CHAPTER 7

FINDINGS AND RECOMMENDATIONS

FINDINGS OF FACT

Reasons for fee increases?

7.1 On the evidence presented to the PJSC it is clear that increases in fees and charges on electronic 'banking' transactions have occurred primarily as a result of the adoption of a user-pays charging structure by financial institutions on a range of services. This has been fostered by the deregulation of financial services in the mid-1980s which resulted in substantial reductions in the financial institutions' margins between borrowing and lending rates. Hence, these margins no longer subsidised to the same extent other services provided by the institutions, including transaction costs, to the same extent.

7.2 Despite this move toward a user-pays system, the evidence presented leaves the Committee in no doubt that there remain substantial cross-subsidies within financial institutions, which make it difficult for consumers to ascertain whether they are paying a competitive or fair price for the service being provided to them.

7.3 The PJSC notes, however, that while cross-subsidisation may reduce the transparency of pricing in the marketplace much of the cross-subsidisation that remains within institutions and the sector as a whole (eg. fee free accounts for customers who hold mortgages) is competitively driven and results in a positive welfare effect for a large number of consumers.

7.4 There is also substantial evidence to indicate that financial institutions have historically underpriced the cost of electronic 'banking' transactions, to attract customers to these new ways of conducting transactions. However, once a substantial base of customers moved away from traditional forms of transactions, such as 'over the counter', to the new electronic forms, the financial institutions increased fees substantially in percentage terms, if not in absolute dollar terms. The net result of which has caused an observable increase in fees and charges across a range of electronic banking transaction services.

7.5 The fact of these fee increases indicates market failure, which the Committee finds largely is a consequence of the lack of real-time disclosure of fees for electronic banking transactions.

7.6 Research conducted for the Bank of Boston clearly demonstrates that greater transparency with regard to the availability to customers of information on fees changes customer behaviour, thereby increasing competitive pressure for fees to be reduced.

7.7 The Bank of Boston survey results found that when customers were advised, immediately before conducting a transaction at an ATM which was not one of their own bank's, that a surcharge would apply, 25 per cent cancelled the transaction and sought out an "own bank" ATM to conduct the transaction.

7.8 One area that has proved problematic to PJSC is the cost of foreign ATM withdrawals. Indeed the PJSC notes that the cost of this service, unlike the cost of other electronic banking transactions, bears no relationship to the marginal cost of providing the service.

7.9 The PJSC is concerned that financial institutions are making abnormal or supranormal profits on foreign ATM withdrawals and that the reason for the disparity between the marginal cost of the service and the price charged may be the result of collusive activity between financial institutions or, at the very least, lack of competition in this service.

7.10 The PJSC finds that on the basis of the Reserve Bank and ACCC study of interchange fees that the banks may be making oligopolistic (in the economic sense of that word) profits through ATM interchange fees. The PJSC also finds that there is the potential for excess profits in other areas of electronic and telephone banking. This is despite economic and competition theory which would predict that such profits would attract competitors who accept lower rates of return, leading to more competition and lower prices for consumers.

What has been the impact of fee increases?

7.11 The PJSC notes that the majority of revenue generated from fees associated with electronic banking has been reinvested into banking infrastructure, such as ATMs, and that this has resulted in a rapid expansion in the ATM network and the development of new and innovative electronic banking services. The net result has been a substantial increase in access to electronic banking services and a substantial increase in the economic welfare of consumers of electronic banking services.

7.12 The PJSC notes that increases in banking fees and charges on electronic banking services are generally viewed as having a regressive impact on lower income groups. However, the existence of a range of safety net services which are voluntarily offered by financial institutions has substantially reduced this impact such that the distributional effect of fee increases can be viewed as having at the very least a proportional impact across consumer segments.

7.13 The PJSC accepts the evidence presented that up to 75% of customers pay no fees at all on personal accounts and that most banks provide substantial fee discounts and exemptions for people who are financially disadvantaged or disabled, and for pensioners and students.

The availability and transparency of fee information for consumers who undertake electronic fund transactions or telephone banking

7.14 The PJSC considers that the availability and transparency of general fee information is good, with the ASIC approved codes of conduct providing comprehensive advice on fees and charges well before they take effect. The EFT Code in particular sets out clear statements which should be enhanced further by the current review. The PJSC notes that the codes are market based and self-regulatory, which provide more effective outcomes than direct regulatory intervention.

7.15 The PJSC especially finds that in any event banks provide more information than the codes require, providing express information on how to manage and minimise fees. This is done by training counter staff to assist in this regard, by information on account statements and by letters to customers. The PJSC commends the banks for the increasingly common practice of disaggregating fees and charges, breaking these down into individual components, thereby enabling the customer to control the impact of excess transaction fees.

7.16 The PJSC also notes that banks publish extensive fee information on the Internet, which is a particularly effective channel for disclosure. Most banks display excess withdrawal fees on the home page each time a customer logs on for Internet banking, as well as listing and explaining other fees in relation to personal and small business accounts. Also, information displayed on the Internet in this way attracts the attention of the consumer better than the more traditional brochures.

