choice

Submission to Senate Economics Committee

on

Competition within the Australian banking sector

November 2010

CHOICE is a not-for-profit, non-government, non-party-political organisation established in 1959. CHOICE works to improve the lives of consumers by taking on the issues that matter to them. We arm consumers with the information to make confident choices and campaign for change when markets or regulation fails consumers.

CHOICE exists to unlock the power of consumers. Our vision is for Australians to be the most savvy and active consumers in the world.

As a social enterprise we do this by providing clear information, advice and support on consumer goods and services; by taking action with consumers against bad practice wherever it may exist; and by fearlessly speaking out to promote consumers' interests - ensuring the consumer voice is hear clearly, loudly and cogently in corporations and in governments.

To find out more about CHOICE's campaign work visit www.choice.com.au/campaigns and subscribe to CHOICE Campaigns Update at www.choice.com.au/ccu.

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1. Introduction

CHOICE believes that consumers in Australia are getting a raw deal from the banks – and we think that is often because of a lack of competition and customer focus. The future health of the banking industry in Australia depends on a renewed focus on its customers.

Banking in Australia matters to Australian consumers, and the policy environment within the industry is allowed to operate is critically important, because banking is a special sector in a number of ways:

- Banks are more inter-related than firms in other industries;
- Consumers suffer from information asymmetries, and are not well placed to judge the quality and price of products;
- Some retail banking products are essential 'utility' services;
- Banks receive wide ranging financial support from the Government.

While the economic and social importance of a strong banking system is clear, customers on the ground are not happy. CHOICE consumer surveys show high levels of dissatisfaction as they struggle with the symptoms of a lack of effective competition and information asymmetry. Poor customer service, high fees and charges, negligible returns from savings, and barriers to switching leave most customers feeling locked into a bad deal.

The Government has put in place welcome reforms, for example the National Consumer Credit Protection Act (including the National Credit Code), and we warmly welcome the proposed new rules for credit cards, mortgage exit fees and financial advice providers. But there is a long way to go before consumers will believe they get a fair deal that would engender a renewal of trust and confidence in the banks.

At present, CHOICE is engaging with consumers across Australia, using a variety of different communication channels, with the aim of enabling the consumer voice to be heard more clearly in the political debate on banking reform. We will submit a summary of these consumer views as supplementary material to this inquiry before the Committee reaches its conclusions.

2. Responses to terms of reference

Current level of competition in retail banking

The OECD, in its definition of competition, states that 'competition is viewed as an important process by which firms are forced to become efficient and offer greater choice of products and services at lower prices. It gives rise to increased consumer welfare and allocative efficiency. It includes the concept of "dynamic efficiency" by which firms engage in innovation and foster technological change and progress'.[1]

The financial services market is becoming more dynamic in some respects, most notably recently in the development of a wider range of products and services without hidden fees and charges from some providers. But CHOICE believes that in a number of important ways there is clear evidence of a lack of competition in retail banking in Australia:

- Consumers are typically not engaged and able to compare the quality or performance of different financial products and firms;
- There remains widespread dissatisfaction with poor customer service;
- Prices and the quality and characteristics of banking products are typically not transparent and easily comparable;
- Products continue to include excessive fees, hidden charges or unfair contract terms;
- There are significant barriers to market entry and growth;
- There are significant barriers to consumer switching;
- There is reduced access to essential banking services, particularly in remote communities;
- Banks exploit consumer inertia rather than genuinely competing on the basis of the quality and value of their products or services;
- Consumers are frequently unable to pursue effective and speedy redress where necessary.

Fees and charges payable on banking products

As noted above, unfair fees and charges are a symptom of an uncompetitive market in Australia. CHOICE has welcomed the Government's recent moves against excessive mortgage exit fees and unfair credit card terms. But it is notable that consumers have been driven to taking collective legal action to recover unfair fees.

Penalties are a big part of the problem; bank dishonour, default and overdrawn transaction account fees amounted to $490 million in 2008. CHOICE led the charge against those penalties, with many CHOICE members joining the class action against the major banks.

[1] http://stats.oecd.org/glossary/detail.asp?ID=3163

Under pressure from consumers, the Big Four banks have responded with fee reductions. NAB went furthest, recently removing account penalties altogether.

