Australian Payments
Clearing Association

PAYMENTS INDUSTRY CONSULTATION PAPER

ASPECTS OF ACCOUNT SWITCHING

SEPTEMBER 2007

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Contents

1 What this Paper is About

1. This is the first public consultation paper issued by the Australian Payments Clearing Association (APCA) on the issue of account switching.

2. The purpose of this paper is to seek the views of the community on issues relating to the processes involved with re-establishing direct credit and debit arrangements when changing accounts from one financial institution to another, and to identify if there is a need for the introduction of measures to facilitate or enhance the ability of customers to change direct debit and credit arrangements when switching accounts.

3. At this stage, APCA has not determined whether a need does exist for the introduction of measures to facilitate or enhance existing account switching processes.

4. APCA believes that a decision cannot be made without a clearer understanding of the benefits and costs that would be associated with any measures proposed in this consultation paper. The input received from this consultation process will assist APCA and its members in making a decision on whether to implement such measures and, if so, to determine appropriate design parameters.

2 The Consultation Process

5. APCA seeks responses to the following questions in relation to switching accounts where there are existing direct credit and/or debit arrangements (note that more details and relevant commentary on the questions can be found from Section 7 onwards).

   Q.1: To what extent do you believe direct credit and debit arrangements provide an impediment to account switching in Australia? Please provide as much evidence as you can to support your view.

   Q2: Are you aware of additional overseas experience that is relevant in the Australian context?

Q3: In your view, do financial institutions already offer adequate support for new customers to transfer or re-establish direct credit and debit arrangements from their old financial institution? Are there any services offered which are particularly useful?

Q4: Would a listing service of the kind described at section 9.1 assist in facilitating account switching? Do you think customers would be prepared to pay for such a service? If such a service was implemented, do you believe it is fairer for the cost to be absorbed by financial institutions (thereby in effect adding to the total costs borne by all customers, whether they switch accounts or not), or for those that make use of the service to bear the cost? Why?

Q5: Would a redirection service of the kind proposed at section 9.2 assist in account switching? Do you think customers would be prepared to pay for such a service? If such a service was implemented, do you believe it is fairer for the cost to be absorbed by financial institutions (thereby in effect adding to the total costs borne by all customers, whether they switch accounts or not), or for those that make use of the service to bear the cost? Why?

Q6: Would a central registry service of the kind proposed at section 9.2. assist in account switching? Do you think customers would be prepared to pay for such a service? If such a service were implemented, do you believe it is fairer for the cost to be absorbed by all financial institutions (thereby in effect adding to the total costs borne by all customers, whether they switch accounts or not), or for those that make use of the service to bear the cost? Why?

Q7: Do you think there are other steps that could be taken to make it easier to transfer or re-establish direct credit and debit arrangements for financial institution customers? Please provide as much detail as possible, including the features and benefits, how the solution would work, what the potential costs would be and how costs should be apportioned.

6. To ensure that the views of all interested stakeholders are considered, APCA invites interested parties to submit comments by 23 October 2007. All submissions will be treated as public documents unless you specifically request that we treat the whole or part of your submission confidential. Comments should be sent to:

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3 Background

7. In a meeting held last year with representatives of four financial institutions,[1] the Australian Treasurer, the Hon. Peter Costello raised concerns about the perceived impediments that may exist for customers wishing to switch their financial institution accounts to alternative service providers.

8. At the Treasurer's request, the Australian Bankers' Association (ABA), on behalf of the four financial institutions, subsequently produced a report entitled "Opening and Closing Bank Accounts - Direct and Indirect Costs" which concluded that while there were no structural or financial barriers for customers wishing to switch accounts, there were possible disincentives caused by the inconvenience of the process. This is essentially due to the perceived 'hassle' of changing accounts due to the number of steps that are necessary to be taken to switch custom from one financial institution to another.

9. As a potential means by which to reduce the time and effort involved in switching financial institution accounts, the report proposed the examination of an option to establish a central registry to facilitate the portability of direct credit and debit arrangements.

