

3 September 2007

Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Sir/Madam

Inquiry into: Australian Securities and Investment Commission (Fair Bank and Credit Card Fees) Amendment Bill 2007

The Consumer Credit Legal Service (WA) Inc is a community based legal service specialising in financial services, particularly matters and policy issues related to consumer credit, banking and debt recovery.

The service provides free legal advice and assistance to consumers in the areas of banking, credit, debt and related matters. We also provide community legal education and seek to identify areas where there is a need for law reform, and then advocate for changes. We have a particular focus on issues that affect low income and disadvantaged consumers.

We are pleased to provide a response to the Senate Economics Committee's inquiry into the Australian Securities and Investment Commission (Fair Bank and Credit Card Fees) Amendment Bill 2007 (the Bill). This response is based on our experiences assisting clients who are having disputes with banks and financial institutions.

We welcome the private member's Bill that proposes to limit fees that can be imposed by banks. Penalty fees have a significant impact on many consumers and have a particularly devastating effect on low income and vulnerable consumers.

Penalty Fees

Banks currently charge a multitude of fees on their products, ranging from general account keeping fees to fees charged for customer defaults (commonly referred to as penalty fees). Penalty fees are commonly charged when a bank customer exceeds his/her credit card limit, overdraws an account, has insufficient funds to honour a direct debit or when a cheque that is presented for payment is dishonoured.

Banks place various titles on penalty fees, including dishonour fees, exception fees and over the limit fees. Penalty fees are generally charged at a rate of between \$25.00 and \$50.00

per default. A lack of transparency within the banking industry makes it unclear how the banks calculate penalty fees. However, we suspect that penalty fees bear no relationship to the amount of money incurred by the bank to process the default.

The banks' policies enabling defaults to occur contributes to an excessive number of penalty fees being applied to bank accounts. For example, it is common policy for banks to allow customer's to exceed credit card limits, however most impose a penalty fee. In practice, the term 'credit card limit' indicates the level of credit, which if exceeded, will incur an additional fee as opposed to any practical barrier to accessing more funds. These policies raise questions about the banks motivation to allow access to over the limit funds and their commitment to ensuring their customers are not suffering from financial hardship as a result of their policies.

The CCLS(WA) Advice Line receives a substantial amount of calls from WA consumers upset at being charged penalty fees, which they generally consider to be extremely unfair. Consumers that complain to the banks are generally told that the fees are allowable under the terms and conditions and that they cannot be reversed. For many of our client's the fees cause financial hardship.

Case Study 1

The client was in financial difficulty and had borrowed \$600.00 from a fringe lender to pay bills and buy groceries. The fringe lender required repayments to be made by direct debit from the client's bank account. The client had no money in the account to cover the second repayment. The fringe lender tried 3 times to take the money out of the client's account over 2 days. The bank charged the client 3 \$35.00 dishonour fees, totalling \$105.00. The client contacted the bank to query the amount Centrelink had deposited into the account and discovered half the payment had been taken up by the repayment and bank fees.

Report into Penalty Fees

In December 2004, the Consumer Law Centre Victoria released a report titled "Unfair fees: A report into penalty fees charged by Australian banks" (the Report) questioning the legality of penalty fees charged by banks. This report found that penalty fees are not only unfair but also illegal in many circumstances. Australian contract law allows payment of a sum of money to an 'innocent party' if a contract is breached. However, a contractual clause of this nature is valid and enforceable only if the amount provided for is a genuine pre-estimate of the loss likely to be suffered as a result of the breach of contract.

The Report found that the fees charged by Australian banks are out of all proportion with the loss suffered by the 'innocent party'. For example, the report estimates that Australian banks could be charging between 64 to 92 times what it costs them to process a direct debit dishonour. It follows that the report found that if these fees are in fact penalties at law then they are unenforceable by the banks against their customers.

In addition, the Report points to the banks failure to disclose the true cost of dishonours to consumers. There is no publicly available information regarding the costs that Australian banks incur in processing dishonours and over the limit use on bank products. It recommends that Australian banks should release sufficient data to enable the Australian public to make an accurate assessment of the costs incurred by banks in processing customer defaults.

The inequality in bargaining power and lack of transparency regarding bank fees is deeply concerning and we support the findings and recommendations of Consumer Law Centre Victoria's report.

Impact of Penalty Fees

In practice, the cost of penalty fees is disproportionately borne by disadvantaged and vulnerable consumers who can least afford to pay them.

The clients that we have assisted with disputes about bank fees generally fall into one or more of the following categories:

- Centrelink recipients;
- People who have experienced an unexpected event that has led to a decrease in income or an increase in expenditure, such as illness and unemployment;
- Low income earners;
- Mentally ill;
- Indigenous people;
- Migrants;

Generally speaking, these categories of people can be characterised as vulnerable and disadvantaged and are often financially marginalised in Australian society. These are the groups of people who can least afford to pay penalty fees. Charging penalty fees can have a severe and disproportionate impact on these consumers. In particular, it can have a devastating effect on a Centrelink recipient and may constitute more than 30% of their weekly income.

Case Study 2

The client had suffered from Bipolar disorder for many years. His condition deteriorated and he was unable to continue working. The client was struggling to make the repayments on his credit card due to his drop in income. The client tried in good faith to meet the repayments but eventually failed to make a repayment by the due date. A late payment fee was applied to the account, which put the account over its credit limit. An over the limit fee was also applied to the account. When the client made the repayment, it simply covered the penalty fees and he remained in default.

