WALLIS INQUIRY — LEGAL IMPLICATIONS FOR FINANCIAL SERVICE PROVIDERS

The Wallis Report — The ACCC Response

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INTRODUCTION

The ACCC welcomes the Financial System Inquiry Final Report. Many of the Report's recommendations are pro-competitive proposals which have the potential to significantly enhance competition and efficiency within the financial services sector in coming years. The ACCC regards the Inquiry's comments on the changing nature of financial services markets as both helpful and well informed. The recommendations will help to complement and reinforce the role of the Trade Practices Act in promoting competition in the Australian economy.

As an outline of my speech today I will firstly consider the general recommendations made by Wallis that are relevant to competition. I will then focus on bank mergers how the Commission analyses bank mergers, how the Commission has evaluated bank mergers in the past, and then consider how ACCC bank merger analysis is likely to emerge post Wallis. Following that I will briefly discuss the consumer protection issues arising from the Wallis Report.

But before discussing any of these things, I would like to spend a minute or two discussing the Inquiry generally.

OVERVIEW OF THE INQUIRY

In calling the Wallis Inquiry, the Government recognised that, to use the words of the Inquiry: "The stability, integrity and efficiency of the financial system are critical to the performance of the entire economy."

It is an essential component of the infrastructure of commerce, providing in excess of $40 billion worth of services annually to other sectors of the economy.

The Inquiry found, however, that there is scope to make our system more efficient. In international comparisons, our system comes out around the middle on most measures. That is, our system works well but is below world best practice.

The Inquiry was thus concentrated on two main objectives:

- identifying the best overall framework for the efficient delivery of regulation; and
- proposing changes to the way regulation is conducted which would enhance competition and efficiency.

In framing its recommendations, the Inquiry had to take account of the fact that the financial system has entered an era of accelerated change that is likely to continue into the next century. It identified a range of forces driving that change, including:

- First, changes in customer needs and profiles. For example, households are increasing both their financial asset holdings and their borrowings from the financial sector. Better access to information and weakening traditional supply relationships are raising consumer awareness of product and supplier value, thereby increasing the competitiveness of the market;
- The second main driver of change identified by the inquiry was technological innovation. As the Inquiry noted, technology has made it easier to access markets and products both domestically and internationally. It has made it possible to analyse and monitor risk more effectively, to disaggregate it on a broad scale, to price more accurately and to redistribute it more efficiently. The Inquiry predicted that the pace of technological change is likely to accelerate over the coming years; and
- The final important factor identified by the Inquiry as driving change was the regulatory framework itself. For example, as they noted, regulatory changes have resulted in the opening of the Australian economy to the global marketplace, including the financial system; it has resulted in the introduction of compulsory superannuation and the taxation system has major implications for investment choices and the international competitiveness of the Australian financial system.

These combination of forces driving change have led to, amongst other things:

- an increased business focus on efficiency and competition;
- the increasing globalisation of markets;
- innovation in product design and distribution channels which have also blurred the boundaries between financial instruments and institutions; and
- a shift in the balance from intermediaries to markets.

As to the vision for the future, the Committee noted that two views predominate on this. One view is that change will remain gradual and incremental. The other is that the financial system is undergoing a "paradigm shift" which "represents a sharp discontinuity from the trend experience of the past".

The Inquiry did not seek to resolve this debate. Rather it took the view that provided processes are genuinely competitive, the private sector is best placed to determine the future shape of the financial system.

This is a view which I endorse.

Having noted the background against which the Committee formed its recommendations, I would now like to move on to consider the recommendations it made for improving the competitiveness of the financial sector (that is, for ensuring that processes are genuinely competitive).

COMPETITION POLICY ISSUES AND THE FINANCIAL SERVICES SECTOR

The Commission submitted to Wallis that there were a very large number of important competition issues that needed to be considered and that these were probably more important than any questions concerning mergers, important though mergers are. These issues include:

- consolidation of the prudential system;
- review of foreign investment;
- lifting restrictions on bank shareholding;
- removal of the "Six Pillars" policy;
- wider and non-discriminatory access to payments systems;
- review of laws that restrict competition;
- universal coverage of the Trade Practices Act;
- promotion of a "level playing field" for all industry participants;
- promotion of competitive neutrality; and
- adoption of consistent and flexible regulation.

The Commission emphasised the importance of all of these points to Wallis and they appear to have been largely adopted in the Report (not that the ACCC claims the credit). I will discuss several of these issues in further detail here.

Unified Prudential Supervision

The Wallis Committee has recommended that all prudential supervision of this sector be brought together under one body called the Australian Prudential Regulation Commission (APRC). The APRC would be separate from the Reserve Bank of Australia which would concentrate on monetary policy and the payments system.

The Commission does not claim expertise on questions concerning the optimum form of prudential supervision of the financial services sector. However, in its submission, the Commission stressed that, other things being equal, the Committee should adopt the most pro-competitive option because of its perception of a link between prudential supervision and the state of competition in the sector.

Without passing judgement on whether the current prudential system is working well or not, in its investigations of bank mergers, the Commission has found that banks have benefited from customers' impressions that banks are generally more secure than non-banks. This has arguably acted as a competitive barrier to non-bank financial intermediaries, regarded by consumers as inferior deposit takers to the banks in this security respect.

