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Strategic alliances: some regulatory issues

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Abstract

Strategic alliances between financial institutions and other parties will raise special regulatory issues. This paper briefly discusses the issues related to:

- sharing information with the alliance partner
- payment systems regulation
- CLERP6 considerations

1 Strategic alliances

Strategic alliances provide the opportunity for organisations to combine strengths in two different markets. The desirable outcome of the alliance is to capitalise on synergies, but to achieve this outcome it is necessary to give careful consideration to the legal as well as the commercial problems. If this is not done, then the alliance risks exacerbating the deficiencies of the individual alliance partners.

Certain legal issues are common to all alliances. Competition issues, customer ownership, intellectual property problems, application of industry codes, and secret commissions are but a sampling of legal and commercial issues that should be resolved between the parties at the earliest opportunity.

There are also special legal issues when one or more of the alliance partners is a financial institution. This paper considers three issues that commonly arise in this situation. These are not the only issues to be considered. In particular, the impact of the Consumer Credit Code will often be substantial.

2 Information sharing

Alliance partners need to share information, and usually they must share information about their customers. When one of the partners is a financial institution, the information shared is almost certain to include financial information and, probably, other personal information.

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There are at least three regulatory regimes that might impact on sharing personal information:

- the bankers' duty of confidentiality;[1]
- Part IIIA of the Privacy Act 1988 (the credit reporting provisions); and
- the private sector privacy regime, due to commence on 21 December, 2001.

The most important point to make is that each of these regulatory regimes is independent of the others. More precisely: an exception (permitting disclosure) in one regime does not justify disclosure under another. So, for example, the "self-interest" disclosure exception in the Tournier duty will not justify a prohibited disclosure under either Part IIIA or the private sector regime.

Non-bank financial institutions should also note that the Tournier duty probably applies to them. There is no direct authority for this, but reading the Tournier case shows that there was no special importance given to the fact that the defendant was a "bank". The deciding factor was the nature of the relationship between the parties, and the considerations which gave rise to the duty of confidentiality apply to most, if not all, financial institutions. For a fuller discussion of this, see Tyree [1].

The Federal Privacy Commissioner released Draft National Privacy Principle Guidelines on 7 May. Submissions on the Draft will be received until 6 July, but it is not expected that there will be any change in the basic thrust of the Guidelines.

The Guidelines are, of course, not binding. However, they provide detailed insight into the way that the Commissioner is likely to interpret the National Privacy Principles. As such, they cannot simply be ignored.

One of the most significant features of the Draft Guidelines is the treatment of "consent". Consent plays an interesting role in the NPPs. It is not justification for collecting information,[2] although it may be used to justify the collection of sensitive information.[3] On the other hand, any use or disclosure of personal information, including sensitive information, may be justified by consent.[4]

The only reasonable time to obtain consent for the use and disclosure of personal information is when collecting it. Unfortunately, most organisations do not have a clearly formulated view of the uses and disclosures that they may wish to make of information. This has led to a frenzy of drafting activity by lawyers in search of the perfect consent clause. Something like "I hearby consent to any use or disclosure of my personal information that XYZCorp may someday possibly wish."

If you have been trying to draft the perfect consent clause, you should probably undertake some other activity. If you are paying someone else to do it, you should probably stop the cheque. The Commissioner's Guidelines on consent are tough. In particular:

[1] The so-called Tournier duty: Tournier v National Provincial and Union Bank of England [1924] 1 KB 461.

[2] The only justification for collection is "necessity": NPP 1.

[3] NPP 10.1(a), but only if the collection is also "necessary".

[4] NPP 2.1(b).

- consent must be informed and specific – broad, vaguely worded clauses will not be acceptable
- consent must be voluntary – it may not be voluntary if the customer is denied services if they refuse to consent
- "opt-out" consents will be valid only in the most limited of circumstances
- consent may be withdrawn at any time - it is not possible to obtain an irrevocable consent.[5]

If these Guidelines remain substantially unchanged, which I predict, then "consent" is going to be a much more difficult concept to manipulate than most of us thought. The basic thrust of the Guidelines is that "consent" must be genuine, specific and informed. Speaking as an individual, this seems to me to be a good thing. Speaking as a consultant, it is welcome as part of the Government's admirable policy of full employment.

3 Payment regulation

Loyalty schemes are often a feature of strategic alliances where one of the parties is a financial institution. A poorly structured loyalty scheme may fall within the Payment Systems (Regulation) Act 1998.[6] The problem sometimes can be difficult because of the confused definitions in the Act.

