CHAPTER 2

THE REASONS FOR AND IMPACT OF FEE INCREASES

2.1 The first term of reference of the Committee was the reason for and impact of fee increases on:

- ATM withdrawal (own machine)
- ATM withdrawal (foreign machine)
- Telephone transactions
- Internet transactions

2.2 The Committee isolated one major issue from this term of reference.

The effect of deregulation and competition on consumers generally

2.3 The major issue here was whether deregulation and competition has resulted in a more efficient market with increased benefits for consumers, or whether market forces have failed, with little benefit for retail customers.

Submissions on this issue from the banks

2.4 The Committee received submissions on its first term of reference from the Australian Bankers' Association and from a number of individual banks. The submissions advised generally that fee levels were set by the market and by competition, which had increased both in quantitative and qualitative terms since deregulation of the banking industry in the 1980s. In relation to the impact of fee increases the submissions advised that these were mitigated by competition, with banks offering products which would assist consumers to minimise transaction fees.

2.5 The ABA emphasised that banks and other financial institutions are subject to competition in pricing their products and services, including electronic services. The ABA noted that a succession of public inquiries has recognised that competition, including market based pricing, is the best way to increase benefits for consumers and the ABA strongly supports this position.

2.6 In addition, the ABA advised that the deregulation of financial markets has led inevitably to a user pays principle for retail transaction accounts and explicit fees for services. Before deregulation, borrowers paid high interest rates and savers received low interest rates to subsidise transactions. Now, however, there is an enormous range of innovative products and the choice of a far larger number of institutions, which set fees and charges based on costs. Explicit pricing has resulted in a more efficient financial system and is fairer to consumers, who pay only for what they use.

2.7 The ABA submitted that a significant number of bank customers pay no fees at all for a wide range of services and, for those who do, both the fee and the amount are low in absolute and relative terms. In any event, rises in fees were not as great as declines in interest margins. Between a third and three quarters of bank customers pay no fees on personal transaction accounts.

2.8 Turning to the impact of fees, the ABA advised that competition has forced banks and other financial institutions to provide fee discounts and exemptions to a wide range of customers, including children, students, pensioners and the disabled. Also, customers will usually be eligible for a fee discount or waiver if they provide their bank with a certain level of business through a home or other loan or by purchasing services such as funds management or superannuation. Centrelink has in collaboration with the ABA produced a popular brochure showing Centrelink customers how to minimise fees.

2.9 The ABA added that an important feature of most bank accounts was either a number of free transactions a month (usually about eight) or a set fee with no limit on transactions. This feature enables customers to minimise fees.

2.10 The ABA noted that most transaction fees have been steady since mid-1999, with the fees on low cost processes such as Internet and telephone payments generally lower than fees from higher cost processes such as over the counter withdrawals.

2.11 The ABA submitted that the impact of these fee structures is that customers are increasingly using cheap and convenient telephone and electronic banking services; this applies across age, gender and regions. These services are also more flexible, with about one third of ATM and EFTPOS transactions taking place outside traditional branch opening hours.

2.12 The ABA gave details of how a dramatic expansion by banks of electronic networks has improved customer convenience. For instance, in the last five years ATM facilities have increased by about 50% to 9,300 and EFTPOS machines by 32% to 265,000. Most banks also provide Internet banking and telephone based services. Australian banks arguably lead the world in investing in electronic banking.

2.13 Individual banks made similar submissions to that of the ABA. The Commonwealth Bank advised that customers now benefit from deregulation and greater competition, paying only for services actually received. Transaction costs can no longer be subsidised by income from other products and the present position is that fees for each service are more directly related to the cost of that service. Nevertheless, the costs of transaction services are still at least three times the fees collected.

