Consumer Protection

Introduction

8.1 This chapter discusses financial sector regulations usually referred to as consumer protection. More precisely, the chapter considers the regulation of financial products and services in five areas:

- regulation of the conduct of business with consumers and the prevention of fraud;
- requirements for the disclosure of information relating to product terms and conditions;
- enforcement of contracts and the resolution of disputes;
- protection of depositors from financial losses; and
- regulation of product terms and conditions for social policy purposes.

8.2 The chapter does not consider the regulation of markets for securities or the regulation of fundraising by companies, except as either relates to collective investment schemes substantially aimed at retail customers. Issues relating to wholesale financial markets more generally are addressed in Chapter 5.

8.3 It is common for the scope of consumer regulation to be limited to retail products or services, and the discussion in this chapter generally adopts this limitation. However, there is no universally accepted definition of the term 'retail'. In many cases, products or services may be offered to both retail and wholesale customers, and in some of these cases the regulation covers both categories. In other areas, different thresholds are adopted as practical means of delineating retail and wholesale products or activities.

8.4 For the purposes of this chapter, it is accepted that retail covers the offering of financial products to individuals for non-business or, in some cases, small business purposes. Generally, consumers are not able to obtain detailed knowledge of the product or the provider without the assistance of effective disclosure or independent third-party advice.

8.5 Apart from the general laws relating to contracts and banking, the main specific regulations which this chapter addresses are:

- rules administered by the Reserve Bank of Australia (RBA) to protect depositors in the event of financial failure of an institution;
- consumer rules administered by the Insurance and Superannuation Commission (ISC);
- consumer regulations for collective investment products, securities dealers and investment advisers administered by the Australian Securities Commission (ASC);
- consumer laws, insofar as they relate to retail financial services, under the *Trade Practices Act 1974* (TPA) administered by the Australian Competition and Consumer Commission (ACCC);
- industry codes of practice for retail financial services, including those monitored by the Australian Payments System Council (APSC);
- prices monitoring and related regulation (ACCC);
- State and Territory credit and fair trading laws that relate to retail services;
- consumer complaints resolution schemes; and
- privacy laws.

8.6 It is beyond the scope and resources of the Inquiry to provide a comprehensive evaluation of, or to provide detailed recommendations on, the specific consumer regulations in all of these fields. Rather, the Inquiry's task is to consider the broad objectives, organisational framework and approaches to consumer protection.

8.7 On the basis of the submissions it has received and the work of the Inquiry to date, the main issues which have been identified and which are discussed further in this chapter are as follows:

- at the Commonwealth government level, whether the best approach to regulation would be to alter the organisational framework for consumer regulation of the financial services industry and, if so, how;
- whether the consumer regulation roles presently undertaken by the States should be modified;
- whether and how the regulatory scheme should encompass privacy regulation;
- whether the current arrangements for the protection of depositors in the event of financial failure are appropriate;
- whether government should impose community service obligations on the financial sector and what the implications of technology and other market developments will be on the effectiveness of these policies; and
- whether the approach to consumer regulation needs to be modified to take account of the development of global retail financial markets.

Commonwealth Arrangements for Consumer Protection

8.8 The first issue for consideration is how best to organise the Commonwealth's existing responsibilities for consumer protection. The main issues and options, except for depositor protection, are set out in this section.

Existing Arrangements

8.9 At the Commonwealth level, responsibility for consumer regulation of financial services is shared among the following organisations:

- the ISC in relation to life insurance, general insurance and superannuation products, and insurance brokers;

- the ASC in relation to securities dealers, investment advisers, futures brokers and advisers, collective investment schemes and debentures;
- the ACCC in relation to economy-wide business conduct laws and price monitoring, each of which may apply to the financial sector; and
- the APSC, an advisory body (reporting to the Treasurer and chaired by the RBA) which monitors industry codes of practice for electronic funds transfer schemes, banks, building societies and credit unions.

8.10 These arrangements have been introduced at different times, often in response to problems being experienced. Accordingly, the schemes generally reflect at least qualitatively different objectives in their varying intensities of regulation. The trade practices regime, which duplicates much of the specific industry regulation, is essentially based on institutions, with the result that similar products offered by different institutions may be regulated differently and subject to different dispute resolution arrangements.

Insurance and Superannuation Commission

8.11 The ISC administers the *Insurance Contracts Act 1984*, the *Superannuation Industry Supervision Act 1993* and the *Insurance Agents and Brokers Act, 1984*, each of which has provisions designed to protect consumers. Amendments to the *Life Insurance Act 1995*, if enacted, will further protect consumers. Although the ISC has issued a number of circulars outlining consumer protection requirements, it cannot legally enforce them. It relies primarily on industry for enforcement. The ISC focuses on improving information disclosure, raising standards of advice and ensuring competencies of advisers. A number of codes of practice and complaints resolution arrangements for the life, general insurance and superannuation industries are listed in Table 1 of Appendix C**.**

Australian Securities Commission

8.12 As part of its broader responsibility for companies and securities, the ASC is responsible for consumer regulations of collective investment products, securities dealers and investment advisers. The main elements of this consumer protection regulation are:

- licensing or registration of securities dealers and investment advisers;
- prevention of fraud by requiring securities dealers to give priority to their clients' orders over transactions on their own account, to keep clients' monies in a separate trust account, and to make reasonable recommendations based on a fair understanding of the clients' investment objectives, financial situation and particular needs; and
- imposition of product disclosure requirements on securities dealers and investment advisers and for fundraisings through units in trusts and debentures.

8.13 The ASC promotes compliance through licensing and surveillance of securities dealers and investment advisers, registration of prospectuses and scrutiny of trustees and managers of collective investment schemes.

Australian Competition and Consumer Commission

8.14 The ACCC is responsible for ensuring compliance with the consumer protection provisions of the TPA, in particular s. 52 which prohibits corporations from engaging in misleading or deceptive conduct.[1] According to the ACCC, it focuses on educating consumers about their rights and businesses about their responsibilities. It works with business to establish self-regulatory responses and backs these efforts with enforcement.

1 These consumer protection provisions are found in Parts IVA and V of the TPA. Part IVA 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.

Australian Payments System Council and Industry Regulation

8.15 Consumer protection and disclosure requirements in respect of deposit and other banking products have been relatively limited and implemented through industry-developed, self-regulatory codes of practice initiated by the Government.[2] These codes seek to foster good relations between institutions and their customers, for instance by requiring dispute resolution schemes, and to promote good banking practice by formalising standards of disclosure and conduct. The APSC, chaired by the RBA, monitors the operation of, and compliance with, the codes of practice for banks, building societies and credit unions.[3] It also monitors an electronic funds transfer code applicable to transactions involving a card and PIN number.

Views Presented in Submissions

Problems identified

8.16 Most submissions supported the view that current consumer protection arrangements involve unnecessary complexity and duplication. Such arrangements increase the costs to industry of compliance and do not necessarily assist consumers to understand the products offered to them. Such arrangements may also create unequal regulatory regimes for functionally equivalent products, thereby encouraging suppliers to arrange their products or services so as to attract the least burdensome regulation. The main areas where problems were identified were as follows:

- *Duplication of Corporations Law and TPA*. The *Corporations Law* establishes a framework designed to promote the provision of information in prospectuses. It prohibits misleading or deceptive conduct but provides for some defences where issuers have made

2 The Martin Committee Report recommended, and the Government endorsed, the development of a legally enforceable Code of Banking Practice to mediate the relationship between banks and customers. A taskforce of Government officials was established to develop the code in consultation with banks, consumer groups and other relevant organisations. Building societies and credit unions were then persuaded to do likewise.

3 APSC is a government non-statutory body established in 1984 to oversee developments and encourage efficiency and stability in the Australian payments system.

reasonable inquiries or exercised due diligence. The TPA at s. 52 also prohibits misleading or deceptive conduct but does not provide for these defences.