The unifying of arrangements for prudential supervision of financial institutions bringing credit unions, building societies, and other non-bank financial intermediaries (insurance companies and superannuation funds) under the same prudential regime as banks, will have a pro-competitive impact on the market. Banks should not continue to gain from any inappropriate perception of extra financial security they have enjoyed to date which has arguably given them an unfair advantage in taking deposits. It should enhance competitive neutrality, removing this unwarranted advantage and improve contestability in the provision of deposit services to increase the scope for competition.

There are advantages to a unified prudential system in relation to the financial services sector. Having a separate differing set of regulatory arrangements operated by different agencies (eg RBA, ASC, AFIC etc) may distort competition by conferring unjustified advantages on some parts of the system at the expense of others. There should be, as far as possible, a level playing field or, in Hilmer terms, competitive neutrality. That is, Government policy should not, other things being equal, confer competitive advantages on some players in the system compared to others.

Foreign Investment

The Commission supported the removal of the blanket prohibition on foreign ownership of the big four banks which was recommended in the Wallis Report and endorsed by the Government. In its submission to the Wallis Inquiry, the Commission also recommended that the Foreign Acquisition and Takeovers Act 1975 should not apply to financial services providers. The Wallis Inquiry did not fully endorse the ACCC's position on this, opting instead for the continued application of the Act. The Government endorsed the Inquiry's recommendation stating that any proposed foreign takeover or acquisition will be assessed on a case by case basis on its merits in accordance with the Act. The ACCC supports this proposal because it allows some increase in foreign ownership of aspects of the Australian financial system.

Whilst the Government and Wallis Committee were prepared to relax the restrictions on foreign ownership, the Government has expressed the view (shared by Wallis) that any large scale transfer of Australian ownership of the financial system to foreign hands would be contrary to the national interest.

The Commission views this development as a significant development which will enhance competition and benefit consumers as a whole. The ACCC agrees with the Inquiry's observation that foreign investment can bring with it a range of benefits for Australia, including injections of capital, access to new skills and technologies, and enhanced competitive pressure in the banking market.

Bank Shareholding Restrictions

The ACCC submitted to Wallis that the shareholding restrictions contained in the Banks (Shareholding) Act be removed. The Banks (Shareholding) Act contains the following bank shareholding restrictions:

- limit of 10 per cent shareholding in a bank – section 10(1);
- except for the CBA, banks are limited to shareholdings of 5 per cent in other banks – section 10A
- shareholdings between 10 per cent and 15 per cent only with the Treasurer's approval – section 10(2) – may be refused in the national interest – section 10(2A); and
- the Governor-General may, if it is in the national interest, permit shareholdings exceeding 15 per cent – section 10(4).

Wallis recommended that the general principle of a widespread ownership of regulated financial entities should be retained. Further, existing legislation and rules should be streamlined through the introduction of a single Acquisitions Act with a common 15% shareholding limit. The Report provided, however, that exemptions may be granted as follows:

- The Australian Prudential Regulation Commission should have the power to approve, subject to prudential requirements, an exemption allowing a licence holder to acquire more than 15% of a licensed institution.
- Any other person may acquire more than 15% of a licensed institution only if the Treasurer approves the acquisition in the national interest.

Liberalisation of Access to the Payments Clearing System

The Wallis Report basically recommended that access to the payments clearing streams should be liberalised and made subject to rules which are transparent and, where appropriate, approved by the ACCC, thereby facilitating wider participation in the payments system.

The easing of access restrictions to the payments clearing and settlement systems will increase contestability in the core of the payments system (services such as ATMs, EFTPOS, home banking, banking through Australia Post, etc) and pave the way for greater competition and efficiency in the provision of deposit and credit services. In the future, there will be a need for close supervision and management of these systems, and the ACCC will be active in these areas to ensure that market power is not abused, particularly in relation to access pricing issues.

The Commission does not consider that the ability of an organisation to participate in the payments system should depend upon its institutional status, but rather upon its prudential soundness. Thus, non-financial institutions should be able to participate in Australia's payments system, providing such organisations meet appropriate prudential standards and are subject to adequate prudential supervision. Such an outcome would enhance competition in the provision of payment services without putting the stability of the payments system at risk.

The ACCC has already had considerable involvement in various clearing systems via the authorisation of APCA's memorandum and articles of association and the regulations and procedures for the paper and bulk electronic clearing systems. The Commission is currently in the process of examining the regulations and procedures for the consumer electronic system (relating to ATMs and EFTPOS) under authorisation. This topic potentially raises very important competition issues.

The ACCC will play an important role in developing access to payments systems through its examination of new authorisations and review of previous ones. The actual implementation and interpretation of the rules and procedure will be by APCA.

The Wallis Report recommendations which directly affect the ACCC are:

- interchange arrangements should be reviewed by the Payments System Board (PSB) and the ACCC;
- the ACCC should monitor the rules of international credit card associations;
- the Australian Payments Clearing Association (APCA) should continue to be the co-regulatory body responsible for the operation and technical efficiency of the various clearing streams. However, membership of the APCA should be open to any organisation approved as a payment service provider by the PSB; and
- payments clearing arrangement should remain subject to the provisions of the TPA. The rules of any industry organisation operating a clearing system should be made subject to approval by the ACCC. If any part of the industry were to develop a monopoly in processing financial transactions, the question of third-party access to the electronic network should be considered under the access provisions of the TPA.

