in relation to adjudication of applications for authorisation of certain types of conduct in the capital markets.

The Commission's adjudication work with respect to Australian stock exchanges dates from the early 1980's. In 1982 the Commission denied authorisation but granted an interim authorisation for the Australian Associated Stock Exchanges (AASE) fixed brokerage rates and restrictions on membership. The AASE abolished fixed brokerage rates in 1984 and amended their membership rules although shareholding restrictions remained until 1987.

In 1984 the Commission granted authorisation with respect to the AASE amended rules until April 1987.

In April 1987 the AASE member exchanges amalgamated to form the Australian Stock Exchange (ASX). In May 1987 the Commission granted an authorisation for the ASX Articles of Association (covering membership) and Business Rules (covering conduct). The Commission has granted a number of authorisations since that time for various amendments to ASX Articles and Business Rules.

The more important recent adjudication matters have related to the automation of trading on the ASX including the 1992 authorisation of the Stock Exchange Automated Trading System (SEATS) computer network trading system and the 1993 authorisation of the T+5 settlement system. In 1994 and 1995 authorisations were granted in relation to the Clearing House Electronic Sub-register System (CHESS).

The Commission has also granted other authorisations in relation to ASX Rules covering its derivatives market, for example, options and share ratios.

The Commission has noted the competitive pressures the ASX faces from overseas stock exchanges and the recent proposals for changes to the ASX structure. The Commission expects to be involved in the future in additional adjudication matters relating to the ASX.

As with the payments system, further authorisation applications relating to the capital markets may come before the Commission and so no recommendations will be made.

The TPA authorisation process is valuable because it demonstrates that the scheme of the Act and the manner in which it is administered are designed to achieve maximum consumer benefit and not merely to promote competition regardless of the realities of a particular situation.

Recommendation 10

The Commission recommends the continued application of the authorisation process contained in Part VII of the Trade Practices Act to all financial services providers.

In the new co-regulatory structure for financial services which the Commission is proposing in Chapter 8, the Commission anticipates that it will be necessary to make use of the adjudication procedure to get authorisation for the rules and procedures of the proposed new regulatory arrangements.

CHAPTER 4

CONSUMER PROTECTION IN FINANCIAL SERVICES

Consumer Protection Issues in the Provision of Financial Services

As with other sectors of the economy, the difficulties that consumers face in purchasing banking, financial and insurance products are related to various forms of market failure and/or other impediments imposed by particular market conditions. The ACCC, from its complaints experience and other work, has identified constraints on the competitive, efficient, smooth and fair operation of markets as including:

- imperfect competition;
- externalities;
- information imperfections and asymmetries;
- transactions costs and contestability; and
- barriers to access.

The first three of these constraints are strict forms of market failure while the latter two represent characteristics of particular markets which can adversely impact on consumers. In order to understand the underlying principles that govern the ACCC's consumer protection activities, and the regulation of consumer protection in financial markets more generally, it is necessary to examine each of these impediments individually.

Imperfect Competition

Wherever the supply-side competition in a market is limited by the presence of a single firm or a small number of large firms, consumers can be disadvantaged by facing higher prices, a limited choice of products and/or poor standards of service. This situation is more likely to arise where significant barriers to entry reduce the contestability of markets by new firms, and especially if those barriers are regulatory or legislative in nature.

The post-World War II structure of the banking industry in Australia had been that of a highly concentrated and regulated oligopoly, where significant barriers to entry existed. This structure impacted negatively on consumers of financial services in a number of ways, especially in terms of access to credit, choice of banking products and the pricing structures imposed.

The deregulatory reforms of the 1980s have brought many advantages of price, choice and service to consumers in the financial sector. Competition has increased between the existing banks, between the existing banks and new bank entrants, and between some products offered by banks and those offered by other financial institutions.

Protecting the gains flowing to consumers from the deregulation of financial services is an important aspect of the ACCC’s competition work. After all, effective and vigorous competition in any market is the best precondition for delivering positive outcomes to consumers.

The Commission's application of the merger and acquisition provisions of the TPA are crucial to promoting competition in financial services to the advantage of consumers. The important point here is that the competition role of the ACCC is integrally linked to its consumer protection role in seeking to establish and maintain competitive structures, conditions and practices in all Australian markets. The universal coverage of the TPA and the interrelationship between competition and consumer issues is central to the expanded role for the Commission under the national competition policy (Hilmer) framework.

Externalities

Wherever the actions of one economic entity impact upon others in a way that is not fully reflected in market prices, an externality occurs. Externalities can take a negative form (by imposing social costs) or a positive form (by providing public benefits).

Negative external effects can have a significant and pervasive impact on consumers. For example, costs can be imposed through damage to the health and/or property of individuals resulting from the sale of unsafe or defective products. Further, reductions in well-being can occur where products are consumed that contain ingredients, or are produced in such a way, that is contrary to the consumers interests or beliefs. To protect and inform consumers such measures as product safety legislation and country of origin/content/environmental labelling standards have been introduced.

Externalities also exist with regard to financial services.

Financial transactions often involve a substantial part of an individual's financial wealth, income flows and rights to the use of physical assets. There are many examples of this, including; deposits of life savings, provisions of funds for retirement (especially with the new RSAs to be offered by banks), credit arrangements for purchase of the family home, and the insurance of residential property and high value consumer durables. Because of this, the consequences of poor quality advice and/or products being sold in the financial sector can be very serious for both the individual and for society as a whole, especially if large sections or specific groups in society are adversely affected. The external costs imposed on society in terms of economic instability, social dislocation and increased welfare expenditure can be very high where financial products fail to deliver what is expected of them by consumers.

Measures such as the licensing of financial operators, industry codes of conduct, and external complaints resolution mechanisms have all contributed to minimising the impact of poor quality financial services on individual consumers and the wider community. In the ACCC's view, it is in the provision of such bulwarks against the sale of sub-standard products and services that initiatives by the financial sector itself can make the greatest contribution to protecting Australian consumers and minimising the external impact on society. To this end a detailed model for the efficient, robust and cost-effective provision of these bulwarks through industry initiatives in the financial sector is presented in Chapter 8.

External costs are also imposed if financial institutions fail through poor financial, investment and risk management practices. Again, problems relating to economic recession, increased social problems and expanded welfare pressure on government budgets can result.

In Australia the key safeguard is the prudential supervision of deposit taking institutions by the Reserve Bank of Australia and Australian Financial Institutions Commission. In some countries deposit or financial product insurance has also served a similar purpose.

Prudential supervision in the financial services sector is intended to minimise the risk of institutional failures that could impose significant economic and social costs on society. Prudential regulation therefore provides a valuable public benefit by maintaining the stability of the financial system and protecting consumers from unsound management of financial institutions. While prudential regulation protects the interests of consumers, it should still be administered in such a way that no particular type or class of institution is unduly advantaged by the prudential conditions and/or guarantees imposed. The ACCC’s general views on the prudential supervision of the Australian financial system are outlined in Chapter 8.

Information Imperfections and Asymmetries

In the financial services sector, the most significant market failure on the demand-side relates to information imperfections and asymmetries between consumers and suppliers.

Since financial products such as home loans or term deposits are purchased infrequently it is hard for consumers to build up knowledge of the specific products and their relative price and conditions. In addition, financial products are inherently complex, often requiring a consumer to compare a range of factors over long time periods. These factors can include the likelihood of various contingencies occurring, several (and variable) price components, detailed conditions of purchase and use, and the links between various core and ancillary products.

Not only does the underlying nature of financial products and their purchase impose a significant information burden on consumers, but the information is not always clearly, coherently or easily presented. Consumers of financial services products often face difficulties in processing information and making informed choices because the necessary information is:

- insufficient, and explanations are inadequate;
- inaccessible due to complexity, language, style, or unavailability;
- difficult to compare with information from other suppliers;
- constantly changing; and/or

- inaccurate, misleading, or in some cases, plainly wrong.

In the past, financial institutions played an important role in helping their customers to overcome these information barriers by providing advice on the range of products that they offered as part of their role as financial intermediaries (between the providers and borrowers of funds). While banks and other institutions still provide personal financial advice through their branch networks, the universality of this advice has been eroded by the increasing range and complexity of financial products on offer, and by the move toward remote and electronic banking.

Increasingly, financial institutions are marketing individual products through a range of new mediums with a reduced focus on their role as bundlers of related services - a process which has also necessitated a reduced emphasis on their information brokerage role. In particular, the expansion of telephone banking (through call centres), the provision of on-line banking services (through personal computers) and the increasing use of electronic banking cards (credit, smart and EFTPOS cards) is shifting the information and search costs toward the customer.

These developments have clear advantages of time and convenience for more sophisticated customers, but for less sophisticated customers it can place an increased burden in searching for and analysing the relevant financial information. Given the high opportunity and transactions costs involved in acquiring the necessary information, many of these less sophisticated, and often poorer customers, may make costly financial mistakes.

Information asymmetries are significant, persistent and pervasive for consumers of financial services and their reduction is central to improving the protection afforded to consumers in these markets.

Transaction costs and contestability

A clear barrier to consumers being in a position to benefit from improved competition in the financial services sector is the high costs often associated with transacting in the sector. These can include costs associated with:

- searching for and processing information about products and suppliers (ie overcoming information asymmetries);
- switching suppliers (eg penalties for early termination);
- negotiating, executing and monitoring performance of a contract; and
- enforcing a contract or obtaining a remedy in the case of a dispute.

While transaction costs exist for consumers in all markets, they are particularly pronounced in relation to financial services. Practices such as penalties for early termination of contracts, and the information problems discussed above, inflate transaction costs in this sector.

One consequence of high transaction costs is reduced contestability. Contestability refers to the ability of consumers to send signals to the market by changing products and/or suppliers. To the extent that transaction costs discourage the ease of switching suppliers, contestability is reduced. And in this context, transaction costs do not just refer to financial costs, but can include costs associated with the time involved and inconvenience caused.

A market of low contestability is also a market where there is a lesser degree of competition than is optimal.

Barriers to Access

In many regards, access to financial services is an essential requirement for most Australian consumers. The ability to receive payments, store wealth and make payments through bank accounts is an important attribute in the lives of most Australians. In this sense, basic banking services have much in common with essential utilities services like electricity, gas and water. Barriers to accessing such services can significantly detract from the quality of life and social standing of individuals and families.

As outlined above, information asymmetries and transactions costs can impose barriers on the use of financial services by customers or potential customers. Other barriers can also exist on the demand-side of financial markets in that particular groups of customers may not have access to the range and types of services and products that best service their needs. The impediments faced by consumers in this area can be physical, in terms of geography or technology, or pecuniary, in terms of their income flows and associated fee structures for certain products.

With the growth of new mechanisms for customer service currently underway in the banking industry, the issue of access to new forms of remote and electronic banking will become an important factor in determining how fully Australian consumers can benefit from increased competition and innovation in the sector. Access is a major concern for residents of rural and remote parts of the country where traditional banking services, provided through retail outlets, are declining in favour of new mechanisms driven by technological developments, such as on-line or telephone banking. It is also a concern for older members of society who are more accustomed to, and comfortable with, undertaking traditional forms of over the counter (OTC) transactions.

To gain full benefit from the new service delivery mechanisms that financial service providers are moving towards, consumers will need access to these technologies, education in their use and comfort with their use. This presupposes a degree of material comfort, technological sophistication and acceptance of non-face to face transactions that many less well off and older members of society may not possess. From society’s perspective it is important that a balance is struck between the cost savings and customer service imperatives of financial institutions in adopting new service delivery mechanisms, and the reduced access to financial services for certain groups in society that can result from these changes.

The impact of changes to the type of financial services being provided and their associated fee structures can also impact adversely on less well off members of society. For example, basic and low cost deposit accounts provide a valuable service for those in society with low financial assets, small or irregular incomes and a lack of financial sophistication. Financial institutions have argued that such accounts provide little interest return because of the low balances held and can impose considerable costs because of the frequency of transactions conducted. Deposit taking institutions operating in a competitive environment are likely to adopt a cost reflective mix of charges and fees for these types of accounts rather than relying on earnings from interest spreads.

If, however, the bank fees and charges associated with basic-type accounts are disproportionate to the underlying costs, and the government fees and charges, associated with providing such accounts, then particular groups of customer may not be able to access the services of certain types of deposit taking institutions. They will be marginalised (disenfranchised) from participating in the mainstream financial system.

From society's standpoint it is important that the right balance is struck between facilitating the access requirements of particular groups of customers (especially those from less well off backgrounds), the revenue needs of government, and the recovery of fixed, variable and opportunity costs imposed on financial institutions in providing those products. The bank fees and charges imposed need to reflect the costs relating to such accounts without imposing an artificially inflated barrier to the purchase of basic and less profitable classes of products and service. Specifically, it would be undesirable for there to be reverse cross-subsidisation of more profitable classes of service or products from basic-type accounts.

Underlying and magnifying the constraints detailed above is the centrality of financial services to participation in a modern society. For the most part, financial services, as a bundle of products, have no close substitutes and so cannot be easily bought or not bought depending on personal preference. All consumers, regardless of their financial status, need mechanisms for storing and saving money, and for making payments to third parties. Most consumers will also need, to a varying degree, insurance products to protect their assets, access to credit to finance the purchase of high value assets, and access to funds for their retirement. Finally, many consumers now, even those on middle to low incomes, also have a need for investment products.

This centrality of financial services products indicates that there is a clear need for these issues to be addressed.

Mechanisms for Addressing Consumer Protection Issues

The above discussion illustrates the difficulties consumers have in participating effectively in markets for financial services. To overcome these constraints, consumers, in general, need structures, rules and initiatives that can provide:

- minimisation or elimination of anti-competitive conduct;

- guarantees about the financial stability of institutions;
- accessible information about products, services, and suppliers;
- information that is transparent, comparable, easily processed, and provided in plain language and an appropriate format;
- reliable third party advice and information brokerage;
- low costs in searching for relevant information;
- initiatives to increase education;
- low costs associated with switching suppliers, and clear and up-front disclosure of any such switching costs;
- highlighting of important information;
- cheap and accessible means of resolving disputes;
- fees and charges that do not reflect more than the cost of supply;
- appropriate levels of facilities to allow access (ie location of manual and electronic outlets and facilities); and
- protection from reverse cross-subsidisation, whereby products subjected to greater competition are subsidised by products subject to limited competition.

Addressing these needs in a cost effective, competitive, and workable manner, is the ultimate goal of consumer protection in the financial sector.

To a greater or lesser extent, current regulatory models and structures have been designed to attempt to satisfy these needs of consumers, and to therefore facilitate effective competition in financial services markets. Not all of these initiatives have been implemented by government, demonstrating that both industry and other organisations have played an important role in addressing consumer needs.

Some examples from the Australian context are outlined below to illustrate the mix of government, industry and consumer initiated mechanisms that currently operate in the financial services sector:

- Minimising anti-competitive conduct - since 1975, Australia has had in place an economy-wide legislative regime designed to discourage and prevent anti-competitive conduct (the TPA). Since the Hilmer reforms, the reach of the Act has extended further so that it applies to all forms of business operating in Australia. The Act is complemented by the existence of an agency with responsibility for enforcing the provisions of the Act and ensuring compliance with those provisions (the ACCC).

- Guaranteeing financial stability - Federal, State and Territory legislation all provide safeguards for the financial stability of institutions. Insurance and superannuation companies, banks, credit unions and building societies are all subject to detailed prudential control. For the banking sector, this role is performed by the RBA; for NBFIs, it is performed by AFIC in conjunction with State and Territory bodies; and for the insurance and superannuation sector, the ISC has a prudential function. Prudential regulators are given powers to collect necessary information from businesses to ascertain their compliance with these requirements.

- Information brokerage - one of the best known information brokerage services is that provided by the Australian Consumers Association's *Choice* magazine. *Choice* regularly provides comparative information and product testing results on financial service products as well as those from other sectors. *Choice* is funded solely by subscriptions. A more recent example is *MoneyCHOICE$*, a service providing comparative information about some financial products over the telephone.

- Transparency of information - voluntary codes of conduct, prepared and administered by industries in this sector, often contain provisions requiring disclosure of information. For example, the Code of Banking Practice obliges banks to make available to a customer details of the standard fees and charges applying to a banking service at or before the time the service is provided to the customer.

- Cheap and accessible means for resolving disputes - many lines of business in the financial services sector have established independent alternative dispute mechanisms for consumers (and in some cases, small businesses). Examples include the Life Insurance Complaints Board, the General Insurance Claims Review Panel, and the Australian Banking Industry Ombudsman Scheme. Most schemes are industry funded, but administered by a body comprising equal demand and supply side representation. Once a consumer accepts a decision of one of these schemes, the decision is binding on the company concerned.

Dispute resolution alternatives have also been established by governments - the Credit Tribunals and the Superannuation Complaints Tribunal, for example. Again, these can provide consumers with relatively cheap and accessible mechanisms for resolving disputes.

- Plain language - many voluntary codes of practice require documentation for consumers to be presented in plain language. For example, the General Insurance Code of Practice requires insurers to ‘express policy documentation in plain language, and design and present policy documentation with the aim to assist comprehension by consumers’.

- Highlighting of important information - for some financial services products, standard form warning and advice notices must be provided to consumers at relevant times in the transaction. These notices draw the consumer’s attention directly to the most important features of the product and/or the consumer’s rights and obligations in relation to that product. Notices can be prescribed by regulation, as is the case with Consumer Credit Insurance, or by a Commissioner’s rule (currently non-enforceable), as is the case with Life Insurance.

These examples illustrate some of the range of solutions that can be found to meet consumer needs, and the range of organisations that can be drawn upon to implement those solutions.

In the Commission's view, the objective of consumer protection is to discover the best mix of solutions, incentives, sanctions, and organisational structures that will cause market players to optimise the outcomes for consumers. There is a role for both rule and non-rule solutions in overcoming market constraints and meeting this objective. To this end, the relative strengths and weaknesses of various forms of rule and non-rule making solutions need to be examined before an effective assessment of the current regulatory structure and possible alternatives can be made.

Rule Making Options

There is a need for specific rules requiring or prohibiting particular types of conduct in the financial services sector. Without some rules, the disparities between consumers and suppliers could be so severe that consumers would be reluctant to transact in the market, and ethical and/or quality suppliers would find it hard to distinguish themselves from fraudulent and/or sub-standard suppliers. In short, certain rules are required before a market can even begin to operate effectively.

Rules can be found in the form of:

- Legislation;
- Regulations;
- Licensing requirements;

- Codes of Practice; and
- Consumer or Customer Charters.

Each of these options have advantages and disadvantages that should be considered when assessing the most appropriate level for particular rules.

Legislation

Legislation is passed by Parliament. Many consumer protection legislative rules are found in the Trade Practices Act and the State and Territory Fair Trading Acts.

Legislation is clearly the most authoritative and persuasive form of rule-making. Requirements have to be clear and unambiguous, compliance with the rules is compulsory, and non-compliance can attract fines or other penalties. Legislation also provides a means of indicating that particular behaviours or conduct are serious enough to attract Parliamentary censure.

However, legislation suffers from being unwieldy to amend in the face of changing circumstances or new developments, and the process of actually developing, finalising and implementing legislative rules can take considerable time. Finally, industry and consumers can have only a limited and informal role in the development of the rules to be enshrined in legislation.

Regulations

Regulations are developed and implemented by government, and therefore suffer from similar advantages and disadvantages to legislation. However, regulations are not subject to the same amount of scrutiny as legislation, and can therefore be somewhat more flexible and easier to amend.

Licensing Requirements

Where entry into an industry is restricted through the issuing of licences, licence conditions can be used to impose specific rules on the licensees. To date in Australia, this method does not seem to have been much used to introduce consumer protection rules. If licensing requirements were to be used to implement consumer protection rules, it would be important to have a range of sanctions available for contravention of licence conditions. Where the only sanction is removal of the licence, sanctions will be rarely imposed because it is so severe.