- *Inconsistent regulation of financial sales and advice.* Inconsistent regulatory treatment is becoming more prevalent as more consumers demand a one-stop shop and financial institutions and other retailers of financial services sell multiple products to the same customers and offer a broad range of financial products. The absence of industry-wide competency-based licensing constrains the ability to define and harmonise competencies for advisers and product sellers.
- *Inconsistent regulation of funds management.* Disclosure requirements on fund managers differ according to whether the product is a unit trust, insurance or superannuation, yet each products' investment objective and underlying portfolio may be virtually identical. Unit trust prospectuses must meet the general disclosure test under the *Corporations Law* and be registered with the ASC. Investment-linked life company products are required to have a disclosure document meeting the more prescriptive guidelines set out in ISC Circular G.I.1. Similar, but not identical, rules apply under the *Superannuation Industry Supervision Act 1993* for public offer superannuation products.
- *Multiple dispute resolution schemes.* The proliferation of dispute resolution schemes may be leading to overlaps, to inconsistencies in outcomes and to consumer confusion. Several types of financial organisation do not belong to industry schemes.

8.17 Not all submissions, however, supported the need for reform of consumer regulation. The Treasury, in particular, considered that the various regulatory initiatives were working well and that changing them would impose significant costs on those institutions that had introduced new information systems and disclosure documentation.

8.18 A number of submissions supported retaining the application of s. 52 of the TPA to the financial sector as necessary to underwrite consumer protection and to ensure consistent consumer protection economy-wide.

8.19 Some submissions supported the existing schemes for dispute resolution, claiming:

- there is substantial diversity in the types of complaints, transaction sizes and appropriate remedies associated with the various products and services;
- industry and product diversity requires significantly different expertise to assess complaints and make appropriate decisions; and
- industry goodwill and co-operation associated with industry ownership of specific schemes have been important to achieving effective arrangements.

Proposals for Change

8.20 A broad range of submissions suggested that consumer regulation in the financial sector be placed under a single entity to ensure a more consistent approach across the financial services industry. The creation of a single consumer regulator was seen by a number of players[4] as a major step towards ensuring consistent enforcement of advisory and product selling responsibilities across the financial system. This was considered to be particularly important for institutions with numerous delivery channels providing a range of financial services.

8.21 The ISC supported the consolidation of consumer protection under a new agency. It proposed a new Retail Investment Commission to assume responsibility for regulating financial advisers and product disclosure and oversee industry-based dispute resolution schemes. The new agency, to be governed by a board (representing regulators, product providers, financial advisers and consumer groups), would be funded by industry levies and be a member of the Council of Financial Supervisors.

8.22 The RBA also supported vesting responsibility for financial sector consumer regulation in a single national authority. Such an authority would take over the finance sector consumer-related activities of the

4 Including groups representing consumers such as the Australian Financial Counselling and Credit Reform Association, Submission No. 107 to the Financial System Inquiry.

States/Territories, the ASC and the ISC and the role of the APSC in monitoring the codes of conduct.

8.23 The ASC did not support the establishment of a new and separate consumer protection regulator for financial services. It did, however, recommend a single regime administered by a single regulator for all financial advisory services, based on the *Corporations Law* and the recommendations contained in the ASC's *Good Advice Report*. The ASC also supported recognition in law of the regulator's ability to delegate, under supervision, the delivery of regulatory outcomes to industry and professional bodies.

8.24 ACCC's preferred option is a sector-wide co-regulatory approach involving increased reliance on industry self-regulation. Under its proposal a small statutory body, coming under the Treasury portfolio, would oversee a larger co-regulatory body responsible for dispute resolution and for setting standards for market conduct. It would administer a new Financial Services Act that set its responsibilities and would empower the industry-based components of the scheme. Industry codes of conduct would be required to meet outcomes described in the new Act.

8.25 The ACCC also recommended the creation of an industry body with coverage of all aspects of financial services to:

- set standards of competency, integrity and conduct;
- ensure compliance with codes of conduct devised by the financial services industry rather than standards imposed by legislation; and
- be the first point of contact for any complaint about a financial service or product and establish standardised methods for handling of complaints.

8.26 Governing this body would be a council consisting of representatives of the various industry lines of business, together with government and demand-side representatives. Parts of the proposed co-regulatory scheme would be subject to authorisation by the ACCC.

8.27 The Australian Consumers' Association supported a separate finance sector consumer protection regulator and an expanded role for industry self-regulation in the overall financial regulatory framework.

It noted, however, that industry self-regulation would not be uniformly effective across the financial sector but would rely, among other things, on a well-established industry association strong enough to enforce compliance.

8.28 A number of submissions[5] supported a single integrated system of regulation for financial advice. There were, however, differing views as to how such a system would operate, particularly whether principals or individual advisers should be licensed.

8.29 A number of submissions supported the integration of existing complaints schemes into a single scheme or the appointment of an ombudsman for the entire financial sector. They claimed the advantages would be:

- one point of contact for consumers to make complaints and have their disputes handled;
- removal of overlaps in coverage associated with the existing schemes; and
- improved cost effectiveness over existing arrangements through economies of scale and scope.

8.30 The Department of Industry, Science and Tourism expressed reservations about the possibility of a single financial system ombudsman at present, given the differences between products and institutions. However, it acknowledged that:

> *a change in supervision arrangements with consequent changes in institutions would require a rethink by industry as to its associations, codes and dispute facilities.*[6]

---

5 Including those of the Financial Planning Association, Submission No. 54; the Australian Lifewriters' Association and the National Council of Life Agents Association, joint Submission No. 109; the Australian Securities Commission, Submission No. 60; and the Australian Competition and Consumer Commission, Submission No. 181 to the Financial System Inquiry.

6 Department of Industry, Science and Tourism, Submission No. 243 to the Financial System Inquiry, p.14.

Approach of the Inquiry

8.31 The Inquiry considers that it can address the organisational arrangements for consumer protection only by deciding concurrently the best broad approach to such regulation.

8.32 The case for specialised regulation to protect consumers in the financial sector was noted in Chapter 4.

Criteria for Good Regulation

8.33 The need for special regulation to protect consumers is accepted. The question is to determine the best broad approach to adopt. In considering this issue, the Inquiry will have regard to the criteria for good regulation covered in Chapter 4.

8.34 Considerations particularly important to consumer protection are as follows:

- *Competitive neutrality*. Equivalent regulatory treatment should apply to functionally equivalent products and services.
- *Cost Effectiveness.* Regulation must be cost effective and appropriately balance efficiency and effectiveness.
- *Transparency*. Guarantees and promises should be made explicit and consumers should be aware of their rights and responsibilities.
- *Flexibility*. Regulation should be responsive to financial industry and market changes.
- *Accountability*. There should be a clear line of responsibility for consumer protection, including political and agency accountability.

Specific Issues in Considering the Options

8.35 Looking both at Australian and overseas experience, the Inquiry has observed that regulation for consumer protection often begins with worthy objectives but disappoints in its application.

8.36 Often, it appears that in translating goals to regulatory requirements, consumers' real needs are lost or neglected. For example,

suppliers may have imposed on them requirements which result in more information or procedures than consumers can readily use, with the resulting cost or confusion being borne often by the latter. In other cases, legitimate consumer concerns are not dealt with, as schemes are too inflexible or narrow to meet rapidly changing needs.

8.37 The Inquiry is concerned not to provide a detailed evaluation of existing rules but rather to make recommendations on the ongoing processes for developing and executing policy in the future. It is important that these processes become better informed, more responsive to change and expressed needs, and more accountable.

8.38 Taking account of these considerations, the Inquiry faces the following issues in deciding its recommendations on possible changes to the regulatory arrangements for consumer protection at the Commonwealth level:

- whether the best approach is to base specialised consumer regulation for the financial sector on:
  - self-regulation and industry codes of practice;
  - statutory rules and procedures administered by public agencies; or
  - arrangements which combine features of both of these.
- whether, in establishing specialised regulatory arrangements, it is desirable to maintain the application of general consumer protection provisions such as those of the TPA (as a 'backstop' or as a means to maintain consistency with other consumer regulation) or whether to replace general laws with specialised laws to prevent duplication of coverage (perhaps requiring provisions to prevent the application of fair trading laws, which mirror the false and misleading conduct section of the TPA, to the financial sector);
- whether combining regulatory arrangements for consumer protection across the whole financial sector would achieve greater consistency of regulation, minimise the risk of regulatory gaps or overlaps, reduce the risk of regulatory capture and develop a stronger single body of regulatory expertise;

- in contrast, whether separate arrangements for different institutions or product areas would produce advantages of specialisation and co-ordination with prudential regulation or other areas of regulation (eg superannuation requirements), or perhaps benefits in competition among regulators; and
- whether the advantages of any changes would be sufficient to justify the costs of change and transition.

