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By email: akendall@apca.com.au

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Dear Mr. Kendall

Consultation Paper – Aspects of Account Switching

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Australian Payment Clearing Association's (**APCA**) consultation paper, *Aspects of Account Switching* (the **consultation paper**).

We appreciate APCA's investigation of issues relating to the practical ability of consumer to switch banking accounts, and options to reduce barriers to switching. We welcome moves to consider the establishment of processes that facilitate simple re-establishment of direct credit and debit arrangements when customers change accounts from one financial institution to another. We believe that enhancing the ability of consumers to change direct debit and credit arrangements when switching accounts is necessary to encourage a fair, innovative and competitive market.

The consultation paper seeks comment on possible payment systems reforms that would enable banking markets to function more efficiently and effectively. However, the lack of detailed information in the consultation paper, especially on the costs of various service options proposed and possible necessary structural adjustments to systems, impede our ability to provide authoritative comment on the best solution to the identified problem. Importantly, any assessment of the costs and benefits of proposed structural changes needs to be accompanied by an analysis of the costs and benefits of not making changes, as well as consideration of who bears the ultimate net costs and benefits. As outlined below, we are concerned that the direct costs relating to difficulties in switching bank accounts and consequent competition are currently borne by consumers.

About Consumer Action

Consumer Action is a campaign-focused consumer casework and policy organisation, dedicated to advancing the interests of low-income and vulnerable consumers, and of

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consumers as a whole. Based in Melbourne, it was formed in 2006 by the merger of the Consumer Law Centre Victoria and the Consumer Credit Legal Service and is funded jointly by Victoria Legal Aid and Consumer Affairs Victoria.

Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest not for profit specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and throughout the community directly.

Consumers' role in effective markets

Fair, effective and competitive markets generally deliver the best price, quality and access to goods and services to the majority of consumers.¹ In our view, competitive pressure is important for productivity, innovation, fair pricing and universal access in the marketplace and increased competition can lead to both one-time and ongoing gains in productivity and efficiency as a response to greater pressures to perform.²

In the financial services sector, there are many institutions providing account services. While the existence of multiple providers is required for competition, this on its own may not be enough to sustain effective competition. Features of the market and consumer behaviour in response to those features can deter competition and create restriction to innovation, better pricing and better service standards.

Importantly APCA's consultation acknowledges that consumers are not simply passive beneficiaries of competition but play a critical role in its success, and that removing obstacles to switching accounts will assist the development of effective competition. We support APCA in its role of enabling Australian consumers to access competitive and efficient payment systems while valuing the role of consumers in creating and maintaining a competitive market.

The consultation also acknowledges that, at present, there are significant barriers to consumers switching between accounts – with the need to change direct debit and credit arrangements a significant but certainly not the only barrier.

In the UK, writers such as Waterson, Waddams and Klemperer have discussed the effect of switching and transaction costs – barriers to consumers switching their service provider in financial and other markets.³ They conclude that these barriers have significant effects on

¹ Consumer Action Law Centre, Submission to the Productivity commission Inquiry into Australia's consumer Policy Framework, June 2007.

² Organisation for Economic Development, *Product market competition and economic performance*, in OECD Economic Outlook, December 2002, available at www.oecd.org.

³ See for example Waterson, M. *The Role of Consumers in Competition and Competition Policy*. University of Warwick Economic Research paper no.607; Klemperer, P. 1995. Competition when Consumers have switching Costs: An Overview with Applications to Industrial Organization, Macroeconomics, and International Trade". *Review of Economic Studies*. 62: 515–539; and Waddams, C., Giulietti, M. & Waterson, M. 2005. Consumer

competition and efficiency, and can result in sub optimum price outcomes for consumers. The research indicates that there are multiple types of switching costs that vary in degree of importance. Klemperer identifies six key switching costs – that is “a cost [that] results from a consumer’s desire for compatibility between his current purchase and a previous investment.” These are:

1. Need for compatibility with existing equipment;
2. Transaction costs of switching suppliers;
3. Costs of learning to use new brands;
4. Uncertainty about the quality of untested brands;
5. Discount coupons and similar devices; and
6. Psychological costs of switching or non-economic “brand loyalty.”⁴

Transaction costs include the direct and indirect costs of consumers having to organise the changeover of direct debits and direct credits. Direct costs include the costs of a consumer having to prepare written material to facilitate the changeover or penalty fees that may be applied if the changeover does not occur as planned, while indirect costs include the “hassle” factor – the feeling that changeover would cause too much hassle and stress for consumers. However, Klemperer and Waterson’s analysis demonstrates there are other switching costs as well, separate to those relating to changing direct debits and direct credits. These include:

- Complexity of analysis of costs – need to know usage pattern, may need complex calculation, opacity of fees and charges;
- Opening new account can be cumbersome; and
- Costs and effort of re-establishing a credit standing.