Codes of Practice

Industry-specific codes of practice are flexible, adaptable, and responsive to changes. Industry members are usually directly involved in the process of developing codes, and the resulting rules therefore stand a greater chance of being acceptable to industry. Often codes can also go into a level of detail that would be inappropriate for legislation or regulations. Codes of practice can also vary in status and enforceability, and as such can take the following forms:

- mandatory codes;

- hybrid codes; and
- voluntary codes.

Mandatory codes of practice can be implemented as regulations under the Fair Trading Acts in most States and Territories. Although these have the same effect and enforceability as regulations, legislation usually requires that a specific consultative process for developing the codes is followed. An example of a mandatory code is the Retirement Village Industry Code of Practice established under the NSW Fair Trading Act.

Codes of practice can also be made mandatory through other legislation. For example, proposed amendments to the Life Insurance Act will give the Insurance and Superannuation Commissioner the power to make the Life Insurance Code enforceable.

Mandatory codes have the advantage of being enforceable, and ensuring universal coverage of the industry.

Hybrid codes of practice can also be enforceable and have universal coverage. However, they can incorporate greater scope for variation in the rules. Instead of legislation mandating a specific code of practice to cover an industry, legislation can require all industry members to become a party to an approved code. In this situation, there is therefore scope for a variety of codes, and no legislative compulsion to become a party to any one particular code. Industry members who feel that their interests are not met by a particular code are free to develop an acceptable alternative. An approach along these lines was originally intended in the case of the General Insurance Code of Practice.

Voluntary codes of practice can be developed primarily by industry, as is the case for the Banking Code of Practice and the General Insurance Code of Practice. Alternatively, they can be developed with a more co-regulatory approach. For example, the Electronic Funds Transfer (EFT) Code is voluntary, but was developed by government in consultation with industry and consumers, and is reviewed and monitored by government.

Where industry members are primarily responsible for developing a code, they will often have a sense of ownership of, and commitment to, the code rules. Often this commitment will be to the spirit of the code, as well as to the strict letter of the rules, even though the code may be voluntary.

On the other hand, voluntary codes developed through a co-regulatory process, with tripartite representation of government, industry and consumer organisations can have a greater degree of credibility than can codes developed primarily by industry. Credibility and accountability can be increased if there is tripartite involvement in administration and monitoring of the code.

Voluntary codes (both self-regulatory and co-regulatory) can also be made contractually enforceable if businesses who agree to be a party to the code also contract to abide with its provisions. In the case of the Banking Code, for example, this is done through the customer's contract with the bank. However, the provisions of the code are only enforceable through private action for breach of contract; there is usually no mechanism for public enforcement of the code.

Consumer Charters

Charters are developed by industry and are often used as a marketing tool. They provide specific levels of performance that consumers can expect, and in some cases, failure to meet those levels of performance will entitle the consumer to a fixed amount of compensation. Charters are more common in the United Kingdom. In Australia, however, AAMI has just released an innovative and meaningful customer charter which provides an example of how charters can be used in the financial sector.

Charters are perhaps the most flexible form of rule making. They are usually developed by individual companies, and can be a way of demonstrating a standard of service and performance above other competitors. Charters, however, will only be credible if they are transparent, address the real concerns of their constituents, have measurable standards, are regularly reported on, and the targets are regularly reviewed.

The Commission's Preferred Approach to Rule-Making in this Sector

The Commission is of the view that the best outcome for consumers of financial services will be provided through a mix of legislative and non-legislative rules working together.

The Commission's preferred approach to rule-making is based upon a recognition of the need for a balance between a prescriptive approach, as is commonly expressed in legislation, and a descriptive approach, as more often found in codes of conduct. It also takes account of the fact that there are significant differences between financial services products, and consequently, different levels of prescriptive rules may be necessary. A retail transaction account, for example, may not require the same level of prescriptive disclosure requirements as might a life insurance policy.

In the Commission's view, consumer protection rule making in this sector is best provided through the application of the general legislative requirements in the Trade Practices Act, together with the implementation of codes of conduct to provide guidance on matters of detail with respect to service delivery and market behaviour. This preferred view is similar to the current approach in this sector, however, the Commission considers that there is some room for harmonisation and rationalisation of industry codes to ensure a consistent approach.

The Commission considers that both the TPA and industry codes of conduct are essential for providing effective consumer protection rules in this sector. Removing either the TPA or codes from the regulatory mix in the financial sector would not be in the best interests of consumers. The scope and interdependent roles of these two rule-making instruments are detailed below.

The Consumer Protection Provisions of the TPA

The consumer protection provisions of the TPA are found in Parts IVA, V, and VA. Part IVA of the TPA prohibits unconscionable conduct in business and consumer dealings. Part V deals with unfair practices, product safety and information, conditions and warranties, and actions against manufacturers/importers. Finally, Part VA provides a right to compensation to those who have been injured, or whose property is damaged, by a defective product.

These provisions are also, for the most part, mirrored in State and Territory Fair Trading Acts.

These consumer protection provisions of the TPA provide the foundation for consumer welfare, and play a vital role in ensuring that markets are fair, effective, and competitive.

Section 52 (in Part V) is probably the most important consumer protection provision of the TPA. It is a general provision, prohibiting corporations from engaging in misleading or deceptive conduct. Compliance with section 52 clearly provides consumers with benefits, assisting them to make informed choices. However, like the other consumer protection provisions in the TPA, section 52 also promotes competitive outcomes. It allows consumers to send correct signals to the market about their purchasing preferences, and enables ethical firms to be distinguished from sub-standard and fraudulent providers. Related sections in Part V expand further on this general prohibition against misleading or deceptive conduct.

Section 52 is particularly directed at reducing or eliminating market failures and transaction costs from the demand side of the market. Given the extent of information asymmetries in financial markets and the high value of many financial transactions, the existence of section 52 (and related sections) is vital in protecting consumers of financial services.

Retention of the TPA in financial services

There has been some suggestion that the consumer protection provisions of the TPA (including section 52) could be replaced by provisions in industry codes. As noted above, the Commission considers that it is important that broad level consumer protection rules for this sector are given legislative force through the TPA, with its advantages of enforceability and sanctions. The Commission is strongly opposed to any proposal that the financial services sector be exempt from the consumer protection provisions in the TPA. Reasons for this opposition are detailed below.

- Economy-wide application - the consumer protection provisions of the Trade Practices Act currently apply to all sectors of the economy.[16] As with the competition provisions of the Act (found in Part IV), economy-wide application is a vital ingredient in the effectiveness of the legislation. Application of Hilmer-type principles would suggest that all sectors of the economy should be subject to the same general consumer protection principles and rules. There is nothing intrinsically unique about the financial services sector that would suggest it should be excepted from those rules.

- Government sanction and penalties - as noted earlier, legislation provides a clear message of Parliamentary censure of particular conduct. Codes, particularly those written by industry, can never have that same sort of impact. A wholesale replacement of the TPA provisions by code provisions would send a signal to consumers that the Parliament considers unfair practices in this sector to be less serious than in other sectors.

  Additionally, the TPA provides for criminal penalties, as well as civil remedies. While there may be sanctions for contravening codes, these will not have the force or indeed the stigma associated with court ordered penalties or remedies. The status and enforceability of court orders are very important where conduct is particularly reprehensible and/or persistent.

[16] There are currently still a small number of exceptions from the TPA provisions in the case of insurance contracts, however, there have been proposals to remove these exceptions.

- Gaps in regulatory regimes - implementation of consistent consumer protection rules through a variety of regulatory regimes across the economy creates the possibility of gaps emerging through which smart operators may be able to navigate. Similarly, the blurring of boundaries between financial and non-financial products may also result in breaches of the consumer protection rules in this grey area falling into gaps between the regimes. Universal application of the TPA significantly minimises these risks and also ensures a consistency of approach across all sectors of the economy.

- Opening the floodgates - allowing the financial services sector to become exempt from the consumer protection provisions of the Trade Practices Act will no doubt lead to a flood of requests from other sectors for an exemption. As sector after sector seeks exclusion of the application of the TPA, the effectiveness of the TPA's unfair practices provisions will erode to the point of being rendered nugatory. An inevitable consequence of such a flood of exemptions will be reduced consumer confidence in the TPA's ability to deal with their concerns.

- TPA providing the foundation for codes - finally, codes of conduct are less effective without the existence of general legislative provisions (ie the TPA) to provide a framework for code obligations. The TPA provisions give a sense of the principles (and associated case law) upon which code requirements are based. Without this foundation, the scope of code obligations would be less clear, and the effectiveness of codes significantly reduced.

In addition to preserving the role of the TPA in this section, the Commission considers it also appropriate to maintain its own role in administering and enforcing those provisions. This is detailed further in Chapter 5.

Recommendation 11

The Commission recommends that the Trade Practices Act, including section 52, continue to apply to all financial services providers.

Increasing the effectiveness of the TPA

Although the Commission regards the TPA as a necessary part of the regulatory mix in this sector, it considers that there are some changes that could be implemented to increase the Act's effectiveness. One important improvement that is strongly supported by the Commission is the introduction of civil penalties for contraventions of the Part V provisions of the Act.

Currently, and with the exception of section 52, contravention of a provision of Part V is an offence. A criminal penalty regime is in place, and contraventions must therefore be proved beyond reasonable doubt (the criminal standard of proof).

The Commission is of the view that there is merit in supplementing this criminal penalty regime by introducing civil penalties for contraventions of Part V. Civil penalties are imposed in respect of a contravention that has been proved on the balance of probabilities (a lesser standard of proof than that used for criminal penalties). The Commission believes that making civil penalties available would increase the range of responses available to the Commission when faced with a contravention of the Act (see Chapter 5 for discussion of range of responses currently available to the Commission). Criminal law (and criminal penalties) would then be reserved for instances where the contravenor knowingly engaged in the prohibited conduct.

Implementing a civil penalty regime for Part V would require a clear delineation of the state of mind required to be established to impose a criminal, rather than a civil penalty. Currently Part V offences are strict liability offences, in that there is no need to prove a particular mental state of mind. If civil penalties were introduced, state of mind would remain irrelevant for the imposition of civil penalties. However, to impose criminal penalties, the existence of a ‘guilty mind’ (that is, for example, that the conduct in question was engaged in knowingly, intentionally or recklessly), would need to be proved beyond reasonable doubt.

Recommendation 12

The Commission recommends that civil penalty provisions be introduced for contraventions of Part V of the Trade Practices Act.

Codes of conduct

While the Commission is of the view that the TPA provides an essential foundation for consumer protection in all sectors of the economy, it also considers that the legislation is, by itself, insufficient in the financial services sector.

Because of the impediments outlined earlier in this Chapter, consumers of financial services and products require additional rules to provide guidance on matters of detail relating to service delivery and market behaviour. In general, the Commission agrees that industry codes are the most appropriate mechanism for dealing with the detail of consumer protection rules in the financial services sector. They should, however, operate to complement the TPA provisions, rather than to supplant them.

The Commission also considers that, for industry codes to be effective in maximising consumer welfare, they must meet certain criteria.

In the Commission's view, effective codes involve:

- a statement of objectives setting out broadly the code's expected outcomes;
- appropriate code rules;
- internal and external complaints and disputes procedures, with independence an important feature of external procedures;

- flexible and relevant sanctions;
- a well-resourced code administrator;
- publicity of the code;
- consumer and business education about the code and its provisions;
- periodic reviews;
- data collection and monitoring; and
- public reporting.

Effective codes also benefit considerably from consumer and government involvement and representation, particularly in relation to disputes handling.

As part of its commitment to developing market sensitive solutions to consumer problems, the Commission has prepared a draft Guide to Fair Trading Codes of Conduct. This Guide provides more details on the features that the Commission considers essential for developing effective codes, and is expected to form the basis of a guide to be released by the Ministerial Council of Consumer Affairs later this year.

The Commission is concerned that not all codes in the financial services sector meet these criteria. It suggests that if the Committee proposes recommending the use of codes for detailed rule-making in this sector, the Committee should detail the benchmarks it sees as necessary for codes, and implement a process for assessing and improving codes against these benchmarks. The Commission's draft Guide could be a useful template for such an exercise.

The Commission also sees that there may be a need for harmonisation and rationalisation of existing codes in this sector to overcome the existing gaps and overlaps in coverage and rules.

For example, the EFT Code provides rules governing liability and other matters for transactions made with a card and a personal identification number (PIN). However, neither the EFT Code, nor any other code, applies in the case of transactions of a similar type, made over the telephone or by computer using a password. In the latter case, institutions offering those services are free to implement their own rules.

In the Commission's view, all consumers of a particular type of facility (ie electronic payment mechanism, credit facility, etc) should be entitled to the same protections, regardless of the type or industry of the supplier. Harmonisation and rationalisation is needed to achieve this goal, and the Commission believes that the proposed structure detailed in Chapter 8 would facilitate this process.

Recommendation 13

The Commission recommends that industry codes of conduct be used as the primary mechanism for transaction and market conduct regulation for all financial services providers.

Non-Rule Making Options

The Commission recognises that rules alone cannot overcome all impediments that consumers face. In some cases, appropriate solutions can be found without the development of rules, and these non-rule solutions can often be as effective as the introduction of rules. Initiatives can be developed and implemented by industry, consumer organisations and government, or by all these parties working together. In the financial services sector, non-rule type initiatives to address consumer needs have included:

- industry complaint handling centres and dispute resolution schemes;
- industry and/or consumer and/or government education campaigns;
- industry continuing education and training programs;
- consumer and commercial information brokerage services;
- registration (negative or positive) of agents;
- consultative arrangements; and
- voluntary guidelines (such as the ACCC Insurance guidelines and the St George Bank finance guidelines).

While these solutions should not usually supplant rules, they can be important in further assisting consumers to participate effectively in the market.

As is the case with rule-making, there is a range of levels at which solutions can be developed and implemented, and it will be important to pitch a solution at the appropriate level.

A good example of non-rule solutions, industry dispute resolution schemes, will be discussed to illustrate the advantages and disadvantages of non-rule solutions. The discussion also highlights the need for greater rationalisation and harmonisation of self and co-regulatory initiatives in the Australian financial services sector.

Dispute Resolution Schemes

One important feature of non-rule responses to consumer problems in this sector has been the development of a number of industry-based alternative dispute resolution schemes. These range from the industry funded Ombudsman or Panel Schemes (ie Banking Ombudsman and Life Insurance Complaints Scheme) to the government funded schemes such as the Superannuation Complaints Tribunal, and the various State and Territory Credit Tribunals.

To some extent, these schemes arose from a recognition that consumer complaints in this sector (and indeed in many other sectors) are not suitable for litigation. Without more informal redress mechanisms, consumer complaints are often not adequately addressed, with adverse consequences for the individuals involved. Additionally, the existence and operation of industry dispute schemes can put pressure on the market to operate fairly and competitively.

The Commission is of the view that these industry dispute schemes are the most appropriate bodies for handling the day to day level of consumer complaints in the financial services sector.

Although the Commission, and indeed other government agencies, has some responsibility for investigating consumer complaints, reliance on government agencies as the sole avenue for redress does not serve consumers well. Government agencies, including the Commission, are not in a position to respond effectively to the majority of consumer complaints. For example, in the period between 1991 and 1996, the Commission received over 1600 (non-pricing) complaints about financial services. Not all of these were necessarily from consumers; some may have been from business or competitors. The Commission, however, was able to achieve redress for the complainant in only a very small percentage of those matters. Other matters, the Commission was not able to take further, for a variety of reasons.

In contrast, the Banking Ombudsman scheme alone received almost 3500 new cases during 1994/95, and was able to resolve more than 2000 cases during the same time period (other cases were discontinued or outside the scheme's terms of reference).

Additionally, industry complaints schemes are in a position to hear and resolve complaints about non-compliance with codes, a function which government agencies such as the ACCC are not able to perform.

Rather than handling the bulk of consumer complaints, the Commission sees its role as one of strategic, rather than transaction, enforcement, intervening only in circumstances where there is persistent and/or blatant contravention of the TPA. As the following Chapter demonstrates, the Commission performs this role effectively, delivering significant and long-lasting results.

While the Commission supports the concept of industry dispute schemes, it does consider that there are some basic standards that such schemes should meet if they are to be credible and effective in achieving their goals.

Of these standards, accountability and independence are the two most important. Within schemes that are funded by industry, independence can be achieved by giving responsibility for governance and administration of the scheme to a council or board made up of equal consumer, government and industry representatives. Accountability can be achieved by regular public reporting. The Commission also considers that these schemes must be accessible to consumers. To operate effectively as an alternative to litigation, the schemes must operate informally, and must take a pro-active part in investigating, rather than just adjudicating, a complaint.

In general, the Commission considers that industry dispute schemes should meet the benchmarks currently being developed by a working group chaired by the Federal Bureau of Consumer Affairs (FBCA).

The current industry schemes, for the most part, do meet these benchmarks and are working well to deliver fair, accessible, cheap, and speedy redress for consumers of financial services. The Commission is therefore strongly in favour of industry dispute schemes having responsibility for resolving the majority of consumers complaints in this sector.

Limitations of Existing Schemes

Although these industry dispute schemes are clearly working well, the Commission considers that some sector-wide changes could improve the effectiveness of the schemes as a whole.

An issue currently of concern in relation to industry-based schemes is that of duplication and overlap. At present there are at least ten distinct schemes in the sector, each operating on industry, rather than product based lines. Appendix B details the jurisdiction of each of these schemes.

As can be seen from this Appendix, there is some duplication between schemes. For example, some investment-type products could be covered by the life insurance, financial planners, superannuation, and/or banking schemes depending on the particular circumstances of the matter.

This duplication and overlap is inefficient and can cause significant problems for consumers trying to resolve complaints against a business in the sector. Not only do consumers face difficulties in ascertaining which body has the jurisdiction to hear their complaint, but in some cases, the remedy available to the consumer can vary significantly between different schemes.

Perhaps more of a problem for consumers is the fact that there are also many common financial products that are not within the jurisdiction of the existing schemes. For example, consumers using credit from finance companies or mortgage originators are not currently able to access an industry dispute scheme if they have a complaint or dispute, and there is no indication that this situation is likely to change in the near future.

The Commission is therefore of the view that there should be rationalisation and harmonisation of the various schemes to ensure that similar standards are followed in all schemes, and that any gaps are plugged. At the very least, consumers should be able to access a “one stop shop” that could accept all complaints about financial services and internally direct them to the most appropriate scheme.

Another limitation of existing schemes is that they primarily handle consumer complaints on an individual basis. Most have very little jurisdiction to investigate complaints indicating a systemic or persistent problem, or to propose solutions to such problems. The Commission considers this to be a serious limitation on the effectiveness of the schemes, and suggests that the powers and jurisdictions of the schemes themselves, or indeed another body, should be amended to ensure that issues of a systemic or persistent nature can be addressed. The Commission proposes a structural solution to this in Chapter 8.

Recommendation 14

The Commission recommends that industry-based dispute resolution schemes be used as the primary mechanism for resolving consumer disputes with financial services providers.

CHAPTER 5

THE ACCC AND CONSUMER PROTECTION IN FINANCIAL SERVICES

In addition to its competition responsibilities on the supply-side of Australian markets, the ACCC has significant consumer protection responsibilities relating to demand-side issues. Most importantly, the ACCC is responsible for ensuring compliance with the consumer protection provisions of the TPA. To this end, the Commission is not a central player in the regulation of financial services any more than it is a central player in the industry-specific regulation of other sectors of the Australian economy. At present, the ACCC is involved in protecting consumers of financial services in three broad ways, these are:

- Providing an underlying platform of consumer protection through the Commission's administration of the TPA - generally translating to the detection and enforcement of significant and systemic breaches of the Act in the financial services sector;
- Working with other regulators and industry to improve the trading environment for consumers and ethical firms alike through its authorisation role and the compliance education and self- and co-regulation initiatives of the Commission; and
- Identifying the existence of significant and systemic problems in particular markets through its market studies and consumer protection research - often

leading to legislative, regulatory or self-regulatory changes to improve conduct in these markets.