Other Pro-Competitive Recommendations

In addition to the issues outlined already, the Wallis Inquiry made a number of other recommendations to promote competition among financial service providers, including:

- more flexible application of licensing rules to corporate groups with non-financial activities;
- allowing mutually-owned companies to operate as, or own, banks;

- encouraging the exercise of greater choice by members of superannuation funds;
- allowing non-operating holding company structures for financial groups;
- facilitating more competition between securities and futures exchanges; and
- creating more equal competition between trading in financial derivatives over the counter and on exchanges.

If all of these changes are implemented they will have an impact on the state of competition in the sector. These changes will be factored into the Commission's decision at the time any issues regarding competition in the sector arise.

WALLIS CONSIDERATION OF MERGERS

The ACCC is pleased to note that the Wallis Committee endorsed section 50 of the Trade Practices Act to continue to apply to the financial services sector and that the ACCC should continue to administer those competition laws.

Further, the ACCC notes the Government's decision that mergers among the four major banks will not currently be permitted. This position is to be reviewed when the Government is satisfied that competition from new, and established, financial industry participants – particularly in small business lending – has increased sufficiently.

The Wallis Inquiry did not comment on specific merger scenarios. Rather, it recommended that mergers in the banking sector be subject only to prudential requirements and ACCC assessment of the implications for competition. The Treasurer has announced that he will retain the power to reject mergers under relevant banking and insurance laws. In exercising these powers, the Treasurer will take into account, but not be limited by, assessments by the ACCC under section 50 of the Trade Practices Act in relation to competition considerations, and the advice of the relevant prudential regulators on prudential considerations.

Mergers Between the Majors – "Six Pillars"

The ACCC is pleased with the Government's decision to remove the "Six Pillars" Policy, which had prevented mergers between the major banks and life offices. The Wallis Report notes that both competition and prudential reasons justify this change in policy and emphasises that rather than having a blanket ban on mergers amongst these institutions, the ACCC should assess the competition implications of any such merger proposal in accordance with the merits of the proposal at the time it is made.

The ACCC also notes the Government's decision to prevent mergers between the four major banks until the government is satisfied that there is improved competition from new and established financial industry participants, particularly with regard to small business lending.

The Treasurer stated the importance of preventing mergers between the big four for the moment was to prevent a situation where conceivably four banks would go down to two in a short period of time, before it had put in place measures which would allow new deposit taking institutions to form, new foreign entrants to come into the market, and to facilitate the enhanced competition that the Government believes is necessary.

The prohibition on the four major trading banks only relates to mergers. Other commercial arrangements or agreements between the big four, including joint ventures, are subject to the application of Trade Practices Law.

The Treasurer has said that in exercising the reserve power to reject mergers under relevant banking and insurance laws, he will take into account the assessment of the ACCC on competition effects.

Mergers Involving Life Insurance and Superannuation Companies

Any mergers between life insurance and superannuation companies would be looked at carefully by the ACCC.

In relation to mergers which might take place between banks and other financial institutions, particularly insurance and superannuation companies, the ACCC may have fewer concerns, but would still view each case very carefully.

In the past, the Commission did not oppose the Colonial Mutual Life acquisition of State Bank of NSW in January 1995. Market enquires 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. Nor did the ACCC oppose the amalgamation of Metway Bank, Suncorp Insurance and Finance, and Queensland Industry Development Corporation (QIDC).

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, and was subsequently prevented by the introduction of the so called "Six Pillars" Policy.

As already noted, the ACCC supports the Government's decision to abolish the "Six Pillars" Policy. The Commission considers that these mergers can be properly dealt with under the merger provisions of the Trade Practices Act.

In light of the abolition of the six-pillars policy, the ACCC will apply the same merger inquiry 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. However, 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 and would be determined by the climate of the industry at the time of the proposal.

Mergers Between the Major Banks

As stated previously, the Government has placed a ban on mergers between the four major banks until it is satisfied that there is improved competition from new and established financial industry participants. As such, any discussion of mergers between the major banks remains purely academic until the Government is satisfied that competition has improved sufficiently to allow such a merger to occur. The Commission has not formed any views on this issue in the past, nor will it do so until any cases come before it in the context of a lifting, or possible lifting, of the prohibition on mergers between the "big four".

Mergers Between Majors and Regionals

The ACCC's preliminary view of the Wallis Report is that the views contained therein about regional banks are not very different from those of the Commission.

In this regard it is worth noting that the Commission formed its views about regional banks in September 1995 when it was making a decision about the Westpac acquisition of the Challenge Bank in Western Australia. The then TPC was careful to stress that the views that it held were views held "at that time", a point it does not usually stress in merger decisions. The Commission emphasised the temporal character of its decision in recognition of the changing structure of the financial services market and further recognised that it may be necessary to re-evaluate the situation should regional mergers occur at a later point in time. It has not, however, had to do any such exercise until the latest Westpac bid for the Bank of Melbourne.

Wallis acknowledges that there is a regional market and that regional banks are important, thus upholding the basic Commission view. However, Wallis recognises that the market is changing, and points out that some parts of the banking market which might once have been thought of as

regional are by now national. The Report further identifies that this perspective on regional banks in general might well change in future and that their position is not immutable.