2.14 As with the ABA submission, the Commonwealth Bank emphasised that the use of electronic transactions, including ATM, EFTPOS, telephone banking and the Internet, has been growing rapidly and now includes four out of every five Commonwealth Bank transactions. The Bank has invested heavily in this new technology to give customers cheaper and more efficient banking services. These new services give customers greater choice, with consequent benefits. The impact of fees on customers has, therefore, not been adverse.

2.15 The Commonwealth Bank submitted that EFTPOS transactions are particularly popular, with over 100,000 outlets. Shop assistants guide customers through transactions, with many customers considering EFTPOS to be face to face banking within a safe transacting environment. In December 1998 the Bank reduced EFTPOS fees and direct entry withdrawals by 12.5%, from 45 to 40 cents. This could be done because of economies of scale.

2.16 The Commonwealth Bank advised that its ATM network is similarly large, with 3,900 terminals. ATM fees for customers using its own machines relate to transactions in excess of a number of fee free transactions over a period, but include relationship rebates and other exemptions. Because these fees depend on transaction activity over the period, it is not possible to determine at a time during the period whether a particular transaction will or will not be subject to a fee. For this reason any fee notification requirement at the time of the transaction would itself have an impact on fees, resulting in a different approach to fee setting, as well as significant compliance costs, both of which could jeopardise the present rebates and concessions.

2.17 The Commonwealth Bank submission also addressed the reasons for foreign ATM fees, levied by banks on customers who use an ATM of another financial institution or ATM provider to recover costs charged by that provider. Foreign ATM fees are a fixed amount depending on the nature of the transaction. The emergence of ATM operated by non-financial institutions illustrate both the demand for ATM services and the willingness of consumers to pay for them; these non-financial institutions usually charge more than financial institutions.

2.18 The Commonwealth Bank confirmed that telephone and Internet banking was particularly convenient and flexible. Over two thirds of Commonwealth Bank customers do not pay transaction fees. One Bank product with 2.4 million accounts provides up to 10 free electronic withdrawals per month, with over 75% of these customers making fewer than 10 such withdrawals. The product has no minimum monthly balance requirement. The Bank in alliance with Woolworths provides a product that can be used in more than 600 Woolworths and related stores. The product includes 50 free in-store withdrawals each month with a further five free electronic withdrawals per month at any Commonwealth Bank ATM, EFTPOS, Internet or telephone banking. The product has no account keeping fee, no minimum balance requirement, a rewards program and interest rates comparable to a cash management trust. Access is through stores, a dedicated call centre (24 hours, 7 days), a dedicated Internet banking site, EFTPOS terminals, the ATM network and worldwide by credit card.

2.19 The Commonwealth Bank also offers a customer relationship fee rebate based on the amounts held by the customer in selected accounts. In addition, the Bank makes special arrangements for children, students, aged and war veteran pensioners and community groups. For instance, the majority of age and war veteran pensioner customers are entitled to a rebate of $6 per month, which allows additional fee free transactions such as three over the counter withdrawals, ten ATM, fifteen EFTPOS, or a combination of these.

2.20 The ANZ Bank also advised of the effect of competitive pressures and deregulation, which has resulted in less cross-subsidisation and in explicit fees for services. The old system of services, such as lending for housing subsidising individual customer transactions, could not be sustained in a competitive deregulated environment. The shift to differential pricing of delivery channels has resulted in a more efficient financial sector and in advantages for consumers, who are now able to shop around for the products which suit them.

2.21 The ANZ Bank submitted that there has been a major shift in the last 15 years in the way that customers access financial services. This change was caused by financial deregulation and the revolution in telecommunications technologies. Competition has forced the banks to unwind cross-subsidies, reduce mispricing and impose explicit fees for service, such as fees on transaction accounts. These fees have caused customers to use cheaper and more efficient financial services, in particular electronic banking.