10. In August 2006, the Treasurer requested the ABA to incorporate the views and interests of other stakeholders such as building societies and credit unions, other financial institutions, small business and consumer organisations when examining the feasibility of establishing a central registry. Additionally, the Treasurer requested that alternative options also be considered to facilitate the portability of direct credit and debit arrangements.

11. In late 2006, APCA agreed to undertake this investigation, on the basis of APCA's experience and breadth of membership, specifically regarding its responsibility for the Bulk Electronic Clearing System, which is the primary mechanism for the processing of direct credit and debit transactions in Australia.

[1] Australia and New Zealand Banking Group Limited, Commonwealth Bank of Australia, National Australia Bank Limited and Westpac Banking Corporation

4 About APCA

12. APCA was established in 1992 as a mutual self-regulatory organisation for banks, building societies, credit unions and other payments organisations. APCA is the primary vehicle in Australia for payments industry collaboration, with a mandate to improve the safety, reliability, equity, convenience and efficiency of the Australian payments system.

13. APCA has specific accountability for key parts of the Australian payments system, particularly payments clearing operations. It is currently responsible for the efficient administration and self-regulation of the following five clearing systems:

    a) Australian Paper Clearing System (cheque and other paper based transactions);

    b) Bulk Electronic Clearing System (direct credit and direct debit transactions, including some telephone and internet banking transactions);

    c) Consumer Electronic Clearing System (ATM and EFTPOS transactions);

    d) High Value Clearing System (SWIFT/PDS transactions); and

    e) Australian Cash Distribution and Exchange System (wholesale cash transactions).

14. APCA's clearing systems provide a single, clear body of rules and decision-making processes governing the conduct of payments clearing and settlement. APCA does not process payments. Individual financial institutions participating in each clearing system are responsible for their own clearing operations which they must conduct according to APCA's rules. More information about APCA can be found at: www.apca.com.au.

15. APCA has around 80 members including banks, building societies, credit unions, the Reserve Bank of Australia (RBA) and other participants in five clearing systems.

5 Establishment and Operation of the Bulk Electronic Clearing System

16. The Bulk Electronic Clearing System (BECS) was established in December 1994 to provide a unified self-regulatory framework for the exchange and settlement of direct credit and debit transactions amongst banks, building societies and credit unions.

17. BECS allows approved organisations, known as Direct Entry Users (more commonly referred to as DE Users), to make arrangements with their financial institution to credit and debit large numbers of accounts (i.e. customer or employee accounts) on a regular basis. The term “DE User” covers organisations that, on the authority of their customers or employees, initiate a direct credit or debit arrangement through their own financial institution with a customer’s or employee’s financial institution. DE Users can include businesses offering repayment facilities, bodies such as a health insurance companies offering monthly repayments of premiums, or employers paying salaries to employees.

18. Organisations can be DE Credit Users in the system, making payments (direct credits) or DE Debit Users receiving payments (direct debits).

19. As at June 2007, more than 219,000 organisations, ranging from large corporates to small businesses were registered as DE Users. Over the last decade the number of DE Credit Users has increased almost threefold to 208,000, while the number of DE Debit Users has increased sixfold to 14,000.[2]

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[2] www.apca.com.au

20. Direct credits are widely used by government departments and businesses for regular payments such as social security benefits, salary and dividend payments. However, with the introduction of internet and telephone banking "pay-anyone" functionality, direct credits have also become an important means by which to effect person to person payments.

