Submission by CHOICE
to the Payments Industry Consultation Paper
Aspects of Account Switching

October 2007

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.

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Summary

Direct Credit and Direct Debit arrangements create significant barriers to account switching. Consumers typically have from several to many direct transfer arrangements in place, and the average number per consumer is growing under pressure from the businesses they deal with. The switching barriers reduce the effectiveness of competition in the banking sector and thus ultimately harm consumers.

There are relatively simple solutions to reduce these switching barriers.CHOICE **recommends** that ACPA work with financial institutions to develop a system under which the ADI or credit provider that the consumer is leaving has an obligation to assist the consumer re-establish equivalent direct debit arrangements with the new institution.

Introduction

CHOICE welcomes the consultation on aspects of account switching by the Australian Payments Clearing Association. The competitiveness of the banking industry relies on simple, cost-free and efficient arrangements for account switching.

This submission demonstrates that the switching costs borne by individual consumers in the process of changing accounts are substantial. These switching costs include risk of monetary loss as well as unnecessarily burdensome amounts of inconvenience. They act as more than 'hassles' – they amount to a significant disincentive to switch and therefore dampen competitive development of the industry.

Industries that have been able to remove barriers to switching have produced highly competitive outcomes for consumers. The Australian banking industry has not developed the type of robust competitive environment that has been observed in other countries and part of this lethargy can be attributed to our payment systems arrangements.

CHOICE believes that a customer's established direct debit and/or credit transfer arrangements are a switching impediment which can be overcome through industry initiatives. We therefore support enhancements to the Bulk Electronic Clearing System that establish a joint responsibility between consumers and their financial institutions for the re-establishment of direct debit and credit arrangements where a customer changes their transaction or credit account.

This consultation presents a new opportunity to increase competitiveness in the industry. CHOICE welcomes the opportunity to work with APCA and other stakeholders to develop a consumer-friendly payment switching framework that will stimulate account switching and increase economy-wide efficiencies through enhanced competition.

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.

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

Direct debit and direct credit arrangements impede account switching because of the costs and risks imposed on consumers who propose to switch. Those costs include

- time in gathering together the necessary information and completing the arrangements needed to re-establish an increasing number of direct credit/debit arrangements that account holders now have
- the cost of phone calls, stationary and postage required to communicate with a large number of parties
- additional bank fees incurred by keeping accounts open longer than necessary
- the risk of penalty fees imposed by the bank or late payment fees imposed by third parties
- the risk of loss flowing from non payment of a time critical transaction.

These costs should not be dismissed, as the Australian Bankers Association claims they should be, as a perceived disincentive caused by inconvenient 'hassles'. Instead, CHOICE believes that switching costs must be understood as a structural barrier to effective competition in the banking industry. Australian businesses are increasingly pursuing efficiencies through electronic payments and as a consequence consumers are entering into a larger volume of electronic payment arrangements. The unintended consequence of this development is that total switching costs have grown and will continue to grow.

Switching costs affect competition in the following manner. When a rational consumer faces costs in changing accounts, he or she will not switch to the financial institution offering the lowest price if the costs (including additional fees and notification costs, monetary and non-monetary) outweigh the price differential between the two financial institutions. If this happens, conventional economics tell us that the consumer is 'locked-in' to the financial institution, who may raise prices to a certain point without fear of losing the customer. High consumer switching costs in the banking industry must be understood to stifle account switching, which in turn dampens industry-wide competition to the ultimate detriment of consumers.

With the exception of changing account details, the Bulk Electronic Clearing System (BECS) for direct debit and credit facilities operates well to meet consumer needs and expectations. The failure of BECS is that re-establishment obligations rest solely on the consumer. The case study countries explored in the C*onsultation Paper* do not leave the sole responsibility for the re-establishment of direct debit and credit transactions with the customer. All countries adopt a mixed-responsibility model, with financial institution playing a role in facilitating direct debit transfers and the customer generally taking responsibility for direct credit transfer (often facilitated by financial institutions).

By placing full responsibility on the customer, the Australian payments system leaves the full risk and cost to the individual and does nothing to minimise switching costs.

Switching costs are directly related to the number of direct debit and credit arrangements that must be re-established and the process involved in managing the re-establishment. The C*onsultation Paper* points out that the number of direct debit and credit users has grown in recent years. Further information available from APCA demonstrates growth also in the number of transactions facilitated through BECS in recent years. This data suggests that not only are a larger number of organisations opting to facilitate payments through BECS, but that the number of transactions they put through the system is also growing. Consumers have typically experienced this growth by more creditors more often requiring direct debit payments.

CHOICE has analysed current direct debit and credit arrangements for average household account holders. The table below indicates the types of direct credit and debit arrangements that a consumer now typically enters into. Some categories (such as dividend payments) may have multiple arrangements, while other categories (for example various electricity providers) are almost exclusively reliant on direct debit arrangements.

Standard Direct Debits	Standard Payment arrangements (which may or may not be with the same financial institution)
- electricity - gas - water - telephone - mobile phone - internet service - rental payment - health insurance - motor insurance - home & contents insurance - charitable donations - union fees - magazine subscriptions - gym membership - council rates - Strata fees - Pay TV - Appliance rental or hire-purchase - road-side assistance scheme - club or association memberships - E-toll/E-way - online subscriptions/services	- Mortgage payment - Credit card payment - Other loan repayment - Savings accounts transfers **Standard Direct Credits** - Salary payments - share dividends - rental income - health fund rebates - social security benefit - payment of interest and commissions

Some combination of the direct debit and direct credit arrangements listed above would reasonably form the payment arrangements for an average account holder.