2.22 The ANZ bank noted that this increase in electronic banking has been rapid and widespread, starting with ATM and moving to EFTPOS, telephone and Internet. In the last three years branch transactions have fallen from 20% to 12% and ATM from 16% to 13%, while EFTPOS has increased to from 41% to 43%. Telephone and Internet banking, which were introduced only during those last three years, now account for 6% and 1% respectively and are growing very rapidly. The reasons for the increase in electronic banking are rising levels of computer literacy, cheaper hardware and Internet access, consumer lifestyle and lower costs compared to traditional branch delivery.

2.23 The ANZ Bank charges transaction fees only for withdrawals in excess of a free number. Fees differ according to the channel used, as set out in the next table:

Channel	**Excess withdrawal fee**
Branch	2.50
ATM	.65
EFTPOS	.40
Telephone	.40
Internet	.20

2.24 The ANZ Bank calculates excess withdrawal fees at the end of each month, reviewing all withdrawals and counting the most expensive withdrawals first to include them in the free withdrawals. The incidence of excess withdrawal fees is low, with about 80% of customers in any given month not paying these fees. About 30% of customers are exempt, including full time students, children and customers with home loans.

2.25 The balance of ANZ Bank customers stay within the fee free limit. Fewer than 40% of withdrawals from all channels incur excess withdrawal fees. Customers therefore tend to ensure that they stay within their fee free limits. In particular, customers restrain their use of the more expensive channels. Also, the low proportion of excess withdrawal fees reflects the ANZ practice of first allocating expensive withdrawals to the allowance of free withdrawals.

2.26 The ANZ Bank has priced its delivering channels differentially since January 1997. Since that time excess withdrawal fees for branches have doubled, while those for EFTPOS and telephone have come down from $1.25 to .40 cents. This last reduction was based on economies of scale as customer usage increased. The Internet excess withdrawal fee at 20 cents represents a loss, but is designed to encourage customer usage in the expectation that it will grow and produce economies of scale which should cut the loss.

2.27 The St George Bank submission advised that at present telephone and Internet banking fees are set as loss leaders to encourage customers to use these new channels. The reasons for the loss were high development costs and low use of the new channel in its initial phase. Once customers start to use the new channels prices will be adjusted. A channel must have high volumes to operate in an economically sustainable manner. The reason for any fee increase is to ensure the commercial validity of the services provided. Cost recovery, competitive pressures and general commercial considerations are also taken into account.

2.28 The St George Bank noted that increases in electronic banking fees have not resulted in a decline in the use of those services, which indicates that customers use them by choice at that level of fee. In addition, customers are given information on how to minimise transaction fees, both when the account is opened and at any other time on request. This information also assists customers to minimise government charges.

2.29 The St George Bank advised that it charges customers a fee to use a foreign ATM, but in return it does not generate fees from substantial related costs, such as free minimum transactions and concessions for customers who maintain a minimum balance.

2.30 The Australian Association of Permanent Building Societies (AAPBS) generally made the same points as the banks, advising that there was an extraordinary contrast in customer services and convenience between the building society of today and that in the previous regulated environment. Building societies, because of the nature of their business, have always been reluctant to impose transaction fees, but the competitive environment now makes this difficult to avoid. Building societies have many customers who have large numbers of transactions on limited savings, accepting more Centrelink customers than their market share would suggest. The building societies support the need of these customers for a low cost transaction service, but there is a limit to moving against the trend to fee income. Building societies must have the flexibility to price their products in a competitive market to generate a reasonable return. Interference in the pricing mechanism can generate instability and lead to unsustainable low margins and loss of confidence. Competition will result in appropriate fee outcomes.

Submissions on this issue from consumer groups

2.31 The Committee also received submissions on its first term of reference from consumer groups and individual consumers. These differed significantly from submissions from the banks in that they disputed that effective competition existed between banks, asserting that supposed competition was of little benefit to retail customers. The submissions advised generally that the effects of deregulation were adverse to consumers, with the impact of fee increases falling most on the vulnerable and disadvantaged segments of society.