Case Study 3

The client had to stop working to care for her sick husband and was experiencing extreme financial difficulties as a result. The client had a substantial credit card debt that she was trying to repay. The bank advised her to directly debit repayments from her savings account where her Centrelink income was deposited to the credit card. The client organised the direct debit to be deducted the day after her pension was deposited to the account. The bank incorrectly deducted the direct debit the day before the pension was deposited and there was no money in the account. The client was charged a \$40.00 penalty fee even though the bank failed to debit the account on the correct day.

Case Study 4

The client was a single mother reliant on Centrelink. She received a letter from the bank informing her that her account was \$37.00 overdrawn. She contacted the bank and was informed that her monthly account fee had been debited to the account and that this had overdrawn the account by \$2.00. Accordingly, the bank had charged a \$35.00 default fee. The client had to be referred to a financial counsellor for emergency relief as she did not have enough money to pay an overdue power bill and was in danger of being disconnected.

Social Costs and Related Problems

In the short term, bank fees can have a devastating impact on disadvantaged and vulnerable consumers. However, the impact is potentially more far reaching and imposes a social cost on the Australian community. Although not exclusively responsible, anecdotal evidence shows that penalty fees contribute to the following related problems;

1. A large amount of Centrelink income is used to repay bank fees and charges, leaving Centrelink recipients less to spend on other expenses.
2. Penalty fees cause significant pressure on community services. For example, financial counsellors spend a notable amount of their time trying to negotiate payment plans for their clients who have incurred penalty fees.
3. Many of the consumers incurring penalty fees are at risk of eviction and disconnection of essential services.
4. Increased financial exclusion and marginalisation of sections of the Australian community.

The Bank's Position

Australian banks commonly justify penalty fees on a number of levels, claiming that:

- They are simply recovering costs;
- They allow accounts to be overdrawn for the benefit of customers;
- Customer's can avoid the fees by keeping their accounts in order;
- The fees are clearly disclosed to customers;

In our opinion these responses have questionable merit. Consumer Law Centre's Report, referred to earlier, clearly found that the banks are not simply recovering costs, but levying fees out of all proportion with the loss suffered by the bank in processing a customer default.

We are also of the opinion that allowing a customer to overdraw their account causes short and long term detriment to vulnerable and disadvantaged bank customers. In the short term, the bank customer must prioritise repayment of the overdrawn amount and penalty fee, potentially leaving insufficient funds for other essentials. If it occurs repeatedly, the bank customer has little chance of efficiently managing their budget or getting ahead.

In our experience, low income consumers are often unable to avoid penalty fees. Many low income consumers use their entire wage or Centrelink payment within the payment period and do not have savings to fall back on. It follows that these consumers often have empty bank accounts and credit cards at their credit limit. This makes them extremely vulnerable to

penalty fees. In these circumstances, it is not always easy to simply keep their accounts in order.

Bank customers usually discover that a penalty fee has been applied to their account after the fact. Most callers to our Advice Line express surprise and outrage. In our opinion, this does not demonstrate that penalty fees are being clearly disclosed to customers. In practice, when a customer opens a bank account they are handed a standard form contract including the terms and conditions, of which they have no ability to negotiate. The terms and conditions are often in a font size 8 print booklet that is very difficult to read for even the most educated and knowledgeable consumers. There does not appear to be any commitment on the part of Australian banks to clearly disclose the fees and therefore assist consumers to avoid them.

The banks' responses to this issue are disappointing and fail to recognise that many of their customer's are experiencing genuine financial difficulties.

Need for Regulation

In our experience, many bank customers feel misled about penalty fees and we believe that there are many benefits in regulating their use, including;

- An increase in transparency in the banking industry;
- A fairer market, with increased consumer confidence in the market;
- Reduced opportunities for exploitation of consumers, especially vulnerable and disadvantaged consumers;
- Overcoming significant barriers for bank customer's to 'talk with their feet' and make informed decisions when choosing banking products;

In general terms, we strongly support the proposed amendment as a starting point to address the problems associated with charging penalty fees.

However, in our opinion the proposed regulation could go further to protect vulnerable and disadvantaged consumers and promote competition within the banking industry. In particular, we recommend a further amendment requiring;

- Limits on the frequency that a penalty fee can be levied;
- The requirement for banks to publicly disclose their processing costs to allow greater transparency and potentially create more competition and a reduction in fees across the industry.

Conclusion

One of the objectives of the ASIC Act is to promote the confident and informed participation of investors and consumers in the financial system. The proposed amendment will contribute to achieving this objective.

The lack of fairness in consumer transactions and the inability to bargain is increasingly concerning. This lack of fairness has been noted within the financial services industry. Members of the Code of Banking Practice must act fairly and reasonably towards their customers and the Banking & Financial Industry Ombudsman must take into account concepts of fairness when making decisions.

Given the questionable legal status of these fees and the impact that they are having on low income consumers, the Australian Government should prioritise the regulation of penalty

fees to correct market inefficiencies and protect Australian consumers from questionable practices.

Thankyou for the opportunity to comment.

If you have any questions or would like to discuss this matter further, please contact us on (08) 9221 7066.

Yours sincerely

Consumer Credit Legal Service

Alison Pidgeon
Solicitor

John Perrett
Co-Ordinator