8.39 The main options arising from these issues are:

- the *current arrangements* (comprising a mixture of general and specialist approaches, perhaps with minor modifications);
- a *dual regulatory scheme* with the general provisions of the trade practices law co-existing with a single consumer regulator based on specialised statutory provisions for the financial services industry;
- a *co-regulatory scheme* which combines the general provisions of trade practices law with industry-based codes and dispute resolution mechanisms supervised by a specialist regulatory entity or board; and
- a *single regulatory scheme* for the financial services industry based on a single specialist consumer regulator with either a co-regulatory or statutory basis, with the separate application of trade practices (and fair trading) law excluded from the financial services sector.

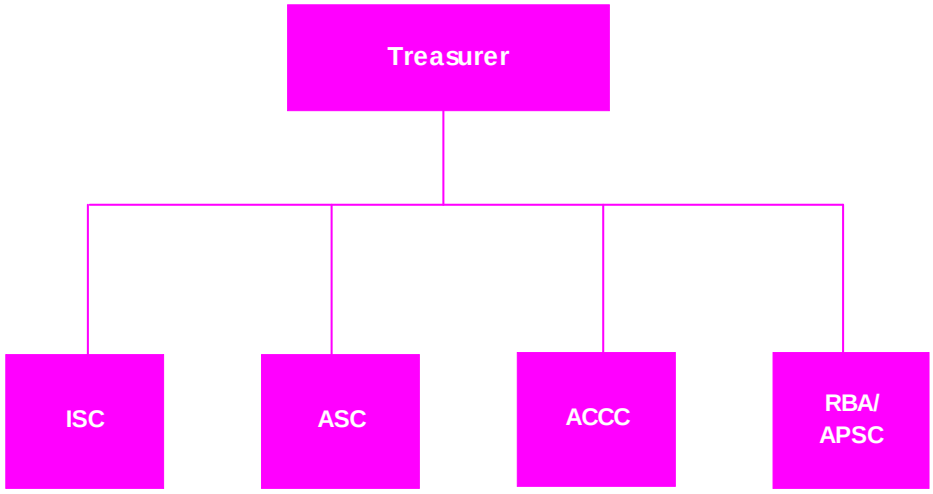
8.40 A more specific option which might be adopted under any of these broader approaches (and which is intrinsic to some of them) would be to rationalise the existing dispute resolution schemes. A narrow option would be to rationalise under one scheme the regulation of financial advisory services.

8.41 The main options that the Inquiry will evaluate are now described in some greater detail.

Retaining Current Arrangements

8.42 This approach is illustrated in Figure 8.1. The basic features of this approach are described earlier under 'Existing Arrangements'.

Figure 8.1: Existing Institutional Regulatory Model



A Dual Regulatory Scheme

8.43 This option would likely involve:

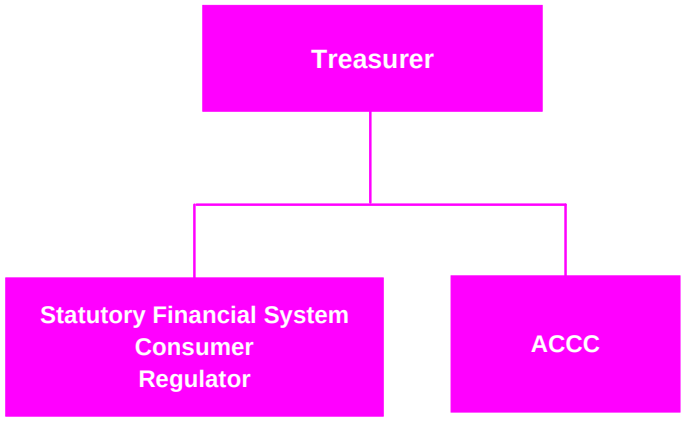
- the creation of a specialist consumer regulator for the financial sector which would take over the consumer protection role of the various existing financial sector regulators;
- the enactment of a new specialist consumer regulation statute covering the whole of the retail financial sector;
- to the extent that the appropriate level of consumer protection varies according to the financial transaction, a number of separate operating divisions under a common board and management structure; and
- the ACCC continuing to administer the consumer protection parts of the TPA in relation to the financial sector.

8.44 The retention of the ACCC and TPA jurisdiction in this area under this option would imply a judgement that the costs of duplication were outweighed by the benefits of retaining coverage for the general consumer regulation scheme. Implicit also would be a judgement that the consumer

regulator could not satisfactorily incorporate in its scheme the provisions now applying under the TPA.

8.45 This option is illustrated in Figure 8.2.

Figure 8.2: Dual Regulatory Model



Co-regulatory Approaches

8.46 This option, which would encourage the financial industry to undertake a more prominent role in self-regulation to protect consumers while the specialist statutory regulators gradually wind down their role, has been recommended by the ACCC.[7]

8.47 A co-regulatory approach could be implemented (as illustrated in Figure 8.3) through the:

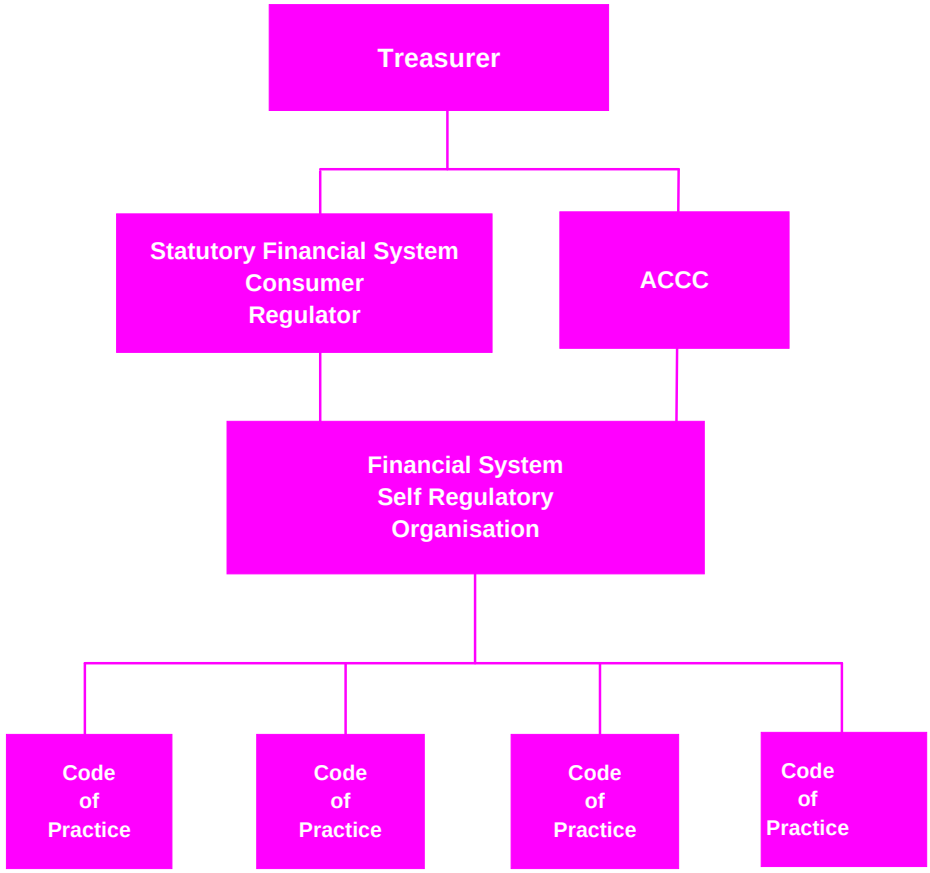
- establishment of a small statutory body, under the Treasury portfolio, with responsibility for overseeing and auditing the

7 Such an approach would be consistent with Ayres and Braithwaite's 1992 notion of responsive regulations by which 'public policy can effectively delegate government regulation of the market place to public interest groups'. Central to this notion of responsiveness is the theme that forms of government intervention will reinforce less intrusive delegated forms of self regulation.

performance of the self-regulatory arrangements (referred to below) empowering the industry-based components of the scheme;

- retention of the universal application of the consumer protection provisions of the TPA to financial service providers, and ACCC monitoring the self-regulatory body, described below, through its power under the authorisation process contained in Part VII of the TPA;
- creation of a body responsible for licensing and monitoring compliance with codes of conduct and overseeing dispute resolution schemes;
  - — it would be an umbrella organisation which establishes a unified structure for the many organisations currently performing self-regulatory functions;
  - — all institutions and individuals which deal with retail clients would be required to be members of the self-regulatory body;
  - — the scheme would consist of codes of conduct devised by the industry rather than standards imposed by legislation; and
- creation of a council, consisting of representatives of the various industry lines of business together with user representatives, to govern the self-regulatory body.