2.32 The most comprehensive submission on behalf of consumers was prepared collaboratively by a number of groups and submitted by the Consumer Law Centre Victoria Limited (CLC). The CLC submission concentrated on the impact of electronic bank fees on vulnerable customers, especially low income earners, benefit recipients, the elderly, the disabled and non-English speakers.

2.33 The CLC submitted that the free market does not deliver banking services to all who need them, as shown by unprecedented lack of consumer confidence in the banks. Increased profits together with increased fees and charges raise the question of whether the banks have any social responsibility towards vulnerable customers. Banks should be forced to adopt corporate citizenship responsibility.

2.34 The CLC questioned the proposition that the free market will control fee increases. The free market in banking benefits wealthy individuals and companies but disadvantages lower and fixed income consumers and customers with high transaction and low balance accounts.

2.35 The CLC submitted that new banking technology is driven more by the banks themselves than by consumer demand. Over the last 10 years banks have successfully changed the banking habits of consumers by discouraging the use of over the counter services in favour of EFTPOS services, initially by increasing fees on the former with no fees or transaction number limits on the latter. Once this was achieved, however, the banks then introduced fees on electronic services.

2.36 The CLC advised that the needs of all consumers are not the same and all customers are not disadvantaged in the same way. Needs are diverse and, in particular, fees on over the counter services discriminate against those with literacy, language or other disabilities due to the difficulties that these people have with electronic banking.

2.37 The CLC suggested that the above conclusions are reinforced by data showing increased use of electronic and telephone banking, with a significant reduction in branch numbers, particularly in non-city branches. All customers, however, need to use branches for certain services and vulnerable customers find the new technologies hard to access.

2.38 The CLC submitted that consumer groups are concerned about the impact of fee increases. Electronic and telephone banking continue to be marketed as more cost-effective transaction methods than over the counter products. However, there have been massive increases in fees for these services, with no regulatory control over either the fees or the increases. There is also significant variation between fees depending on the terms and conditions of different accounts and the form and number of transactions. Fees are also important because a larger proportion of bank profits are deriving from non-interest income. Specifically, consumer issues in relation to fee increases are:

- it is hard to determine the actual cost of banking services, given the limited range of information provided by banks on how charges are set and applied;
- different fee structures and complicated terms and conditions limit the ability of consumers to make informed, low cost decisions about banking services;
- regulation of bank fees and charges is inadequate;
- services in remote areas have been particularly affected by branch closures and reductions in service, accompanied by invitations to use poorly explained electronic banking services which are followed by dramatic fee increases;
- fees do not apply equitably, with high value customers given exemptions while high transaction and low balance customers pay disproportionately more for what is fundamentally an essential service.

2.39 One of the groups which contributed to the CLC submission was the Finance Sector Union (FSU), which represents 85,000 members employed throughout the finance industry, including the banks. The FSU advised that it has felt the impact of relentless cost cutting by banks, accompanied by waves of retrenchments. This has led to chronic understaffing of branches, together with a culture of overwork and expectation of overtime and increased hours. In addition, staff often bear the brunt of public outrage against fee increases, adding to existing high levels of work stress.

2.40 The FSU advised that fees to cover the costs of services are legitimate, but that there is concern about their level. There is, for instance, no link between fees and job security. Also, the FSU was concerned about the use of fees to modify customer services, particularly when there is no link between the cost of services and the fee charged and the introduction of fee free channels which are changed to fee based once customers have started to use them. There is also certain confusion about fees and charges, which have become so complex that it is hard for customers and staff to keep fully informed about them.

2.41 The FSU submitted that it sought the outcomes of an improvement in the relationship between the industry, customers and the general public, promoted by an open exchange of information, with a genuine commitment to ensuring access to low cost financial services for all. These outcomes would be facilitated by:

- monitoring of all fees, not just those on electronic transactions;
- a regular examination of the impact of fees on the cost of providing essential banking services;
- the development of core information which must be provided to customers when new fees and charges are introduced; and
- requirements that bank staff are fully trained in relation to new and existing fees and charges.

