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Appendix A

Regulatory Impediments *to* Introduction of Shared Banking Facilities in Rural and Regional Australia

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BY EMAIL

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Dear David

REGULATORY IMPEDIMENTS TO INTRODUCTION OF SHARED BANKING FACILITIES IN RURAL AND REGIONAL AUSTRALIA

The Parliamentary Joint Committee on Corporations and Financial Services (**Committee**) is currently conducting an inquiry into the level of banking and financial services in rural, regional and remote areas of Australia. The Committee's terms of reference provide that one of the issues the Committee will focus on will be:

> *"options for making additional banking services available to rural and regional communities, including the potential for shared banking facilities".*

You have requested that we provide an advice as to whether there are any potential regulatory impediments to the establishment of shared banking facilities.

In summary, we consider that the per se provisions of the *Trade Practices Act* 1974 (**TPA**), as administered by the Australian Competition and Consumer Commission (**Commission**), and the obligations imposed on licensees by the *Financial Services Reform Act* 2001 (**FSRA**) are likely to pose significant regulatory impediments to the commercial arrangements by which banking facilities may be shared.

Shared banking facilities would attract a high level of scrutiny by the Commission. Although it is possible to apply for authorisation of the commercial arrangements to address the risk that the Commission may allege a contravention of the TPA, the process involves lengthy time delays and its outcomes are highly uncertain.

The establishment of shared banking facilities would also result in uncertainty in the application of obligations imposed by the FSRA on Australian financial services licence holders or, at best, an onerous and costly compliance burden. These difficulties may not be overcome by amendments to licence conditions.

We examine the regulatory impediments imposed by the TPA and the FSRA in turn below.

1. APPLICATION OF TRADE PRACTICES ACT 1974 TO SHARED BANKING FACILITIES

1.1 Risks associated with application of the Trade Practices Act 1974

If any proposal for the sharing of banking facilities were planned or implemented by banks, it would be essential to give consideration to whether the prohibitions on restrictive trade practices under the *Trade Practices Act 1974* (**TPA**) would apply to the commercial arrangements.

1.2 Relevant sections of the Trade Practices Act 1974

The provisions of the TPA which apply to commercial arrangements between competitors include, most importantly:

- *collective boycotts* or *market sharing* under section 45. This section prohibits the making or giving effect to a contract, arrangement or understanding containing an exclusionary provision. Under section 4D, an exclusionary provision must be between competitors and have the purpose of preventing, restricting or limiting the supply or acquisition of goods or services to or from particular persons or classes of persons or on particular conditions;

- *price fixing* under section 45A. This section deems a provision of a contract, arrangement or understanding to substantially lessen competition if it has the purpose, effect or likely

effect of fixing, controlling or maintaining price (or a discount, etc) in relation to the supply or acquisition of goods or services by competitors.

Each of these provisions is a per se offence which does not require proof that the conduct concerned had the purpose or effect of substantially lessening competition to establish a contravention.

1.3 Potential for enforcement action in respect of sharing of banking facilities

The sharing of banking facilities could encompass, for example, arrangements involving:

- the sharing of physical infrastructure, eg: branch premises and information technology;
- the sharing of employees and joint provision of customer services;
- the appointment by one bank of another bank to act as its agent or representative; or
- the appointment of an authorised representative to represent more than one bank in the provision of customer services.

In some circumstances, these arrangements may provide an opportunity for information regarding prices, costs, products or services (including proposals for products or services) to be shared. In addition, some arrangements may require banks to agree on the costs each will incur in the sharing of banking facilities.

Whilst any such arrangements will not necessarily contravene the prohibitions on restrictive trade practices under the TPA, including the per se offences under sections 45 and 45A, it is highly likely that the arrangements would attract close scrutiny by the Commission.

Our view is supported by the Commission's investigations into the operation of the Visa, MasterCard and Bankcard credit card schemes in Australia and the BPAY scheme, an outsourced payments collection service.

In August 2000, following its investigation of credit card schemes, the Commission commenced proceedings in which it alleged that the members of these schemes in Australia (including 4 of the ABA's member banks) made an arrangement or arrived at an understanding which contained a provision to the effect that they would each charge merchants a specific interchange fee, when acting in their capacity as an issuer in a domestic credit card transaction. Further, they alleged that the members gave effect to this arrangement or understanding in each transaction. Although the defendant disputed the Commission's allegation that the arrangements contravened the

prohibition on price-fixing, the issues raised by the Commission's interpretation of the prohibition were not resolved as the Commission discontinued the proceedings. Further, the Commission has publicly expressed its view that the joint venture defence in section 45A(2) does not apply to the conduct in question.[1]

The Commission has also issued notices under section 155 to some of the ABA's member banks in which it alleges that it has reason to believe that aspects of BPAY may contravene the prohibition on price-fixing under the TPA. Specifically, the allegations relate to the setting of the Capture Reimbursement Fee, which we understand is used to reimburse members of the scheme for certain costs they incur in capturing a bill payment from payer customers.