Figure 8.3: Co-Regulatory Model



Source: Derived from Australian Competition and Consumer Commission, Submission No. 181 to the Financial System Inquiry.

Single Regulator

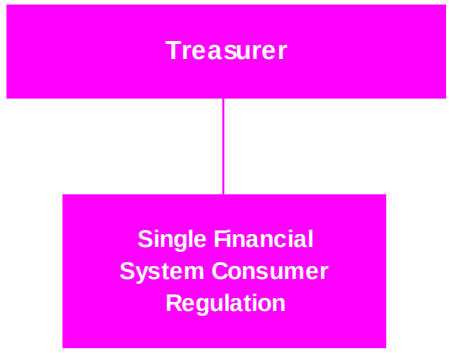
8.48 This option would involve the creation of a separate consumer regulator for the financial sector which would take over the consumer protection roles currently undertaken by the financial sector regulators and the ACCC. Therefore, unlike the dual regulator approach, the ACCC would not administer the TPA in relation to the financial sector. The TPA would need to be amended to explicitly exclude from its application those transactions covered by the financial system scheme.

8.49 Under this option, it would remain for consideration whether the financial sector scheme replicated the existing s. 52 of the TPA in relation to false or misleading statements or whether it extended for some or all financial services the 'reasonable inquiries and due diligence' defences now available under the *Corporations Law*.

8.50 The single separate regulator could take the form of either a statutory scheme (as set out above under the second option) or a co-regulatory scheme (as set out above under the third option). In either case, however, the ACCC would no longer play a role.

8.51 This option is illustrated in Figure 8.4.

Figure 8.4: Single Regulatory Model



Other Issues

8.52 The Inquiry has also received submissions on:

- codes of conduct to cover new payment technologies, including home banking, smart cards, stored value cards and transactions conducted over the Internet; and
- the need for a business credit code or ombudsman scheme for small and medium sized enterprises.

The Inquiry will give further consideration to these issues in its Final Report.

8.53 In preparing its Final Report, the Inquiry will also consider the appropriate arrangements for the regulation of financial advisers.

State and Territory Consumer Protection Laws

8.54 This section discusses the existing consumer protection roles of the States and Territories in relation to the financial system.

8.55 The main areas of State/Territory consumer protection legislation which affect the financial sector are fair trading legislation and consumer credit legislation.

Existing Arrangements

8.56 Fair trading legislation contains provisions which mirror, in part, the consumer protection provisions of the TPA. They cover:

- misleading and deceptive conduct;
- false representations;
- unfair marketing practices; and
- product safety and information standards.

8.57 Until recently, consumer credit legislation in force throughout Australia was far from uniform. This lack of uniformity in itself raised the cost of compliance for credit providers operating across State/Territory borders. In addition, the legislation in most States/Territories had been criticised for being outdated, being overly prescriptive and covering only a small proportion of the consumer credit market (predominantly loans up to $20,000).

8.58 Recognition of these problems with existing legislation led to pressure for the States/Territories to introduce uniform legislation. After a lengthy period of negotiation, a new scheme under the *Uniform Consumer Credit Code* (UCCC) was introduced in all Australian States/Territories on

1 November 1996 (except in Tasmania, where the new scheme is scheduled to commence in March 1997).[8]

8.59 The scheme was developed under an intergovernmental Uniform Credit Laws Agreement, 1993. In accordance with the Agreement, uniform laws were effected by 'template' legislation, based on the law of one State, Queensland.[9] The other States/Territories then enacted legislation to apply that law to their own jurisdictions, except Western Australia which passed consistent but not technically uniform legislation.[10] Amendments to the laws require the approval of the Ministerial Council of the States/Territories.

8.60 The key features of the UCCC are:

- precontractual disclosure requirements; and
- sanctions which may be applied where a credit provider fails to comply with provisions which, depending on the nature of the breach, can involve civil and criminal penalties, compensation to the consumer and setting aside of relevant contractual and security provisions.

8.61 In most States/Territories, disputes under the UCCC will be heard in either the courts or the commercial tribunals.

Views Presented in Submissions

8.62 Given that Commonwealth legislation has application in precedence to State/Territory laws, the TPA (which generally applies to the conduct of corporations in trade or commerce) has application for virtually the whole of the financial system. Accordingly, very few issues have been raised with the Inquiry specifically in relation to the fair trading laws.

---

8 Individual credit providers may, with the agreement of the relevant Minister, comply with the UCCC from 1 November 1996.

9 Passed through the Queensland Parliament on 2 September 1994.

10 As an alternative, any State/Territory (other than Queensland) may enact consistent legislation.

8.63 A large number of submissions raised the UCCC as a major area of concern. The submissions which dealt with this matter raised the content and / or the jurisdiction of the credit laws as causes for concern.

Content of Credit Laws

8.64 Industry participants expressed concern that the new credit laws do not achieve a reasonable balance between user protection and efficiency objectives. The main criticisms raised are outlined below.

- *Excessive penalty regime.* It was claimed this has the potential to penalise a credit provider in a way which is disproportionate to the gravity of the offences or the economic loss suffered by the consumer and is inappropriate in light of competitive forces in the retail credit market. In particular, the Australian Bankers' Association (ABA) claimed that:

  experience with determinations on civil penalties under the Credit Acts has demonstrated that substantial civil penalties will be imposed in respect of conduct falling far short of conduct which under common law is deserving of an award of exemplary damages.[11]

- *Inconsistent contract 'reopening' provisions.* These provisions may apply to credit contracts considered by the courts to be 'unjust'. It was claimed these do not provide consumers with the incentive to exercise care and judgement in choosing financial services. According to the ABA:

  it is inconsistent with the principle of disclosure (truth in lending) for there to be a reserve power to unwind a transaction freely entered into on an informed basis.[12]

- *Excessively prescriptive disclosure requirements.* The harshness of penalties for breaches may stifle innovation as more innovative

11 Australian Bankers' Association, Submission No. 126 to the Financial System Inquiry, p.135.

12 Australian Bankers' Association, Submission No. 126 to the Financial System Inquiry, p.133.

products are likely to require more complex disclosure, carrying greater risk of errors and thus penalties.

- *High cost.* The high cost of implementing, and operating under, the law was largely attributed to the extent of the disclosure required and the penalties regime under the laws.

8.65 The Australian Securitisation Forum (ASF) raised particular problems with the application of the UCCC to mortgage securitisers. In particular, the UCCC exposes many trustees to civil and criminal penalties as a result of the actions of third parties over which they have no control. This arises because, under many mortgage securitisation programmes, the lender of record is the trustee; yet the trustee does not initiate or manage the loan. The ASF claims that the effect will be that, if a manager or mortgage originator commits a breach of the UCCC, the trustee will be held responsible. The ASF is concerned that this will substantially deter the development of mortgage securitisation. Transitional arrangements have been implemented which only partially address these concerns.

Jurisdiction of Credit Laws

8.66 Submissions from the industry were almost unanimous in their opposition to the jurisdiction of the laws residing with the States/Territories. According to Westpac Banking Corporation (Westpac), consumer credit is a national business which is becoming more international as the availability of consumer finance on the Internet grows. The Westpac submission states of the consumer credit market:

> *It is clearly no longer a State-based business, and leaving responsibility for its regulation at this level (of government) risks impairing the ability of Australian financial institutions to compete in what will increasingly become a global market.*[13]

8.67 In addition, the fact that so many governments have to reach agreement on any proposed amendment will inevitably make it difficult to ensure that the regulation of credit providers will adapt readily to the changing competitive market.

---

13 Westpac Banking Corporation, Submission No. 90 to the Financial System Inquiry, p.150.

8.68 Groups representing consumers were generally more supportive, stating that the new legislation should be given a chance to work before there is any contemplation of a transfer of responsibility to the Commonwealth.[14]

Approach of the Inquiry

8.69 Despite the fact that the UCCC has now finally been introduced by all States/Territories except Tasmania, the views presented in submissions suggest that the legislation continues to raise significant concerns. The Inquiry will give further consideration to these concerns. In doing so, it will pay particular attention whether, if the regulatory framework for consumer protection at the Commonwealth level is restructured, net benefits may also arise from the inclusion of existing State/Territory responsibilities within that scheme.