As noted in the previous Chapter, the Commission would like to see a revised, rationalised and harmonised consumer protection structure of financial services along the lines suggested in Chapter 8. Such a structure would bring the manifold advantages of minimum necessary intervention, promotion of competition, competitive neutrality, durability, flexibility, simplicity, and would still provide an effective means for maximising consumer welfare and addressing market problems. Within that largely co-regulatory and tripartite structure there would remain important legislative and regulatory bulwarks for ensuring appropriate levels of consumer protection.

In the new consumer protection framework being proposed by the ACCC, the Commission would have essentially the same three roles as it currently has in protecting consumers of financial services. However, the authorisation role of the Commission with regard to areas such as codes of conduct, licenses and dispute resolution mechanisms would be made more explicit and would be more comprehensively applied.

In addition, the Commission's administration of the TPA as a backstop to other measures of consumer protection would remain and be absolutely crucial in an environment of regulatory and institutional change. The Commission's ability to provide high quality, independent and outcomes focused research into marketplace issues would also remain as an important reference and check for government, the community and industry on the progress and effectiveness of the new approaches to consumer protection being adopted in the financial services sector.

This Chapter will proceed in three parts. The first outlines the Commission's role and strategies in protecting Australian consumers, with special reference to financial services. The second provides some examples of the ACCC's consumer protection activities in the financial services sector, to illustrate the strategic role of the Commission's work and the far reaching and pervasive impact of that work. These examples also illustrate the long time-frames and general complexity of identifying problems and implementing improvements in consumer protection under the current regulatory structure. Finally, the Chapter concludes by addressing suggestions made in some circles that the financial services sector should be exempted from ACCC enforcement of the consumer protection provisions of the TPA. This view is challenged and rejected on a number of very clear and well accepted grounds.

The ACCC's Role and Strategies in Protecting Australian Consumers

Consumer Protection Role

The consumer protection provisions of the TPA are found in Parts IVA, V, and VA. Part IVA of the TPA prohibits unconscionable conduct in business and consumer dealings. Part V deals with unfair practices, product safety and information, conditions and warranties, and actions against manufacturers/importers. Part VA provides a right to compensation to those who have been injured, or whose property is damaged, by a defective product. Ensuring compliance with these provisions is achieved through both enforcement action and other activities.

Section 52 is probably the most important consumer protection provision of the TPA. It is a general provision, prohibiting corporations from engaging in misleading or deceptive conduct. Compliance with section 52 clearly provides consumers with benefits, assisting them to make informed choices. However, like the other consumer protection provisions in the TPA, section 52 also promotes competitive outcomes by allowing consumers to send correct signals to the market about their purchasing preferences, and by enabling ethical firms to be distinguished from sub-standard and fraudulent providers.

Given the extent of information asymmetries in financial markets and the high value of many transactions, the administration of section 52 by the ACCC is vital to the Commission's work in protecting consumers of financial services. It is by abusing the information gaps faced by consumers that sub-standard and fraudulent operators exploit consumers and draw business away from reputable and ethical suppliers of financial services. The administration of section 52 by the ACCC not only protects consumers but assists business by sanctioning providers whose conduct is unethical.

As a Federal government agency seeking to provide cost-effective and high value-added outcomes, the ACCC is not in a position to investigate all matters that are brought to its attention. In its enforcement of the consumer protection provisions, the ACCC gives priority to matters in which:

- there are national, multi-state or international features;
- there appears to be a blatant disregard of the law;
- the conduct involves significant public detriment;
- successful enforcement will have a significant deterrent or educational effect;
- significant new market issues (eg arising from economic, regulatory or technological change) are involved; and/or
- there is a detriment to disadvantaged individuals or groups.

Particular conduct that the ACCC is most concerned about includes: misleading or deceptive conduct or claims in relation to financial services; newly deregulated industries (eg utilities) or industries where competition has been recently introduced (eg telecommunications); misleading job advertising; price; labelling of country of origin and 'environmentally friendly' products; home building problems; unconscionable conduct; and product liability. Given that, for the most part, the consumer protection provisions of the TPA are mirrored in State and Territory Fair Trading legislation, the ACCC gives priority to matters that are of national significance, or which adversely affect large numbers of people.

As well as ensuring compliance with the consumer protection provisions of the TPA, the ACCC contributes to consumer welfare along a much broader front. It does this by working to implement changes which promote competition, ensure that the markets for goods and services are highly contestable, reduce information asymmetries, reduce unnecessary or inflated transactions costs, and which improve access to goods and services for all consumers.

The consumer protection enforcement and other activities of the ACCC in the financial services sector are particularly directed at reducing or eliminating market failures and transaction costs from the demand-side of the market. Appendix 8 of the Commission's first submission provided an illustration of the ACCC's activities in this area since the deregulatory reforms of the mid-1980s. Primary activities include enforcement, industry self-regulation, compliance education, and market studies.

Enforcement

The ACCC's enforcement activities are based on the concept of the pyramid of enforcement, where greatest effort is spent on activities to encourage compliance that involve minimum market intervention.

The ACCC has enforcement powers which provide it with a range of legislatively-based and informal remedies to prevent misconduct and secure compliance with the TPA. In doing this the legislature made a decision to differentiate between the nature and amount of the penalties available under Parts IV and V of the TPA. As noted earlier the penalties available under Part IV are extremely high, up to a maximum of $10 million (section 76). These are pecuniary penalties imposed through the use of civil proceedings. The Part V penalties, while still significant, are not as high as for Part IV with a maximum of $200,000. The Part V penalties are fines and are imposed as a result of a criminal prosecution (section 79). As was noted earlier, the Commission considers it appropriate to supplement these penalties with the introduction of civil penalties for contraventions of Part V. The ACCC also has standing to seek injunctions, both interim and permanent, under section 80 of the TPA.

Other remedies under the TPA include corrective advertising (section 80A), damages (section 82) and ancillary orders in favour of persons who have suffered loss or damage as a result of a contravention of the TPA (section 87). Section 83 provides that where it is proved that a person contravened a provision of Part IV, IVA or VA, findings of fact by a Court may be used as *prima facie* evidence in subsequent related proceedings for compensation.

Under the TPA the ACCC has extensive evidence gathering powers including especially section 155.

In carrying out enforcement activities the ACCC has elicited four objectives which it seeks to achieve:

- The first and most important is to stop unlawful conduct which is occurring.
- The second is to compensate the victim of the unlawful conduct.
- The third, which is ongoing and is carried out even in the absence of specific complaints, is to implement strategies which will prevent the unlawful conduct from being repeated by the original offender or engaged in by another party.

- The fourth is to punish the offender.

The ACCC believes that its resources are best directed at prevention and so it has placed special emphasis on compliance education and other mechanisms such as codes of conduct. It has been the ACCC's experience that structural solutions such as devising codes of conduct or assisting an organisation to design and implement compliance programs can be highly effective in achieving compliance with the requirements of the TPA. It is also clear that efforts directed only at prevention through education and other types of co-operation will not always be sufficient. The regulator must be able to react to breaches of the law and other failures to co-operate by bringing different types of pressure to bear on the offender.

To achieve this the ACCC has adopted a pyramid of enforcement. The use of this approach requires that an array of powers and remedies, such as those noted above, be available to the regulator. This is so that enforcement action can be matched to the type of misconduct which has occurred. This ensures that the punitive effect available to the regulator is sufficient to make sure that the regulated entity, acting rationally, will decide that it has more to lose as a result of the regulatory action than it has to gain from the misconduct. A model of a consumer protection pyramid of enforcement was provided in Appendix 10 of the Commission’s first submission to the Inquiry.

The ACCC's enforcement philosophy of stopping unlawful conduct, compensating the victim, preventing recurrence and punishing the offender embodies the principles of the pyramid of enforcement. The TPA allows for the ACCC to have an array of remedies available to it, so that, at whatever level the offender fails to be co-operative and act in compliance with the law, the ACCC is able to deliver a measured and appropriate response.

At the base of its enforcement activities is the ACCC's role in collecting and responding to consumer and industry complaints. Since February 1991, the ACCC has recorded approximately 1800 complaints relating to the financial services sector. The major product groups complained of are Banking Services - Financial, Motor Vehicle Insurance, and Home Finance Contracts, while the practices most complained of are representations, advertising, and credit (see Appendix C for more details).

It is from relevant complaints that the ACCC is alerted to the industry problems that may ultimately result in litigation. Appendix 8 of the ACCC's first submission describes recent litigation in the financial services sector, and includes matters involving life insurance, guarantees, and investment products.

When seeking to stop unlawful conduct or prevent its recurrence the ACCC can seek an injunction under section 80 of the TPA. With the exception of merger cases, any person may apply to the Federal Court for injunctive relief. In merger cases, only the ACCC may make an injunction application. The Court may grant an interim injunction pending determination of an application. In considering whether or not to grant an interim injunction the following principles are relevant:

- the Court must be satisfied there is a serious question to be tried;
- if there is a serious question to be tried the Court must consider the balance of convenience.

Another way to prevent unlawful conduct is through the use of enforceable undertakings. Under section 87B of the TPA the ACCC may accept a written undertaking in connection with a matter in relation to which it has a power or function under the Act except Part X (International Liner Cargo Shipping). If the undertaking is breached the ACCC may seek orders from the Court directing compliance with the undertaking, the giving up of any financial benefit gained from the breach, compensation for any other loss or damage as a result of the breach or any other appropriate orders. The ACCC has prepared publicly available guidelines on enforceable undertakings.

Compliance Education

Compliance education is designed to assist businesses in minimising the risk of contravening the TPA and to encourage compliance with the TPA. It is a pre-emptive, rather than reactive strategy, and is addressed to both competition and consumer protection issues.

In its compliance education work, the ACCC has sought to work co-operatively with industry associations and individual businesses. At the simplest level of its work, the ACCC has produced a generic compliance program, *Best & Fairest,* that can be used for in-house training in any industry. There has been a strong response from the marketplace for this product.

At a level that involves more direct and ongoing contact with individual businesses and associations, the ACCC's compliance education work has included compliance reviews of a business' operations; developing and presenting customised training programs and seminar series, as well as one-off seminars for senior management; and review of other educational tools such as computer-based training. In the financial services sector, the ACCC has co-operated with credit unions, funds managers, and many banks and insurance companies to deliver compliance education - this has included over twelve major banking and insurance companies as well as around 80 credit unions (see Appendix D for details).

Compliance education is an important part of the ACCC's administrative settlements. In most cases, section 87B undertakings include a commitment to in-house compliance training and an agreement to provide or perform some kind of service in promotion of industry wide compliance. For example, AMP, in the case discussed in Appendix 7 of the ACCC’s first submission, agreed to implement a compliance program to the Commission's satisfaction, as well as to contribute $100 000 to the funding of a community education television program on insurance related issues that was directed at consumers and small business.

Self-regulation

Supporting and encouraging self-regulatory initiatives, including codes of conduct, is an integral part of the ACCC's work. The ACCC is of the view that, under the right circumstances, self-regulatory initiatives can be an effective way of achieving fair trading outcomes on an industry wide basis. Often, industry 'ownership' of the initiative will result in greater commitment than could be achieved through, for example, regulation or litigation. Additionally, self-regulation initiatives can often be very flexible and cost effective for industry, involve little or no cost to taxpayers, and can address consumer issues before problems arise.

Much of the ACCC's work on codes and other self-regulatory initiatives has occurred in the financial services sector. In recent years, the ACCC has assisted in the development of codes, complaint handling systems and dispute resolution schemes. Particular examples include the EFT Code of Conduct, and the General Insurance and Banking Codes of Practice. In all these cases, appropriate improvements to the consumer protection regime were achieved with industry support and commitment, and without the need for costly government regulation.

In relation to the Banking Code of Practice, the ACCC has a representative on the Australian Payments System Council (APSC). The APSC was established by the Commonwealth government in 1984 to oversee developments in the Australian payments system and to promote the efficiency and stability of the system. The APSC has a strategic role in monitoring and assessing the payments system in

Australia, while the on-going operational functions relating to the payments systems are the responsibility of the Australian Payments Clearing Association (APCA).

Membership of the APSC encompasses representatives of banks, other financial institutions, relevant government agencies and consumer and retail groups which meet approximately quarterly. The Council is chaired by a senior officer of the RBA.

The ACCC's involvement with the Council follows a widening of the charter of the APSC in 1993 to encompass consideration of consumer interests and monitoring of the Code of Banking Practice and EFT Code. The APSC's current Charter is to:

- monitor and report to the Commonwealth Treasurer on developments in Australia's payments system;
- foster improvements to the efficiency, stability and competitive environment in Australia's payments system;
- promote the adoption of appropriate industry standards and practices, and the protection of consumer interests;
- promote community awareness of payments issues; and
- promote sound consumer/banker relationships, including monitoring of the operation of, and compliance with, the new Code of Banking Practice.

It is primarily with regard to achieving the last three of these aims that membership of the APSC was widened to include the ACCC and consumer and retail interest groups.

Market Studies

Detailed market studies complement the other consumer protection activities of the ACCC. They aim to analyse the forces at work in under-performing markets, identify structural or technological changes likely to cause competition or consumer problems, and to develop proposals for change to address these problems. Market studies can be used to indicate pre-emptive strategies for dealing with consumer problems, and can often be a precursor to codes or other self-regulatory initiatives.

In recent years, the ACCC has been requested by Ministers to undertake a number of significant studies in the financial services sector.

In 1992, the former TPC reviewed consumer experiences with the life insurance and superannuation markets. It found that many of the consumer problems in these markets could be related to inadequate, and sometimes misleading, information and advice. The report made recommendations addressing the issues of information disclosure, training of agents, and consumer redress, and many of these recommendations have since been implemented through a range of mechanisms including the Life Insurance Code of Practice or the ISC's disclosure circulars.

In 1995, the former PSA reviewed the fees and charges applying to retail transaction accounts. The implementation of the PSA's recommendations has resulted in more competitive and cost-reflective pricing, while at the same time, increasing the accessibility of transaction accounts for those on low incomes.

The present emphasis of the ACCC's market studies work relates to enforcement in the global market and to electronic commerce.

As an enforcement agency, the ACCC will need to consider how its enforcement goals can best be achieved in a global market, where traditional enforcement approaches are likely to be less effective. It is intended that the global marketplace project will develop a coherent strategy for addressing market failures and other problems that may emerge from a global/borderless market.

As with the development of the global market, the increase in electronic commerce, and especially on-line commerce over the Internet, will impact upon the way in which the ACCC carries out its enforcement functions. The project will identify and analyse consumer protection problems in cyberspace and related forms of electronic commerce, and seek the most appropriate solutions to pursue in extending consumer protection into markets based on electronic commerce.

Financial markets will be a key aspect of both projects since the development of borderless markets has implications for the way in which banking products, insurance products and investments are sold to Australian consumers. The advent of smart cards, home-banking through telephones or computers, and the emergence of cyberbanks and international insurance brokers operating on-line, will present many challenges to the interests of Australian consumers.

The ACCC's market studies are a means to place the Commission in an informed and pro-active position to discharge its duty to consumers of financial services. Market studies are particularly important in enabling the Commission to understand the possible impact of new products and service delivery mechanisms in the provision of financial services.

Impact of ACCC Consumer Protection Activities in the Financial services sector

Many of the product-based industries in the financial services sector have undergone significant changes in recent years, many of which have been designed to improve consumer welfare and confidence. Industries where major changes have been implemented include life insurance, general insurance, and banking.

The consumer protection activities of the ACCC (and the former TPC) have been an important catalyst for many of these changes. While the ACCC has not been the only agency to which consumer complaints have been directed, the ACCC has been at the forefront in identifying the underlying consumer issues that are demonstrated by these complaints. Once a problem has been recognised, the ACCC has proposed workable, effective and durable solutions, which have been, for the most part, adopted by government. The ACCC has also been instrumental in developing further any recommended solutions, and in the practical implementation of solutions by industry and other regulatory agencies.

In part, the success of the Commission's activities results from the fact that it has no responsibility for regulating the sector on a daily basis, and it is therefore able to bring a measure of freshness and objectivity to the process. Additionally, given its economy-wide enforcement outlook, the Commission can consider an economy-wide picture when assessing problems and proposing solutions.

Some Examples

The diagrams below illustrate examples of ACCC involvement in the financial services sector and indicate the extent of that involvement in the introduction of changes in a number of industries. In many instances, it is clear that without this involvement, necessary changes may not have been proposed or implemented, either at all, or within a similar time period.

These examples also illustrate the many and varied ways in which the Commission is involved in the financial services sector. As noted above, this can range from enforcement of contraventions of the TPA, as identified by consumer complaints, to working with industry through compliance education and self-regulation work, to market studies and reports either for government or for ACCC, consumer and industry use in identifying and resolving systemic problems in particular markets.

Consumer Guarantees

1996	Industry Codes to be fully implemented by end of 1996.
1994	Codes of Practice developed for credit unions and building societies, with similar requirements relating to guarantees.
1993	Banking Industry Code of Conduct developed by Taskforce (jointly chaired by TPC) and finalised by the Australian Bankers Association. Code is contractually enforceable and monitored by the Australian Payments System Council. The Code includes requirements: • that consumer guarantees be limited in amount; • to recommend that the guarantor seek legal advice; • for the disclosure of the borrower's contract and information about the borrower's account (with the consent of the borrower); and • for written warning about the effect of the guarantee.
1992	TPC released its report on consumer guarantees. It largely supported the Martin Committee's recommendations relating to guarantees.
1991	Martin Committee released its report on banking and deregulation. Major recommendations relating to guarantees: • a contractually enforceable code of practice be developed under the auspices of the TPC, and subject to TPC monitoring; • the details of the banker-guarantor relationship be clarified in the code of practice and include the undertakings given in the NAB case; • banks should be obliged to inform guarantors of the reasons for requiring a guarantee and of material facts about the borrower and the transaction; • amendments to the Privacy Act be made to permit banks, with the borrower's consent, to advise the guarantor of the state of the borrower's account on inquiry, or as soon as the account becomes overdue; • unlimited guarantees no longer be permitted; and • guarantees to be in plain English.
1991	Based on results of its inquiry, TPC provided a detailed submission to the Martin Committee on Banking. Aspects of the submission relating to consumer guarantees included recommendations for a contractually enforceable code of practice, monitored by the Commission.
1991	Following consumer complaints, and concerns expressed by the Banking Ombudsman, the TPC initiated a national inquiry into the nature, underlying causes, and scale of the guarantee problem.
1990/91	TPC litigation against NAB (Conn case). In an out of court settlement the bank undertook to: • make TPC proposed amendments to its training manuals and its form of guarantee; • include the issue of unconscionability in its training program; and • suitably publicise the undertakings.
1990/91	Numerous complaints about guarantees made to the TPC and other government and community agencies.

Life insurance and Superannuation

1995	Circular 304 (now GI1) revised and implemented following market research on the most easily understood format of presenting life insurance information. TPC involved in the consultation process.
1995	Code of Practice developed and finalised by an ISC/TPC/FBCA Taskforce. The Code sets minimum standards for sales practices, oversight by life companies and brokers of competence and conduct of their staff and agents, and dispute resolution arrangements.
1995	Proposed consumer protection amendments to the Life Insurance Act circulated by the ISC as an exposure draft for comment. The amendments would give statutory backing to the Code of Practice and disclosure requirements.
1994	ISC released two circulars relating to information disclosure (304 and 305), designed to ensure that promotional material and policy documentation contains certain key information and is presented in a suitable format. The circulars were developed in consultation with industry, consumers, the TPC and FBCA.
1993	Reform measures announced by the Government, including a compulsory code of practice and stronger disclosure requirements.
1992	TPC reported on the industry. Major recommendations included requirements for: • disclosure of the relationship between the intermediary and the life office(s); • disclosure of commission and benefits; • needs based and know your client analyses; • documentation of reasons for recommendations; • review of policy documentation; • advice of cooling off period; • development and revision of ISC disclosure guidelines; • public enforcement of the Insurance Contracts Act; and • improvements to industry dispute schemes.
1992	Research begun by the TPC as a result of a Ministerial direction to review the industry and consumer experiences.
1980s/90s	Complaints about life insurance and superannuation made to TPC and others.