I note that there has been a variety of interpretations placed on this element of the Wallis Report. Some commentators have bluntly said that the report has unfavourable implications for the Westpac/Bank of Melbourne merger proposal, whilst others claim that it clears the way for the merger to proceed. The fact is that there is a degree of comfort and a degree of discomfort for both views in the Wallis Report. The ACCC itself has not made up its mind on this matter and will not be in a position to do so for some weeks whilst it is conducting extensive market enquiries and other research and analysis, in accordance with its July 1996 Revised Merger Guidelines, while having regard to the Wallis Report.

The ACCC is considering the Westpac/Bank of Melbourne matter in the context of section 50 of the TPA, as distinct from the authorisation provisions which would require the Commission to take formal consideration of public benefit arguments. Section 50, on the other hand, is purely based on whether the merger, will result, or is likely to result in a substantial lessening of competition.

The comments of the Wallis Report on the geographic dimension of banking markets, technological trends and changes to consumer behaviour should not be interpreted in any way to imply a given outcome for the Westpac and Bank of Melbourne case. Speculation and interpretations based on this information on the outcome of such issues are ill-advised, since, at this point the ACCC is yet to assess the myriad of factors and issues relevant to this matter.

BANK MERGERS

Over the years the Commission has dealt with relatively few bank mergers. Recent mergers considered by the Commission include the Commonwealth Bank's acquisition of the State Bank of Victoria in 1991 (under the dominance test), CML/State Bank of NSW in January 1995, Advance Bank/Bank of South Australia 1995, Bank of Scotland/BankWest, September 1995, and recently St George/Advance Bank. However, the most recent significant bank merger examination was in September 1995 when the then TPC conducted a comprehensive evaluation of Westpac's acquisition of Challenge Bank in Western Australia.

As you will all be aware, the recently proposed merger between Westpac and the Bank of Melbourne is currently being considered by the Commission. This merger raises a range of interesting issues and provides the ACCC with an opportunity to re-examine the market definition it employed and reassess competition issues with regard to the Westpac/Challenge merger in 1995. I will say very little else on this matter today, except to re-emphasise that the Commission assesses each merger on a case-by-case basis and that implications for the assessment of this particular merger should not be drawn from the findings of the Wallis Report.

As background to the Commission's position on bank mergers and how they are assessed, I think it will be useful if I firstly consider how things were handled during the Commission's consideration of Westpac/Challenge in September 1995. I will then discuss the Inquiry's comments on market definition issues.

Westpac/Challenge

Following extensive market inquiries, the proposed acquisition was found not to be in breach of section 50 of the Trade Practices Act which prohibits mergers or acquisitions which would have the effect, or likely effect, of substantially lessening competition in a substantial market for goods or services. The ACCC's submission to the Wallis Inquiry provided a detailed review of the reasons behind the Commission's decision in that matter.

The Commission's decision in Westpac/Challenge generated considerable interest and debate, particularly in relation to the way in which the banking market was defined.

Retail Product Market

The Commission took the approach in Westpac/Challenge that there was a cluster of banking-type functions (deposits, loans, transactions), and participants were limited to those offering the full range of products and services identified in the cluster.

As to the broader question of whether there is a retail banking market or a wider financial services market, whilst taking due account of the changing role of these institutions for certain parts of its analysis, the Commission did not accept that retail banking services were part of a wider financial services market. Banks have certain distinctive features, such as providing retail transaction accounts, which separate them from other financial service providers.

Retail Geographic Market

Despite arguments posed that the market should be defined as national, the Commission considered in Westpac/Challenge that the relevant geographic area of the market was regional for both retail and small business banking.

It was considered that retail customers were unlikely to seek out potential suppliers of banking services interstate in response to a moderate price increase. Similarly, potential interstate suppliers of such services were considered to be unlikely to respond to a moderate price increase in another state.

Small Business Banking

While not given as much attention as retail banking in the Westpac/Challenge matter, the Commission recognised that it was likely that a separate market existed for small business customers who have several special banking needs not generally exhibited at the retail level. These additional requirements may include, for example, after hours cash deposits, lines of credit and overdraft facilities.

The ACCC concurs with the comments made by Wallis in relation to small business customers in that regional branch structures are likely to be more important as small business customers tend to establish closer business relationships with their bank in order to meet both their own and the bank's needs. Based on the strength of these ties and the need for a local branch presence, there is an argument in favour of a regional market definition for small business banking.

In considering market definition, however, the Commission has held the view that the concept of a market is dynamic and that market definition may change depending on the particular matter under investigation and over time. This is particularly relevant to the banking industry, which has seen considerable change and development over recent years, and this process is likely to continue, if not accelerate, in the foreseeable future.

Wallis and Market Definition

The Wallis Inquiry found, consistent with the ACCC's submissions, that it was not possible to define markets or assess mergers in the abstract. That is, these tasks can only be performed in the context of a specific merger proposal. The Inquiry did not look at all of the factors which must be considered when defining a market or assessing a merger in practice, since this requires intensive fact based market investigation which can only be properly undertaken in the context of a specific merger assessment.

The Report comments on trends occurring with the financial system which are of relevance to the process of assessing mergers.

The Report also contains a review of the Commission's approach to questions of market definition. The Report essentially upholds the correctness of the core views that the Commission

took in September 1995 when it considered the Westpac/Challenge merger. In particular, it accepts that the regional definition of markets was correct and that regional banks play an important role in stimulating competition. However, the Report does emphasise changes which are occurring in the market.

