Submission to the Financial System Inquiry

31 March 2014

57 Carrington Road Marrickville NSW 2204

Phone 02 9577 3333 Fax 02 9577 3377 Email ausconsumer@choice.com.au
www.choice.com.au

The Australian Consumers' Association is a not-for-profit company limited by guarantee.
ABN 72 000 281 925 ACN 000 281 925

About CHOICE

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. As vital today as when we were founded in 1959, CHOICE continues to fight for consumers and uncover the truth.

By mobilising Australia's largest and loudest consumer movement, CHOICE fights to achieve real change on the issues that matter most to Australian consumers.

To find out more about CHOICE's campaign work visit www.choice.com.au/campaigns and subscribe to CHOICE Campaigns Update at: www.choice.com.au/campaignsupporter.

1. Executive Summary and Recommendations

CHOICE welcomes the inquiry into Australia's financial services sector. Seventeen years after the Wallis Review, the Financial System Inquiry (FSI) is a timely opportunity to build on that work and further strengthen a sector that provides essential services to Australian consumers.

This is particularly the case given the ongoing rapid pace of technological advancement and the continued globalisation of economic activity – of which the financial services industry is a central component. It is also appropriate to review the financial services industry in the wake of the global financial crisis (GFC) and the regulatory response that followed.

The GFC highlighted not only the systemic risk of financial system upheaval, but also the impact on consumers and society more broadly – and this impact is the primary focus of CHOICE. Our role is to empower consumers, through providing the unbiased information that consumers need to make informed decisions, and by promoting reforms that ensure the interests of consumers are both protected and strengthened. CHOICE welcomes the opportunity to do this in the context of the FSI.

The GFC also served to highlight the robustness of Australia's financial system during and since that period of turmoil. The Wallis reforms reflected substantial structural change, and broadly speaking, CHOICE believes that those reforms have advanced the interests of consumers, who are of course the single largest end users of banking and financial services. In particular, CHOICE would highlight the licensing requirements, external dispute resolution arrangements, and industry-specific regulation as examples of the strengths of the current regime.

Importantly, the current regulatory regime allows for flexibility to respond to developments in the marketplace – something that CHOICE considers to be a hallmark of good regulation. The industry specific consumer protections that apply to the Australian financial services sector were arguably important contributing factors in minimising the impact of the GFC in this country. Sector-specific consumer protections have proven to be highly effective both for individuals and for promoting system stability and achieving broader economic outcomes. Having said this, the FSI represents an opportunity to assess the current regulatory structure and build upon the solid foundation of the Wallis reforms to continue to drive competition and consumer protection, ensuring Australia's financial system remains robust into the future.

In particular, CHOICE believes that there is scope to further enhance the current competitiveness of Australia's financial system from both the supply and demand perspective. We believe that consumers are fundamental to the competitive process – indeed, the best consumer protections actually increase competition.

This submission draws on new consumer research to provide insights around the everyday experiences and priorities of Australians using financial services and products. In doing so, we build on the case outlined in our 2012 *Better Banking* report, a copy of which is available on the CHOICE website for the information of the Inquiry.

This submission contains a number of recommendations that CHOICE considers to be both realistic and achievable. They recognise the commercial realities and needs of Australia's financial system, seek to promote competition, and also ensure consumers both continue to be protected and benefit from a sound financial services sector.

The recommendations outlined in the body of the report can be summarised as follows:

Recommendation 1: Recognising the role of consumers in generating demand-side competition, investigate options that enable to consumers to easily make choices between service providers.

Recommendation 2: Reassess current approaches to product information and disclosure across the range of financial products and services in order to improve the level of transparency within the sector and enable consumers to better engage with service providers on a more equal footing.

Recommendation 3: Consider ways in which government can work with industry to provide consumers with safe and secure access to their own personal data in order for them to gain insights into their own use of products and services, and to make better choices about the products and services which best suit their needs.

Recommendation 4: Maintain the ban on mortgage exit fees, given the positive outcomes of this initiative for enhancing competition, choice and informed consumer decision making.

Recommendation 5: Maintain the regulatory powers of ASIC, including through adequate funding to enable ASIC to perform its functions effectively. Ensure that ASIC has the capacity to deal with new products and developments in the market.

Recommendation 6: Maintain the important role of External Dispute Resolution schemes in Australia's financial services sector, recognising their substantial benefits for both consumers and the market overall.

Recommendation 7: Have particular regard to recent and future trends and developments in technology, including the increasing prevalence of e-commerce and m-commerce. The potential benefits of these technologies are significant, particularly for increased competition, however this requires that consumers have confidence and are adequately protected in a constantly changing environment.