Consumer Credit Insurance

1996	It has been proposed to Ministers that the ACCC conduct a review of the effectiveness of changes to regulation and industry practices in addressing the issues identified in the Commission's original study.
1994	Insurance code of practice developed in consultation with the TPC - covering claims procedures, disclosure, and training of agents.
1994	Recommended changes to the Insurance Contracts Act implemented to require disclosure notices, provide a cooling off period, and to give the ISC the power to enforce the Act on behalf of policyholders. Act also changed to allow the ISC to collect statistics from an insurer. The ISC publishes aggregate information on underwriting results, claims, and commissions, on a 6 monthly basis.
1993-94	ISC consultation to develop statutory point of sale and post-sale notices.
1992	Government Working Party (FBCA, ISC, TPC) formed to develop mechanisms for implementing the recommendations.
1991	TPC reported. Major recommendations included: • annual reporting by insurers on underwriting results, claims paid and denied, commission paid etc; • implementation of plain language standard form point of sale and post sale information; • introduction of a cooling off period; • improved training for agents; and • public enforcement of the Insurance Contracts Act.
1991	TPC given a ministerial direction to review the CCI market.
1990	Committee looking at Uniform Credit Legislation raised CCI issues in discussions.
1987	AFFCRA published report on consumer problems with CCI.

Electronic Funds Transfer

1994	At the request of Commonwealth Ministers, the TPC and Treasury reviewed the operation of the code. The report of the review was finalised in 1995 and is awaiting release. The report recommends some minor changes to the Code and its administration to improve the effectiveness of the Code.
1990	At the request of Commonwealth Ministers and SCOCAM, the TPC and Treasury reviewed the operation of the code and the actions taken by card issuers to implement the revised EFT Code arrangements.
1989	Australian Banking Industry Ombudsman Scheme established, with jurisdiction to handle EFT complaints.
1989	At the request of the Treasury and Minister for Consumer Affairs, the TPC and Treasury reviewed the issue of onus of proof in EFT disputes. The report recommended amendments to the code to improve the complaints procedure, and the establishment of an independent dispute resolution forum. The changes were endorsed by Commonwealth and State Ministers.
1989	Third report of the working group. Recommendations included: • institutions should be reminded of the need to comply with the information disclosure requirements of the code, and to revise their electronic banking contracts to comply with the code; • the working group should examine present complaint handling requirements to better assess the problem of the onus of proof; and • industry associations monitor and report on members compliance with the code.
1988	As a result of Ministers' dissatisfaction with the degree of industry compliance with the procedures, SCOCAM asked the TPC to participate in a working group to assess the adequacy of the implementation of the procedures. The TPC's report found: • a wide variation in the availability of information, in the extent to which the procedures were translated into terms and conditions, and in branch awareness of the procedures; • inadequacies in the allocation of liability in the procedures, in the dispute procedures and in the administration of the procedures.
1986	Working group expanded to include State Government representatives. Second report released, recommending that financial institutions adopt a form of code of conduct, the 'Recommended procedures to govern the relationship between users and providers of EFT systems' (the code).
1985	First report of the working group released.
1984	Commonwealth Government working group established to examine the rights and obligations of users and providers of EFT systems.
1981	The Campbell Committee report in the financial system recommended that the Government establish a Taskforce to consider whether there was a need for legislation to protect the users of Electronic Funds Transfer (EFT) systems.

Implications

In addition to illustrating the many ways that the ACCC is involved in improving consumer protection in financial services, the above examples also illustrate:

- The interconnectedness of ACCC strategies in improving the market. Rarely does the Commission use just one type of strategy. For example, enforcement activity is often accompanied by complementary compliance education activities, and assistance with developing self or co-regulatory responses.

- The backstop and strategic role played by the ACCC. The ACCC gains considerable clout from its enforcement activities, and this often enables it to achieve its goals of compliance and improved market conduct without needing to resort to litigation. The ACCC has had a significant influence on the operation of the sector, and often has the fresh perspective, economy-wide view and lack of regulatory capture that enables it to play this strategic role.

- The long time frames involved in achieving results. Whilst the Commission would consider that its activities have been highly successful, it is clear that, for a variety of reasons, there can be a significant time period between the identification of a problem and the implementation of effective solutions. The highly regulatory, fragmented and duplicative structure of the current system has been a contributing factor to these delays, and a source of frustration for many of the parties involved, including the Commission.

As noted previously, the ACCC is of the view that it is well placed to continue providing an effective role in making financial markets work better. However, it also considers that there is significant room for a much greater role to be played by industries themselves. The regulatory structure proposed in Chapter 8 does give the industry a primary role, and importantly, also retains the ACCC's role of enforcing the TPA as a backstop.

Under this proposed structure, the Commission believes that, in the future, problems such as those described above would be addressed significantly differently, with cheaper, speedier, and more effective results. The Commission envisages that, under such a structure, matters could resolved through the following process:

- The sector-wide scheme would be able to quickly identify the existence and scope of a problem, since all consumer complaints about financial services would have been directed straight to the proposed new industry co-regulatory body;
- Consumers would have little difficulty in discovering the appropriate body to which complaints could be taken;
- The sector as a whole would have the opportunity to develop market sensitive and workable solutions to the identified problems;
- Solutions could be developed taking into account responses to similar sorts of issues across the sector, with the result being an increase in consistency;

- Solutions could be developed to provide both redress for individuals, and mechanisms to ensure that the problem across the industry did not arise again - including compliance education, codes of practice, review of documentation, standards required for advisors, etc;
- Adverse publicity could be minimised;
- Long term solutions could be achieved more quickly, and could be more durable, than if they were proposed by government agencies;
- Industry members would ‘own’ solutions, and could therefore be more committed to ensuring that they achieve the desired results;
- The ACCC and the proposed new statutory body would be available to provide assistance in developing codes of practice, etc through their authorisation, compliance and oversight roles; and
- Involvement of external agencies (such as the ACCC) through litigation would remain as a backstop, coming into play only if the sector had failed to satisfactorily address the problem.

ACCC Retention of Part V of the TPA in Relation to Financial Services

The ACCC is of the view that whatever regulatory structure emerges from the Inquiry it is important that the competition and consumer protection provisions currently in place in the financial services sector should not be diminished.

Trade Practices Enforcement as a Backstop to Regulatory Reforms

As outlined elsewhere in the ACCC’s submission, our preferred approach to reforming the regulatory structure of the financial services sector would be to employ a well structured and managed system of industry co-regulation to carry out much of the detailed administration relating to such areas as licensing/vetting of industry operators, industry codes/standards, and complaints resolution schemes.

In this way much of the micro work of protecting consumers of financial services would be undertaken by the industry itself. This has the advantages of utilising specialist industry knowledge, involving the industry members in enhancing consumer outcomes, and doing this at little or no cost to the taxpayer. To oversight this largely co-regulatory structure an independent Federal agency will need to be established, the Australian Office of Financial Services (AOFS). The AOFS would be a relatively small organisation that had sufficient powers to ensure that adequate outcomes were achieved through the co-regulatory structure but at minimal cost to the taxpayer.

However, there needs to remain a backstop or underwriting framework of undiluted competition and consumer protection legislation that applies to the financial services sector, as it applies to all other sectors of the Australian economy. Given the size of the transactions involved in purchasing financial products and the information problems present in financial markets it is vital that consumers retain the protection of the TPA as a base-line of protection to their participation in financial markets. This will be especially important during the transition phase from the old to the new (improved) regulatory structure, where new arrangements, institutions and structures are developing.

To this end, existing trade practices legislation should remain in place and be administered by the ACCC which is well known to the industry, public sector agencies and consumers alike.

The Role of an Economy-wide Competition and Consumer Protection Agency

Since the ACCC operates across many sectors of the Australian economy it is able to view the operations of any given sector from an economy-wide perspective. This means that the danger of regulatory capture, where a symbiotic relationship between industry members and a regulator/enforcement agency develops, is greatly diminished.

Unfortunately, examples of capture have been a reasonably common phenomenon where industry-specific regulators have been required to enforce legislation for the protection of consumers, both overseas and in Australia. The universal application of the TPA by the ACCC is a form of insurance for consumers against capture and/or other forms of regulatory failure by industry-specific institutions charged with a consumer protection role.

By operating on an economy-wide basis the Commission is also able to achieve consistency of application of the TPA. The financial services sector is an integral part of the Australian economy and as such whatever regulatory structure is adopted in the financial services sector it is important that consumers and businesses in that sector are treated in the same way as those in other sectors. This is not to say that additional safeguards for depositors, investors and policy holders should not be put in place in the financial services sector: they should be, especially if this is done in a market sensitive and cost-effective manner. However, these should be additional to, and not a substitute for, the comprehensive application of the TPA by the Commission.

If parts of the TPA either did not apply to the financial services sector or were administered by an industry-specific regulator, there is a very distinct danger of variable application of the trade practices law across the Australian economy. Such a situation that would be undesirable *per se*, and would also be a step back from the intention of the Hilmer reforms. The Hilmer process established the ACCC as the vehicle for enforcing a national competition framework - including full application of the consumer protection provisions of the TPA to financial services.

Increasing convergence of the type of products and services being sold by financial institutions in the face of differing regulatory regimes has been a key factor in seeking a level playing field for all participants in the financial services sector. This is a theme that is at the heart of the Inquiry.

However, it is also important that a level playing field in enforcement and promotion of competition and consumer protection is maintained across all sectors of the Australian economy. In pursuing the former, the Inquiry should not lose sight of the latter. It is for this reason that the application of all parts of the TPA to financial services should remain and be administered by the ACCC.

Public Perception and Consumer Confidence

Quite apart from the possibility of capture and the consequent erosion of consumer rights that can result from industry self-, co- or specific-regulators having an ultimate Part V enforcement role, there is the issue of public perceptions of such an arrangement.

Recent research from the UK suggests that some of the industry-specific regulators charged with overseeing consumer interests in the electricity, gas and water industries are not well known to the public and are not highly regarded by them in terms of their consumer protection role. The main reasons for this were the lack of a local presence for the regulators and a perceived lower priority being assigned to consumer protection relative to their licensing/regulatory functions - a perception of remoteness and of capture.[17]

This sort of evidence very much supports the existence of the ACCC as an economy-wide consumer protection watchdog. The ACCC is well known to Australian consumers and has regional offices in all State and Territory capitals, including Darwin, plus offices in Tamworth and Townsville. More importantly, the ACCC is recognised by consumers, and by consumer organisations and advocacy

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[17] Devon County Council (1996), *Off who?, Off what? Off where?: A review of the utility regulators' role in protecting the interests of consumers*, Department of Trading Standards and Consumer Protection, Exeter, Devon, England. Similar themes and concerns regarding the consumer protection role of public utilities regulators in the United Kingdom can be found in Meek, C. (1996), "Privatisation Doesn't Necessarily Equal Competition: The UK Experience", paper presented to the Corporatisation and Privatisation Conference, Royal Institute of Public Administration in Australia, Brisbane, March; and in the National Consumer Council (1989), *In the absence of competition: A consumer view of public utilities regulation,* HMSO, London.

groups, as a national, independent and wide-ranging consumer protection watchdog. Consumers and their advocates know who to contact if they believe an infringement of the TPA has occurred, and adequate remedy or resolution has not occurred through industry-specific channels.

In simple terms the ACCC has a significant market presence that is recognised by both consumers and industry in the financial services sector and the Australian economy generally.

To allow the Part V provisions of the TPA to lapse, or to be enforced by industry-specific bodies, could seriously undermine consumer confidence in the extent of consumer protection in the financial services sector. This could be particularly damaging in a climate where regulatory changes were taking place, consumers of financial products and services were confronting a growing range and complexity of financial products, and financial institutions were adopting new mechanisms through which financial services are provided.

The Boundaries of the Financial Services Sector are Not Clearly Defined or Discerned

Financial transactions form part of other purchasing activities. In the simplest cases EFTPOS facilities or credit cards can be used to purchase goods and services. In more complex cases arrangements for loans and insurance form part of a package that consumers of property and consumer durables are offered at the point of sale.

In this sense the influence of the banking, finance and insurance industries on the welfare of Australian consumers is pervasive and far reaching.

The difficulty in enforcing consumers rights is that, particularly in more complex transactions involving the sale of finance and insurance as part of a package deal, possible breaches of the TPA may not fall neatly into financial and non-financial aspects. If an industry-specific regulator has charge of the consumer protection provisions of the TPA then there is a very real danger of breaches in this area falling between the cracks. At present the ACCC can view the whole web of transactions and information flows as a totality and act accordingly.

Recent developments in telecommunications and computing technology are changing still further the manner in which financial services are delivered and blurring the boundaries of the financial services sector in another direction. Increasingly, it is possible for financial institutions to service their customers through a combination of telephone, on-line and smart card banking. Where problems arise, for example with a banking transaction on the Internet, a range of entities may be involved - ranging from providers of software and hardware, to providers of connection services and telecommunications capacity, to the creators of web sites as well as to the financial institution itself. The following Chapter of the submission will examine the implications of these new technologies for consumer protection in the financial services sector in more detail.

The holistic approach offered by universal application of the TPA by the ACCC not only enhances the effectiveness of enforcement activities but facilitates its compliance and education work. The universal application of the TPA assists the Commission and business in understanding their legal obligations with regard to consumer issues. These obligations apply to all Australian firms regardless of industry-specific regulation or self-regulation which may be in place.

Recommendation 15

The Commission recommends that the existing role of the ACCC in the enforcement and administration of the TPA be retained in relation to all financial services providers.

CHAPTER 6

NEW TECHNOLOGIES, CONSUMER PROTECTION AND THE DELIVERY OF FINANCIAL SERVICES

Recent developments in telecommunications and computing technology are likely to bring significant changes to the way in which financial services are delivered. Increasingly, it is possible for financial institutions to service their customers either at their homes or offices (through telephones and on-line computer networks) or at ATMs, bank booths and retail outlets (through the use of electronic cards). However, the impact of these changes is going to depend very much on the acceptance and take-up of new electronic service delivery mechanisms by the customers of financial institutions in Australia.

To consider the implications of new service and transactions technologies in the financial services sector this Chapter will proceed in four parts. First, the underlying rationale for adopting new service delivery mechanisms will be considered along with a brief description of these mechanisms. Second, the generic problems that these new technologies raise for Australian consumers will be outlined, but consideration of the particular problems raised by the Internet will be deferred to the end of the Chapter. Third, the implications of this for the mechanisms and structure of consumer protection to be adopted in the Australian financial services sector will be considered. Finally, the particular detection and enforcement difficulties raised by virtual and borderless mediums (like the Internet) for selling financial services will considered.

New Technologies, Cost Savings and Client Service

For service delivery organisations, new technologies can present opportunities to simultaneously reduce costs and enhance client service. The advantages for financial institutions are essentially fourfold, electronic service delivery can:

- improve customer service to vital segments of the customer base;
- lower costs (especially on labour) per transaction/inquiry;
- provide opportunities to re-engineer existing retail operations; and
- facilitate the compilation of more complete customer databases.

In the first instance, these new forms of customer service enable certain types of transactions and inquiries to be handled more rapidly and conveniently for customers. This allows the firm to deliver improved customer service to important segments of its customer base, especially for high value professional customers, leading to improved customer goodwill and loyalty, and ultimately to increased profits.

Secondly, these new forms of client service generally operate with lower staffing and infrastructure costs than traditional retail branch networks - relying more on investments in IT and telecommunications. This enables banks to provide basic services (eg account balance inquiries and deposits/withdrawals from low value retail accounts) which currently have high costs but low returns to banks, much more cheaply than with OTC transactions - possibly up to ten times more cheaply.

A third and related advantage is that by servicing an increased proportion of the customer base remotely, service delivery organisations can rationalise their branch networks. Significant returns can then be made on the sale or lease of commercial property, while work flow processes in their remaining retail network operations can be re-engineered. More efficient back office procedures can bring cost savings, while front office operations can be redesigned to deliver more effective customer services over the counter. This then enables retail outlets to focus on their marketing role in expanding sales of high value products to walk-in customers.

The fourth advantage is that because electronic banking mechanisms record in detail the spending, earnings and portfolio decisions of customers, financial institutions are provided with an improved customer database. This has enormous potential for market research and the targeting of high value products at niche markets through direct selling techniques. Put another way, electronic service delivery mechanisms improve the information base upon which marketing and other commercial decisions are based.

For financial services, and more particularly in retail banking, these new technology-based mechanisms for remotely servicing customers, marketing products and facilitating electronic transactions form part of a closely integrated network. They can take the following forms:

- existing magnetic stripe electronic cards;
- cash/stored value/smart cards;
- ATM, booth and post office banking;
- telephone banking; and
- on-line banking.

A brief overview of these new technologies will be provided before a discussion of the consumer protection issues raised by new customer service mechanisms in the financial services sector is entered into.

Electronic payment cards can take many forms. Well established examples are credit and transactions cards. The latter were originally restricted to enabling customers to withdraw cash or check account balances through Automatic Teller Machines (ATMs), but have grown in usage dramatically since the introduction of Electronic Funds Transfer at Point of Sale (EFTPOS) technology and the increased functionality now available in many ATMs.

Newer types of electronic cards include the cash/stored value/smart cards that are currently being trialed in Australia. These cards are generally designed to be used for frequent low value transactions that coins and small denomination notes are now used for. They make use of smart card (integrated chip) technology which gives greatly increased functionality relative to traditional magnetic stripe cards, such as credit, EFTPOS and telephone cards.

Smart card technology is also being used in conjunction with card reading machines to enable consumers to record and check their own transactions. In smart card systems like Mondex, cash can be loaded onto the card at participating financial institutions but no audit trail is kept of where and how the money is spent. Bilateral transfers between individuals can take place as with cash but with the potential for much larger transactions. The widespread use of such systems for the transfer and storage of electronic currency raise a number of serious concerns for agencies concerned with consumer protection, law enforcement, tax collection, prudential regulation and monetary policy.

To complement the growth in usage and functionality associated with electronic payment cards, banks are seeking to establish an improved network of automated banking outlets. Part of this growth will likely come from increased availability of ATMs and an increase in the types of transactions that can be undertaken through them. In addition, new forms of services can be offered through secure banking booths in supermarkets and through retail outlets such as giroPost facilities at post offices. The use of electronic payment cards in combination with these new types of scaled-down service outlet could see significant rationalisation of existing retail branch services by banks and other financial institutions.

New technologies are also enabling financial institutions to service their customers remotely through telephones and on-line computer networks.

Call centres and enhanced client server IT systems, and especially on-line transaction recording systems, enable banks to provide their customers with more convenient access to a range of retail banking services over the telephone. There is a clear complementarity between the expanded use of electronic cards and telephone banking - together they make it possible for consumers to undertake a wide range of routine inquiries and transactions independently of traditional branch office networks. As noted above, this enables low or no value transactions to be conducted more cheaply by electronic means, while at the same time freeing up the more expensive OTC resources to concentrate on selling high value products and servicing residual walk-in customers.

The use of on-line computer systems could take home banking even further by enabling customers to make a wide range of inquiries, transactions and transfers using their home computers.

At present open computer systems like the Internet are used by financial institutions largely to market products and provide general information to customers and potential customers. Over time as security concerns are addressed, connection rates rise and the level of comfort with transacting business over the Internet increases, it is likely that personal computers will become another means through which retail banking can take place.

A more secure but costly alternative to Internet banking is provided by closed proprietary on-line computer networks, where the customer is connected to the banks IT systems through secure telephone lines so that they can access their own accounts.

Consumer Protection Issues

The adoption of these new forms of service delivery by financial institutions raises a range of consumer protection issues. At a broad conceptual level these difficulties are similar in many ways for smart cards, telephone banking and on-line banking and can be classified into groups of related problems. Unless these problems are resolved properly, the degree of consumer protection, and consequently consumer confidence in using these new forms of electronic banking, could remain low. The following groups of problems are probably the most crucial:

- liability for loss, errors and unauthorised transactions;
- security of transactions and payment details;
- protection and usage of data (privacy concerns);
- transactions records and audit trails;
- pricing and costs;
- dispute resolution;
- barriers to access;
- increased information problems; and

- protection of consumer rights in virtual and global marketplaces.