These investigations indicate that the Commission has closely scrutinised arrangements by which banks jointly participate in arrangements to provide a service to customers, alleging that the setting of wholesale fees, which are necessary to facilitate a transaction involving the customers of different banks, involves price-fixing conduct. As a consequence of the Commission's view of the application of this prohibition, we consider that there is a real risk that arrangements which involve the sharing of banking facilities will also attract the Commission's scrutiny.

1.4 Management of risk of potential enforcement action in respect of shared banking facilities

Where there is a risk that a provision of a contract, arrangement or understanding might give rise to a breach of section 45 of the TPA, section 88 of the TPA provides that a corporation can apply for and the Commission may grant an authorisation to ensure the corporation does not breach the TPA during the period in which the authorisation remains in force. The Commission may grant an authorisation under section 90(6) of the TPA if it is satisfied that any lessening of competition arising from the provision would be outweighed by its benefit to the public.

There are, however, a number of aspects of the authorisation process that apply when parties seek authorisation which undermines their ability to use the process efficiently. In summary, these aspects include:

- the absence of any time period within which non-merger applications must be approved;
- the process of review by the Australian Competition Tribunal, which adds significantly to the delay and uncertainty of the review process;
- the potential for exposure of commercial information relating to the parties to authorisation to other interested parties, including competitors.

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[1] George Lekakis, *Australian Financial Review*, 8 December 2000.

These disadvantages of the process are discussed in detail in several submissions to the Trade Practices Act Review Committee.[2]

Two examples illustrate the difficulties with the process:

- On 6 September 1996, the Australian Payments Clearing Association (**APCA**) lodged two applications for authorisation in respect of its proposed Regulations and Procedures for the Consumer Electronic Clearing System (**CECS**) and a further application on 22 May 1997. Some 12 months later, on 20 August 1997, the Commission issued a draft determination proposing to deny authorisation to APCA. On 16 December 1998 and 7 July 1999, APCA lodged amendments to its Regulations and Procedures and requested that the Commission finalise its consideration of the applications for authorisation. The Commission's final determination, in which it granted conditional authorisation to APCA, was granted on 16 August 2000, over 4 years after the initial application. The authorisation only applies until 7 September 2003.

- The rules established by Newsagency Councils in New South Wales, ACT, Victoria and Queensland which maintain a system of distribution for the publications of each of the publisher members in a defined and exclusive territory operated under a series of authorisations granted between 1980 and 1985, following applications initially made in January 1975. In the early 1990s, the Newsagency Council of Victoria lodged an application which was intended to replace its 1982 application. On 30 July 1993, the Trade Practices Commission granted authorisations of the system authorised in 1982, with some modifications. Following a challenge by 7-Eleven Stores Pty Ltd and others, this authorisation was set aside by the Tribunal in its decision dated 11 November 1994, leaving the 1982 application in place.[3] The Trade Practices Commission then commenced a review of the authorisations in June 1995 and resolved to revoke the authorisations, granting substitute authorisations until 1 February 2001. This decision was again the subject of a challenge by 7-Eleven Stores Pty Ltd and others, which resulted in the Tribunal revoking the substitute authorisations and granting further authorisations for a shorter period.[4]

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2 See Submissions to the Trade Practices Act Review Committee by the Business Law Committee of the Law Council of Australia, pp. 66-78; Australian Bankers' Association Submission to the Review of the Trade Practices Act (Dawson Review), pp. 13-15; Business Council of Australia, *Towards Prosperity, Submission to the Dawson Review of the Trade Practices Act 1974 and its Administration*, pp. 13, 72-77.

3 *Re 7-Eleven Stores Pt Ltd, Australian Association of Convenience Stores Incorporated and the Queensland Newsagents Federation* (1994) ATPR 41-357.

4 *Re 7-Eleven Stores Pt Ltd, Independent Newsagents Association, Australasian Association of Convenience Stores* (1998) ATPR 41-666.

These examples illustrate the difficulties that arise from the delays caused by the absence of any time limitation on the Commission's consideration of non-merger applications and the uncertainties involved in the process of review by the Australian Competition Tribunal.

2. RISKS ASSOCIATED WITH APPLICATION OF THE FINANCIAL SERVICES REFORM ACT 2001

If any proposal for the sharing of banking facilities were planned or implemented by banks, it would be necessary to ensure that the commercial arrangements were structured to allow the banks to comply with their obligations as holders of Australian financial services licences.