Recommendation 8: Have regard to the issue of a 'level playing field' in the provision of banking and financial services, and whether the current arrangements are in the best interests of consumers.

Recommendation 9: Maintain and bolster initiatives that improve the financial literacy of consumers to enable them to make better and more informed decisions, and reduce the current level of information asymmetry held by the financial institutions. In particular, provide ongoing support for financial counselling services to assist Australians in vulnerable circumstances.

Recommendation 10: To the extent that the FSI considers the Future of Financial Advice amendments, determine whether the regulatory environment is adequate to ensure consumers have access to quality financial advice, can have confidence in the financial planning industry and facilitate access through the provision of simple or limited advice.

Recommendation 11: Identify impediments to consumers accessing affordable, transparent and convenient payment options, including for online payments given the growth in the online retail. As a priority, this should include enforcement of the Reserve Bank of Australia's rules limiting excessive credit card surcharges.

Recommendation 12: Investigate opportunities to improve product disclosure, insurance products and fee transparency in superannuation. Consideration could also be given to any regulatory impediments relating to the allocation of Australia's superannuation savings that can help to diversify the exposure of consumers – particularly those of or nearing retirement age – to global equity markets and, by doing so, reduce the financial risks they face.

Recommendation 13: Fund a centre for superannuation consumers to improve the operation of the superannuation system, so that it delivers the best possible income for Australian consumers.

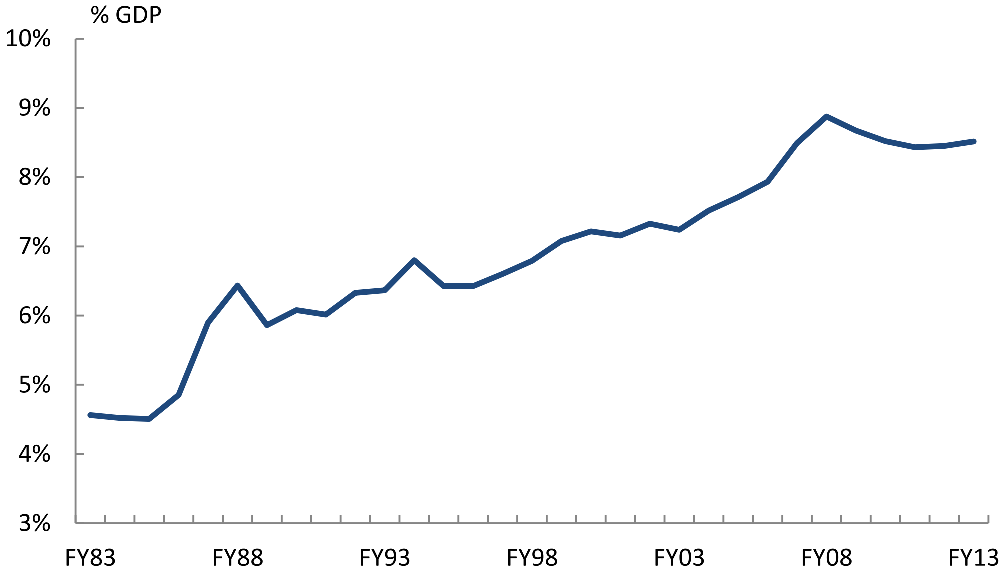
Recommendation 14: Investigate and seek to address any market failures in Australia's insurance sector to promote consumers' access to affordable insurance cover, such that they are able to protect themselves against a range of adverse events.

Table of Contents

2. Introduction

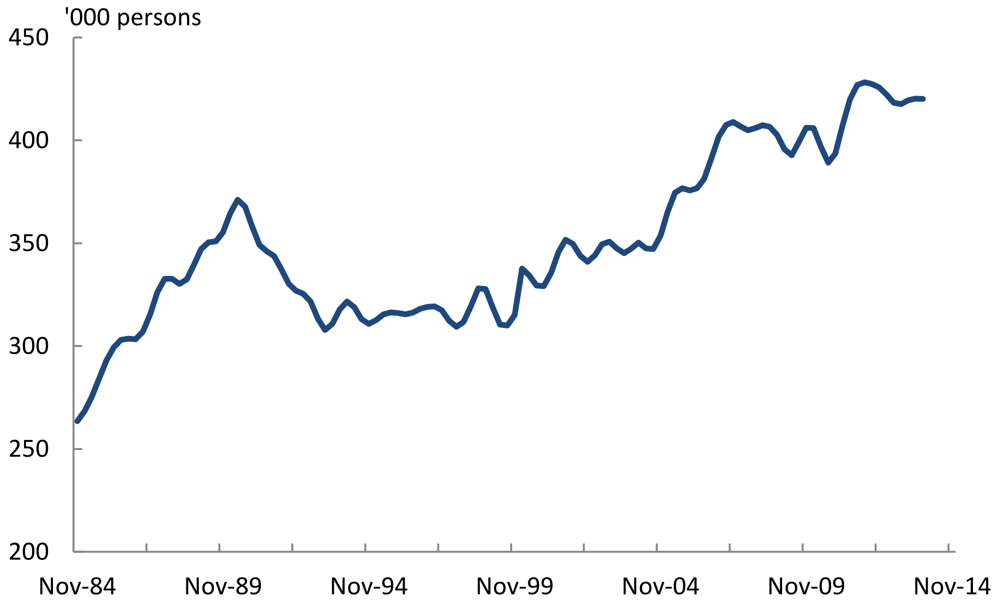
The role of the finance and insurance sector in Australia has been growing in importance over time. In 2012-13, the Financial Services sector accounted for around 8.5 per cent of Australia's GDP, up from 7.2 per cent a decade ago and 6.4 per cent 20 years ago (Figure 1). The sector currently employs around 420,000 people (Figure 2).