2.42 The CLC expressly addressed issues for rural and regional customers, advising that in these areas branches are closing due to new technology, cost cutting and mergers, with queues forming at the branches which remain. Customers especially in rural areas have become accustomed to face to face banking and find it difficult to adjust to electronic banking, apart from the extra cost of branch banking.

2.43 The CLC submitted that physically, mentally or socially disadvantaged people do not find electronic banking to be user friendly. Also, such people often pay more in fees and charges because they are unable to select the most cost-effective package for them out of the large number of alternative banking services and electronic options available.

2.44 The CLC made a number of recommendations about fees and education in relation to electronic banking, as follows:

- if a bank closes a branch and does not provide the local community with an ATM, and the only nearby service is not the user's bank, then the user's bank must pay the cost of any extra transaction fees;
- people with a disability who must deal directly with a teller because they are unable to operate an ATM should not be charged a fee;
- people with different levels of financial knowledge should have explained to them at their level how best to use a product;

- banks have a responsibility to inform individual customers of products which will assist the customer's specific circumstances and to encourage them to use those products;

- access to electronic cash or credit in hotels and clubs can entice people into gambling habits; which is a problem which should be addressed by education; and

- a fund should be established, paid for by the banks, to educate users of banking services, although if such education is successful, aided by the demise of the generation not brought up with electronic banking, then the fund need only be transitional.

2.45 The CLC submitted that numerous government inquiries have made many recommendations to benefit consumers but few have been adopted. The Prime Minister has stated that the banks have a community responsibility and that the government would take action if this responsibility is not met. The CLC suggested that the banks are not meeting these obligations, with unprecedented disapproval and mistrust of banks by the public. Therefore the government should act urgently and intervene to regulate fee increases.

2.46 Mr John Watkins MP, the NSW Minister for Fair Trading, submitted that the deregulation of the banking system which had commenced in 1985 had changed the delivery of banking services. Previously there was a choice of branches in suburbs and small towns, which provided services free of fees. Now many banks pursue niche markets, with more off-street outlets in shopping centres and stores but fewer full branches.

2.47 Mr Watkins advised that before deregulation the banks recovered the costs of transaction services through interest margins. However, in the present competitive environment the banks attract the most profitable customers by waiving fees, while imposing fees on the smaller, higher cost accounts. The banks now encourage the use of electronic banking, but while older and less able people can use ATM and EFTPOS, telephone banking is more complicated and Internet banking is irrelevant for many customers. The impact of these developments has been a consumer backlash.

2.48 The National Council of Women of Victoria (NCWV) submitted that fee levels reflect the fact that banks are more interested in the business sector than in individuals or families. It was deplorable that the banks pressured customers to use ATM by placing fees on counter transactions, then imposed fees on ATM transactions. In particular, the number of free ATM transactions per month disadvantages the elderly who do not wish to keep money in the house. People are also disadvantaged when a local branch closes and the nearest ATM is not operated by their own bank.

2.49 The NCWV advised that telephone banking is difficult for the elderly, those for whom English is a second language, the intellectually challenged and those with hearing difficulties. There is also a range of problems with the actual operation of telephone banking and with bank staff in branches not being trained to explain Internet banking. The banks, however, have pressured retail customers to use these channels.

2.50 Submissions received from other individual consumers made similar points to the above submissions. For instance, Mr Bill Watson, a retired bank manager with 34 years experience in the industry, advised that when ATMs were first installed there was free interchange between all banks, even overseas. This was because each bank would incur the same operating costs. The free service soon attracted customers. Later, however, each bank decided to impose a fee on transactions by customers of the other banks and to pass on this fee to customers. The same process occurred with EFTPOS. Now the banks encourage customers to use ATMs and EFTPOS by imposing fees on over-the-counter transactions.