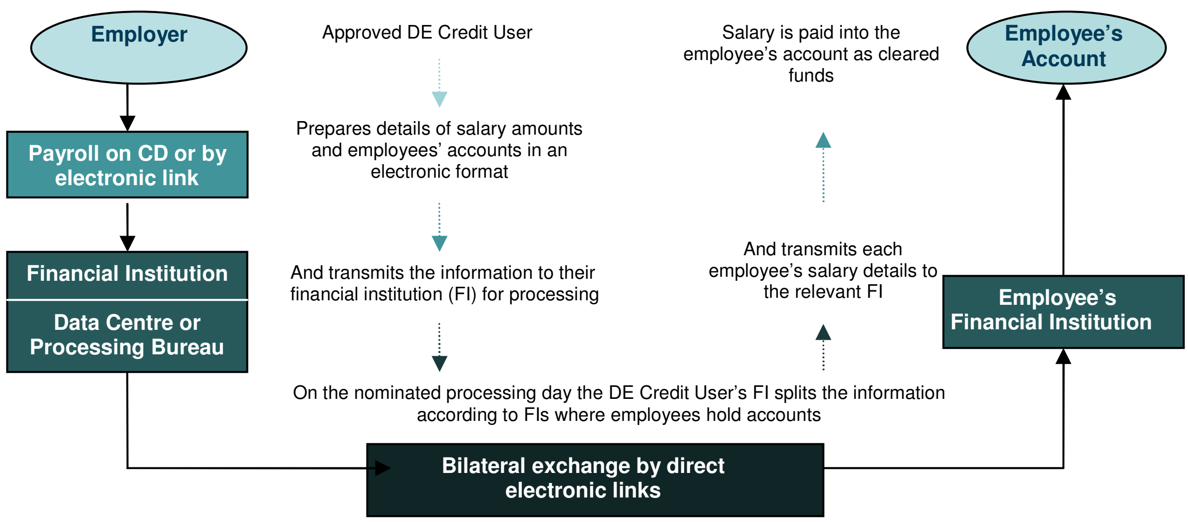
21. To initiate a direct credit, a payer must provide details of the payment and the intended recipient's account details to their financial institution.

22. Direct debits are most commonly used for recurring bill payments (i.e. insurance and utility bill payments). Direct debits may be for either fixed or variable amounts.

23. To initiate a direct debit a customer will provide an ongoing authorisation, known as a Direct Debit Request (DDR) to a DE Debit User to debit a nominated account.

BECS Transaction Processing Diagram

Direct Credit Salary Payment

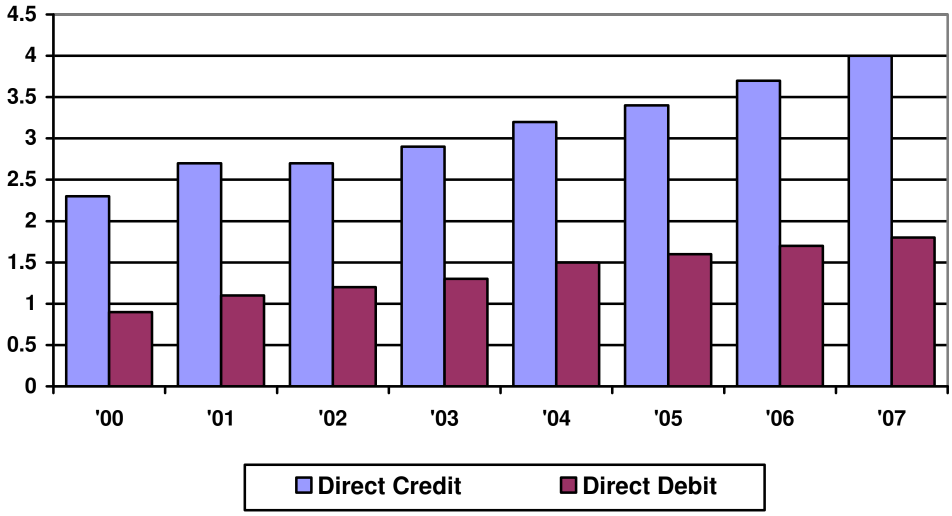


24. BECS has experienced consistently strong transaction growth for some years. There are around 4.0 million direct credits (with a value of $19.9 billion) and 1.8 million direct debits (with a value of $15.7 billion) processed each business day. For the year ended 30 June 2007, the number and value

of direct debit transactions increased by 6.21% and 15.78% respectively and the number and value of direct credit transactions increased by 6.34% and 14.7% respectively.[3]

25. Direct credit and debit transactions account for 32.1% of total non-cash retail transactions in Australia by volume and 81.5% by value.[4]

Average number of direct credit and direct debit transactions per business day (in millions)



26. BECS has proved itself highly adaptable as technology and customer demands evolve. As referred to above, BECS is now utilised for internet and telephone banking "pay-anyone" transactions.