7.17 The PJSC finds, however, that a major shortcoming is a lack of fee disclosure at the point of transaction of electronic banking, which is often the most significant time in relation to informed consumer decisions. This is because the information which is disclosed is generic, applying only to that particular product, rather than personalised advice about the effect of a particular transaction upon the individual consumer. This reduces the availability of critical information and the ability to make an informed choice.

The feasibility of implementing a real-time disclosure regime on electronic fund transactions and telephone banking

7.18 The PJSC notes that there is a consensus that real-time disclosure, or disclosure at the point of transaction, is technically feasible, although there are different views about the time within which this can be introduced. One view is that this could only be implemented in the medium to long term, because of technical difficulties and high costs, which would be paid by the consumer. Another is that significant real-time disclosure could be achieved within one or 2 years in relation to Internet and telephone banking and ATM. Regardless of the timing, however, the PJSC finds that the introduction of real-time disclosure would result in downwards pressure on fees and charges.

7.19 In spite of this downward pressure, the PJSC accepts that there would be substantial costs if real-time fee disclosure was implemented immediately. These costs include replacement of the present front-end computers to which ATMs are connected, new operating systems, longer response times with longer queues and bigger call centres.

7.20 The PJSC expressly finds, however, that a 5 year delay in implementing real-time fee disclosure would have an unacceptably adverse effect upon consumer welfare. The PJSC finds that Internet and telephone banking and ATMs afford opportunities within a shorter time frame to introduce significant aspects of real-time disclosure.

The role of ASIC in ensuring bank, non-bank financial institution and non-financial institution suppliers and operators of those facilities, provide appropriate fee information on electronic and telephone transaction banking

7.21 The PJSC notes ASIC's general role in enhancing disclosure and transparency in the financial services market. The PJSC has confidence in the processes established by ASIC to review the EFT Code and, in particular, in the principles of operation agreed by the ASIC Transaction Fee Disclosure Working Group.

Additional matters arising from the inquiry

7.22 The PJSC finds that another significant issue that arose from the evidence was that of ‘surcharging’. Surcharging refers to a situation where an ATM operator charges a transaction fee, for conducting banking services via an electronic terminal, which does not relate to the maintenance of an account held by a financial institution.

7.23 The PJSC notes that no financial institutions in Australia impose a surcharge, although the practice is common, for instance, in the United States, where it causes considerable controversy. The PJSC endorses the position that any surcharge should be subject to effective disclosure prior to the transaction.

7.24 The PJSC warns, however, that the non-financial institution operators who impose surcharges are not signatories to the EFT Code, whose provisions apply only to financial institutions. The PJSC cautions that this is a potential loophole which should be addressed, to ensure appropriate disclosure requirements for third party operators. The Committee’s finding in this instance is reinforced by the fact that approximately 4,000 ATMs have been purchased by non-financial institutions in the last 12 months.

7.25 While the issue of banks having what are termed community service obligations was not a term of reference of the inquiry, it was raised by some witnesses and the Committee notes that banks need to address this issue. The PJSC notes that communities, particularly in rural and regional Australia, expect a minimum level of banking services as part of the community infrastructure. To foster good customer relations by seeking to meet community expectations is in the banks’ own commercial interests. Accordingly, the PJSC expects that the banks will seek to maintain the feasibility of traditional services, such as branches, but where they are closed, banks should make special efforts to compensate for this by facilitating alternative ATM and other electronic and telephone banking for those affected.

Recommendations

7.26 The PJSC **recommends** that a framework for a real time disclosure regime on electronic and telephone banking needs to be established in no more than two years and implemented within six months of the finalisation of the framework. On technical grounds the PJSC would accept the exclusion of EFTPOS transactions from this timeframe.

7.27 The PJSC **recommends** that ASIC report back to the Committee its progress in implementing this recommendation on a quarterly basis, with a review of its progress at the two year deadline.

7.28 The PJSC **recommends** that financial institutions provide to customers:

- a transaction statement through their ATM terminals and through their Web Sites setting out the number of previous transactions undertaken in at least the last month;
- that monthly account statements include a breakdown of all fees and charges, not simply a lump sum amount, and that these fees and charges be displayed in a prominent manner; and
- that as a transition to real-time disclosure, a warning notice be displayed at all ATMs immediately indicating that a fee will be charged on foreign ATM transactions.

7.29 The PJSC **recommends** that interchange fees between banks in relation to foreign ATM transactions be abolished immediately and replaced by direct charging with the effect of reducing foreign ATM transaction fees from approximately $1.50 to 50 cents.

7.30 The PJSC **recommends** that all of these recommendations be included as requirements in the EFT Code of Conduct.

7.31 The PJSC notes that the practice of surcharging creates a potential risk for consumers and that as a matter of course **recommends** that any surcharge must be disclosed. Consequently, the PJSC **recommends** the insertion into the EFT Code of Conduct of a provision that would require parties to the Code to make it a condition of their merchant agreements that surcharges be disclosed in time for a transaction to be cancelled.

7.32 The PJSC **recommends** that if, two years after the introduction of real-time disclosure, the level of electronic banking fees provides evidence of continuing market failure, then the Productivity Commission should inquire into the reasons for this and recommend measures to alleviate it.

Senator Grant Chapman
Chairman