The Inquiry's broad observations on both the demand and supply side characteristics of the retail banking segment led it to the findings that:

- the cluster of services methodology used by the ACCC in the Westpac/Challenge merger should be closely questioned and at least narrowed;
- while the market for some retail banking products is moving from being regional to national, the pace of that movement varies depending on the product. The market for a limited number of products, such as housing loans and credit cards, may be already national. The market for some other retail and SME products may be national in the future, but they do not appear to have yet reached that point; and
- on the issue of efficiencies and mergers, the report notes that the evidence about efficiencies and mergers is at best inconclusive – although clearly there are large savings available from well managed mergers. It notes that, in practice, the issue will only arise in the context of an authorisation procedure and that it would be up to the organisation claiming the efficiency benefits to make its case to the ACCC.

The ACCC believes that the Wallis Inquiry's views on these matters and those of the ACCC are not much different. To the extent that there are differences, these are likely to be largely a result of the difference in timing of the two evaluations. Had the Commission needed to conduct its own research at this time, it is likely that the Commission would have reached similar conclusions to the Wallis Inquiry.

While I have no wish to discuss all of the Inquiry's finding on market definition in detail, a few brief comments may be useful.

Clusters

In relation to product clustering, the Wallis Report relied on evidence provided by Roy Morgan Research to suggest that, although consumers continue to bundle some of their financial products, a large percentage of consumer banking-type products are not bundled. Further, evidence suggests that consumers are unbundling their banking products where sufficient price incentives exist.

On the supply side, for traditional banks to compete with new players, such as mortgage originators, they must encourage customers to bundle through relationship banking, or where this cannot be achieved, they must unbundle their pricing, as is starting to occur. The Report also produced evidence that institutions continue to bundle some, though not all, products, although some institutions bundle more than others.

Wallis suggests that the products likely to be the focus of future bank merger assessments are transaction accounts and small business products, especially small business finance. This was reasoned as being due to the limited number of effective substitute suppliers to the banks for these products at this time.

Intuitively, the findings of the Wallis Inquiry appear to indicate that the degree of bundling by both banks and bank customers has declined since Westpac/Challenge. The ACCC is conscious of these changes and will consider them in the context of any specific merger considerations. In particular, mortgage originators have had a pro-competitive impact on the home loan market, making the sector more competitive, giving customers greater price incentives to switch between suppliers for their range of banking requirements.

It is not clear that adopting the Wallis Committee's views at their strongest – that cluster analysis should be dropped – would have affected any major ACCC decisions that have been made thus far. Nor would the future adoption of a new form of analysis based on product by product market evaluation seem likely to lead to major changes in outcomes.

Regional versus National

In regard to a regional banking market definition, Wallis made the following comments:

- new delivery mechanisms on the supply side make traditional branches less important and a national marketplace more feasible if the problems associated with price and brand awareness can be overcome;

- on the demand side, consumers do not yet choose to utilise these new delivery mechanisms to their full potential – for at least some financial products, consumers do not look beyond suppliers with a physical local presence when selecting their provider. As an example of customer inertia to use new, and some not so new, delivery mechanisms, Wallis provided survey evidence stating that around 45% of consumers have never used EFTPOS facilities, around 35% have never used an ATM and over 80% have never used telephone banking;

- Wallis recognised that one of the most important factors for making the market national will be reducing the transaction costs involved in switching accounts especially by improving access to affordable and comparable national pricing information; and

- Wallis recognised that the market will become national for some products before others.

The Commission recognises that there are numerous new and exciting developments in the delivery of banking products to consumers through new technologies.

There has been an increase 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 ATMs. Credit unions are also engaged in a program to offer services to rural and remote area residents where a 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 plans to allow banks, building societies, credit unions and life offices to offer Retirement Savings Accounts.

The Commission is also aware of the prospect for significant changes to customer behaviour which may result from the introduction of new technologies. However, it remains to be seen whether these new and expanded distribution channels are to be considered as complements to, rather than substitutes for, traditional branch banking. Bank branches are currently undergoing considerable change in terms of their location, size and function. It is anticipated that the role of the branch will continue to evolve from being primarily transaction processing centres to relationship developers and sales outlets.

The Commission will be looking to find any credible evidence of a significant uptake of new technologies or of major changes to customer behaviour that would lead us to accept that such new technologies are significantly impacting on the way that Australian retail customers do their grocery shopping or pay their electricity bill, for example. The ACCC recognises that customer use of new technologies will increase, but this seems to be an evolutionary rather than a revolutionary process.

The Wallis Inquiry's extensive evaluation of the banking industry will provide the Commission with some valuable insights into how the banking industry has changed and evolved since its consideration of Westpac/Challenge in 1995, such as the emergence of new players like the mortgage originators.

As already mentioned, the ACCC has not had the need to revisit the banking industry since the merger of Westpac and Challenge Bank in 1995, and the Commission is re-examining the definition of the banking market in light of the recent changes in the industry and will closely assess the findings put forward in the Report.

Moreover, a key issue is quite simply that the precise impact of these technological and consumer behaviour changes can only be judged by the ACCC for specific merger scenarios at the time that they occur, as recognised by the Wallis Report.