27. BECS is also considered to be a highly cost-effective and efficient mechanism for handling high volumes of mostly low value electronic payments. As noted in a report prepared for the Department of Communications, Information Technology and the Arts (DCITA) - *Exploration of Future Electronic Payments Markets*, "the cost of the payments system in Australia is not trivial, with estimated economy-wide resource costs of around $13 billion per year - equivalent to 1.7 per cent of GDP…direct entry appears to involve the lowest cost to the economy - lowest in cost per transaction and cost per value

[3] APCA
[4] APCA

transferred…considerable economic efficiencies would be obtained if greater use was made of the electronic payments."[5]

28. BECS operates on the basis of a de-centralised infrastructure with payments bilaterally exchanged through computer links between financial institutions, unlike many other countries where direct credit and debit transactions are processed through a central processing switch.

6 Bulk Electronic Clearing System Enhancements

29. In 1997 APCA initiated a project to improve the administration of direct credit and debit arrangements, with the aim of encouraging increased use of these efficient payment mechanisms. At the time, the then current arrangements, particularly for direct debits, were characterised as being paper reliant, inflexible (a standard form of customer authority being required in all cases), inefficient and not conducive to electronic commerce. The centrepiece of the changes introduced in March 2000 was the implementation of a more flexible form of customer authority for direct debits known as a Direct Debit Request (DDR). Significantly, the new DDR arrangements:

   a) enabled tailoring of customer authorities by DE Debit Users (i.e. merchants and other billers) to better meet their particular requirements (unlike the previous standard industry form) and differentiate their product offerings, thereby promoting more innovative use of direct debits;

   b) introduced electronic lodgement of customer authorities by customers with DE Debit Users, thereby facilitating electronic commerce;

   c) transferred responsibility for the administration and maintenance of customer authorities from a customer's financial institution to the DE Debit User, thereby eliminating previous administrative inefficiencies, such as the need to transfer authorities to a customer's financial

[5] Department of Communications, Information Technology and the Arts (DCITA) - Exploration of Future Electronic Payments Markets, p. 44

institution and the resulting 14 day delay in drawing against such authorities.

30. The significance of this transfer of responsibility for the administration and maintenance of customer authorities (and the underlying rationale) will be important when considering the overseas account switching models detailed in section 7.2 of this paper.

31. To further encourage use of direct debits, additional changes were introduced by APCA in 2001 and 2002 to tighten and standardise the procedures to be followed by financial institutions and DE Debit Users when a customer requests cancellation of a direct debit authority.

32. Most recently, in 2007 APCA commenced the Low Value Payments Industry Direction Project. The objective of this project is to develop an industry road map for the evolution of Australia's low value payments systems (of which BECS is a significant component) so that they continue to meet the foreseeable needs of both participants and users over the medium to long-term. Recommendations arising from the project are expected to be presented to the industry during 2008.

7 Process for Re-establishment of Direct Credit and Debit Arrangements

7.1 Australia

33. In Australia, a customer's authority for direct credit and debit transactions made to or from their account are held as follows.

Direct Credits

a) Where the customer has initiated a recurring payment from their account (i.e. loan repayment) or a non recurring payment to a third party from their account (i.e. internet or telephone banking "pay-anyone" transaction) by way of a direct credit, the customer's authority will be held by the customer's financial institution.

b) For third party initiated direct credits (i.e. salary payment by an employer to an employee), the customer's authority will be held by the third party initiating the payment to the customer's account (i.e. the customer's employer).

Direct Debits

a) For direct debits, a customer's authority, in the form of a DDR, will be held by the DE Debit User (i.e. insurance, gas or electricity provider).

34. When a customer decides to switch their account to another financial institution, they are responsible for advising DE Users of any change in their account details and determining which direct credit and debit arrangements require re-establishment. Many customers change their accounts and re-establish direct credit and debit arrangements without any assistance. However, where a customer does require assistance in re-establishment of these arrangements, they may avail themselves of the following two forms of support.

Online Account Switching Support

35. All of the major financial institutions in Australia and a significant number of smaller financial institutions currently offer comprehensive online account switching support to new customers who wish to open an account. These account switching support services generally consist of the following:

a) free online information explaining the service, together with step-by-step instructions on how to use the service;

b) standard letters that can be personalised to a particular DE User advising of a change in account details (these letters can be printed, signed and then posted to the DE User by the customer); and

c) email and/or phone support numbers to assist customers with any further queries relating to the service.