Australian consumers can now choose an account with no monthly fee, no fees for certain 'everyday' transactions and no penalty fees. Of the major banks, ANZ and Commonwealth have yet to introduce an account with an avoidable monthly fee for standard customers (though like most banks, they offer low-cost basic accounts for pensioners and other low income groups and in some cases as part of home loan packages).

ANZ's Access Select account charges $2 per month in return for six 'free' electronic transactions; Access Advantage has a $5 monthly fee, with unlimited withdrawals from the bank's own ATMs, phone and internet banking, branch, cheque and EFTPOS access. CBA's standard transaction accounts have $4 and $6 monthly fees.

Some accounts have specific conditions to waive the monthly fee - commonly, to make a regular monthly deposit of at least $2000. Some institutions go further, charging nothing for certain 'everyday' transactions. Holders of such accounts can make an unlimited number of the following transaction types, without paying any fee: ATM transactions at the bank's own network; BPAY; branch cash deposits and withdrawals; cheque facility; direct credits and debits; EFTPOS; and 'pay anyone' internet transactions.

Even with the best accounts, not all services are free and interest usually is not paid – extra savings are often best directed elsewhere. A major expense is using 'foreign' ATMs – those belonging to another bank or network. Approximately 40 per cent of withdrawals are from such machines, and these $2 transactions add up to about $640 million per year. Also, all accounts charge fees to use your debit card for cash withdrawals and purchases when overseas.

However, statistics released by the Reserve Bank[2] show that major banks have also recouped the income they lost after cutting transaction account penalty fees, such as overdrawn account fees and direct debit dishonours, with new penalty fee revenue from credit cards and personal loans. Household income from penalties, known in the industry as 'exception fees', has been maintained at approximately $1 billion per year.

According to the RBA, 'there was a shift in household exception fee income away from deposit accounts towards loans… exception fees on credit cards continue to make up the largest share of exception fees paid by households, growing by 10 per cent over the past year. Exception fees on personal loans also grew significantly'.

Overall, bank fee income (including penalties) from households increased by 3 per cent to $5 billion in the year to 30 June 2009. Table 2, below, shows this was due to housing loan fee income increasing by 17 per cent, which was much higher than the average annual growth of 7 per cent recorded between 2003 and 2008, and broadly in line with growth in housing

[2] RBA, Banking Fees in Australia, *Bulletin*, June Quarter 2010.

lending. According to the RBA, the increase in housing fee income was “driven by establishment and early exit fees, with the available information suggesting that break fees on fixed-rate loans accounted for a significant proportion of the overall growth in fees... fee income from personal loans grew by 14 per cent, which is attributable to both an increase in account-servicing fees and an increase in exception fees”.

The RBA figures relate to the year ended 30 June 2009. Since then, some positive changes have been made, including penalty fee reductions on transaction accounts as a result of our sustained fair fees campaign and new ASIC guidance on mortgage exit fees which appears to have prompted some providers to scrap a range of fees related to home loans. These improvements are likely to be reflected in statistics for 2010 when released next year. But the fact remains that there has in recent years been a shift of consumer focus to personal loans and credit cards, where penalty fee income has offset any reductions in transaction account fees.

Table 1: Penalty fee income from households (source: RBA)

	2008	**2009**	**Annual growth**
Deposit accounts	516	476	-8%
- transaction	503	465	-8%
- other deposits	13	11	-13%
Loans	493	536	9%
- housing	45	42	-6%
- personal	21	24	13%
- credit cards	427	470	10%
Total	1,009	1,012	0.3%

Table 2: Banks' fee income from households $mil. (source: RBA)

	2007	2008	2009	Growth 2009	Average growth '03-08
Housing loans	997	1057	1235	17%	7%
Personal loans	445	485	552	14%	11%
Credit cards	1,199	1,332	1,434	8%	17%
Deposits	1,797	1,918	1,713	-11%	6%
Other fees	87	107	97	-9%	9%
Total	4,525	4,890	5,032	3%	9%

CHOICE recommends that the Government and regulators stamp out disproportionate banking charges across the board – as the UK government is doing – through a voluntary agreement with the banks where possible, through guidance and if necessary by introducing further regulation so that all fees and charges are based on reasonable costs incurred by the provider.