In addition to the issues raised by Wallis, the Commission will be looking closely at a number of other issues in its consideration of future bank mergers, including:

- product clusters;
- regional and national market boundaries;
- access to payments systems as a barrier to entry;
- access to ATM and EFTPOS networks;
- the effect of new technologies on how banking is conducted;
- evolution of branches, phone banking and other electronic distribution networks;
- economies of scale and scope as a barrier to entry;
- the dynamic characteristics of the banking industry; and
- the level and importance of any efficiency and cost saving claims made by the parties.

CONSUMER PROTECTION

Before moving on to discuss the Inquiry's actual recommendations in the consumer protection area I would like to say a few quick words about the tasks involved in providing consumer protection for the users of financial services.

Those tasks are much, much broader than the functions undertaken by the ACCC. They involve laws which provide positive disclosure regimes; they involve licensing regimes; they involve detailed rules on selling and marketing practices; they involve fastidious checking of documentation by regulators and many more functions. The role played by the ACCC to date in enforcing economy-wide consumer protection laws in respect of the financial sector is but one small, yet vital, part of this complex picture. Up until now, these separate roles have been divided amongst a number of different State and Federal regulators depending upon the institution offering the product and the conduct in question.

The situation is confusing and inefficient for both business and consumers. The Inquiry, rightly in my view, decided that in order both to improve the level of protection provided to consumers and to improve the level of competitive neutrality operating in the system, this regulatory mishmash needs to be rationalised.

As most of the functions needed to be performed by any new financial sector consumer protection body were not functions traditionally performed by the ACCC, and could have meant a significant refocus of the type of work undertaken by the Commission, the ACCC did not vie for the job of being the new regulator. Instead, we hope to work co-operatively with any new regulator to emerge from the Inquiry so that our many years of experience in providing protection to consumers of financial services continue to make a valuable contribution to the overall level of protection provided.

The Commission's preliminary reaction to the consumer protection arrangements in the Wallis Report is that it is encouraged that many of its recommendations were adopted, that the Trade Practices Act still applies across the economy, and that the principles in that Act have been endorsed as the most appropriate way for ensuring that consumers' interests are held paramount.

However, the Commission has some concerns to ensure that consumer protection is maintained at the current level and that consumers are given proper support and adequate protection under the new regulatory arrangements.

General Consumer Protection Recommendations

The underlying principles of the Wallis Report deserve praise, and many of the Report's goals and recommendations were in line with the ACCC's submissions. Many of them will serve to enhance the rights of consumers and ensure that they are protected against unscrupulous behaviour by those who provide financial advice and financial services. In particular, the Report recognises that we are part of a dynamic market place and that market driven regulation should be paramount.

Within the broader goal of establishing a consistent and comprehensive regulatory structure, the Report embraces several suggestions and recommendations on consumer protection made by the ACCC. The ACCC supports the Report's recommendations on:

- the need to employ a broad range of regulatory approaches for effective consumer protection in the sector, including codes of conduct;
- the important role of industry codes of conduct as a means of providing protection to consumers, and the importance of co-regulatory approaches to administering codes of conduct;
- the importance of consistent and comparable disclosure requirements to enable easy comparison between products by consumers and to promote competitive neutrality between different types of institutions;
- the establishment of a uniform set of requirements for the licensing of financial sales advice and dealing, which will make it easier for consumers to recognise that financial advice is being provided by reputable and accountable providers;
- the establishment of a central gateway for (external) dispute resolution schemes, and a broadening of their coverage to include small business cases; and
- the need for international co-operation between regulators in the context of financial services and products becoming available through electronic and global markets.

The Report thus recognises the emergence of global markets and addresses the new problems that may arise for consumers of financial services in this context (as discussed below).

Linkage of Competition and Consumer Protection Issues

A feature of the Wallis Report and a potential difficulty confronting its effective implementation is the assumption that consumer protection and competition issues are able to be separated. The ACCC has often stressed the point that consumer protection is an integral part of competition and competition is an equally important part of consumer protection.

Ironically, the Wallis Report is permeated by the sensible philosophy that competition is vital for enhancing consumer welfare. However, in an administrative sense, the Report then separated the two issues. The ACCC has often found that many cases involving potential breaches of Part V of the Trade Practices Act also involve other parts of the Act. For example, it is quite

common that anti-competitive agreements also involve elements of misleading and deceptive conduct.

It can also be the case that third-line forcing cases, for example, can not be easily classified into competition or consumer protection only behaviour. In either situation, splitting competition elements of the TPA from consumer protection elements is very difficult in a practical enforcement context. It is therefore vital that enforcement agencies, particularly those involved in the financial services sector, have this flexibility and scope in the legislation they administer.

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. It also means that a key piece of legislation governing the commercial activities of business (the TPA) can be administered in a consistent and coherent way across the entire economy.

Unfortunately, examples of capture have been a reasonable 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. If parts of the TPA 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.

Corporations and Financial Services Commission

The Inquiry recommended the establishment of the Corporations and Financial Services Commission (CFSC), a single market conduct and disclosure regulator for the financial sector. It further recommended that the current consumer protection provisions of the TPA be duplicated in the legislation to be administered by this new body, and that the CFSC should administer these provisions in the financial services sector.