8.70 Some of the specific issues in considering such options are:

- the advantages of having credit laws administered together with State/Territory fair trading laws;
- problems that may be caused by the incomplete coverage of Commonwealth laws (credit provision extends beyond the corporations power);
- the advantages of a single jurisdiction in maintaining a uniform national law;
- the advantages of combining credit issues with broader financial sector consumer protection arrangements at the Commonwealth level (this in turn will depend in part on the choice of model adopted for the structure of the financial sector consumer protection regulator);
- the extent to which each level of government has in place the appropriate court infrastructure to deal with consumer disputes; and
- issues associated with meeting the cost of credit regulation.

14 Consumer Credit Legal Centre (NSW), Submission No. 166 to the Financial System Inquiry.

Privacy

8.71 The Inquiry is investigating technological advances which are transforming the way in which the financial sector conducts its business. Technologies such as electronic commerce, stored value cards and the Internet can generate a considerable amount of information about individuals. As more and more interactions occur electronically, there will be increasing amounts of information can be gathered, stored and used. This information, when used for direct marketing and credit risk analyses, has a commercial value.

8.72 An important issue flowing from this is the extent to which the individual has control over what happens to information about him or her. Privacy protection will be an important element in promoting consumer confidence in the use of new technologies. It is also a more longstanding matter of concern in relation to all forms of personal record-keeping and use.

Existing Arrangements

8.73 Privacy protections are currently provided through 3 means: Commonwealth legislation, State and Territory legislation and industry codes of practice.

8.74 The *Privacy Act 1988* is the primary legislation for the protection of individuals' privacy. It contains 11 information privacy principles which are based on the Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data developed by the OECD in 1980. These cover the collection, use, access to, and security of, personal information. However, the Privacy Act is primarily limited to:

- the information handling practices of the Commonwealth and ACT agencies;
- those who hold and use tax file numbers; and
- the activities of credit providers and credit reporting agencies in their handling of credit-related information about individuals.

8.75 There is no general application of the Act to the private sector.

8.76 Victorian, Queensland and South Australian legislation regulates privacy in relation to credit and some other prescribed information.

8.77 Certain financial sector codes of practice include some privacy provisions, for example the banking, electronic funds transfer, credit union and building society codes of practice.

8.78 Customer information within the financial sector is also protected through the common law duty of confidentiality.[15]

8.79 Some pressure exists for an extension of current privacy protection. This is partly as a response to a recent European Union directive which, from 1998, will restrict the flow of personal data on European citizens between the European Union and other countries which do not have equivalent privacy laws.

8.80 There are a number of further developments:

- The New South Wales Government is planning to introduce a Bill which would provide for the development of binding codes of conduct, and there are proposals for new legislation in Victoria.
- Visa and MasterCard propose an industry code of conduct that would prevent banks and card companies from colluding to join information together or to sell information to marketing organisations.
- A direct marketing code of conduct is being developed by the Australian Direct Marketing Association in conjunction with a Standing Committee on Consumer Affairs working party, and codes of conduct (containing privacy provisions) are being developed by a number of organisations for stored value cards.

8.81 The Federal Government has made a commitment to work in consultation with the States and Territories to ensure the implementation of a privacy law regime in Australia comparable with best international practice.

---

15 Companies have a common law duty of confidentiality which prevents disclosure of all information about a customer provided in confidence except where it is required by law or the customer consents to the transfer of this information.

8.82 The Government has issued a discussion paper on a possible co-regulatory approach modelled on the *New Zealand Privacy Act 1993*. Under this approach, legislation would set down general information privacy principles and provide for the Privacy Commissioner to issue sector-specific codes of practice which may modify or elaborate the principles in relation to specified information, agencies, activities, industries or professions. Industry would be involved in the development of these codes which would be instruments subject to disallowance by both Houses of Parliament. In the absence of a code, the principles would apply as legal obligations on the public and private sectors.

8.83 While the Government is seeking views on the approach detailed in the discussion paper, it has yet to take a firm view on whether a co-regulatory or some other approach to a privacy law regime should be taken.

Views Presented in Submissions

8.84 The Privacy Commissioner described the current state of privacy laws in Australia as incomplete and unsatisfactory. In the Commissioner's view, people are left devoid of any privacy protection in the majority of their dealings with the private sector and State/Territory governments. This view was supported by the results of surveys conducted by the Privacy Commissioner which indicate that people are becoming increasingly concerned about privacy.

8.85 A number of financial institutions raised concerns that the unco-ordinated and prescriptive introduction of privacy protections into the private sector has the potential to severely constrain innovation in electronic commerce. For example, Colonial Mutual Life Assurance Society believes that a coherent national approach to privacy regulation, based on co-operation between Federal and State governments,

> *is critical to ensuring a consistent approach to privacy is taken nationwide and to simplify the compliance process.*[16]

16 Colonial Mutual Life Assurance Society., Submission No. 88 to the Financial System Inquiry, p.48.

8.86 National Australia Bank noted the potential for privacy laws to restrict the ability of companies operating under a holding company structure to offer customers an integrated range of products and services. In a similar vein, the ANZ Banking Group (ANZ) considered that financial institutions should be allowed to exchange marketing and credit information with companies within the group and that the bankers' duty of confidentiality should be extended to cover the activities of the group as a whole rather than individual entities within the group.

8.87 A number of submissions suggested that the restriction, under the Privacy Act, on reporting good credit behaviour (positive credit reporting) to credit reference agencies disadvantages consumers and can have adverse efficiency implications. Westpac claimed that:

> *the absence of positive credit reporting means that good customers are having to subsidise those who are not ... and because of the greater risks involved, [results in] higher costs generally for all borrowers.*[17]

8.88 Positive credit reporting was raised in overseas consultations (including those with Moody's Investor Services and GE Capital) as an important factor contributing to greater efficiency in the provision of financial services.

Approach of the Inquiry

8.89 The issue for this Inquiry is how to balance the need of the financial sector for information against the individual's desire for privacy. This issue is of importance to the financial system, given that financial institutions are essentially in the information business. They use information about their customers to:

- price and manage the risks associated with lending;
- develop new financial instruments; and

17 Westpac Banking Corporation, Submission No. 90 to the Financial System Inquiry, p.158.

- bundle products and market financial services, by targeting customers who are more likely to be interested in a specific product, using sophisticated database marketing techniques.

8.90 The Inquiry does not intend to make detailed recommendations on the nature of specific rules in this area. Consultations are presently under way examining this issue in detail, and recommendations will be made to the Attorney-General on regulatory changes in this area. However, given that any changes to privacy protection could have a major effect on the efficiency of the financial system, the Inquiry will examine two issues:

- what principles should guide any extension of the privacy regime; and
- which regulator should be responsible for administering privacy protection in the financial sector.

Principles for Privacy Extension

8.91 The approach to privacy regulation which emerges from the current consultative process should:

- strike an appropriate balance between consumer protection, consumer choice and the effective and efficient delivery of financial services to consumers;
- be carried out in a way which enables it to adapt to the changes accruing in the market, including covergence in financial service providers and products;
- avoid or eliminate any duplication of coverage;
- not stifle innovation which is of benefit to consumers; and
- provide a coherent and uniform regime.

Which Regulator?

8.92 One of the broader issues for this Inquiry is whether the current consumer protection arrangements can be made more efficient and effective by reducing the number of regulators with responsibility in this area. In this context, it is appropriate to consider which agency should administer the

privacy regime in relation to the financial sector — the universal regulator (ie the Privacy Commissioner) or a financial system consumer regulator.

8.93 The main advantages of regulation by a financial system consumer regulator are:

- greater expertise and understanding of the financial sector and hence of the issues involved in applying appropriate privacy principles; and
- a reduction in the number of regulators with responsibilities in the financial sector and hence in the scope for inconsistency in approach to drive up the costs of compliance.