These issues will need to be considered and satisfactorily resolved as new forms of electronic banking are introduced. They are briefly outlined in turn below, except for the final set of issues which will be discussed in more depth in the final section of this Chapter.

Liability

One of the key concerns for consumers is the liability for loss, errors and unauthorised transactions arising from their use of new types of electronic cards, telephone banking and on-line banking. The situation is complicated where third or fourth parties are involved as would be the case with the use of smart cards to pay for goods and services or to transfer cash between individuals. This complication also arises with telephone and on-line banking where, in addition to the financial institution and its customer, telecommunications carriers, suppliers of IT systems and specialist (call centre or web site or Internet) service providers may also be implicated in any problems that arise.

Liability for loss is a clear concern for Mondex-type smart cards which have the capacity to be loaded with high values of electronic cash but where there is no audit trail in place. The (legitimate and illegitimate) attractions of anonymous electronic transaction cards for consumers need to be balanced against the risks of loss that could result from theft, fraud or malfunction. Consumers need to be clear about their liabilities and how they can be minimised in using such devices.

It is vitally important that the liability of each participant is made clear and that fault can be assigned for different classes of events. The way these rights are assigned and the balance of responsibilities should also be consistent across different mediums for electronic banking.

In the financial services sector, the EFT Code of Conduct is an example of how clear liability rules can improve the operation of a market. In the early days of consumer EFT services, there were concerns that the way financial institutions were allocating loss was unfair. The Code was a response to this, and imposed clear and equitable rules for liability in cases of disputes. In the Commission's view, the EFT Code would be an appropriate template for new codes applying to other forms of electronic banking.

In a sense, the problem is all about ensuring that property rights for the use and misuse of these new technologies can be and are assigned - and that this is done in an efficient, fair, workable and clear manner. Without this, disputes involving such problems will be difficult to resolve. Not only will this result in detriment to consumers but it could also contribute to a lack of acceptance of these new forms of electronic commerce by the public.

For example, the terms and conditions applying to telephone banking are similar to those governed by the EFT Code as regards post-notification liability for customers. As with transactions cards a customer must notify the bank if they believe that their

PIN and/or access password has become known to a third party, at that point their liability ceases.

However, while the post-notification arrangements are similar, there are major variations in the pre-notification arrangements. For EFT cases, the consumer incurs no liability where he or she has not contributed to the losses in any way; incurs the full amount of losses where the consumer is found to have contributed to the losses wilfully or through negligence; and liability is limited to $50 in cases where it is unclear. For telephone banking, by contrast, the outcomes vary from bank to bank as does the clarity and detail of terms and conditions regarding unauthorised pre-notification transactions.

Clearly inconsistencies in the distribution of rights and liabilities between different electronic banking mediums place a high information burden on consumers and can expose users to risk of loss. Not only do codes of practice need to be developed in regard to all forms of electronic banking, but they need to be consistent across mediums as far as is possible and they need to be developed within a reasonable time-frame.

Currently, a code of practice for smart cards is being developed but has taken some time to reach a final form. The delays have not only had the potential to place consumers at risk but the resultant uncertainty over the balance of rights and responsibilities may have contributed, at least in part, to the lower than expected take-up of these cards during recent Australian trials.

Security

A related issue for consumers in using these new banking technologies, especially in undertaking telephone or on-line financial transactions, will be the security of payment details such as credit card numbers or bank account details. In the first instance, the consumer will need to be sure that their transaction is going to the right account/institution and that the correct amount is paid/debited/credited. This will require appropriate mechanisms for customers to gain secure access to their accounts, and to define and authorise the transaction they wish to make.

At present PIN numbers are used for transaction cards and EFTPOS transactions. Similar arrangements are likely to operate for smart card systems. For telephone and on-line banking, a separate access identification number is used in addition to the consumer's PIN. As a further precaution, the types of transactions that can be conducted through these channels are presently limited to general bank and product information, checking of, and transfers between, customer accounts. Payment of moneys to third party accounts is not currently available through these channels unless the account has been pre-authorised, although paying of (government and utilities) bills is available through some banks.

However, as the range and sophistication of payment functions available through electronic means grow, security will be a key issue, especially where open on-line systems like the Internet are used. Consumers will need to be satisfied of two things. The first is that payment information is safe when being transmitted, and secondly, that it is secured appropriately by the vendor once it is received and stored.

For the first case it is easy to imagine a scenario of a third party intercepting the communication of payment details, and then using that information to make fraudulent transactions on the consumer's account. As is the case with EFT disputes now, it may be very difficult to prove that the consumer did not make a particular transaction. For many IT specialists, however, it is the second case that causes more concern. The potential harm that can result from hacking of information once it has been compiled and stored by institutions is huge. The first case, while a serious problem, may be the equivalent of an individual being robbed in the street, while the second is more akin to a bank vault being emptied out.

Privacy

While the protection of payment details is an obvious concern for consumers and financial institutions, there are other consumer protection issues relating to how information is gathered and used. As noted above, telephone call centres, on-line transaction recording systems and interactive computer systems can provide valuable real time information on trends in sales, complaints and marketing for financial institutions. In this sense, data generated by new service delivery mechanisms can be a valuable tool for market research helping to keep firms informed and responsive to their customer base. The internal use of aggregated information for these ends by firms is entirely appropriate provided that the information is adequately protected.

However, if this information is used by firms, or made available to third parties, for consumer profiling or direct marketing then the rights of consumers can be infringed. Not only will consumers' privacy have been infringed but a valuable commodity (information) will have been created (and possibly on-sold) from data that was supplied by clients solely for transaction purposes.

The use and ownership issues surrounding customer information gathered through electronic mediums by financial institutions is going to be a major challenge for consumer and privacy regulators. It is imperative that these rights are established and protected in new electronic environments if they are to become the pervasive medium for commerce and information exchange that they are expected to become. To this end, consideration should be given to the extension of privacy guidelines, similar to those applying to government agencies and to the management of credit details by private institutions, to encompass other types of information and transaction records being kept by private institutions.

Transaction Records and Audit Trails

Another consumer issue closely related to the security and privacy of on-line transaction information is the type and legal status of transactions records. What record of electronic transactions will be supplied to consumers? What legal status will these records have? What type of audit trails will remain for reference in cases of disputed or missing records?

It is important that any such records are universally (and legally) accepted by financial institutions, the courts and government agencies, and are supplied as requested to consumers. It is also important that such records are cost effective so that their production/distribution does not impede new forms of electronic commerce. Likewise, cost effective means of recording transactions for audit purposes need to be found in an environment where the use of traditional paper audit trails may not be practical.

Pricing

New service delivery and payments systems provide improved service to clients and cost savings to institutions. As was outlined above, the gains to firms take the form of reduced staff and property costs, more efficient client service and administrative processes, and expanded customer information bases. On a per transaction basis, the costs of electronic banking for financial institutions is manifold times lower than for OTC transactions.

The gains to consumers are in terms of reduced costs of time, effort and transport involved in travelling to a retail branch to carry out transactions. The advantages of electronic banking are also reflected in the extended hours of availability relative to OTC banking.

Against this there are other costs to the consumer such as:

- the cost of telephone calls (generally ranging from a free call to standard local call rates);
- fees for ATM transactions (varying between nil and $0.65 for use of a banks own ATMs to between $0.75 and $1.00 for use of other ATMs);
- costs for direct on-line banking (usually comprising a connection fee, monthly charges of around $5.00 and connection time fees based on telecommunications charges); and
- Internet connection and access charges for Internet banking (with access charges working out at around $0.10 to $0.15 per minute).

Obviously for home computer banking the consumer will have the cost of computing hardware, modems and software which is likely to have been purchased for other reasons. To a large extent this is also true for Internet connection and support costs as well.

It is important that the cost savings and other pecuniary benefits enjoyed by financial institutions through increased use of electronic banking are passed on, at least in part, to those consumers who choose to use these more cost effective banking mediums. At present the fees and charges are broadly reflective of operating costs, but this could change over time as take-up rates increase and OTC services decline. If this was to occur, it would have clear advantages for institutions but be detrimental to the interests of consumers.

Dispute Resolution

The above discussion illustrates that disputes are likely to arise between consumers and suppliers over a range of issues relating to electronic banking. It is important that where disputes arise, consumers know about and have access to transparent, fair, accessible, speedy and affordable complaints resolution procedures. Ideally, complaints resolution procedures that are available to consumers should be both internal to the financial service providers, as a first step, and external, for complaints that cannot be resolved internally.

Banks that are party to the Banking Code are required to have in place internal dispute resolution mechanisms which cover consumer products and delivery mechanisms as part of the Code of Banking Practice. For external complaints handling, the Banking Industry Ombudsman presently serves this function for retail banking. Complaints regarding electronic banking can be considered by both the internal and external schemes. Other parts of the financial services sector have a variety of external complaints handling bodies which can cover complaints regarding electronic transactions and delivery of services, as well as traditional OTC cases.

Quite apart from the advantages pointed to in Chapters 4 - 7 of this submission, for greater uniformity, harmonisation and rationalisation of the existing complaints resolution schemes in the financial services sector, such changes would also have advantages for handling of complaints regarding electronic service delivery. Not only do liability rules need to be uniform across service delivery mechanisms but the treatment of complaints regarding new service delivery mechanisms needs to be consistent across delivery mechanisms and product types.

Access

For many people the growth of new technologically driven services will provide a more convenient way to undertake transactions and an expansion of the range of financial services available to them. All of this is a good thing - providing of course that adequate solutions to the above problems can be found.

However, the growth in electronic banking may have some serious implications for those who cannot gain access to these new systems or, through fear, habit or preference, choose to conduct their financial transactions through more traditional means. For example, groups like the aged (who may prefer the more personalised service of over the counter operations) and those from lower socio-economic backgrounds (who may lack the resources and education to access, say, on-line services), may be less likely to use electronic banking.

Over the longer run, the expansion of electronic service delivery and transaction mechanisms, and the take-up of this by the more technologically literate, may see the erosion of traditional financial service delivery mechanisms. These may take the form of branch office closures, higher fees and costs for traditional over the counter transactions, and cream skimming as institutions cross-subsidise vigorous competition in these growing and more affluent avenues for delivering their products by higher fees and charges in less profitable areas. Given the centrality of financial services to an individual's participation in a modern society, as discussed elsewhere in this submission, appropriate safeguards need to be put in place to avoid individuals being marginalised from the financial services market.

Information Problems

The sale of complex financial services through call centres and on-line networks may see a decrease in the use of street outlets and agents by investment and insurance companies.

In the past, these operations have been an area of concern for the Commission because of cases where intermediaries have given misleading or inaccurate advice. However, enforcement action, legislation and industry self-regulation have provided an environment where intermediary advice is generally of an acceptable standard. For some products, consumers now receive mandatory information on contract conditions, disclosure of commissions is encouraged and set cooling-off periods are provided to give consumers time to reflect on their purchase. Intermediaries can complement these initiatives by providing consumers the opportunity to explore the details of complex financial decisions in an interactive way.

The lower costs of retailing these products on-line could develop a strong cost incentive to direct market these products rather than incur high branch office and agency costs. If this happens, there will be a divorcing of the sale of these products from the giving of advice on purchase and use. If this information and advice is not readily available, there is a strong danger that consumers will not have the information needed to be able to choose the most suitable products. This is not to suggest that the system works perfectly at present but rather that it could deteriorate over time to the detriment of a great many consumers of financial services.

As noted in Chapters 4 and 5, the issue of information asymmetries between consumers and providers of financial services is a key problem in this sector of the economy. It is the existence of these information gaps which leave consumers open to fraudulent and misleading conduct by sub-standard operators in the financial services sector. Many of the worst problems have been addressed through considerable efforts on the part of the public sector, government, industry and consumer groups. More specifically this has encompassed:

- ACCC enforcement of section 52 of the TPA (which prohibits firms from engaging in misleading or deceptive conduct);
- recent legislative changes to improve conduct such as disclosure requirements, set cooling off periods and post-sale notification flowing from ACCC and other market studies; and
- industry self-regulation such as codes of conduct developed in consultation with the ACCC, other government agencies and consumer advocacy groups.

Direct selling of complex financial products through electronic means has a distinct risk of by-passing many of the above measures that have been designed to operate in traditional OTC environments. For more sophisticated and generally better off consumers this will be less of a concern because of their better understanding of financial products and the ability to pay for appropriate third party advice when required.

For less sophisticated consumers, however, the direct selling of financial products could place them at serious risk. As noted elsewhere in this submission, the information problems that can result form the unbundling of product sales from the provision of OTC financial advice by banks and other financial institutions is a serious issue that needs to be considered by the Inquiry. This unbundling is facilitated, and indeed suited to, remote service delivery mechanisms like telephone and on-line banking.

Implications for Consumer Protection in the Australian Financial Services Sector

The key implication of all of this for consumers is that unless these problems are addressed there is a very real danger of risk being transferred from institutions to consumers. In the absence of codes of conduct and other mechanisms which define clearly the balance of rights, responsibilities and risks in using new technologies to deliver financial services, consumers can be left exposed. The Commission regards this as an undesirable situation for which appropriate, workable and effective solutions need to be found in a timely manner.

For some of the issues raised above, technical solutions are currently being developed or put in place. On the security side, the use of two-tiered identification numbers and limitations on transfers to third parties are already in use for telephone and on-line banking through closed systems. For banking on the Internet, the development and adoption of public key encryption standards and other firewalling systems will provide greater security for information transmitted in cyberspace and should open up this medium for personal banking. Similarly, the provision of electronic audit trails and transaction records are essentially problems that require technical solutions. An important catalyst for the acceptance of these technical solutions will be the adoption of appropriate standards by industry and government.

Industry Based Solutions

For the setting of security and audit standards, rules on liability, and the establishment of dispute resolution mechanisms, the most effective solutions are likely to be achieved through the adoption of industry codes of conduct and licensing requirements. As a first step licence conditions and codes of conduct can be then be enforced and administered by industry associations (and other self- or co-regulatory bodies). They can also be complemented by industry programs of compliance, compliance education and public education.

At the next level they can also be overviewed, audited and authorised by independent regulatory bodies such as the ACCC and the proposed AOFS. This input serves two broad purposes. One is to provide checks and balances on the appropriateness of individual codes and licensing requirements as protections for consumers. The second is to enable those agencies to provide assistance to industry in establishing the appropriate co-regulatory frameworks to address consumer issues in the first instance and to continue to do this as conditions change.

The ACCC is strongly of the view that the balance of incentives is very much in favour of industry developing appropriate, workable and effective solutions to many of the problems raised by new technologies. This is especially so in generating the confidence and comfort necessary for consumers to accept these new service delivery mechanisms. To this end, a degree of co-operation will be required between financial service providers, telecommunications companies and members of the IT industry in addressing consumer protection problems posed by electronic transactions and service delivery mechanisms.

It is also possible for industry codes to address problems relating to information, pricing and privacy by applying suitably high standards to the business and ethical conduct of the industry members. In these areas, though, new technologies have raised problems that may require some regulatory solutions.

Regulatory Solutions

A good example is in regard to providing fail-safe protection for consumers subject to misleading or deceptive conduct in changing market environments where information asymmetries can be compounded. This underscores the importance of section 52 of the TPA and its administration by an independent economy-wide regulator like the ACCC. Part IV of the TPA and the Prices Surveillance Act are also important bulwarks in maintaining competitive and fair prices in markets undergoing significant technological change.

Another issue identified above that may require legislative solutions is the issue of privacy. As already noted, it seems appropriate that data collected by private firms from transactions records and other payments details should be subject to the same privacy provisions as data held by government agencies or providers of credit. This would require an extension of the coverage of the existing law. Problems of access and availability of new technologies have wider social implications which may have policy implications for government.

The Way Forward

The ACCC is not in a position to conjecture on the precise detail of solutions that may develop for consumer protection problems raised by electronic banking. Having identified those mechanisms that are likely to be most effective in developing solutions, the Commission believes it is more constructive to identify the characteristics of a consumer protection framework that will enable the right mix of solutions to develop. The key dynamic characteristics are flexibility, durability, competitive neutrality and minimum necessary regulatory intervention. A consumer protection framework that embodies these characteristics is proposed by the Commission in Chapter 8 of this submission.

Chief among those characteristics is flexibility. The consumer protection structure and instruments adopted should be capable of accommodating changes to the types of products offered, the mediums through which products are delivered and the types of firms offering those products. To establish the flexibility needed, only the minimum necessary intervention should be imposed on the industry, enabling those with the industry-specific knowledge to respond rapidly to new developments in the market. A flexible structure is also likely to be a durable one in that it will minimise the danger of new products, supply mechanisms or suppliers rendering the existing consumer protection structure and mechanisms impotent or irrelevant.

Competitive neutrality is also important in that consumer protection problems should be dealt with similarly regardless of the product or medium through which services are applied.

The Commission is of the view that the current system is not particularly well suited to coping with change of the type posed by electronic banking. The inconsistencies imposed by a rigid and fragmented structure have lead to variations in such important areas as the content and coverage of codes of conduct, external complaints handling bodies and the allocation of liability across delivery mechanisms. The wider problems confronting the existing framework will be outlined in more detail in the following Chapter of this submission.

Some examples relating to codes of conduct for electronic banking are instructive here. As noted above, the EFT Code is a useful model for developing codes for new service delivery or payment mechanisms. Presently, an industry code for smart cards is being developed with government and consumer input, but unfortunately it has had a long gestation period at a time when smart cards have already been extensively trialed and community concerns and speculation are growing. More worrying still are those situations where codes are yet to be developed, and the current distribution of liabilities is inconsistent with other codes, as with telephone banking. A code or codes governing home banking through telephones and computers is desirable and should, where possible, embody the same principles as those established in the EFT Code.

Consumer Protection in Virtual and Global Marketplaces

So far the above analysis has tended to focus on the implications of new technologies for the structure of consumer protection in Australian financial markets. Mention has been made of home banking through the Internet, however, the implications of banking services being available in cyberspace go far beyond what has already been considered. The difficult and altogether less tractable problems associated with Australian consumers purchasing financial products in cyberspace warrant special consideration.

Open on-line networks like the Internet have been made possible by recent developments in IT and telecommunications systems. In essence these systems allow subscribers to communicate with other network users by providing connection facilities between computers. They also provide scope for various types of home-entertainment, home-shopping and home-banking transactions. It is the provision of electronic retail and banking transactions to consumers through on-line systems that presents possibly the biggest challenge for competition and consumer protection agencies like the Commission.

At present the virtual and borderless on-line environment of the Internet is a very new medium for commerce. However, over the coming months and years the Internet will in all likelihood become a major means for Australians to purchase many of the goods and services that they require, including banking, finance and insurance products. Established banks currently use the Internet largely as a means of providing basic information to consumers and promoting products. Once encryption technology and standards have been developed, however, usage rates rise and consumer confidence with conducting transactions on-line increases, then the range of financial products and services offered over the Internet will almost certainly rise.

The types of problems that consumers may face now and in the future through using open on-line systems, and in purchasing goods and services through these systems, are similar to the types of problems already discussed above. In time we can expect that solutions to some of the above problems as they exist in cyberspace will be provided by:

- technical developments in areas such as encryption, screening systems and electronic audit trails;
- the need for the on-line industry to generate consumer confidence and to impose minimum standards for legitimate operators will create pressures for self-

regulation. (indeed, we have already seen the development of the Internet Industry Association of Australia (intiaa) Code of Conduct); and

- education and public awareness campaigns regarding on-line commerce and fraud.

However, additional problems arise in detecting, proving and prosecuting breaches of consumer rights, such as those found in the TPA, in cyberspace.

First, the anonymity and borderless nature of the Internet and other on-line services means that identification and location of operators in cyberspace may not be possible. At best, identification and location may only be possible electronically and not physically.