The new body would seek to establish a consistent and comprehensive disclosure regime for the whole financial system, albeit one with flexibility to apply different rules, in response to different situations. The new regulator would also have responsibility for the regulation of investment advice and sales of retail financial products, including the licensing of financial advisers under a single regime. It would oversee industry based schemes for complaints handling and dispute resolution, and establish a common point of access for consumers.

I can see the need for the new CFSC, and indeed, many of the principles underlying its creation were based on the ACCC's main submission to the Inquiry. We submitted that it is important to get rid of the "ad-hoc" basis of the existing legislative web of regulation so as to ensure that there is competitive neutrality between different types of institutions offering the same or similar products. The ACCC's view is that equivalent regulatory treatment should apply to functionally equivalent products and services. Finally, the ACCC realised that there was a need for a straightforward and simple regulation system that could be easily accessed by all consumers.

However, in this package, the Report's recommendations relating to the consumer protection regulation of financial services do give the Commission some concern. As noted above, the Report suggests that the CFSC will have legislation that mirrors the Trade Practices Act and the two organisations will develop an operating agreement to determine how we operate in conjunction with each other. The ACCC is encouraged by the Inquiry's recommendations to maintain the economy-wide application of the consumer protection provisions of the TPA. However, the ACCC would be concerned if its jurisdiction over Part V of the TPA is withdrawn in regard to the financial services sector or if it ceases to have any consumer protection role in financial services.

The roles of the two organisations obviously still need to be sorted out, but if the ACCC were to be shut out of consumer protection in financial services entirely, the new body may not, at least

initially, be able to maintain the level of support to consumers that they presently enjoy. The ACCC's extensive experience and independent role has delivered a substantial amount of benefit to consumers of financial services through significant enforcement actions, market studies and reforms to improve the operation of markets. The AMP 50 million dollar settlement that compensated almost 300,000 policy holders is just one example of this.

Consumer groups have recognised this track record and are understandably concerned that a regulator with a good record of independence and effective enforcement action should have a reduced role in the financial services sector. The important thing from the ACCC's viewpoint is that we are keen to ensure that consumers of financial services continue to have the same high level of protection and that there are continued good outcomes for them.

The ACCC currently shares jurisdiction with many other regulators, including Austel, State consumer affairs agencies and the ASC. There has never been a problem, nor an overlap of functions between these groups. All jurisdictional problems have been resolved with sensible agreements. In any case, our reading of the Report does not necessarily exclude the ACCC, and indeed on page 248, the Report states that the recommendations "... would not require the ACCC's jurisdiction over these areas to be formally withdrawn. Indeed, maintaining its jurisdiction would remove any risk of a regulatory gap emerging."

In this context of a new consumer protection regulator being created, it is important to note that an effective consumer protection regulator will need to have:

- the right people with the right training and mix of skills;
- a clear integration and alignment of purpose between the operational, middle management and senior levels of the organisation;
- the appropriate procedures/mechanisms for prioritising, managing and following-up enforcement activity;
- the legal experience, knowledge, evidentiary procedures, and wherewithal to pursue and win litigation;
- a record of success and integrity in enforcement activity; and
- a recognised and respected profile amongst industry and consumers.

These conditions can take some time to evolve. To the extent that they may not be present for some time, they represent a significant transitional cost that may be borne by consumers. This cost would be significantly compounded where a successful enforcement agency was removed from a sector while a new sector-specific regulator was being established to undertake some or all of the existing agency's functions. The risks involved in such a strategy, and the potential transition costs for consumers and society, can be significant.

Given that there is no need for such a transitional cost to occur since it is possible for the ACCC to continue to perform its existing role while the CFSC develops its skills in this area, it seems logical to ensure that transition arrangements are put in place which ensure no deterioration in the level of protection provided to consumers.

The ACCC would propose that the operating agreement between the CFSC and the ACCC for the first five years provide for concurrent jurisdiction in this area whilst still providing guidance as to which agency should take action in which instance. A range of co-operative mechanisms should be pursued including joint investigation and litigation teams so that the ACCC's experience and skills in undertaking Part V type consumer protection actions can be shared with the new organisation. Indeed, a specialised task force could be set up with staff from both agencies. The exact details of the co-operative arrangements should be left to the two agencies to develop and refine as things progress. At the expiry of, say, five years, it would appear

appropriate to renegotiate the co-operative arrangement so that the CFSC more clearly played the lead role and the ACCC took more of a backseat role.

The Government will undoubtedly give very careful consideration to these matters. The Commission is confident that suitable, practical and effective arrangements can be put in place to enable both the CFSC and ACCC to work together so that consumers are well protected, industry does not face undue regulatory burdens and taxpayers' funds are deployed in the most cost-effective way.

Furthermore, the Report favours the current economy wide approach to framework regulation, as per the Hilmer reform process. There is no way that an exemption for the financial system from the economy-wide application of the Trade Practices Act could sit with this policy without having every other industry sector asking for similar exemptions.

To exempt just the financial system would be a regulatory anomaly that would confer special treatment on a single, although important, sector of the Australian economy, at a time when the regulatory trend has rightly been in the opposite direction. Economy-wide application of legislation like the TPA is the surest way to ensure consistency in application and the avoidance of "regulatory havens" in the Australian economy.

Globalisation

With the move towards globalisation and borderless markets, the ACCC is pleased that the Wallis Report recognised this trend in recommending that the new agency conduct work in this area. It is important to note, however, that the ACCC is also well placed to observe how new forms of electronic and borderless commerce will impact on market structures and upon the regulatory arrangements adopted to protect individual consumers.