In preparing this submission, CHOICE sought to clarify the position of customers in changing their account details. The *Bulk Electronic Clearing System (CS2) Procedures (amended July 2007)* contains all procedures for the operation of the system. APCA claims confidentiality over clause 5.21 Notification to user of Transfer or Change to Customer's Account, making it unavailable for our comment. The *Consultation Paper* does not shed any further light on the process a customer must go through to change account details. We are therefore left to infer that a customer must make a written, signed notification to re-establish the account authorisation with the Direct Entry User (that is the merchant that hold customers authorisation for direct debits and direct credits).

While financial institutions have a direct, electronic method of communication with the Direct Entry Users, the customer typically does not. A typical Direct Entry User does not make the process easy or simple to amend authorised account details – i.e. information is not typically available on bills, nor is there any obligation on the user to make that information readily available.

Because the consumer wears the full liability of the re-establishment process, they are also liable for any direct debit dishonour fees charged by the bank and/or the biller as a result of delays or errors. CHOICE has recently criticised banks for the excessive penalty fees charged for direct debit default. The fees may be as high as $50 and are in addition to fees charged by billers for late payment or payment dishonour. Additionally, we are aware that consumers routinely keep multiple accounts open for an extended period of time to avoid such fees. Consequently, the consumer pays additional account keeping fees for an unnecessary extended period of time.

There are various estimates of switching rates in Australia and CHOICE accepts that the annual switching rate of around 3.1% suggested in the *Consultation Paper* is likely to be accurate. It is concerning that this rate is so far below the UK rates of 4-6%.

We are aware anecdotally that while customers know there are better offers available, the benefit of changing accounts is not perceived to be worth the effort. Further, BankWest has provided research to CHOICE that found 28% of people are open to switching bank and 60% would do so if there were easier processes in place. Tools are now widely available to reduce search and information costs associated with finding a better deal. There has been no corresponding development in reducing switching costs associated with direct debit and credit re-establishment. We therefore believe that switching costs do inhibit switching rates in the banking sector.

CHOICE intends to undertake further analysis on barriers to account switching. Upon their publication, we will be pleased to brief APCA on our findings.

Q.3: 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?

CHOICE has reviewed the switching tools available on a number of financial institution websites. The sites we reviewed had responded to high switching costs by developing pro-forma letters and/or checklists for notification of third parties. Pro-forma letters generated online by banks offer limited assistance to consumers dealing with a time-consuming, risky and costly process. None of the tools we reviewed were able to provide a complete list of Direct Entry Users and their postal contact details. Nor did the financial institution accept any responsibility for re-establishing the authorisation – any errors made were still at the cost of the customer. The tools could also not be described to have universal accessibility. There are many Australians who do not have access to private and secure internet and printing services.

Most significantly, we found the effectiveness of these tools is constrained by the structure of the BECS system. While a step in the right direction, the development of support services is ultimately constrained by a system that places large responsibility on the individual consumer and none on the financial institutions or Direct Entry Users. Addressing switching costs ultimately requires cooperation from the 'old' financial institution (the one the customer is leaving). Yet under the current structure there are no obligations and certainly no incentives for cooperation.

Q.4-6: Would A) a listing service, B) a redirection service or C) a central registry service 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, or for those that make use of the service to bear the cost? Why?

CHOICE believes that direct debit and credit transfers are a switching impediment which can be overcome through industry initiatives. We therefore support enhancements to the Bulk Electronic Clearing System that establish a joint responsibility between consumers and their financial institutions for the re-establishment of direct debit and credit arrangements where a customer changes their bank account. A listing service, central registry and redirection all have merit and warrant investigation into the least cost implementation. We offer the following comments on these proposals.

The proposed **listing service** would enable the old financial institution to provide the customer with a listing of a customer's regular transactions. CHOICE could only support an *enhanced* listing service, which went beyond providing information about direct debit and credit transaction history and saw financial institutions taking responsibility for the notification of new account details to authorised Direct Entry Users. An enhanced listing service should enable old financial institutions to notify Direct Entry Users of the customer's new details. We note that financial institutions can authorise the cancellation of any existing authorisation within the current system constraints and see no reason why excessive costs would be incurred under such a model.

A new **central registry** that gave the financial institutions direct access to the customer's authorisations would be the most costly solution to the problem posed by switching costs. However, it remains an option that should not yet be rejected on cost grounds in the absence of an effective alternative solution. Modelling of the costs involved in developing a central registry should proceed on the basis that the market failure is substantial and requires attention. However, as noted earlier, consumers generally enjoy the vast benefits of a safe, secure and efficient Bulk Electronic Clearing System. It is in the area of account switching the BECS fails consumers.

A **redirection service** that obliged old financial institutions to link customers' transactions with their new account for a fixed period of time would minimise the costs and risks borne by switching consumers. We disagree with comments by some industry stakeholders that such a service would act merely to delay costs. We are aware that consumers maintain multiple accounts longer than is necessary precisely because there are no redirection services at the current point in time.

On the point of costs, we believe the system changes should be paid for by the participating financial institutions. The benefits of improved switching will directly benefit the financial institutions by facilitating greater customer flows.

Q.7: 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?

Switching accounts should be simple, straightforward and low-risk for consumers. We believe this can be achieved within the confines of the current system. Upon notification of an intention to switch bank accounts the customer's 'old' financial institution should be obliged to advise authorised Direct Entry Users of the new account detail provided by the customer. The 'old' financial institution should re-direct credits and debits to the new account for a fixed timeframe to account for the time required for the Direct Entry User to update their authorisations.

Lastly we make the point that Australia has fallen behind global best practice in minimising switching costs. We see no reason why Australian consumers should not enjoy a payment system with the features of those in the United Kingdom, the Netherlands or Ireland that minimise switching costs for consumers. Given the economy-wide benefits that flow from a robust payments system and a competitive banking industry, these reforms should be prioritised by APCA and its industry members.