Second, the operation of on-line systems across international boundaries raise clear jurisdictional impediments to nation based regulatory and enforcement agencies like the ACCC. Most nations have very limited powers to enforce legislation on persons operating outside their jurisdiction. This is a more general problem associated with the wider growth in global commerce and as such is not confined to on-line commerce conducted through mediums like the Internet.

Third, global transactions raise issues of conflicts of law - that is the question of which country's law should govern the transaction. The more traditional problem of the consumer and supplier being in two different countries can be complicated in the case of on-line transactions. For example, the supplier can be based in one country, the home page in another, and the goods delivered from a third country to the consumer in a fourth country.

Finally, in seeking redress for transnational transactions themselves, consumers will face a range of difficulties. In the first instance uncertainty about where to start and what agency (or jurisdiction) is responsible for their problem may discourage further action by consumers. Even if this is resolved the consumer may need to confront differences in language and legal systems, and higher costs in communications and acquisition of information than they would if they were dealing with a local supplier.

The same jurisdictional dilemma applies to nation-specific industry self-regulation as to regulation and enforcement by government bodies. New strategies for detection of breaches and the enforcement of consumer protection laws in cyberspace are therefore needed. Some international solutions based on a combination of industry self-regulation and input from national and international bodies suggest themselves. For example:

- global industry codes developed through international industry bodies;
- increased and more formal co-operation and information sharing between nation-based regulators;
- an increased role in consumer protection for international organisations like the Organisation for Economic Co-operation and Development (OECD) and World Trade Organisation (WTO); and

- vetting and identification of ethical operators by large global IT, telecommunications and credit providing companies.

The implications of all of this are far from clear. At this time it is difficult to predict the extent to which the Internet will be used to market, sell and purchase financial products within and across borders. While some banking, insurance and financial products from abroad are being offered in cyberspace at present, it seems that for the immediate future the Internet will serve more as a sophisticated marketing tool. Transactions would then be taking place through more familiar channels like OTC, telephone and mail. What it does mean though, is that overseas financial institutions will be able to market their products without having a significant physical presence in Australia.

In time, transactions over the Internet are likely to expand and grow as they become more secure, safer and commonplace. There are many variables and many obstacles to overcome before cyberspace replaces existing mechanisms for delivering financial services, and cyberbanks threaten the market of existing deposit taking institutions. In the meantime, the vexing issues raised by the possibility of mass commerce on the Internet are confronting national regulatory agencies across the globe and solutions are being sought.

The ACCC is undertaking two projects relating to the Internet. One on consumer protection in on-line marketplaces and the other on the enforcement of consumer rights in global and borderless markets, like cyberspace. These projects and their importance to the ACCC in discharging its functions with regard to protecting Australian consumers are discussed elsewhere in this submission. As a valuable source of information for the Committee on both the competition issues and consumer protection issues emerging in the world's largest on-line market, the Committee is referred to a recent publication by the United States Federal Trade Commission, *Anticipating the 21st Century (Volumes 1 and 2).*[18]

In the short term, it is clear that the problems identified above need to be monitored and addressed. In the longer term, the Commission believes that the co-regulatory structure proposed and outlined in detail in the Chapter 8, will provide the characteristics necessary to develop consumer protection mechanisms in a timely and effective way.

Recommendation 16

The Commission recommends that the Inquiry consider mechanisms to ensure that consumer problems and issues arising from globalisation and new technologies in the financial services sector are monitored and addressed in a timely manner.

[18] *Anticipating the 21st Century: Competition Policy in the New High-Tech, Global Marketplace, Volume 1.* (A Report by the Federal Trade Commission Staff), May 1996; Special Supplement of Antitrust & Trade Regulation Report, Vol. 70, No. 1765, June 6 1996; & *Anticipating the 21st Century: Consumer Protection Policy in the New High-Tech Global Marketplace, Volume II.*(A Report by the Federal Trade Commission Staff), May 1996; Special Supplement of Antitrust & Trade Regulation Report, Vol. 70, No. 1765, June 6 1996 (Both Published by The Bureau of National Affairs, Inc., Washington DC 20037.)]

Internet addresses: http://www.ftc.gov/opp/global/report/global1.htm and http://www.ftc.gov/opp/global/report/global2.htm

CHAPTER 7

THE EXISTING REGULATORY STRUCTURE FOR CONSUMER PROTECTION AND OPTIONS FOR REFORM

The Effectiveness of the Existing Regulatory Structure

While the Commission regards a number of the features of the existing regulatory structure as workable and effective, it is concerned that the fragmented and rigid nature of the current regulatory system creates some significant problems. Key amongst these problems are those of inadequate coverage, duplication, lack of competitive neutrality, lack of flexibility, high costs and the regulatory burden imposed on industry. These problems relate to a range of tensions within the current system which apply to non-rule solutions and to both government and industry-based rule solutions. They can also contribute to decreased innovation in the sector and higher prices for consumers.

This Chapter will proceed by outlining the main features of the current regulatory structure for protecting consumers of financial services and then discussing some of the problems of the existing structure. The key features of a more effective and desirable regulatory structure are then listed. These criteria are then employed to assess three of the possible options for reforming the regulatory structure for consumer protection in the Australian financial services sector. The model proposed by the Commission in Chapter 8 will be shown to be the option which is best aligned to the key features of a more effective and desirable regulatory structure.

Key Features of the Existing Regulatory Structure

The existing regulatory structure for financial services is primarily based on product or industry classification. A variety of independent regulators have been established, each responsible for different product groups (for example, the RBA, ISC, AFIC, etc). Similarly a variety of different rules and regulations apply to different parts of the sector, again based primarily on product and industry classification.

Supplementing government regulation, a variety of industry self- and co-regulation initiatives (including codes and dispute resolution schemes) have been developed. Again there is a variety of such initiatives, each focused on a different line of business within the sector, and without necessarily any consistency between the different initiatives.

In general, the regulatory structure and rules have developed over time, in a reactive and piecemeal manner, without the establishment of a structure to plan for and address future changes.

Problems with the Existing Regulatory Structure

The current regulatory structure does provide a large amount of legislative protection for consumers, at least in theory. The creation of industry-specific regulators also ensures that there is a great deal of technical and industry-specific knowledge within the regulators, and often a good working relationship between the industry and the relevant regulator.

However, the existing regulatory structure does suffer from some significant faults. The development of regulators and regulations based on industry or product classification does not reflect the similarity of functions performed by different products (for example, life insurance products and superannuation can both provide retirement incomes). In the current structures, different consumer protection rules can apply to a number of products each serving the same function for the consumer, and there is therefore an absence of competitive neutrality.

The current structure, with industry-specific regulators, also suffers from risk of capture of those regulators by industry. The result of industry capture is that the regulator becomes so close to the industry that it is not able to regulate it objectively or effectively, especially as regards consumer protection and/or product safety responsibilities. The problem of capture has been particularly apparent in the United Kingdom in recent years.

As a result of its reliance on product classification, the current structure has a limited ability to respond effectively to changes in the sector, such as the advent of smart cards and Internet transactions. The structure is therefore neither particularly flexible or durable, especially in light of the expected changes to this sector arising from the use of new technologically driven service delivery mechanisms as outlined in Chapter 6.

The current regulatory structure is complex, and the plethora of regulations and regulators places a regulatory burden on industry that many regard as unnecessarily high.

Finally, as noted in Chapter 4, there is a large number of industry initiatives such as codes and dispute schemes, that are in some cases overlapping, and in other cases, introducing gaps in coverage. There is certainly much greater scope for a consistent or harmonised approach to these industry initiatives.

The Key Features of a More Effective Regulatory Structure

The above discussion highlights a number of factors that the Commission considers need to be examined when developing a new structure for consumer protection in financial services. The Commission has identified the following features of an effective regulatory structure:

- minimum necessary intervention - intervention is costly both for businesses and government;
- promotion of competition;
- competitive neutrality - no one business type should be subject to lesser amounts of regulation, or differing rules, than another business type providing the same outcome for consumers;

- provides inexpensive and speedy consumer remedies;
- maximising consumer welfare;
- durability - the structure should remain stable in the face of industry changes and other changes;
- flexibility - the structure should be able to adjust to accommodate changes in industry and changes in technology;
- simplicity; and
- provides an effective mechanism for addressing market problems.

These features should be kept at the forefront in any discussion of consumer protection structures. Most importantly, any changes should focus on the desired outcomes, and the best way of achieving those outcomes, rather than focus on the institutions or procedures involved.

Options for Reform of the Regulatory Structure

There are clearly many options for reforming the regulatory structure in this sector. The above discussion has already highlighted the key features and deficiencies of the status quo. The following section describes two possible models that could be regarded as alternatives, but which are each toward the extremes of the options available. It also foreshadows the Commission's preferred model (as a third option), which incorporates the key features noted above and steers a middle path between these two extremes.

Option 1 (industry self regulation)

One option for the financial services sector would be to rely entirely on industry self-regulation for consumer protection matters. Industry bodies, such as those already in existence, could have responsibility for licensing parties, providing dispute resolution mechanisms, and implementing and policing consumer protection rules (for example, relating to disclosure and market conduct). In this scenario, it has also been suggested that the financial services sector could be exempted from the consumer protection provisions of the Trade Practices Act.

A regulatory structure based primarily on industry self-regulation would clearly result in a decreased regulatory burden for industry and minimal government intervention. It would also bring the financial services sector in line with other industries that have no industry-specific regulators, and would retain a considerable degree of industry technical knowledge. Finally, a structure based on self-regulation could be flexible in the face of technological and other changes in the sector.

However, there are also some significant disadvantages in relying solely on industry self-regulation in this sector. It is highly likely that there would be a loss of consumer protections and a loss of consumer confidence in transacting in the sector. Industry self-regulation clearly involves a great deal of self-interest in the rules and outcomes of disputes, and that self-interest may not operate in the best interests of society as a whole. Without mechanisms for oversight, there is no guarantee that the sector would be able to self-regulate effectively.

A structure based entirely on self-regulation arguably breaks away from the Hilmer model of having universal economy-wide laws, and runs the risk of a lack of consistency and competitive neutrality across the sector. Additionally, as noted in Chapter 4, the Commission would be strongly opposed to any proposal that the financial services sector should be exempt from the consumer protection provisions of the TPA.

Finally, a structure based only on self-regulation would not necessarily be stable or durable, due to the lack of consumer confidence and the lack of oversight.

Option 2 (large sector-wide consumer protection regulator)

A second option is to create a new regulator to be responsible for all consumer protection regulation in the financial services sector. This regulator could have functions associated with dispute resolution, disclosure, licensing, and market conduct. In addition, general competition and consumer protection laws would apply and be enforced by a separate economy-wide regulator.

This approach would rationalise existing industry regulators and industry initiatives. It could ensure that there was consistent treatment and rules for the whole of the sector, and would therefore facilitate competitive neutrality. With one consumer protection regulator, consumer welfare could be easily promoted, and there would be a minimal amount of complexity from the point of view of both consumers and businesses. Additionally, since the regulatory agency would have responsibility for a whole sector, there would be a significantly lower risk of industry capture.

However, this option also has some disadvantages. Reliance on a consumer protection regulator for all consumer protection matters could increase the regulatory burden on businesses and result in higher levels of government intervention. A move away from industry-specific regulators may mean that the regulator does not have sufficient technical expertise, and there is still a risk of capture on a sector-specific basis. Finally, a proposal along these lines would result in industry members losing control of dispute resolution schemes and other initiatives that have been developed voluntarily.

In many ways, Option 2 has the potential to suffer from some of the same problems that have afflicted the current system of regulation in the financial services sector, as well as of reinventing the wheel through re-regulating current industry-based initiatives.

Specifically, there could remain important practical problems of regulatory failure in delivering effective consumer protection through a highly regulated and bureaucratic system. These include the risk of capture and of a conflict of functions in carrying out a wide range of regulatory activities, some of which may distract or conflict with the carriage of consumer protection in a pure sense. In addition, a lack of flexibility and adaptability in the face of change could severely handicap a sector-wide regulator where significant and pervasive technical changes are impacting on service delivery mechanisms, products and the type of institutions operating in the sector. The dangers of this and the shortcomings of the existing regulatory system in addressing these dynamic issues have already been noted in the previous Chapter.

Option 3 (sector-wide co-regulation with targeted checks and balances)

A third option, preferred by the Commission, is to rely on sector-wide industry co-regulation for consumer protection, with targeted checks and balances to ensure that the scheme is working effectively.

The Commission has developed a new regulatory structure for consumer protection along such a basis, and this proposal is detailed in the next Chapter. In the Commission's view, this proposal incorporates the key features of a more effective regulatory structure noted above. Importantly, it also builds on the existing institutions and structures, including dispute resolution schemes and other industry initiatives, to create an environment that will enable consumers to transact confidently and securely in the financial services sector.

Recommendation 17

The Commission recommends that the Inquiry propose a regulatory structure for consumer protection in the financial services sector that:

- **involves the minimum necessary intervention;**
- **promotes competition;**

- **promotes competitive neutrality;**
- **provides inexpensive and speedy consumer remedies;**
- **promotes consistency;**
- **maximises consumer welfare;**
- **is durable;**
- **is flexible;**
- **is not unnecessarily complex; and**
- **provides an effective mechanism for addressing market problems.**

CHAPTER 8

REGULATORY STRUCTURE

The ACCC has a clear interest in the type of regulatory arrangements which may result from the Inquiry's recommendations. While this extends to prudential supervision of financial services the ACCC's main interest is in relation to the consumer protection aspects of any new regulatory arrangements which may be recommended.

In any system of regulation it is important that three principles, which have already been referred to in Chapter 1, are followed. First, the system of regulation should be competitively neutral. Second, regulation should be consistent and consistently applied. Third, the system of regulation should be flexible and adaptable so as to be capable of dealing with developments which occur after the regulatory structure was put in place.

The first requirement is a very important one for the Commission. The ACCC enforces Australia's competition laws and appreciates that some of its enforcement activities will clearly have competitive effects. That, however, is not what is meant by competitive neutrality of regulation. What that phrase means is that if the same line of business is engaged in by different entities then none should be favoured by regulations or requirements which place a more onerous burden on the others. It also means that one type of entity should not be given advantages over others when they are all performing substantially the same functions.

Two examples can be given. First, unincorporated enterprises which did not engage in trade or commerce outside their home State or Territory have not been subject to the Trade Practices Act. This meant that merely by reason of the vehicle through which one conducted a commercial enterprise one may have been able to avoid the application of significant business conduct legislation. Part IV (Restrictive Trade Practices) of the Trade Practices Act now applies to all unincorporated entities with effect from 21 July 1996 (except in Western Australia which is expected to follow soon after). Entities newly exposed to the TPA will not be subject to the pecuniary penalty provisions of Part IV until 21 July 1997.

A striking example of the second can be seen in the manner in which government business enterprises (GBE's) formerly enjoyed Crown immunity or government guarantees or other benefits and exemptions not available to commercial enterprises. The Hilmer reforms are removing these unwarranted advantages. The shield of the Crown in right of the States and Territories was removed with effect from 21 July 1996 (except for Western Australia which is expected to follow soon after) and State and Territory authorities will be subject to the pecuniary penalty provisions of Part IV from 21 July 1997.

Competitive neutrality allows entities to compete with each other on commercial bases, such as the quality and price of their products, without the market-distorting effects of legal or doctrinal protection for some enterprises.

The second requirement, consistency of regulation, is more or less self-evident. Inconsistency of regulation, either in content or application, increases the cost of compliance and reduces the incentive to comply. A strong sense of grievance and injustice can be engendered in those who feel that they are being required to comply with rules and regulations which others seem able to avoid. Consistency and even-handedness of application also encourages entities to quickly return to a state of compliance after a transgression if they know that they will regulated in the same manner as they were prior to their episode of non-compliance.

ACCC market inquiries indicate that there is a belief that State Supervisory Authorities (SSAs), which enforce the Financial Institutions (FI) Code on behalf of AFIC, act inconsistently with one another causing, at least, frustration and an uneven regulatory burden.

This is not a new problem in Australia where the federal structure has meant that there is a multiplicity of State and Territory agencies, often with an overlapping Federal agency, performing similar functions. Of Manners Gentle[19] by Peter Grabosky and John Braithwaite describes some of the disparities not only between

[19] Grabosky and Braithwaite, Of Manners Gentle 1986, OUP, Melbourne.

the way different industries are regulated but also in how regulators in the various States have markedly different approaches to the regulation of the same industry.

Consistency in the content and application of regulation also allows entities to compete from an equal starting point and is a significant factor in providing an environment conducive to vigorous and effective competition. There is a school of thought in economics which claims that the only barriers to entry in an industry are market-distorting interventions by government. While the ACCC's analysis is considerably more sophisticated than that, it is true that inconsistency of regulation can cause market distortions including regulatory arbitrage.

The third requirement, flexibility, is perhaps a key point for the Inquiry. Flexibility of regulation ensures that developments in products, services, methods of production or supply, the emergence of new players, changed market characteristics, or changed consumer behaviour can be accounted for and dealt with within current regulatory structures. A high level of flexibility ensures that regulation is neither easily defected from by regulated entities nor left behind by changes which may not have been anticipated when the structure was put in place. For example, the ACCC considers that developments such as the globalisation of commerce and e-commerce could change the manner in which financial services are provided in the near future. The Commission does not, however, know exactly what sort of changes might occur.

Flexibility ensures that defection from or evasion of the regulatory scheme is minimised by enabling the method of regulation to adapt to new developments. Flexibility thus promotes universality of application which in turn promotes higher levels of protection for consumers. It also means that those who cannot or do not defect from the regulatory scheme do not suffer any sort of competitive disadvantage because of their compliance.

The three principles of competitive neutrality, consistency and flexibility are also important because they prevent misconduct without hindering market driven changes, developments and enhancements which may be made by industry to increase competitiveness or perform other socially useful functions.

The ACCC is strongly of the view that any new regulatory arrangements which are recommended by the Inquiry should embrace these three principles.

The Commission has an alternative regulatory scheme which it proposes to the Inquiry as an effective way of achieving the outcomes referred to in Chapters 4 to 7 as well as overcoming the problems and shortcomings of the current regulatory arrangements.

Overview of the Proposed Scheme

The current regulatory arrangements in relation to the provision of financial services in Australia are complex, disjointed and involve both State (and Territory) and Federal legislation and agencies. The method in which complaints can be handled, both by government agencies and industry schemes, can depend on the State or Territory the consumer or provider is in, the type of institution, the type of product and the type of consumer.

The ACCC believes that many of the complexities and disparities in the current system detract from consumer welfare and hinder competition. To remedy this the ACCC proposes a system which consolidates some aspects of prudential supervision and places greater responsibility on industry-based schemes. The type of scheme proposed by the ACCC strikes a balance between the extremes of government prescription of all types of activities engaged in by financial services providers and a situation where providers are more or less completely unsupervised.

The ACCC sees some slight pro-competitive advantage from consolidating the prudential supervision of banks and building societies, credit unions and friendly societies under one prudential regulator.

For consumer protection the ACCC proposes that there be a harmonisation and standardisation of existing industry-based complaints schemes to create a system of highly effective and cost effective co-regulation of the financial services sector. These schemes would come together under an industry-wide body having overall responsibility for complaints registration, assessment and allocation. This industry-wide body would also carry out activities relating to the accreditation of industry members, inspection and compliance, and public education.

The industry-based component of the scheme would also include mediation and adjudication functions.

The industry-based component of the proposed scheme would be supervised by a small independent statutory body, under the Treasury portfolio. The principal responsibility of the statutory component would be the audit of the industry-based component based on agreed performance criteria. The statutory component would also have responsibility for the development of financial services sector policy and referral of matters falling outside the jurisdiction of the industry parts of the scheme.