BECS Returns Process

36. Existing BECS functionality provides that if an account is closed by a customer following the opening of an account at a new financial institution, direct credit and debit transactions attached to the closed account will be returned to the DE User's trace account. This will prompt the DE User to seek updated instructions from the customer. Generally, a direct credit or debit transaction linked to a closed account will be returned within one day. The BECS returns process provides a simple yet effective safeguard mechanism should a customer overlook a current direct credit or debit arrangement.

7.2 Overseas Practices

37. A survey undertaken by APCA during the first half of 2007 has found that overseas the administration and processing of direct credit and debit transactions, and the process by which they are re-established, differs quite significantly from Australia. The following is a brief summary of a number of overseas models selected for comparison.

New Zealand

38. In New Zealand, a financial institution is the holder of the customer's authority. This could be for direct credits established by the customer or direct debits established between a customer and a DE Debit User, but excludes third party initiated direct credits (i.e. salary or dividend payments).

39. On establishment of an account by a customer at a new financial institution, a service known as File Pass may be initiated by the new financial institution to the old financial institution on behalf of the customer, requesting amendment of any instructions held by the customer's old financial institution. The customer is charged a fee for this service.

40. Direct credits sent by a third party initiator are excluded from the File Pass service. Thus, the customer remains responsible for advising a third party initiator when establishing accounts at a new financial institution.

41. Clearing and settlement of direct credit and debit transactions occur via a central processing switch, unlike Australia where clearing and settlement occurs on a bilateral basis.

United Kingdom

42. In the United Kingdom, a financial institution is the holder of the customer's authority. This could be for direct credits established by the customer or direct debits established between a customer and a DE Debit User, but excludes third party initiated direct credits (i.e. salary or dividend payments).

43. On establishment of an account by a customer at a new financial institution an Inter-Bank Transfer Service exists where a new financial institution will request from the old financial institution a list of Direct Debit Instructions (DDI) and other direct credits (except those initiated by a third party) paid from the customer's account. Each DDI will be passed by the new financial institution to the appropriate DE Debit User either electronically or manually. The DE Debit User must then action this advice within 3 working days. The Inter-Bank Transfer Service does not include updating of third party initiated direct credits. The operation of the Interbank-Bank Transfer Service is contained in the UK Banking Code.

44. Clearing and settlement of direct credit and debit transactions occur via a central processing switch, unlike Australia where clearing and settlement occurs on a bilateral basis.

45. It is also understood that a third party, non-financial institution service provider, offers a switching notification service to financial institutions and their customers on a commercial basis.

Netherlands

46. In the Netherlands, a customer's financial institution is the holder of a customer's authority for direct credits established by the customer. The DE Debit User is the holder of a customer's authority for direct debits established between a customer and a DE Debit User.

47. On establishment of an account by a customer at a new financial institution, the new financial institution on behalf of the customer can use an Interbank Switch Support Service (ISSS) to facilitate re-routing of direct credits and debits to the new account for a period of up to 13 months. For direct debits the ISSS will instruct the DE Debit User to update their respective database with the new account details. Additionally, the customer will be provided with a list of customer initiated direct credits by the old financial institution to give to the new financial institution. However, for third party initiated direct credits, the customer remains responsible for informing the DE Credit User of any changes to account details.

48. Clearing and settlement of direct credit and debit transactions occur via a central processing switch, unlike Australia where clearing and settlement occurs on a bilateral basis.

Canada

49. In Canada, a customer's financial institution is the holder of a customer's authority for recurring direct credits established by the customer only. A customer's financial institution will not hold an authority for third party initiated direct credits. A direct debit authority established between a customer and a DE Debit User is held by the DE Debit User.

50. On establishment of an account by a customer at a new financial institution, a Notice of Change (NOC) request may be initiated by a customer's new financial institution to other financial institutions. Within 30 days of receipt of a NOC from the customer's new financial institution, a receiving financial institution must forward the NOC to DE Users. A limitation with the NOC process is that DE Users are currently under no obligation to action the NOC

forwarded to them, though it is understood that this situation is scheduled to be reviewed in the near future.