There has not been any substantial research in Australia which provides data about the exact cost of switching accounts whether monetary, temporal or psychological. The UK research referred to above, however, identifies costs of the types listed above – in particular the ‘hassle factor’, especially when a consumer has multiple arrangements established. The research also indicates loyalty and explains that often consumers’ historical relationship with the financial institution creates a sense of false security which leads to failed competition, causing obstacles to the proper functioning of the market.

Lessons from behavioural economics

Developments in behavioural economics challenge traditional economic assumptions regarding *homo economicus* – the notion that consumers in general will act with rational self-interest. This thinking can also help us understand the notions that guide consumer

Choice and Industrial Policy: a study of UK Energy Markets. *The Economic Journal*. 115: 949- 968. See also from the United States: Camerer, C., Issacharoff, S., Lowenstein, G., O’Donoghue, T. & Rabin M. *Regulation for Conservatives and the Case for “Asymmetric Paternalism”*. 2003. University of Pennsylvania Law Review. 151: 1211-1254.

⁴ Klemperer, as above, pp 517-18.

behaviour and therefore make more accurate predictions. Behavioural economics identifies systematic biases and departures by consumers from the perfectly rational model of consumers and highlights variance in consumer behaviour. In our view, these systematic biases or departures need to be considered in determining whether intervention is necessary and in judging the efficacy of proposed responses to problems. By helping to identify failures in the market, behavioural economics may support designing the most effective response to removing of barriers to switching accounts.

There are two of the insights from behavioural economic that are particularly relevant in this context, firstly studies in behavioural economics highlight that consumers often have 'bounded rationality'. Accordingly, consumers do not approach each decision or choice with perfect rationality (assessing all available options and prices) but rather use 'rules of thumb'.⁵ This is due to limitations of knowledge, cognitive capacity and computational resources. This means that people are unable to process and compute all the alternatives available to them. Indeed, bounded rationality as a concept encompasses several other biases, which may act as rules of thumb or heuristics to simplify decision making.

Another factor which needs to be highlighted is 'habits' of the consumer. Habits explains that people do many things without consciously thinking about them and these habits are hard to change – even though people might want to change their behaviour, it is not easy for them to do so.⁶ Neoclassical economic theory, on the other hand, assumes that people act rationally to maximise their utility (given their particular preferences). Therefore, according to neoclassical economics, a person would not do something out of habit, such as ordering the same type and size cup of tea from the same cafe on their way to work each morning. Rather, they would undertake a full analysis of all the available cups of tea, including the types and sizes available and all the price options offered in the market. This can help explain the phenomena of inertia even when consumers may know they can obtain a better deal elsewhere.

Whilst behavioural economics is still a developing field, an emerging body of work is already providing insights about why markets, and regulatory intervention in markets, succeed or fail. This analysis could help inform APCA by assisting it form a better understanding of consumer behaviour and the appropriate mechanisms that are more likely to assist consumers switch their bank accounts.

Re-establishment of direct credit and debit arrangements

Many financial institutions in Australia provide consumers with advice and standard letter templates to support new customers re-establish direct credit and debit arrangements. However, in order to use these services, the customer has to take the responsibility of making a list of all direct debit and credit arrangements, and of informing the organisations

⁵ See for example, Khaneman, D (2002), *Maps of bounded rationality: A perspective on intuitive judgement and choice*. Nobel Prize Lecture.

⁶ New Economics Foundation (2004), *Behavioural Economics: seven principals for policy makers*. NEF: London.⁷ Review of bank switching services on www.uSwitch.com

involved. The services provided by financial institutions are generally useful, but there are varying levels of accessibility. For example, some forms/templates are hard to locate on financial institutions' websites, even though they may be user friendly. We feel that these services, while helpful, do not motivate the consumer to switch accounts. The hassle factor of going through the process, identified above, is still significant. There are also financial costs in particular penalty fees that may be applied by both the bank and service provider if all arrangements are not accounted for.

A service enhancement example, that may enable consumers to switch more easily, is that of the Abbey Bank in the UK. Abbey Bank provides customers using its switching service with a named contact who manages the move of all direct debits, standing orders, bill payments and salary. The contact keeps in touch with the customer each step of the way to ensure they are fully up to date with the transfer process. This service is provided free of cost to the consumer and if any charges are incurred as a result of the switching process, Abbey provides a full refund.⁷

Overseas payment systems

We commend APCA's comparison and evaluation of payment structures of other countries that impact upon the establishment of direct credit and debit arrangements. From the analysis we are able to derive that the Australian payment structure is fairly unique and, perhaps, as the paper points out, low in cost. However, it is also clear that Australia's system has fallen behind in international developments. Additionally, we are concerned that Australia's current structure may actually be hiding significant costs due to its inability to support the complexities of future transactions.