8.94 The main advantages of regulation by the Privacy Commissioner are:

- it would enable the Commissioner to take an economy-wide perspective, thereby minimising the danger of regulatory capture;
- it would ensure a level playing field in enforcement and protection is maintained across all sectors of the economy; and
- it would avoid the problem that, with increasing blurring of boundaries between financial and non-financial sectors, possible breaches of privacy regulations may not fall neatly into financial and non-financial aspects.

8.95 Each approach will be further considered by the Inquiry. Other approaches which provide for some integration of these alternatives could be developed.

Protection of Depositors

8.96 As noted in Chapter 4, the fundamental objectives of the prudential regulation of deposit-taking institutions (DTIs) are to reduce systemic risk in the financial system and to provide 'safe havens' for depositors.

8.97 The main approach is to seek to ensure through prudential regulation that DTIs minimise the risk of financial failure by conducting their activities in a prudent fashion.

8.98 However, the experience in all countries has been that prudential regulations cannot completely eliminate the risk of failure. Accordingly, it is necessary to have in place arrangements for dealing with the effects of financial failure if it occurs. The principal purpose of these arrangements is the protection of depositors as consumers. Because such depositor protection arrangements have implications for reducing systemic risk, they also have a 'prudential' role.

8.99 This section considers these arrangements in Australia, particularly from the point of view of the protection of depositors.

Existing Arrangements

8.100 Depositor protection arrangements in Australia vary between banks, building societies and credit unions. But none provides an explicit guarantee of deposits. Under extreme circumstances, therefore, it would be possible for depositors in any of these institutions to be exposed to the risk of loss of some or all of their funds.

8.101 While regulatory arrangements do not guarantee deposits, governments have guaranteed deposits in State and Commonwealth-owned banks. However, in recent years, all of these banks have been privatised, and the explicit government guarantees applying to their deposits are being phased out.

Banks

8.102 Division 2 of the *Banking Act 1959* which provides for 'Protection of Depositors' comprises the following main elements:

- Under s.12, the RBA is required to exercise its powers and functions 'for the protection of the depositors of the several banks'. To date, when a bank has been in serious financial difficulties, the RBA has exercised this responsibility by arranging for the bank to be taken over by another bank.
- Under s.14, in the event that a bank is about to fail, or fails, the RBA may appoint a person to investigate the bank and it may assume control of the bank and carry on its business. Once the RBA has

assumed control, it must carry on the business of the bank until the depositors are repaid or it is satisfied that suitable provision has been made for the repayment of depositors.

- Under s. 16, deposits are afforded priority over other liabilities (in respect of a bank's assets in Australia) in the event that a bank is unable to meet its obligations or it suspends payments.

8.103 In effect, these three provisions provide a 3-tiered response to bank failure.

8.104 First, provided the bank is still solvent, it is possible to seek a new owner (or to obtain fresh capital from existing owners) to save it from failure. However, alternative owners or sources of capital would need to be available for this to be possible. This has implications for the ownership arrangements of banks (see Chapter 7) and for the structure of the banking industry (see Chapter 6).

8.105 If these arrangements are not possible, to avoid the delays and disruptions of receivership or liquidation, the second tier provides for the control of the bank to pass to the central bank. The bank can then continue operating, with depositor protection and central bank support, until its future is determined.

8.106 Finally, if the bank is unable to meet its obligations and suspends payments, depositors have the partial protection of their priority ranking among claimants upon the assets of the bank. In these circumstances, the bank is likely to be wound-up.

8.107 To date the provisions of sections 14 and 16 have never been used because the RBA has been able to manage the difficulties of banks without taking control of them. Banks have been merged with other banks or new capital has been obtained, with the only losses being those incurred by shareholders. Given that these provisions have never been used, there is no experience by which their effectiveness can be reliably assessed.

8.108 Apart from residual government guarantees applying to formerly government-owned banks, neither government guarantees nor deposit insurance schemes stand behind bank deposits in Australia. This is in contrast to other developed countries (see Appendix D). However, if a bank

in Australia fails, because deposits rank ahead of liabilities to the central bank, any financial accommodation afforded by the RBA to the bank before it fails (including during a s.14 administration) could effectively contribute to paying out depositors. This could ultimately be at government expense (since any RBA losses reduce its dividends payable to the Commonwealth), although such exposures would be reduced by the extent of non-deposit liabilities over which the RBA itself has priority under s.86 of the *Reserve Bank Act 1959*.

Building Societies

8.109 There are no special depositor protection provisions for building societies. In the event that a building society experiences serious financial difficulty, its supervisor may seek to merge it with another financial entity. However, if the society fails, depositors have no greater protection than that afforded other creditors.

Credit Unions

8.110 Like building society depositors, credit union depositors are not given preference in a liquidation. However, each credit union contributes to a State-based contingency fund which may provide some assistance to depositors in the event of serious financial difficulty or failure. The use of the contingency funds is a matter for discretionary action on the part of each State Supervisory Authority, and there is no guarantee of deposits by the relevant contingency fund. Funds may be used to assist in an orderly resolution of financial difficulties, by among other things, transfer of engagements or wind-up.

Views Presented in Submissions

8.111 Few submissions had much to say about the arrangements for the protection of depositors against financial failure. It is possible that this reflects the fact that, since their origins in 1945, existing arrangements have been successful in protecting bank depositors from loss, and that these arrangements do not impose direct costs on banks or their depositors.

8.112 Submissions referring to depositor protection arrangements, especially under the Banking Act, expressed a mixture of views. Some supported the thrust of existing arrangements[18]; some suggested arrangements be extended to other DTIs[19]; others suggested arrangements should be limited[20].

8.113 A common theme is that arrangements should be clarified. The RBA, for example, noted that there may be ambiguity in the wording of the Banking Act. Under s.14(2), the RBA may take control of a problem bank until depositors are repaid or provision is made for their repayment or the RBA believes it is no longer necessary for it to remain in control.

8.114 However, there is no power for the RBA to act as, or appoint, a liquidator. Because the reference to deposits being repaid might be taken by some to imply that deposits would be repaid in full, the RBA favoured amendments to the Act to clarify its powers and to make it clear that depositor protection does not mean an official guarantee of deposits. This view was also supported by Westpac. The ASC suggested also that there should be clear disclosure at point of sale of guarantee arrangements in place. DIST made the additional point that the effects of any changes to prudential arrangements will need to be carefully explained to customers to avoid undermining the credibility of the regulatory system.

8.115 Likewise, the Department of the Treasury considered arrangements should be clarified. It favoured reliance by investors on their own risk assessments of institutions and products, based on improved disclosure by institutions, rather than reliance on regulatory authorities. Treasury saw it as desirable to remove perceptions that banks have special status in the financial system. Consistent with this, it favoured the removal both of

---

18 See for example, Reserve Bank of Australia, Submission No. 111; the Commonwealth Bank of Australia, Submission No. 186; Westpac Banking Corporation, Submission No. 90; and Colonial Mutual Life Assurance Society Ltd, Submission No. 88 to the Financial System Inquiry.

19 See for example, Australian Association of Permanent Building Societies, Submission No. 93; Credit Union Services Corporation (Australia) Limited, Submission No. 162; and Consumers' Federation of Australia, Submission No. 135 to the Financial System Inquiry.

20 See for example, Commonwealth Department of the Treasury, Submission No. 143; National Australia Bank, Submission No. 131; National Mutual Holding Ltd, Submission No. 32; and Aussie Home Loans, Submission No. 176 to the Financial System Inquiry.

depositor protection requirements from the Banking Act and of bank supervision responsibilities from the RBA.

8.116 National Mutual Holdings Ltd also suggested that the implied government support for bank deposits is inappropriate. It noted that there is prospective access by investors to off-shore banks without similar protection; that increasing securitisation should reduce the need for bank liquidity support and depositor protection; that it is anomalous that superannuation, which is a mandated investment, is not given the same treatment; and that product innovation is leading to the development of a range of near-deposit products.

8.117 Submissions generally have little to say about deposit insurance as a means of promoting depositor protection. Most submissions which addressed the issue[21] opposed the introduction of deposit insurance on the basis that it would create adverse incentives for depositors and management of institutions, involve difficulties in setting premiums related to risk and increase moral hazard. DIST, however, saw merit in deposit insurance as a means of distinguishing a safe form of deposit, especially from other products offered by the same institution. CUSCAL and Creditlink favoured abolition of contingency fund arrangements currently in place for credit unions. The Inquiry notes the prevalence of schemes overseas and that both the advantages and disadvantages of various schemes were cited during discussions.