Consider even a very simple loyalty scheme that allows customers to collect "points" which may be redeemed for cash or goods at a wide range of participating merchants. Can the scheme be a "purchase payment facility"? The definition in the Payment Systems (Regulation) Act 1998 is:

> (1) A "purchased payment facility" is a facility (other than cash) in relation to which the following conditions are satisfied:
> (a) the facility is purchased by a person from another person; and
> (b) the facility is able to be used as a means of making payments up to the amount that, from time to time, is available for use under the conditions applying to the facility; and
> (c) those payments are to be made by the provider of the facility or by a person acting under an arrangement with the provider (rather than by the user of the facility).

It may be that the facility is not "purchased", but that is far from obvious. It is also obvious that the legislation was scarcely meant to catch simple loyalty schemes, but the definitions are so confused and general that their interpretation is unpredictable. If the scheme is a purchased payment facility, then the "holder of stored value" (HSV) must be an ADI.[7]

[5] Withdrawal may be a breach of contract. On the other hand, it might be argued that any attempt to make consent irrevocable might be unconscionable.

[6] A loyalty scheme may also fall within the various state trading stamp legislation.

[7] The "holder of stored value is the person referred to in (c) above. The fact that this person need not necessarily hold any value is just one of the peculiarities of the Act. See Tyree [3].

To make matters worse, the Banking Amendment Regulations 2000 (No 1) (gazetted on 15June 2000) introduced a new aspect to the definition of "banking business". Under the new regulation, the *provision* of a PPF is "banking business" for certain types of PPFs. There is no indication of what it means to "provide a PPF", but it is obvious that the "provider" need not be the HSV. For example, Company X issues a stored value card, making arrangements with Company Y to make the payments. Company Y is the HSV who must either be an ADI or must obtain an exemption from the RBA. Presumably Company X is the "provider" who, if the new Regulation applies, is carrying on "banking business". The result is confusing and does not meet the objectives claimed in the press release. See Tyree [4] for a more complete discussion.

Notice that my simple loyalty scheme permitted the customer to withdraw cash. Is the facility an "account" for the purposes of the Financial Transactions Reports Act 1988? AUSTRAC has recently received an opinion from the Australian Government Solicitor on the application of the FTRA to cash management trusts. Using the reasoning of that opinion, it would be easy to find that the loyalty scheme is an "account". The results would be commercially disastrous. For more discussion on these issues, see Tyree [5] and [2].

4 CLERP6 issues

There may be licensing implications in a strategic alliance where one of the parties is a financial institution. The Financial Services Reform Bill 2001 ("CLERP6") purports to introduce a uniform licensing scheme to regulate financial service providers. While we can assume that the financial institution is the holder of an Australian financial services licence, it is likely that the other partner is not. This can introduce unforeseen complications.

For example, the definition of "financial product" in CLERP6 includes any facility for making "non-cash payments". Some loyalty schemes, either by design or by accident, may be facilities for offering "non-cash" payments.

Similarly, if the non-financial partner of the alliance will be facilitating the distribution of financial product, it may be necessary to consider if the partner requires an Australian financial services licence. This requirement would make the alliance substantially less attractive for the non-financial institutional partner.

The problem arises in an acute form where the strategic alliance is between a retailer and a financial institution. The intention is that the retailer should assist in the marketing or provision of the financial institution's products.

Section 911B provides circumstances where it is possible for one person to provide financial services on behalf of another. The most important is where the "agent" is an "authorised representative". The original draft of the Bill contained a severe restriction on the arrangement: an employee of an authorised representative was not included in the list of those who could provide financial services on behalf of the principal. The effect of this was, for example, that every employee of the retailer would need to be an authorised representative.

This was clearly unworkable for the retailer/financial institution alliance of the type we are considering. The current draft of the Bill contains some limited exceptions. In effect, employees may provide the services if the service is the provision of:

- a basic deposit product or
- a non-cash payment facility related to a basic deposit product.

A "basic deposit product" is defined in a long and rambling paragraph in s761A. Of most importance:

> (b) any return to be generated for the depositor on the amount from time to time standing to the credit of the facility is an amount that is set out in, or that is calculated by reference to a rate or rates that are set out in, the governing terms;

This does not describe most current deposit products.

5 Conclusion

Strategic alliances between a financial institution and another partner will raise regulatory questions beyond those faced by other strategic alliances. Most, but not all, of these problems may be overcome by careful design.

References

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[3] Alan L Tyree. Regulating the payment system - part 4 - purchased payment facilities. *JBFLP*, 10(4):305–307, 1999.

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[5] Alan L Tyree. Cmts, ftra, etc, etc. *JBFLP*, 12(1), Mar 2001.