51. In Canada, direct credit and debit transactions are exchanged bilaterally, similar to the Australian model - a central processing switch does not exist.

52. A third party, non-financial institution service provider offers a switching notification service to financial institutions and their customers on a commercial basis. It is understood this service works well.

Ireland

53. In Ireland, a customer's financial institution is the holder of a customer's authority for recurring direct credits established by the customer only. A customer's financial institution will not hold an authority for third party initiated direct credits. A direct debit authority established between a customer and a DE Debit User is held by both the DE Debit User and the customer's financial institution.

54. In order to assist a customer when they transfer their account to another financial institution a Code of Practice on Switching Accounts and Business Account Switching Code have been introduced. The Code of Practice and Switching Code have several components. First the customer's new financial institution is to provide a switching pack to the customer, which explains the process and timescales for completion of the various steps involved in account switching. Next, the new financial institution is to have the new account operational within 10 working days of application approval. Finally, the old financial institution is to provide information on direct credits and debits in order to complete the switch of account. Additionally, the customer's old financial institution will advise DE Users of the new account details. This is to be completed within 7 working days. It is understood that the application of the Switching Code is limited to direct debits and customer initiated direct credit payments. Responsibility for updating account details for third party initiated direct credits (e.g. salary) remains with the customer.

55. In Ireland, direct credit and debit transactions are exchanged bilaterally between financial institutions, similar to the Australian model - a central processing switch does not exist.

8 Summary Assessment

56. In the majority of the overseas models investigated, clearing and settlement of direct credit and debit transactions occurs through a central processing switch. In Australia, clearing and settlement of direct entry transactions occurs on a bilateral basis. Therefore those overseas models where a central processing switch underpins the functioning of an account switching service, or automated notification of new account details are not currently considered technically feasible for Australia.

57. In a number of overseas models, the customer's financial institution is the holder of a customer's authority for direct debits, whereas in Australia, the DE Debit User is the only holder of such authorities. Therefore those overseas models where the customer's financial institution holds the customer's authority are not currently considered feasible.

58. In all overseas models where an account switching service has been implemented, the customer remains responsible for advising third party initiators of direct credits of any changes in account details.

59. In a number of countries, non-financial third party service providers have entered the market, offering a "switching notification" service to financial institutions and their customers on a commercial basis.

60. A central registry does not form part of any account switching support service in any of the countries surveyed.

9 The Australian Experience

61. The main purpose of this discussion paper is to gather experiences and views from payment users and providers on the extent to which direct credit and debit arrangements create impediments for account switching. Preliminary analysis has discovered no strong statistical or survey evidence in this area. It is estimated that in Australia, 3.1% of financial institution customers switch their accounts to alternative providers on an annual basis, compared with 4-6% of United Kingdom customers.[6] These statistics are of uncertain significance as to the overall level of impediments, and we have no guidance as to the extent to which direct credit and debit arrangements are a factor.

Q1: To what extent do you believe direct credit and debit arrangements provide an impediment to account switching in Australia? Please provide as much evidence as you can to support your view.

Q.2: Are you aware of additional overseas experience that is relevant in the Australian context?

62. The following sections focus on aspects of existing arrangements to identify whether there are views as to how they could be improved.

9.1 Financial Institution Support for Changing Direct Credit and Debit Arrangements

63. As outlined in section 7.1, many financial institutions already offer facilities to assist in the transfer or re-establishment of direct credit and debit arrangements. This suggests that there are already some market incentives for financial institutions to facilitate account switching.

Q3: In your view, do financial institutions already offer adequate support for new customers to transfer or re-establish direct credit and debit arrangements from their old financial institution? Are there any services offered which are particularly useful?

[6] European Competition Authority, Competition Issues in Retail Banking and Payments Systems Markets in the EU, Conference Paper, May 2006, p. 18

64. One of the potential challenges of changing financial institutions is that the customer needs to identify existing direct credit and debit arrangements that are to be transferred from their old financial institution. Some customers will maintain their own records, but many may not. For the latter, identifying the arrangements to be transferred requires searching through statements (online or paper) from the existing account. Because the old financial institution does not have a complete list of all direct credit and debit arrangements established by the customer (it will only have a record of direct credits initiated by the customer, such as "pay-anyone" transactions), it is not easy for the financial institution to facilitate this.