Approach of the Inquiry

8.118 One of the general principles for good regulation in the financial system is that it should ensure that consumers understand the nature of the promises made to them and the likelihood that such promises will be kept.

8.119 It appears that the great majority of depositors in Australia are either unaware of, or unclear about, the level of security afforded their deposits with banks, building societies and credit unions. Most people

---

21 See for example, Australian Bankers' Association, Submission No. 126; National Australia Bank, Submission No. 131; and Reserve Bank of Australia, Submission No. 111 to the Financial System Inquiry.

assume that their deposits are completely safe under all circumstances. Indeed, because of depositor priority and supervision arrangements, this is a reasonable assumption under all but the most extraordinary circumstances. However, there is no government guarantee of deposits and no insurance scheme to back them in the event of extraordinary failure.

8.120 One danger in this situation is that, should a DTI fail, the government could be pressured to make good any loss suffered by depositors. This could expose taxpayers to the burden of such losses.

8.121 Another risk is that any false belief may distort the allocation of savings in favour of deposits, or deposits of a particular kind, against alternative savings instruments. It is reasonable to ask whether all deposits, including larger deposits competing directly against alternative instruments, should be afforded such treatment.

8.122 If expectations are not met at some time in the future, there is also a risk that contagion effects will be amplified.

8.123 Another reason for considering the means by which depositors are protected arises if arrangements for the prudential regulation of DTIs are covered by a single scheme (discussed in Chapter 7). If this is the case, two questions arise: should all deposit takers be treated in the same way in relation to depositor protection and, if so, should one of the current arrangements or some other arrangement apply?

8.124 At the very least, it would be necessary to decide whether depositor preference should be extended to building societies and credit unions and to decide the future of existing contingency fund arrangements for credit unions.

8.125 In many comparable overseas jurisdictions, the various problems associated with depositor protection are resolved in part by explicit guarantees from the government. In other jurisdictions, the government provides no guarantee or other protection, but instead insists on, or directly imposes, a scheme of deposit insurance.

8.126 Most countries try to limit taxpayers' exposure to the risk of loss. In some cases, this is done by placing a cap on the value of deposits subject to

protection. In other cases, schemes specify that only a certain percentage of deposits is protected.

8.127 In most countries where the government provides a guarantee, the exposure is also limited by the establishment of a deposit insurance fund, so that resources required to meet the costs of claims are drawn from the institutions rather than from taxpayers (see Appendix D).

8.128 Of course, there are many examples where these schemes have proven inadequate and the governments concerned have been called upon to find large amounts of money to meet guarantees (even where the schemes are stated to be wholly industry funded). It is clear that badly designed depositor protection arrangements can readily suffer problems of 'moral hazard', whereby the protection encourages behaviour that creates the same risks that it is intended to avert.

8.129 Despite the mixed experience overseas with mechanisms to make more explicit the degree of depositor protection, the Inquiry notes that most overseas experts see merit in such mechanisms, provided they are properly designed.

8.130 In view of all of these considerations, the Inquiry will further consider the arrangements for depositor protection in Australia. In particular it will review:

- the rationale and appropriate scope for protection of depositors;
- whether the Government should seek to make its commitments to depositor protection more explicit;
- whether the arrangements for managing institutional failures now provided for in the banking and other laws are likely to be operationally effective under the types of circumstances that might prevail in the future. This includes consideration of the implications of these requirements for other areas of prudential regulation, including the ownership rules and restrictions on mergers;
- the best means, having regard to the principle of competitive neutrality, of providing similar treatment to the different types of DTIs, particularly if a single national scheme of DTI regulation is established;

- whether there are cost-effective means, including capping of amounts subject to protection, or through insurance or fidelity fund arrangements, for limiting the government's exposure to the risk of losses; and
- how, under the various arrangements, competition in the financial system can be maximised while appropriate incentives are retained for ensuring prudent behaviour and the minimisation of the risk of moral hazard.

Community Service Obligations

8.131 There have been suggestions that banks should have a social obligation to provide free basic banking (transaction) services. There has also been discussion of the social implications of closures of bank branches.

8.132 This section considers whether government should impose community service obligations (CSO) on the financial sector and the implications of technology and other market developments for the effectiveness of such a policy.

8.133 For the purpose of this paper, a CSO is defined as a government requirement for an organisation to provide a product or service at a price below that which would be charged, or to carry out activities relating to outputs or inputs which it would not elect to do, on a commercial basis. Such a requirement may take the form of regulation or suasion.

Existing Arrangements

8.134 The Government has not in recent years required financial institutions to carry out community service obligations. Concerns about the levels of fees and charges imposed by banks led the previous Government to direct the Prices Surveillance Authority (PSA) to conduct a public inquiry

into fees and charges imposed on retail transaction accounts (RTAs). The PSA released its Report on 11 July 1995.[22] The key findings of the Report were that:

- the market process would deliver appropriate outcomes for consumers and that a regulated basic banking product was not necessary at that point in time;
- there were a number of inefficiencies and inequities in the current design of fees and charges — in particular, account-keeping fees discriminate against people with low-balance accounts; and
- better information should be supplied to consumers so they can make the right choices about the banking products that suit them.

8.135 The Report also recommended that fees and charges on RTAs should be formally monitored for a period of 3 years.

8.136 This recommendation was not adopted. The Government has recently indicated that it would not intervene in bank fee-setting practices provided that there was sufficient competition among the banks.[23]

Views Presented in Submissions

8.137 Consumer and welfare groups raised concerns that the benefits of deregulation have not been spread evenly among the community. For example, the Good Shepherd Youth and Family Service (GSYFS) suggested that deregulation has resulted in low income earners and disadvantaged groups bearing a disproportionate share of increased costs and diminishing access to the banking system.

8.138 Three types of impediments to access were identified in submissions:[24]

- *Affordability*. Service fees for the use of traditional services such as over the counter transactions place consumers who do not have

22 Prices Surveillance Authority 1995, Report No 65.
23 Costello, The Hon Peter 1996.
24 Good Shepherd Youth and Family Services (GSYFS), Submission No. 122; and Australian Financial Counselling and Credit Reform Association, Submission No. 107 to the Financial System Inquiry.

access to or are unable to use new technologies at a financial disadvantage.

- *Technology*. The introduction of new technology, while winding back on traditional services, tends to disadvantage groups such as the intellectually or physically handicapped, minority groups and the aged.
- *Geographical access.* Bank branch closures exacerbate the above problem for remote communities.

8.139 Adequate access to the full range of benefits available from the financial system was also seen by certain groups as a fundamental right of all Australians. For example, the GSYFS considers that:

> *bank accounts provide security against physical loss and theft and to some degree against financial loss through inflation.*[25]

These groups also suggested that the regulatory regime for the financial system should include appropriate mechanisms to ensure access to credit and financial transaction accounts on fair terms.

8.140 The banks' view can generally be characterised as follows. Pricing interference forces banks to price services in a way which:

- means that profitable customers cross-subsidise unprofitable ones (this means banks risk losing their more profitable customers to specialist competitors such as mortgage originators, which do not have to carry this burden);
- restricts their flexibility in changing their mix of revenue over time, with possible adverse consequences for prudential considerations; and
- prevents them from encouraging customers to adopt more cost-effective transaction practices, thereby limiting their ability to reduce their cost structures and reducing efficiency in the handling of transactions across the whole banking system.

---

25 Good Shepherd Youth and Family Services, Submission No. 122 to the Financial System Inquiry, p.5.

Approach of the Inquiry

8.141 The Campbell Committee addressed the provision of social assistance and concluded broadly that, where a government wished to pursue social objectives, direct fiscal subsidies were strongly favoured in preference to financial regulation, for a number of reasons related to effectiveness, equity and accountability.[26]

8.142 Similar views have since been expressed in the Hilmer Report on National Competition Policy. In particular, it noted:

> *If a government chose to favour a particular sector or activity for strategic, social or political reasons, it will generally be more efficient to provide direct budgetary assistance. While subsidies of this kind may impact on competition between subsidised and non-subsidised sectors or activities, the efficiency losses will often be less than those associated with permitting anti-competitive behaviour. Moreover, the transparency of the assistance will ensure that the desirability of that special treatment is subject to regular scrutiny.*[27]

8.143 The Inquiry will consider whether banks should be required to:

- offer a free basic banking product; and
- ensure customers have access to branch banking.