ASIC has indicated in its Consultation Paper 135 (*Mortgage early exit fees: Unconscionable fees and unfair contract terms*) that it would consider issuing a regulatory guide on unfair fees generally. ASIC recently issued Regulatory Guide 220 on mortgage exit fees. **CHOICE submits that the Committee recommend that ASIC develop a regulatory guide as a matter of priority.**

How competition impacts on unfair terms that may be included in contracts

Competition alone often does not guarantee the elimination of unfair contract terms because they are routinely not adequately disclosed and therefore not considered by consumers at the time of making purchase or service decisions.

CHOICE has campaigned for many years for unfair contracts terms legislation to be introduced on a national basis and we are delighted that this reform commenced on 1 July 2010 as an element of the Australian Consumer Law and in corresponding provisions of the *Australian Securities and Investments Commission Act 2001* (ASIC Act). While the application of the new regime will provide significant benefits for consumers, it is not a complete solution. In particular:

- the regime only applies to consumer contracts (that is where the supply is wholly or predominantly for personal, domestic or household use);

- there remains some ambiguity in applying the regime as to when a term will be considered "unfair", particularly when applying the second limb of the unfairness test, i.e. whether it is "reasonably necessary in order to protect the legitimate interests" of the bank;

- similarly there will be some doubt about whether particular terms are part of the "upfront price" (and therefore not covered by the regime) in the context of a banking service

- the regime does not prohibit particular unfair terms until such time as a court has determined the term is unfair.

The issue which is likely to cause the most difficulty for both consumers and the industry is the level at which terms should be considered unfair. In CHOICE's submission, the obvious and fair rule would be that all fees should be based on the banks cost of providing the service to which the fee relates or the loss that is incurred as a result of a default. This not only provides a fair outcome for consumers and banks, it is likely to enhance competition because it will make it more difficult for institutions to offer artificially attractive interest rates which are supplemented by fee income. It is also consistent with the approach under common law penalty doctrine and the some existing rules on fees (eg sections 32 and 78 of the National Consumer Credit Code).

The likely drivers of future change and innovation in the banking and non-banking sectors

CHOICE believes that the key drivers are likely to be:

- enhanced consumer mobility, achieved through easy switching and simpler comparisons of products

- action to address technical and institutional barriers to new entrants and the growth of existing institutions – a level playing field – for example in relation to access to the payments system

- greater transparency in the banking sector – for example in relation to funding costs, the pricing of products and services, and regular, published scrutiny by the ACCC of competitive forces within the market.

- developments in technology.

We address some of these points in more detail below.

The ease of moving between providers of banking services

A high level of consumer inertia in the transaction account market means that market forces cannot be relied upon to constrain anti-competitive outcomes. Customers in the sector have historically displayed a high level of inertia. In the early 1990s the then Governor of the Reserve Bank observed that:

> Competition in the real world, however, seldom works in the manner described in the textbooks. There it is assumed that customers will actively play their part, and be prepared to shop around and switch their business if necessary… But in practice many borrowers are reluctant to shop around for a number of reasons, including inertia and the convenience of current 'packaged' services (comprising housing loan, cheque account, credit cards and so on), reluctance to try non-traditional sources of funds, and the actual or perceived costs of switching some or all transactions from one bank to another. To the extent that customers do not shop around for individual products, however, the competitive pressure on banks is reduced.[3]

This remains true, and the rate of transaction account switching in Australia remains low. A survey recently commissioned by CHOICE found that:

- 78.5 per cent have not even thought about switching in the last two years;
- 11.8 per cent have thought about switching and not done so;
- 7.6 per cent of people surveyed have switched bank accounts;
- The most common major reason people choose not to switch is because it takes too much effort to sort out all the paperwork (50.4 per cent);
- Not having enough time to research the best deal (48.4 per cent) and not believing they will be better off anyway (44.1 per cent) were also major reasons for not switching.
- Older people – 50 years+ - are least likely to switch (3.4 per cent).[4]

There are higher rates of switching in the UK: the Office of Fair Trading reports[5] that the annual rate of switching in the personal current account market was 9.2 per cent in 2009 compared to around six per cent in 2006, that around 12 per cent of consumers in 2010 had switched cash ISA (a tax exempt savings product) provider in the last year and 24 per cent of residential mortgage customers switching provider in 2010. However, the UK Consumers Association, Which?, reports that switching rates have slowed since the GFC as a result of the belief among consumers that the largest providers will not be allowed to fail by the government and are therefore safer – and that therefore an unintended consequence of the UK government's approach to the 'too big to fail' issue discussed below, and the publicity given to it, is a reduction in consumer mobility.