The ACCC is currently pursuing enforcement action against international scammers that perpetrate fraud against Australian consumers through a process of international co-operation with other national enforcement agencies. Two recent examples of the ACCC's involvement in international enforcement activities are the Golden Sphere pyramid selling scheme and the Destiny Telecom telecard scheme.

More specifically, the Golden Sphere pyramid selling scheme was run by a Vanuatu company, for which the ACCC sought to restrain promoters and instituted a class action on behalf of participants who lost money in the scheme. The Destiny Telecom telecard scheme operated out of California, for which the ACCC obtained an injunction to prevent the promotion of the scheme, the signing up of new participants, and the use of credit card details that have already been provided.

As with many new frontiers, the pursuit of global electronic commerce has run ahead of legal and enforcement solutions, attracting "bandit" and "cowboy" elements which have created a genuine concern for consumers. It is here that the new CFSC will need to focus much of its future enforcement work and seek the expertise and experience of other national regulators like the ACCC.

Still further, given the trend towards globalisation and borderless markets, it makes sense to the Commission that there should also be a general migration of State-based finance regulation to the Commonwealth over time – in much the same way as other sectors of the Australian economy have been "Hilmerised".

The Wallis Report clearly recognised the need to avoid duplication by the CFSC and the ACCC. However, the Report did not tackle as vigorously the potential duplication by the State and Territory regulatory bodies. The current situation would not only have the CFSC enforcing its legislation but also the State and Territory bodies enforcing their consumer credit and fair trading legislation in relation to the financial services sector.

Due Diligence Defences

The ACCC noted in its Wallis submission that, 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 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.

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.

However, the Commission believes that it is wrong in principle that where mistakes in prospectuses result in losses to investors, investors rather than prospectus issuers should bear those losses, and does not agree that the "due diligence" exemption should be extended to the TPA.

Also, the Commission believes that section 52, with a strict liability basis, is the more economically efficient law. It establishes a more efficient distribution of risks in financial markets and reduces the likelihood of principal-agent and adverse selection problems arising in financial markets, as outlined below:

- *Distribution of risks*

  One of the key conditions for perfectly competitive markets is fully informed buyers and sellers. In financial markets, where one of the parties to a transaction is less well informed about the characteristics of the product than the other, market efficiency can be distorted in that the less well informed party can bear a higher risk in the transaction without a commensurate increase in returns.

  The Commission is of the opinion that strict liability, such as that contained in section 52, encourages suppliers of financial services to ensure that information supplied to consumers is accurate, thereby enabling the consumer to make a well informed and efficient choice regarding their portfolio of financial assets.

- *Principal – agent problems*

  Allowing a due diligence defence where misleading or deceptive conduct occurs would also create the potential for considerable principal-agent problems which will increase the inherent riskiness of financial markets and lower their efficiency.

  The Commission is of the view that, if a due diligence regime governs the way in which financial services are provided, suppliers will be reasonably entitled to reply on information supplied by a third party. It may also lead to situations where less than fully accurate or adequate information is collusively supplied to providers of financial services by third parties with a view to deceiving consumers about the underlying nature of the product. In this case, both parties can fall back on a "best endeavours" defence leaving the customer to bear the risks associated with inaccurate or inadequate information.

  In short, the removal of strict liability rules will lower the risks (and costs) associated with various forms of misleading and deceptive conduct in the financial services sector.

- *Adverse selection in financial markets*

  Following on from the above point, the Commission is concerned that, with a reduction in the risks, and therefore expected costs, associated with providing inaccurate information to purchasers of financial products, less careful suppliers of financial services and products can be expected to enter the industry. At present, the existence of section 52 with a full liability application discourages suppliers who are unable or unwilling to ensure the accuracy of information supplied to customers.

Those who make prospectuses and give financial advice are in the best position to check all information and ensure that it is correct. Therefore, it is both economically inappropriate and unfair to make consumers and investors bear the loss for the mistakes of others. Those in the best position to control the mistake should be responsible. The current proposal skews the market in favour of the larger bodies and contradicts normal consumer protection principles, thus shuffling the interests of consumers closer to the bottom of the deck.

However, to the extent that the Inquiry identified a need to allow a due diligence defence for certain prescribed documents, for reasons of promoting certainty and reducing costs for fundraising, its recommendation leaves scope for compromise. While not agreeing that such a defence should apply in these circumstances, the Commission is extremely concerned to see that it is strictly limited to cases where the information being provided is clearly prescribed through other means. To this end, the ACCC believes that the recommendation offers scope for innovative and practical solutions to be developed, such that the potential damage to consumers and investors is minimised.

CONCLUSION

As mentioned previously, the ACCC is not in a position to discuss the merger of Westpac and the Bank of Melbourne until extensive market enquires are made. Naturally, the Commission will be taking into account any relevant changes in the banking industry which have occurred since the Commission last comprehensively investigated the industry during the Westpac/Challenge merger in 1995.

We are facing exciting times in the development of the banking industry. The Commission anticipates the implementation of recommendations made by the Wallis Committee to promote diversity and competition in the banking industry while maintaining system stability. These pro-competitive changes should provide positive outcomes for economic efficiency and for consumers of financial services.