Basic Banking Product

8.144 A free basic banking product has in the past been recommended by welfare and consumer groups as a means of overcoming the high cost of access to banking for some groups. While there is a divergence of views concerning the particular features of a basic banking product, all views recognise three needs: to provide a safe and accessible means of keeping money; a means to obtain cash; and a way to make payments to third parties.

26 Australian Financial System Inquiry (Campbell Committee) 1981, p. 628.
27 Report by the Independent Committee of Inquiry (Hilmer Committee) 1993.

8.145 There may, however, be problems in requiring financial institutions to provide basic banking products. The Inquiry will consider the following questions in its Final Report.

- First, is it practical to attempt to enforce a CSO on all providers of financial services, given the difficulty of identifying all such providers in a 'convergent' world, and given that imposing a CSO on a subset of financial service providers would run counter to the principle of competitive neutrality?
- Secondly, is obliging particular types of financial institutions to provide community services, without explicit compensation, an efficient way of achieving government social objectives?
- Thirdly, in a dynamic and rapidly changing financial sector, to what extent can the market itself discover ways of dealing with the problem of access to financial services for disadvantaged groups? For example, does the stored value card offer the potential to serve as an alternative to retail transaction accounts? The Department of Social Security is already conducting trials of the use of stored value cards for emergency payments to certain recipients.
- Fourthly, is there a diminishing capacity to impose obligations to provide goods/services at prices below the full costs of production by imposing higher charges on other users?
- Fifthly, do restrictions on the setting of fees and charges assist those they are intended to assist, namely those on low incomes?

Access to Branch Banking

8.146 Technological developments are increasing the range of media by which customers may access financial services. These technologies include:

- automatic teller machines;
- mobile banking services;
- giroPost branch networks;
- agency and kiosk networks;
- telephone-based access services;

- the Internet; and
- EFTPOS.

8.147 As the application of these media becomes more widespread, the need for customers to access branches in person diminishes. As noted in Chapter 3, the increasing use of these technologies may in future reduce the economic viability of traditional branch networks. The Inquiry recognises, however, that technological developments will not completely address the problem of access to banking services for all groups. The Inquiry will further consider these issues, taking account of similar questions as are noted above for basic banking services.

Protecting Consumers in a Global Market

8.148 This section looks at the implications for consumers and the regulatory framework of a possible increase in the scale of cross-border sales of financial services.

8.149 International sales of retail financial services have been available for some time, but have been constrained by the costs of distance. New technologies may reduce some of these costs, making it easier to provide financial services in countries where the service provider does not have a physical presence.

8.150 It remains unclear, however, whether these developments will result in any substantial globalisation of retail financial markets. The extent to which retail consumers would be willing to purchase services from overseas suppliers is as yet unknown.

8.151 Consumers are currently not protected in their direct dealing with overseas financial service providers. A financial service offered from abroad on the Internet may be fraudulent, or the offerer may engage in misleading and deceptive conduct. Misleading information could be provided about whether or not an institution is prudentially regulated or about the features of the financial product offered. More generally, if complaints or disputes arise about the service provided, it may be significantly more difficult for a customer to obtain satisfaction or redress from overseas suppliers. There may

also be problems with the security of transactions. Issues also arise in relation to the supply of retail financial services to overseas customers by Australian-based providers.

Existing Arrangements

8.152 Australia's existing consumer protection regime is primarily designed to protect consumers in Australia who purchase a financial service from a provider located in Australia. In dealing with an overseas-based provider, the primary legal recourse for a consumer is through the courts. This can involve problems in determining which country's law applies and which court jurisdiction should hear the case. Litigation can also be prohibitively expensive and, even if successful, it may prove difficult and expensive to enforce.

8.153 Regulators face similar expenses and problems in seeking to bring actions against a foreign provider which has breached Australian consumer protection requirements for the provision of financial services.

8.154 In practice, consumers using foreign service providers through such vehicles as the Internet squarely face the *caveat emptor* doctrine — 'buyer beware'. To a considerable degree, the market itself must supply solutions which would enable consumers to use services with confidence. This may take the form of suppliers offering means for assuring the rights of their customers or the development of independent accreditation services. Security is also vital, and encryption and other mechanisms are being actively pursued to meet this need.

8.155 In addition, regulators have begun to pursue greater international co-operation and information sharing and have established new formal and informal alliances. There have been early attempts to establish international norms. For example, the International Organisation of Securities Commissions has a working group whose mandate includes looking at disclosure issues to facilitate cross-border listings and issuance.

Views Presented in Submissions

8.156 Key themes raised in submissions were:

- recognition that consumer confidence is necessary for these delivery mechanisms to be effective;
- the risks to consumers in accessing financial services across borders (CML and ANZ both suggested that consideration should be given to educating consumers as to the risks involved in dealing with unsupervised organisations using new technology);
- the need for international co-operation among regulators to create appropriate standards[28]; and
- the need to ensure that financial institutions based in Australia are not placed at a competitive disadvantage compared with overseas competitors in similar jurisdictions because they are subject to a stricter regulatory regime[29].

Approach of the Inquiry

8.157 The Inquiry will not attempt to predict the extent or timing of the development of global markets for retail financial services. However, it seems clear already, from the developments which have been observed in Australia and elsewhere, that there is scope for the globalisation of at least some retail service markets at some time in the next few years. In consultations with Forrester Research Inc of the United States, it was suggested that by mid 1998 most of the security aspects of electronic commerce over the Internet will have been addressed. In addition, while Internet fraud will continue to be a risk, it needs to be kept in perspective as there are security risks in all transactions regardless of the transmission media used.

28 See for example, ANZ Banking Group, Submission No. 94 and Consumers' Federation of Australia, Submission No. 135 to the Financial System Inquiry.

29 ANZ Banking Group, Submission No. 94 and Australian Mutual Provident Society, Submission No. 97 to the Financial System Inquiry.

8.158 This being so, the Inquiry's main concern is to ensure that the regulatory framework which it recommends for the Australian financial system is able to adapt appropriately to any such developments. Import competition in this form may be a desirable means of increasing pressures for greater efficiency and performance by Australian firms.

8.159 The main concerns which need to be taken into account are:

- ensuring that firms subject to domestic regulation are not placed at a competitive disadvantage relative to overseas firms supplying retail financial services markets, whether in Australia or overseas;
- ensuring that Australia is not used as a base for firms seeking to commit fraud or to deceive or mislead customers overseas; and
- achieving an appropriate balance, in the interests of consumers, between the need to protect consumers from misconduct and ensuring that the Australian marketplace is as open as possible to competition from abroad.

8.160 These concerns have a number of important potential implications, including for the following.

- *Adjusting the style and intensity of regulation.* To the extent that the market is globalised, then so too are regulatory arrangements effectively exposed to international competition. It will be essential that Australia find and maintain the best style and optimal intensity of consumer regulation, because to fall short will reduce consumer confidence in suppliers subject to the regime, while to impose excessive burdens may result in higher costs which damage competitiveness. Getting this balance right is equally important for consumers as for local suppliers.
- *Accommodating international regulatory co-operation.* Although it is too early to determine the full extent of the need for or prospects of international co-operation among regulators in this area, increased international regulatory co-operation may prove to be necessary and worthwhile in the future. It will be important that the Australian regulatory arrangements be designed to be open to, and participate in, such co-operation.

- *Achieving competitive neutrality in cost recovery arrangements.* If markets globalise, it will be important to ensure that the cost recovery arrangements for regulation do not discriminate against Australian suppliers, domestically or internationally.

8.161 In addition to these considerations, submissions to the Inquiry have proposed that it should also consider specific measures which may be taken to increase consumer protection in the global market.

8.162 Examples of the type of measures that might be taken include:

- promotion of international industry codes of conduct or ethics;
- development of international industry dispute resolution arrangements;
- provision of screening or accreditation services;
- educational programs for consumers;
- establishment of international agreements or protocols as a basis for harmonising regulatory arrangements in as many jurisdictions as possible;
- development of mutual recognition regimes; and
- pursuit of multilateral or bilateral mutual assistance treaties between national regulators.

8.163 The Inquiry has not formed a firm view whether it can or should make recommendations on these specific matters. It will give further consideration to these issues and report its conclusions in the Final Report.