In a paper published by the Reserve Bank of Australia (**RBA**)⁸, the potential problems of continuing to maintain a bilateral payment structure in Australia were raised. While noting the merits of the bilateral system, it also outlines a range of deficiencies. Bilateral arrangements are thought to pose two particular challenges when the system reaches maturity. The concerns are that:

- Access can become quite difficult if more than a handful of links need to be established; and
- A large number of bilateral links may make the system difficult to update or renovate.

The RBA paper also highlights that gaining access to a network based on bilateral linkages can be more difficult and more expensive than obtaining access to a system with a single point of access, especially when there are a large number of existing partners. This contradicts APCA's view which identifies that a bilateral structure, such as the Australian one, to be cost effective. We find that the consultation paper's lack of discussion about costs, both the costs of making changes to the system and costs of not making changes, prevents us from coming to a conclusion on this issue. However, we do believe that it is

⁷ Review of bank switching services on www.uSwitch.com

⁸ Reserve Bank of Australia (2006), *Payment systems developments and architecture: some background*.

possible the system needs to undergo a structural adjustment in order to maintain functionality. This may involve significant costs. These costs must be balanced against the costs presently being borne by individual consumers and the costs in terms of efficiency, together with the risk that not making such changes may result in even costlier outcomes for consumers in the long run. Hence we would like to urge APCA to undertake a full cost benefit analysis of system re-structures, including analysis of the cost of inaction.

Service Options

The options put forth by APCA aim at encouraging and enabling consumers to switch financial institutions without much effort or stress, and we are in support of the establishment of processes which would encourage this outcome. We emphasise that enabling consumers to switch between financial organisations more easily will enable more competition in the market and as such produce innovative and best price option products for consumers. The question of course is which outcome will best achieve this objective. It is not possible to reach a conclusion at this point given the need for further cost benefit analysis. We simply note that the decision should not focus on the lowest cost option, but the lowest cost option that will achieve the desired outcome. This requires attention to how consumers will respond, in fact, rather than assumptions about what consumer 'should' do.

In this context, we suggest some enhancement to the listing service suggested by APCA may better support the process of switching. While requiring a list of all direct credit and debit transaction to be made available by the 'outgoing' financial institution at the request of the consumer may make help reduce the stress felt by the consumer in undertaking the same task, placing responsibility on the 'incoming' institution to undertake this exercise on behalf of the consumer would even further reduce transaction costs. It is also likely to be more efficient given the capacity of financial services providers to achieve economies of scale. We understand that financial institutions keep records of all transactions and from these records it may be able to identify a list of repetitive credits or debits. Again we are unable to understand clearly what costs maybe involved in providing this service, as there is no indication of this in the issues paper.

APCA also canvasses the option to establish a redirection service. Making enhancements to the Direct Entry System to enable an automated redirection of information to the Direct Entry Debit User⁹, in the instance where the Direct Entry Debit user is unaware of the new account from which the charges are to be debited, may also help support consumers to switch accounts without hassle. If this option were to be chosen it would be important to ensure that the proper incentives were in place on providers and recipients of information to ensure relevant changes were made quickly and effectively. Otherwise consumers may be exposed to costs resulting from failures of redirection, such as penalty fees.

⁹ The term "DE User" (DE credit and DE debit) 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.

With regard to the central registry service, we are unable to determine what exact service outcome will be established in terms of making the re-establishment of direct credit and debit with a new financial institution. The international experience compiled in the consultation paper notes that the central registry did not form any part of the account switching support service in the countries surveyed. We understand that establishing a central registry, where a strong bilateral system is at work would in fact generate substantial costs in changing the physical infrastructure as well as establishing other related bodies or authorities. We are aware that changing the architecture of the system will be costly, but as mentioned previously we stress again that a thorough understanding of the exact costs of both establishing such a change and again not achieving such a change is critical to assess its benefits.

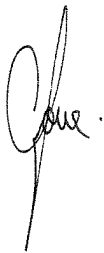
APCA has sought comment on who should bear the cost of suggested service enhancements. The lack of information on what these costs are or how big or small they may be inhibits our ability to make any conclusive remarks. However, we feel that charging the individual consumer for a particular service will only act as a further disincentive to switching accounts. For this reason we would not support any charge being placed on consumers for them to switch accounts.

Finally, we encourage APCA to continue engaging with stake holders on a regular basis to achieve the best possible outcomes for Australian consumers.

Should you have any questions about this submission, please contact us on 03 9670 5088.

Yours sincerely

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