A diagram of the proposed scheme appears below:

ACCC's proposed co-regulatory scheme

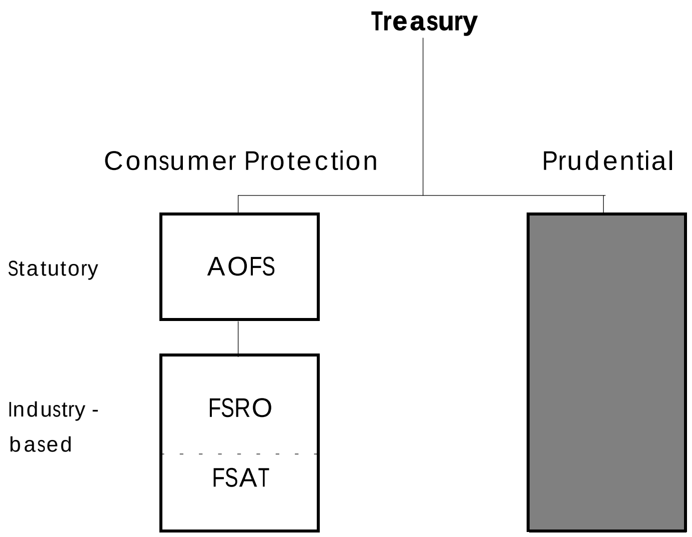

Figure 1: Overview of proposed co-regulatory scheme

Prudential Regulation

The ACCC accepts that competition regulation and consumer protection can be distinguished from prudential regulation and that prudential regulation necessarily has some different objectives. The Commission recognises that in prudential regulation there are important supervening factors such as the need to ensure systemic stability and institutional stability. It also recognises the critically important contribution that financial system stability makes to consumer welfare. The Commission does however believe that, under one umbrella of prudential supervision in the financial services sector, these objectives can also accommodate a process of promoting a more competitive environment.

In keeping with the views expressed above on competitive neutrality, consistency and flexibility as important goals in achieving a competitive environment in the regulation of the financial system, the ACCC perceives that a slight pro-competitive outcome could be achieved by the streamlining of prudential supervision functions in the financial services sector.

Given that the ACCC has neither responsibility nor particular expertise in relation to prudential supervision, it feels that it would not be appropriate to make specific recommendations about a new structure for prudential regulation in Australia. The ACCC is also mindful of, and sympathetic to, the RBA's reported comments on restructuring of prudential supervision. However, it is the Commission's view that the prudential supervision of banks by the RBA and the prudential supervision of other deposit taking financial institutions by AFIC could be combined. This may make the AFIC institutions - building societies, credit unions and friendly societies - more competitive with banks.

The Commission says this because, as noted earlier, anecdotal evidence suggests that consumers place reliance on the 'banking premium' in that they have a perception that banks are guaranteed and are an extremely safe place to deposit funds. Building societies, credit unions and friendly societies have the same prudential standards applied to them (with some variations, by institution, in relation to capital adequacy ratios) as those applicable to banks. In the case of all these institutions the prudential standards are those set by the Bank of International Settlements under the Basle Concordat. The AFIC institutions do not however have the security of the RBA as lender of last resort.

To bring all of these institutions under a single prudential regime would, the Commission contends, bring consumers' perceptions about the security of the AFIC institutions more into line with the reality that they already meet stringent OECD prudential standards.

While the AFIC institutions generally would not have the capacity to affect systemic stability, their institutional stability is a key to public perception of their competitive position in relation to banks in the provision of financial services. The Commission therefore would support uniform prudential supervision, by the same regulator, as, on the whole, pro-competitive. In a situation where there may be two or more different models for prudential regulation the ACCC takes the view that, other things being equal, that model which best promotes competitive outcomes be preferred.

Recommendation 18

The Commission recommends that, in determining a structure for prudential supervision of financial services providers, a key factor to be taken into account should be the choice of a model that best promotes competition.

Consumer Protection

In contrast to its position on prudential regulation the ACCC has considerable expertise as well as an abiding interest in consumer protection issues. In addition, where the ACCC was loath to propose a particular structure or to go into detail about regulatory arrangements for the prudential supervision of financial institutions, the ACCC wishes to propose a comprehensive consumer protection scheme for the provision of financial services to retail customers.

The structure of a financial services consumer protection scheme proposed by the ACCC is predicated on two important factors: first, that Part V, Consumer Protection, and Part IV, Restrictive Trade Practices, of the TPA retain universal application to financial services providers and, second, that the ACCC play a significant role in monitoring the consumer protection body through its powers under the authorisation process contained in Part VII of the TPA.

Bearing in mind these important provisos, the ACCC believes that highly effective regulation, which translates to highly effective consumer protection, can be achieved by setting up an industry body which brings together a wide range of industry knowledge and expertise. This would remove a raft of unnecessary and inappropriate (and at times ineffective) government regulation. It would also give the financial services industry, broadly defined, responsibility for the fair, honest and ethical conduct of its members.

The underlying charter of such a scheme would be to ensure that the consumer's interests are properly served by a competitive financial services industry which adheres to the highest standards of probity. The scheme would make use of regulatory arrangements already established and funded by industry with the proposed new components of the scheme to be funded through industry contributions. This would significantly reduce government outlays on regulation and associated activities in the financial services sector.

Chapter 5 discusses the problems of faced by consumers in this sector - market failure, information failure, misrepresentation and the like - together with the outcomes required to ensure that there are adequate levels of consumer protection. It is important that consumers have available to them all of the necessary information to be properly informed when making decisions about products and services being offered to them.

The ACCC has consistently identified market failures in the financial services sector which harm consumers. The ACCC's response to this has been to implement remedial action, through a combination of education, compliance training, the development of industry codes and enforcement action, to raise awareness amongst consumers and business. In many cases the ACCC action has come after a specific regulator has failed to act on the matter. In doing this the ACCC has attempted to be strategic in its approach and to ensure that action taken by it promotes general consumer protection principles rather than merely investigating and acting on a single transaction.

Two interesting and paradoxical phenomena seem to characterise much of Australian business regulation. The first is that some industry-specific regulators appear not to have met the public's expectations of them. This can to some extent be blamed on the regulators who had a large part to play in shaping these expectations. The second is that in many respects industry self-regulation activities in Australia have performed extremely well in delivering complaints handling and dispute resolution mechanisms to consumers and in doing so have made a significant positive contribution to consumer welfare.

The ACCC believes that it is not only possible but is desirable to harness the positive contributions which self-regulatory schemes can make and couple these with effective government oversight to create a leveraged hybrid scheme of co-regulation which delivers high levels of cost effective consumer protection.

The Australian Office of Financial Services (AOFS)

Under the ACCC's proposed structure a small statutory body, coming under the Treasury portfolio, would have oversight of a major financial services industry-based regulatory body. The principal responsibility of the statutory body would be the audit of the industry-based component based on agreed performance criteria. The statutory component would also have responsibility for the development of financial services sector policy and referral of matters falling outside the jurisdiction of the industry parts of the scheme.

The statutory body, the Australian Office of Financial Services (AOFS), would be a national government agency with regulatory powers covering the broad range of financial services. The AOFS would be set up by and would administer new legislation, the Financial Services Act. This new Act would set out the responsibilities of the AOFS and would empower the industry-based components of the scheme to their responsibilities under the scheme.

The proposed new Act would be descriptive rather than prescriptive. This means that, having established the scheme, the Act would set outcomes and assign broad responsibilities instead of providing minute detail of how these were to be, respectively, achieved or discharged. It is envisaged that this new Act, together with the Codes of Conduct discussed below, would eventually replace the majority of legislation which currently governs the activities of financial services providers.

The AOFS would be a strategic and targeted regulator responsible for setting performance criteria for the industry-based components of the co-regulatory scheme. The AOFS would not be a transaction regulator: its role would be to ensure that the industry components were effective in doing this. This would leave the AOFS to concentrate on policy development and on monitoring the effectiveness of the scheme. The AOFS's performance would be judged on its success in ensuring systemic problems were identified and redressed, that effective regulation did not break down because of jurisdictional restrictions and by ensuring that industry could not unilaterally change the terms of reference for its regulatory functions.

A diagram of the structure of the AOFS appears below:

Australian Office of Financial Services (AOFS)

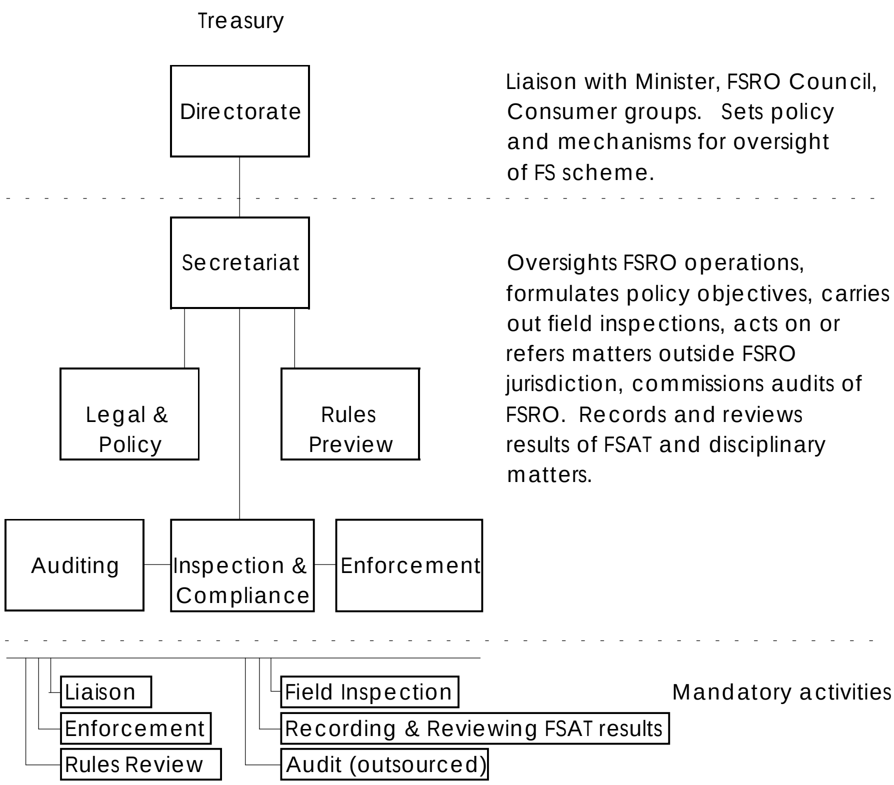

Figure 2: Australian Office of Financial Services

The AOFS would be responsible for overseeing the activities of an industry regulatory body which we would propose be called the Financial Sector Regulatory Organisation (FSRO). This industry body would be divided into two parts, one of which would carry out its executive functions, and the other, the Financial Sector Adjudicatory Tribunal (FSAT), would carry out its adjudicatory functions.

The AOFS would carry out (or commission) audits of the FSRO and FSAT. This audit function is the critical role played by the AOFS to ensure that co-regulation by the FSRO is effective. The audit role would encompass all aspects of the FSRO's activities. The AOFS would be responsible for establishing performance criteria for the FSRO and FSAT. Its audit activities would measure the performance of the FSRO and FSAT against these criteria on an annual basis.

The AOFS would have the power to disallow amendments to the Memorandum and Articles of Association, by-laws, business rules and the like of the FSRO and FSAT. This function is crucial to the AOFS's ability to ensure that the FSRO acts always in the public interest. The ACCC understands that in the United States the Securities and Exchange Commission (SEC), for stock exchanges, and the Commodity Futures Trading Commission (CFTC), for futures exchanges, have such a power. Under the ACCC model this would give the AOFS the power to ensure that the industry component of the co-regulatory scheme was not able to change its terms of reference unilaterally.

The AOFS would carry out (or commission) inspections of FSRO members. This would be in addition to compliance inspections carried out by the FSRO itself. These inspections would be done to satisfy the AOFS that the FSRO was properly enforcing all of the requirements made of FSRO members. This part of the AOFS function serves several purposes. It is a field-based audit of the effectiveness of the FSRO's supervisory activities and it reminds FSRO members that the government regulator also has an interest in their activities. It also allows for the government regulator to stay in touch with industry participants.

In addition to its policy making and audit functions it would be necessary for the AOFS to have an enforcement role.

An enforcement role is necessary because not all matters can be properly dealt with by the industry-based components of the co-regulatory scheme either because they fell outside the jurisdiction of the scheme or because they involved serious or widespread criminality. It has not so far been thought appropriate in Australia for a private body to gather evidence using compulsory powers or for private bodies to carry out enforcement of the general criminal law.

As an example, the Australian Stock Exchange (ASX) generally investigates suspected misconduct by its members or licensees and for this purpose it can request information and statements from members and licensees. The ASX does not have the power to obtain evidence or information from private citizens. In such cases the information is obtained from private individuals by the ASC using its statutory powers. The ASC can then refer appropriate matters back to the ASX while at the same time providing the information obtained using ASC compulsory powers.

In cases of criminal misconduct, where no remedy open to the FSRO is appropriate, the FSRO would refer the matter to the statutory regulator for proper disposition.

The AOFS may then investigate the matter itself, or it may be appropriate to refer it to the Australian Federal Police (AFP), Director of Public Prosecutions (DPP) or other agency.

The Commission understands that in the United States some of the legislation administered by agencies such as the CFTC and the SEC includes felony provisions even though the agencies themselves do not have any jurisdiction to investigate or prosecute criminal offences. In cases where criminal prosecution is warranted, typically because the seriousness of the misconduct requires a greater range of penalties than merely civil redress, the criminal investigation agency, in these cases the US Department of Justice, seconds relevant experts from the CFTC or SEC to assist in compiling the criminal brief. Such a course may also be appropriate here with the AFP or other agency seconding AOFS staff in appropriate cases.

It would also be necessary for the AOFS to be able to take action in cases where the FSRO has no jurisdiction such as in relation to unlicensed persons providing financial services.

The internal rules of the FSRO would be enforceable in the Courts. This would include all Codes of Conduct developed by the FSRO. The AOFS would have standing to take civil action in respect of breaches of the FSRO’s internal rules. To date it has been found that leaving such a role to an industry-based regulatory body is not effective. As an example of this, the business and listing rules of the ASX are enforceable in the courts on the application, inter alia, of the ASX. The ASX has declined to seek enforcement of its business rules and listing rules because it is a private organisation and it does not have a full indemnity against costs and damages which may be awarded against it should an action initiated by it be unsuccessful. Although this could be remedied by providing the FSRO with a full indemnity such a course may be against public policy. In such a situation standing for the AOFS to commence proceedings would ensure that the FSRO's internal rules are enforceable.

The AOFS would also have standing to commence civil proceedings, including in the name of a private party, and to intervene in proceedings already underway. The AOFS would also need to have standing to seek injunctive relief. For these purposes the AOFS would need to be, in common with other regulators such as the ACCC and the ASC, exempted from having damages awarded against it or from having to give undertakings as to damages when taking injunctive action. This would ensure that matters not properly dealt with by the FSRO or FSAT can still be acted on and it would ensure that the AOFS could take action when it is in the public interest to do so.

The Financial Sector Regulatory Organisation (FSRO)

While the AOFS is the statutory regulator, the lead regulator would be the Financial Sector Regulatory Organisation (FSRO). This industry body would have coverage of all aspects of financial services. All institutions and individuals which deal with retail clients would be required to be members of the FSRO. The FSRO would set standards of competency, integrity and conduct to be met by members.

A diagram of the FSRO appears below:

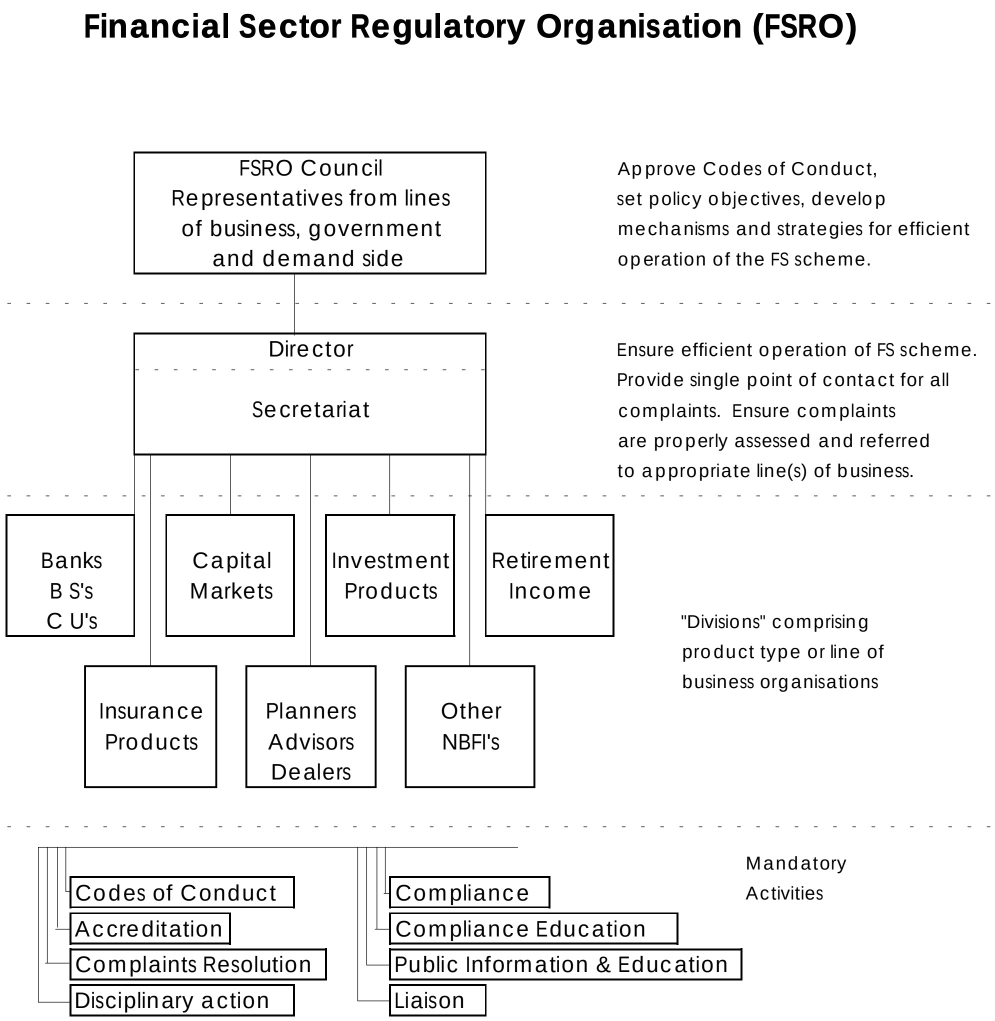

Figure 3: Financial services sector Regulatory Organisation

The ACCC has some significant concerns about the nature of industry licensing schemes and it is important that any such scheme is implemented for the right reasons. Licensing schemes can have serious anti-competitive effects and any scheme administered under the proposed co-regulatory model must be designed to be a process of certification of competence and not merely a ‘gatekeeper’ process designed to protect the incumbents from competition.

As the accreditation authority, the FSRO would be required to ensure that members demonstrate a continuing commitment to meeting high standards of competency and integrity. The membership requirement would be a means of attaching the jurisdiction of the co-regulatory scheme to all actors in the financial services sector. In this respect it would be similar to the requirement under the Telecommunications Act that service providers belong to a complaints resolution scheme as a condition of their licence.[20]

The FSRO would be the first point of call and single point of representation for any person, including consumers, businesses and competitors, with a complaint or grievance concerning the provision of a financial product or service.

The FSRO would be an umbrella organisation which established a unified structure, including standardised methods for complaints handling, disciplinary and administrative procedures, for the many organisations which currently perform self-regulatory functions.

Within the FSRO there would be wide scope for several divisions responsible for different lines of business and types of activities carried out by licensed persons. These divisions could be made up of existing industry associations and schemes. The FSRO as an umbrella organisation would be responsible for co-ordinating these different activities thus promoting uniformity of regulation.

[20] Section 64 Telecommunications Act.

The maintenance of a separate identity for each of the lines of business, within the unitary structure of the FSRO, is crucial to the scheme's acceptance by industry and so to its success. It is important that the industries which fund self-regulatory schemes, at some considerable cost, retain a strong sense of identification with them.