2.1 A person who carriers on financial services business must hold a licence

A person who carries on a 'financial services business' in Australia must hold an Australian financial services licence.[5] A financial services business encompasses a wide range of activities, many of which could be conducted by shared banking facilities, including:

- providing financial product advice;
- dealing in a financial product; or
- providing a custodial or depository service (for a financial product or an interest in a financial product).[6]

A 'financial product' also has a broad definition as a facility through which a person:

- makes a financial investment;
- manages a financial risk; and/or
- makes non-cash payments (ie: any payment made in a form other than by physical delivery of notes or coins).[7]

Examples of financial products include: deposit accounts (including savings accounts, term deposits and cash management accounts),[8] retirement savings accounts,[9] cash management

5 FSRA, section 911A.
6 FSRA, section 766A.
7 FSRA, section 763A, 763D.
8 FSRA, section 764A(1)(j).
9 FSRA, section 764A(1)(h).

trusts[10] and consumer credit insurance.[11] Each of these are products used by retail and small business customers throughout Australia.

2.2 Financial services licensee may appoint an authorised representative

One of the ways in which licensees could share facilities is by each appointing a person as its authorised representative for the purpose of providing financial services on behalf of the licensee.[12] A person becomes an authorised representative of a licensee by means of a written notice from the licensee authorising that person to provide a specified financial service or financial services on the licensee's behalf, being services covered by the licensee's licence. One person can be an authorised representative for two or more financial services licensees if each licensee consents to the person being the authorised representative of each of the other licensees.[13]

However, where a representative represents more than one licensee in respect of a particular class of financial service, the licensees would be jointly and severally liable for the representative's conduct within the authority of those licensees in relation to that class of service.[14] The prospect of joint and several liability for the licensees who appoint a single authorised representative is likely to operate as a significant disincentive to establishing commercial arrangements of this kind. For example, a representative's conduct may relate to the issue or transfer of a financial product of one of two licensees only. If the conduct does not result in the issue or transfer of the product to the customer, and is within the scope of the authority granted by both licensees, both licensees are jointly and severally liable for the conduct.

2.3 Principle obligations in relation to the provision of financial products

A second regulatory obstacle arises from the need for licensees to ensure compliance with obligations imposed by the FSRA. While multiple licensees may appoint a single representative to provide financial services on their behalf, each licensee must ensure that the representative complies with the obligations under its respective licence. The licensee, not the representative, has ultimate responsibility for all services provided under the licence.[15]

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10 FSRA, section 763B.
11 FSRA, section 764A(1)(d).
12 FSRA, section 916A(1).
13 FSRA, section 916C(1).
14 FSRA, section 917C(4).
15 ASIC Policy Statement 164 at paragraph 26; *Corporations Act*, section 796B.

Some examples of the obligations with which each licensee must ensure that its authorised representative complies, and the difficulties of ensuring compliance where a single authorised representative is appointed by more than one licensee, are as follows:

- Each licensee has a separate obligation to "take reasonable steps to ensure that its representatives comply with the financial services laws". ASIC has interpreted "take reasonable steps" to mean that the licensee must monitor and supervise the activities of representatives to ensure they are complying with the law. As this obligation is not qualified in any way (other than by reference to the relevant class of service covered by the licence) it is arguable that each licensee must implement monitoring and supervisory procedures in relation to their authorised representative's compliance with financial services laws, even where the representative provides a financial service on behalf of another licensee;

- Each licensee must ensure that its authorised representatives are adequately trained, and are competent to provide those financial services. This obligation ensures that each licensee must separately train and test its representatives. In a situation where there are multiple authorities for one representative, this gives rise to a high training burden and possible inconsistencies between instructions;

- Each licensee must ensure that its authorised representatives comply with disclosure obligations in relation to retail clients. These include giving clients a financial services guide before they are provided with a financial service, giving clients a statement of advice when they receive personal advice and giving clients a product disclosure statement before they decide to buy a product. The burden of compliance with this obligation would also be onerous where an authorised representative acts for a number of different licensees.

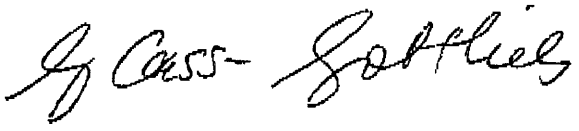
2.4 Uncertainty re compliance with FSR obligations where banking facilities shared

The establishment of shared banking facilities would create uncertainty for Australian financial services licence holders in relation to compliance with the above obligations imposed by the FSRA and an onerous and costly compliance burden.

Under section 992B of the FSRA, ASIC has the power to vary or revoke the conditions of a licence. However, since the obligations referred to above derive from statute, rather than the licence, ASIC may not amend the licence conditions to address the difficulties described above. As such, it would be necessary to legislate to create exemptions or more practical obligations with which banks may comply to facilitate the sharing of banking facilities by licensees.

Please contact any of us if you have any questions in relation to this advice.

Yours sincerely



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