65. However, it is conceivable that the old financial institution could provide a listing of regular direct credit and debit transactions occurring on the customer's account (via utilisation of the financial institution's transaction history database). This would allow the customer to more easily identify and determine which direct credit and debit arrangements to re-establish with their new financial institution. The ability and cost of doing so would vary from financial institution to financial institution, depending on their technology and operational processes.

Q4: Would a listing service of the kind described assist in facilitating account switching? Do you think customers would be prepared to pay for such a service? If such a service was implemented, do you believe it is fairer for the cost to be absorbed by financial institutions (thereby in effect adding to the total costs borne by all customers, whether they switch accounts or not), or for those that make use of the service to bear the cost? Why?

9.2 Enhancements to the Direct Entry System

66. Drawing on components of the overseas models, it may be possible to enhance both the DE message set and the internal systems of financial institutions to allow the customer's old financial institution to advise a DE User's financial institution of re-direction details when an account is closed. Under this proposal the current payment transaction and return transaction record used in bilateral exchanges between BECS members would be

enhanced to include redirection details (as provided by the customer to their old financial institution). DE Users may also need to enhance their internal systems to action a change of account advice from their financial institution.

67. This would operate when a direct credit or debit is received by the old financial institution for an account which has closed. For a direct debit, the old financial institution would send an enhanced return transaction record to the DE Debit User's financial institution. The enhanced return transaction record would include 'redirection details' of the new account (the old financial institution cannot "forward" the transaction to the new financial institution, because the DE Debit User would not have authority to debit the new account, a new DDR would need to be completed by the customer). For a direct credit, the old financial institution would send a modified payment transaction to the customer's new financial institution.

68. It is not yet clear how much cost and risk is entailed for financial institutions in this proposal, but significant system changes are likely to be involved.

Q5: Would a redirection service of the kind proposed at section 9.2 assist in account switching? Do you think customers would be prepared to pay for such a service? If such a service was implemented, do you believe it is fairer for the cost to be absorbed by financial institutions (thereby in effect adding to the total costs borne by all customers, whether they switch accounts or not), or for those that make use of the service to bear the cost? Why?

69. In the report to the Treasurer (see section 3, above), the ABA proposed the examination of an option to establish a central registry to facilitate the portability of direct credit and debit arrangements. In essence, a central registry would maintain direct credit and debit information for all financial institution customer accounts, whether or not the customer required a separate record of this information. By this means, customers' direct credit and debit arrangements would in effect become independent of their financial institution or account.

70. This would involve a fundamental change to the existing system, which as explained above currently relies for speed, efficiency and cost-effectiveness on a decentralized data model. It is conservatively estimated that around 40 million separate customer records would need to be held in a central registry.[7] These would, of course, need to be regularly updated by all existing financial institutions and/or DE Users on behalf of customers (with appropriate authority). New linkages, messaging and platforms would be required. Access rights would have to be strictly controlled to protect data integrity, confidentiality and privacy. Clearly, the cost would be substantial.

Q6: Would a central registry service of the kind proposed at section 9.2 assist in account switching? Do you think customers would be prepared to pay for such a service? If such a service were implemented, do you believe it is fairer for the cost to be absorbed by all financial institutions (thereby in effect adding to the total costs borne by all customers, whether they switch accounts or not), or for those that make use of the service to bear the cost? Why?

9.3 Other Possible Solutions

71. Depending on the extent to which financial institution customers perceive that direct credit and debit arrangements represent a disincentive to account switching, and where the problems are, there may be other things the industry could do to reduce these disincentives.

Q7: Do you think there are other steps that could be taken to make it easier to transfer or re-establish direct credit and debit arrangements for financial institution customers? Please provide as much detail as possible, including the features and benefits, how the solution would work, what the potential costs would be and how costs should be apportioned.

[7] For simplicity, it has been assumed that each person over the age of 18 is likely to have a minimum of 3 direct credit and/or debit arrangements associated with an account.