The ACCC anticipates that industry would accept the proposal it puts forward as a sensible accommodation of the desire for industry ownership of the scheme coupled with the benefits of some standardised procedures and a 'single desk' point of contact for consumers. The ACCC proposal is not designed to derogate from any function or to lessen involvement by industry in self-regulation. Indeed the ACCC proposal would seek to considerably strengthen industry involvement in regulation by providing it with a scheme of active co-regulation.

Governing the FSRO there would be a Council which would consist of representatives of the various industry lines of business together with government and demand-side representatives. The industry representation acknowledges the need for industry ownership and would be a source of expertise for the organisation. The strong demand side representation is designed to ensure that the regulatory regime which results from the scheme takes full account of the needs of the consumers of financial products and services. The government representation on the board would ensure that legitimate government interests in the efficacy of the scheme are also taken into account.

Importantly the FSRO scheme would consist of Codes of Conduct devised by the financial services industry rather than standards imposed by legislation. There is a strongly held view in the industry that such Codes, which would need to deal with matters such as disclosure, risk management, reporting, valuation, licensing requirements and professional standards, are more responsive and adaptable to changes in the marketplace. Industry sponsored codes would be tempered by the AOFS's power to disallow FSRO rules. Taken together with the broad range of membership of the FSRO Board this is designed to ensure that a suitable balance between many competing interests is achieved.

The Commission is aware that the application of general laws for policing transactions and day to day market conduct can place onerous requirements on particular segments of industry in certain circumstances. An example that has recently been debated is the prospectus regime under the Corporations Law, especially as it applies to small and medium enterprises seeking to raise funds. It has been argued that another example in the financial services sector is the application of section 52 of the TPA to financial and investment advisors. In both cases, a due diligence defence has been proposed as a solution to the problems faced by particular industry players.

The Commission is aware of such problems and is conscious of finding a workable remedy without any diminution of general consumer and/or investor protection laws. A co-regulatory scheme of the type being proposed by the Commission can address the concerns of industry with regard to the costs of compliance while still providing general laws to underwrite consumer protection. This can be achieved through a scheme where codes of conduct and practice, subject to authorisation by the ACCC, are the key rule making mechanisms.

The use of codes would obviate the need for changes to section 52 of the TPA, or to other industry-specific legislation which contains an equivalent provision, to incorporate a due diligence defence, or to remove the application of section 52. This outcome could be achieved by allowing the various codes, which would be subject to authorisation under Part VII of the TPA, to contain due diligence defences provided the overall level of protection of consumers' interests remained high.

In cases where there was a breach of section 52 but not of the relevant code, because of the existence of a due diligence defence, the Commission could exercise its discretion not to take action. However, the Commission would retain its right to initiate enforcement action and it would be expected to do so in cases where there was a systemic or widespread breakdown in the consumer protection coverage provided by the codes.

Such a course would be in keeping with the ethos and spirit of this co-regulatory proposal by giving industry a high level of involvement in formulating the various codes. It would also retain the strategic role of the ACCC to guard against market failures which significantly harm consumer interests. The Commission would anticipate that a very small proportion of matters would fall into the category of not offending against a code but still requiring enforcement action. The availability of action in these few cases completes the comprehensive level of protection afforded by the co-regulatory scheme.

The scheme administered by the FSRO would have universal application to all financial services providers including individuals who provided any sort of financial service or product. Obviously the scheme would need to be drafted so that things such as the provision by a retailer of ‘cash out’ with an EFTPOS purchase did not attract a licensing requirement or other liability.

Minimum standards for accreditation would be set by the FSRO (in consultation with the AOFS). As the responsible authority the FSRO would need to ensure that continuing education and competency testing programs formed part of the accreditation procedure.

There are several models for this some of which, such as the Continuing Legal Education courses, involve participation in lectures and workshops while others are in the nature of self-assessment. The Financial Planners Association publishes self-assessment questions in its monthly magazine while the Royal Australian College of General Practitioners has a comprehensive self-assessment program, called the *check* program, which tests practitioners clinical knowledge over a 12 month course. To ensure that accreditation serves a useful purpose the Commission takes the view that some version of these types of programs should be incorporated into a competency assessment and development scheme.

The FSRO would be required to carry out compliance inspections of all members. This function would ensure that minimum prescribed standards of conduct of business were being met. The FSRO would also have an obligation to carry out compliance education for members.

The FSRO would be under an obligation to report instances of serious misconduct or criminality to the AOFS and it would be a matter for the AOFS and FSRO to determine between them how other matters would be disposed of. The ASX/ASC MOU's on company matters and membership matters are examples of how this might be achieved. The FSRO would also be required to report breaches falling outside its jurisdiction, eg, where it becomes aware of an unlicensed person providing financial services, to the AOFS.

The FSRO would also have an obligation to conduct public education activities and promote fair and ethical business conduct. Fulfilling this obligation would include ensuring that appropriate information about different financial services and products is readily available to consumers and that uniform standards and terminology, to assist consumer in making comparisons, is used by industry.

The FSRO's responsibilities would extend to all products offered by all types of financial services providers and it would be required to liaise and co-ordinate with the RBA (or other prudential regulator) when auditing or inspecting entities which were also prudentially supervised.

Complaints handling

One of the most important activities for the FSRO would be complaints resolution. The FSRO would be required to have in place complaints handling procedures which ensured that complaints were properly recorded, assessed and reviewed. There is an Australian Standard (AS 4269-1995) for complaints handling and this would seem to be an appropriate minimum standard to which the FSRO should adhere.[21]

The procedures, methods of referral and disposition of complaints would be standardised under the aegis of the FSRO so that consumers would not have to battle through a wide range of industry sector schemes in an attempt to gain redress. It is a particular strength of the co-regulatory scheme that it provides a 'one-stop shop' for consumers while still getting maximum benefit from the expertise and industry knowledge of practitioners and adjudicators in the various lines of business.

[21] The Standard is reviewed in Zumbo, "Implementing a complaints-handling process: what is best practice?" (1996) 11 TPLB 103

A diagram of the Complaints Process appears below:

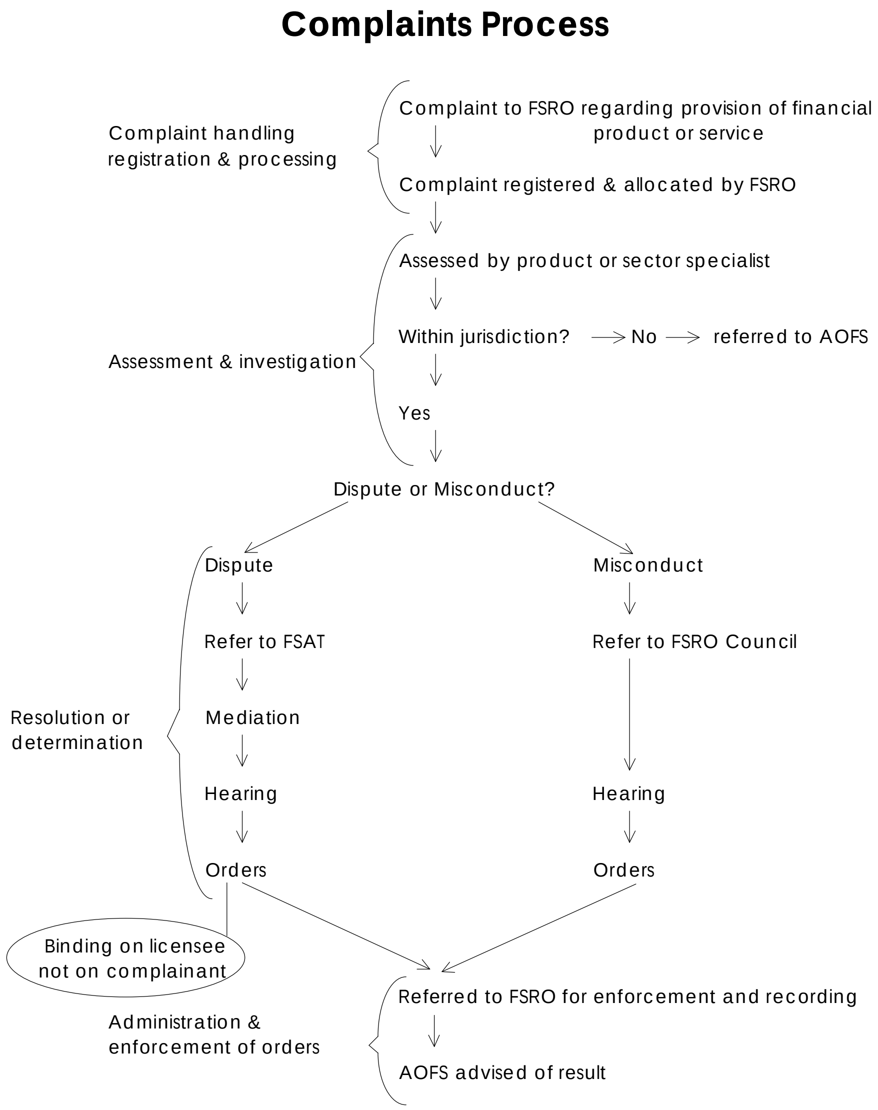

Figure 4: Complaints Process

After recording and assessment, the FSRO would be responsible for investigating complaints with a view to taking further action.

As with other regulatory bodies the FSRO would necessarily have some latitude in determining how to approach individual complaints. The investigation would entail obtaining full details of the alleged misconduct from the complainant together with supporting documents or other information and putting the allegation to the member for a response. Members would be bound to supply requested information to the FSRO and to attend an interview if required. As noted earlier, matters falling outside the FSRO's jurisdiction would be referred to the AOFS.

The Council of the FSRO, and the AOFS, would both be required to ensure that all complaints are appropriately resolved. To assist in this process the FSRO and FSAT would both be required to advise the AOFS of all complaints received and the manner in which they were handled.

The retention of Part V (Consumer Protection) of the TPA in relation to financial services would also ensure that another backstop is in place so that, as a final safeguard, consumers would still have redress. The ACCC with its necessarily different, economy-wide focus would also be able, as it does now, to take action in cases where it has identified instances of market failure which result in widespread detriment to consumer welfare.

The FSRO would endeavour throughout the course of handling a complaint to resolve the matter. In cases where this has not occurred the matter would then be referred to the FSAT for a determination.

As with the FSRO, the FSAT would be an umbrella organisation comprising the various adjudicatory bodies already operating in the financial services industry. The FSAT would establish a unified structure for the various adjudicatory schemes and set standardised procedures for them. The FSAT would draw its membership from industry representatives, demand-side representatives and government.

The FSAT would be encouraged to use alternative dispute resolution mechanisms to the greatest extent possible and to engage in active case management so that matters are disposed of in a timely manner. Organisations within the financial services sector have reported significant success in using alternative dispute resolution to achieve good results in commercial and consumer disputes and the use of ADR is to be encouraged.

The ACCC recognises that different procedures may be appropriate for different types of complaints handled by the FSRO and FSAT. Some complaints might be more properly thought of as commercial disputes, for example, over the cost of a service or the like, while others may involve a level of misconduct which exposes the licensee to the risk of penalty. For matters which amount to commercial disputes the FSAT would determine the matter. A complainant would not be bound by a determination or award made by the FSAT.

Financial Sector Adjudicatory Tribunal (FSAT)

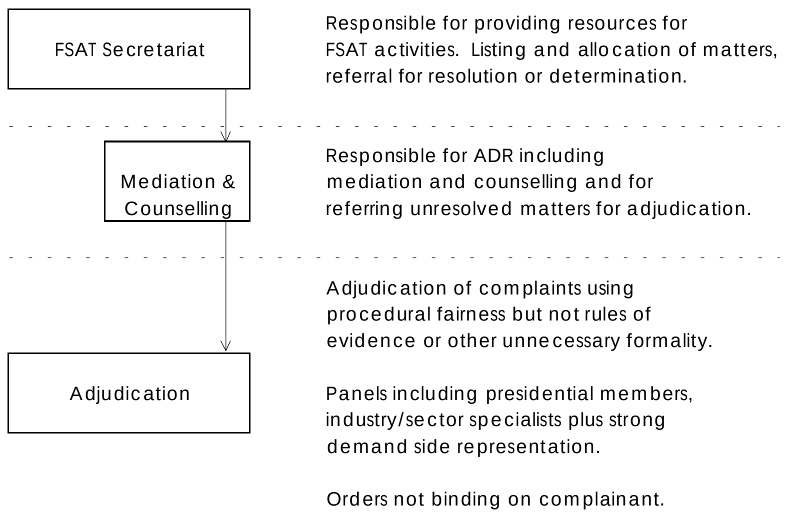

Figure 5: Financial services sector Adjudicatory Tribunal

In cases which amounted to allegations of misconduct by an accredited member the Council of the FSRO would hear and determine the matter. The Council would have the power to impose licence restrictions or suspend or revoke a licence, levy pecuniary penalties and other orders. It could also be empowered to impose a more strict compliance regime on licensees where appropriate.

Penalties imposed by the Council of the FSRO would be subject to appeal. The availability of an appeal process also enhances the soundness of the process and ensures that the Council's power to impose penalties does not work undue hardship. A diagram of the Financial services sector Adjudicatory Tribunal appears below:

As with other schemes, for example, the Australian Banking Industry Ombudsman, the complainant would not be bound by the decisions of the FSAT which relate to compensation or other award made to the complainant. If a complainant was dissatisfied with the outcome of a determination of the FSAT they would still be entitled to exercise their private rights to take action, for example, seeking remedies under the Trade Practices Act. As noted earlier, retention of the TPA is a condition of the ACCC's support for this scheme.

Of course the complainant would not be entitled to appeal against the penalty imposed by the FSRO Council, although the AOFS may be given such an entitlement.

The main purpose of the scheme proposed by the ACCC is to standardise the method of complaints handling and resolution by disparate organisations within the finance sector. This process would necessarily involve a transitional period during which different adjudicatory schemes, some of which are public, some private, make adjustments so that for each line of business within the financial services sector the same range of compensation, penalties and other orders are available. There is no inconsistency in seeking to incorporate adjudicatory schemes which are currently set up by government into the co-regulatory scheme. The process of harmonisation of accreditation, compliance and adjudication, all with a view to enhancing consumer protection, will involve a comprehensive process of re-engineering many aspects of regulation and control.

This process will involve the migration of a large number of functions from government to the industry-based components of the co-regulatory scheme. The ACCC's considered view is that the scheme should be judged on the effectiveness of the outcomes it can achieve rather than with whom a particular role or function rests. The transition which the financial services industry regulators (public and private) will be going through is likely to be matched by a change in the balance of State and Federal legislative control of the provision of financial services. The ACCC anticipates, without stating a view on its desirability, that much State-based legislation dealing with the provision of financial services will be removed in favour of national laws.

Authorisation

Parts of the proposed co-regulatory scheme would be subject to authorisation by the ACCC. This process allows the ACCC to ensure public benefit accrued from having such a scheme. The authorisation process would be used to impose on the FSRO and FSAT an audit and review process which allowed the ACCC to test the effectiveness of their enforcement activities. In doing this the ACCC would be removed from the day to day contact with the FSRO that the AOFS would have and would be well placed to determine its effectiveness in providing consumer protection to all users of financial services. As noted in Chapter 3 and the ACCC's first submission, the Commission has been involved in a significant number of authorisation matters in the financial services sector.

The ACCC has also been involved in authorising accreditation and self-regulation schemes. A good example of this is the former TPC's authorisation in June 1994 of the Agsafe and Avcare accreditation scheme and code of conduct for the transport, storage and handling of farm chemicals.

Prior to this authorisation a series of inconsistent and inconsistently applied State standards applied to various types of farm chemicals. This contributed to a situation where farm chemicals were not being properly handled and where conduct which was lawful in one State may not have been in another. The statutory regulators responsible for dealing with the transport, storage and handling of farm chemicals were not able to enforce appropriate standards.

As a result of the authorisation process an accreditation scheme was put in place and industry participants were given responsibility for enforcing uniform national standards. This meant that an effective method of regulation, funded by industry participants, took over from a series of patchy and inconsistent State regulation. The Commission was of the view that the scheme provided such benefits to industry and to the public that the scheme should be authorised. The scheme is subject to regular review by the Commission.[22]

[22] Application for Authorisation by Agsafe Ltd and Avcare Ltd, Application No's A90528, A90529, A90530, 8 June 1994.

The Agsafe/Avcare scheme is a potent example of industry providing self-funded solutions to difficult and complex problems in an area plagued by different laws and regulations and different levels of enforcement of them.

Strengths of the proposed co-regulatory scheme

The advantages which the ACCC sees for this scheme over the more traditional models which apply currently in Australia are several. It would be industry-based and could more easily bring together industry expertise and knowledge so that problems of the regulator, or the legislation it administers, lagging far behind industry developments would be eliminated or at least significantly reduced.

Those regulated by the scheme would feel a greater sense of ownership of a scheme which comes from within the industry and would be assured of a greater opportunity to have a say in how the scheme operates. This would remove the confrontational ‘us-and-them’ attitude which too often pervades traditional regulation.

The proposed scheme would also bring together a diverse range of associations, tribunals and other entities which work on similar types of matters or have similar goals. There is scope for considerable synergies to be achieved by bringing these bodies together under a unified structure. It would enhance the standing and credibility of each individual body through a collective strengthening of their roles.

A diagram of the composite schemes is attached at the end of this Chapter.

For the consumer, it would provide a single body to whom they could turn for advice and action on complaints involving the provision of a financial service or product or the conduct of a financial services provider. Handling of complaints, identification of problem areas and co-ordination of response would be greatly improved by having a single overarching structure with responsibility for these matters.

The government's role would be greatly simplified with the AOFS providing policy direction and oversight to the scheme and the ACCC ensuring that, through the authorisation process, there is clear public benefit from the scheme.

The inclusion of strong demand-side representation on the FSAT and on the Council of the FSRO would also allow for a type of tripartism.

Tripartism is a regulatory model proposed by Ian Ayres and John Braithwaite in Responsive Regulation[23]. The 'pure' tripartism proposed by the authors involves a co-ordination of the relationships between the regulator, the regulated entity and the beneficiaries of the regulation (typically the general public or a class of consumers). Tripartism fosters the participation of public interest groups in the regulatory process. It does this in three ways by giving interest groups access to all the information which is available to the regulator, by allowing the interest group a 'seat

[23] Responsive Regulation: Transcending the Deregulation Debate, New York, OUP, 1992

at the table' in negotiations between the regulator and the regulated entities and by giving the interest group the same standing to take action that the regulator possesses. As the authors themselves concede, their model is theoretical only and needs practical application to test its validity.

The ACCC is not proposing such a radical departure from general regulatory models but it does see considerable merit in having a highly visible, highly credible level of representation of consumer interests involved in the decision making processes of those who control the provision of financial services. This would ensure that deliberations made by the relevant bodies would include, as an integral part of the process, those matters of particular interest to the users of the products and services.

The ACCC believes that this model, along with the change to prudential regulation mentioned earlier, will promote the principles of competitive neutrality, consistency and flexibility. The scheme will provide universal consumer protection for users of financial products and services but will do so in a manner which gives industry a vital stake in the outcomes so that new developments can be responded to without the delays often caused by statutory regulation. The scheme will also achieve a balance between the competing interests of government, industry and consumers through a system of audit and oversight and strong demand-side representation without lessening the capacity of industry to maintain control over its future development.

The proposed co-regulatory scheme is inextricably woven into the financial services industry and because of this it is as 'future-proof' as is practically achievable. The market failures already identified by the ACCC will continue to be problems to be guarded against and the needs of consumers in terms of disclosure, product information (whatever the product or source) and protection of rights will also remain. This is so because regardless of whether any given type of organisation, structure or product exists there will always be financial services providers and there will always be users and consumers of these services. The co-regulatory scheme will necessarily evolve, change and develop as the providers and the products do.

Recommendation 19

The Commission recommends that a new structure for consumer protection regulation be established incorporating the following features:

- **a small statutory body responsible for policy making and oversight of the system;**
- **a larger co-regulatory body responsible for transaction regulation, dispute resolution and market conduct; and**
- **continued application of the consumer protection provisions of the Trade Practices Act.**