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[3] Fraser, B. 1994, 'Some current issues in Banking' in RBA Bulletin AGPS Sydney June pp9-17 (emphasis added). See also Citi Australia and Australia Institute, *Evidence versus Emotion: How do we really make financial decisions*, December 2010 (available at http://www.citi.com.au/citigroup/pdf/Citi_Fin_Report_full_document.pdf)

[4] Newspoll survey for CHOICE (1,203 people surveyed nationally; 29-31 October 2010, by telephone)

[5] Office of Fair Trading, Review of barriers to entry, expansion and exit in retail banking, November 2010

In Australia in 2008, the Government announced a high-level agreement with the banks to simplify account switching. A key part of the reform package was designed to overcome the fact that increasing use of direct debit and direct credit arrangements has made switching financial institutions both more complex and riskier for the consumer.

After years of arguing that simpler processes were needed, CHOICE was pleased to see action finally taken on this issue. However, the industry implementation of the package through the Australian Payments Clearing Association (APCA) has been hopeless. It provides consumers with no more than a list - on paper - of their current direct debit arrangements. It requires multiple physical trips to financial institutions and provides no guarantee that the notifications will be undertaken free of charge. The model uses an outdated approach in an industry which relies increasingly on the internet for everyday banking.

The Bulk Electronic Clearing System, which manages direct debit and credit arrangements, has structural limitations, but CHOICE believes it is possible to work within these limitations to facilitate simple redirection of authorised Direct Debit and Direct Credit payments.

Consumers expect to be able to go to their chosen new bank and authorise them to transfer all their direct payment arrangements to their new transaction account. Anything less will deter many consumers from acting, substantially reducing the ability of competition to deliver good consumer outcomes. The implementation strategy adopted by industry organisations does not go far enough to remove barriers to account switching.

To achieve a simple and effective account switching process, the system must:

- Require a single customer authorisation to the new Financial Institution, either physically or on-line.
- Upon customer authorisation, require the new Financial Institution to undertake the merchant notifications of new payment details at no cost to the customer.
- Protect the consumer from risk of penalties imposed by financial institutions or merchants caused by timing issues in the transfer process.
- Enable consumers to transfer their bank account numbers from their old Financial Institution to the new provider.

We recommend these measures now be made mandatory for all ADIs within a clear timeframe.

In addition, CHOICE **recommends that the regulators should be charged with ensuring that consumer comparisons between products becomes much easier**, for example by introducing compulsory, standardized, plain language information on charges and other fees, charging structure scenarios, and other potential tools such as a traffic light labelling system for all appropriate consumer finance products.

The impact of the large banks being considered 'too big to fail' on profitability and competition

Financial stability is clearly crucial for every consumer, and during the global financial crisis the Government worked hard to prevent the kind of banking meltdown many other countries experienced. But CHOICE believes that financial stability does not have to be pursued at the expense of competition or to the detriment of consumers.

We share concerns expressed in other countries that banks around the world may be returning to 'business as usual' with risky trading and continuing poor service for consumers. Poor regulation of consumer finance in other parts of the world can be costly both to Australia's economy and our consumers, for example where there is continuing irresponsible lending practice. We support internationally coordinated steps to change the culture of excessive risk-taking by banks, to ensure they hold sufficient capital and to see that bankers are incentivised to provide good customer service and long term value. We welcome the recent agreement by the G20 Summit in Seoul to carry out a programme of work on consumer financial protection, to report to the G20 Summit in 2011 in France; we hope Australia will take a lead in this work and ensure that it results in effective action to better coordinate consumer financial protection and renewed competition in banking worldwide.

In Australia the GFC reduced competition and will continue to alter the nature of markets for some time. If the bank mergers that took place during the GFC were being proposed during less challenging times it is unlikely they would have been approved[6], there would at least be non-bank competitors able to keep rates and fees in check in the lending markets. But in the prevailing environment, competition from smaller players cannot sufficiently constrain excessive market power.

Following the most recent mergers the market share of the four largest banks has reached critically high concentration levels in transaction, savings, wealth services and lending markets. In particular there is an extra competitive advantage provided by the taxpayer to the Big Four banks through the implicit government guarantee they enjoy, which enables them to access wholesale funds where otherwise this would be more difficult or more expensive.

CHOICE supports policy which acts to prevent the banking market being a duopoly or even monopoly. However, given the recent consolidation in the market, it may be time to consider revisiting the policy to extend its reach further. An extension of the policy could assure Australian consumers that their support of mid-tier banks will not simply lead to the bank becoming a takeover target from one of the Big Four.

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[6] Speaking in May 2009, the Chairman of the ACCC Graeme Samuel said "The advice that we had at the time from both APRA and the Reserve Bank, I think, gave us absolutely no choice. We had to approve that merger. … I'd have to say that if we were looking at any mergers involving one of the big four banks in Australia, we'd be looking at it very vigorously indeed..." (Lateline Business 26 May 2009, transcript available: http://www.abc.net.au/lateline/business/items/200905/s2580572.htm)

We note that the 2008 House of Representatives Inquiry into Competition in the Banking and Non-Banking Sectors raised concerns about the adequacy of current mechanisms to monitor the state of competition within the banking and non-banking sectors. The House Committee subsequently recommended reviewing the Trade Practices Act to provide the ACCC powers to investigate and address issues of concern in markets and regulated sectors. In our view, these powers already exist.

Our recommendation is that the ACCC carry out full market investigations of the banking sector, and to establish effective systems to monitor and address the state of competition and any other relevant aspects of retail banking markets in an annual survey of Australian banking competition.

Regulation that has the impact of restricting or hindering competition within the banking sector, particularly regulation imposed during the global financial crisis

CHOICE is aware that regulation will often have an adverse impact on competition. In most cases, however, that impact is part of a policy consideration that other benefits outweigh the impact on competition. In some instances, poorly designed or implemented legislation can have an adverse impact on competition and it is not a difficult task for industry lobby groups to present individual examples where that occurs. In situations where it can be established that the anticompetitive effect of regulation clearly creates a consumer detriment that outweighs the public benefit of the policy intent, that regulation should be reviewed.

Following the National Competition Policy reforms of the mid-1990s and the introduction of regulation review procedures by the Office of Best Practice Regulation, and the extensive testing that legislation is subjected to in the Regulation Impact Statements, CHOICE considers that, as a whole, regulation in the banking sector contributes far more to effective competition than it hinders.

Opportunities for, and obstacles to, the creation of new banking services and the entry of new banking service providers

Even under normal market conditions, there exist barriers to entry in the retail banking market. The structure of the Australian banking market is such that there are significant hurdles for new entrants. This includes:

- incumbents' branch network size;
- a payments system based on bilateral relations and with a high threshold for membership;
- obstacles to consumer switching which have not been alleviated by reforms instigated by the Treasurer in 2008.

In the UK, the Office of Fair Trading has investigated four aspects of personal and SME banking where there may be potential barriers to entry or expansion: regulatory requirements and processes; access to essential inputs, such as IT systems, payment schemes, information and finance needed to offer retail banking products; the ability of new entrants to attract customers and achieve scale, and issues around exiting the market.

We recommend that the ACCC similarly carries out an immediate review of barriers to new providers entering the banking market, and of barriers that prevent existing smaller providers from growing.

We also recommend that the Government finds practical ways to promote the role of mutuals, for example by extending and refocusing its wholesale funding guarantee for the mutual sector alone, so that it can access funds to enable their share of the market to grow in a sustainable way. There may also be a role for using Australia Post as a vehicle for better marketing and enabling access to more building society and credit union products than is the case at present.

Other policies, practice and strategies that may an enhance competition in banking, including legislative change

CHOICE frequently receives reports of very poor standards of complaints handling by banks. We believe the regulators need to act to drive up standards of complaints handling, ensuring quick and effective redress, including publication of complaints data by financial institution. The Government should also review the effectiveness of collective action, including the possible imposition of collective redress without court action.

We would also recommend the introduction of a super-complaint system, similar to that in the UK. This would enable designated consumer bodies to submit ‘super-complaints’ to the regulator where they consider that there is a feature in the financial services market, such as the structure of the market or the conduct of those operating in it, that appears to be significantly harming the interests of consumers.