Figure 1: Financial and Insurance services – share of Australia's GDP



Source: ABS

Figure 2: Financial and Insurance services – employment



Source: ABS

But beyond this significant economic impact, a safe, efficient and productive financial system is critical to the proper functioning of a modern and prosperous society. Consumers need to have confidence in all aspects of the financial system.

Banking and finance services are essential for Australian consumers. It is hard for people to play a full and productive part in the community without access to effective financial products and services. As a minimum, we need bank accounts to be paid by employers; to receive income in welfare or retirement; to hold our savings securely; and as the basis for carrying out millions of transactions every day.

In addition, banking and finance is somewhat different to other sectors in terms of the nature of the relationship between the market participants and consumers. Individual consumers often tell CHOICE of their feeling of powerlessness when dealing with financial institutions. This is partly because understanding the market and the terms and conditions of different products is often impossible for individuals to do alone. The extent of this "information asymmetry" between providers and customers who need their products is atypical.

For these reasons, market dynamics alone are not sufficient to protect consumers and provide the products and services they demand. Market forces need to be supplemented by an appropriate regulatory framework in order to balance the sometimes competing aims of business and consumers and deliver outcomes which are in the best interests of the community overall – not just one element thereof.

CHOICE believes that one of the most important characteristics of Australia's financial system is its framework of industry-specific regulation, as distinct from a reliance on general consumer protection legislation. CHOICE advocates for consumers across many sectors that feature industry-specific consumer protections, for example product safety, pharmaceuticals and food safety. In each case, the approach is based on the level of risk to the consumer, including the likely consequences of failure. Financial services can involve significant risks to consumers, given the substantial consequences of unsafe products, such as the loss of a home or retirement savings, and the essential and compulsory nature of certain services, such as superannuation contributions. It is not appropriate to rely solely on the sorts of 'after the fact' protections provided by general consumer protection law, like penalties for misleading or deceptive conduct, or unfair contract terms. The level of risk involved in many areas of financial services requires proactive, pre-sale protections.

The consumer protections put in place in the Australian financial system by successive governments have arguably contributed to minimising the impact of the GFC in this country. They are relevant to system stability and broader economic outcomes – benefitting all stakeholders, not just individual consumers – and should be maintained.

CHOICE strongly supports regulation that promotes competition, protects consumers and ensures that banks and other financial institutions behave responsibly on a genuinely level playing field. These goals need not be in conflict.

As the Chair of the US Federal Deposit Insurance Corporation puts it: 'there can no longer be any doubt about the link between protecting consumers from abusive products and practices and the safety and soundness of the financial system.'[1]

In a similar vein, the European Commission says that 'safeguarding systemic stability in the short-term should not result in longer-term damage to the level playing field and competitive markets.'[2]

As the single largest group of end users of financial products and services, consumer interests should be central to any investigation of Australia's financial system. Further, any comprehensive assessment of the efficiency and competitiveness of the financial services sector should consider the capacity of consumers to drive competition on the demand side, rewarding those businesses that most efficiently meet their needs and preferences.

Research undertaken by CHOICE (see section 2a below) provides insight to the priorities of consumers for the FSI (see Figure 3):

- The vast majority (89 per cent) of respondents feel that it is important the Federal Government focus its review of the Australian financial system on increasing protection for consumers. This is followed by reducing excessive credit card surcharges (86 per cent), providing better information for banking customers (84 per cent), increasing competition between banks (83 per cent), increasing stability of the banking sector (83 per cent) and making it easier to switch between banks (78 per cent).

- In comparison, decreasing regulation of banks (46 per cent) and increasing dividends to the banks shareholders (40 per cent) are seen much less important for the review.

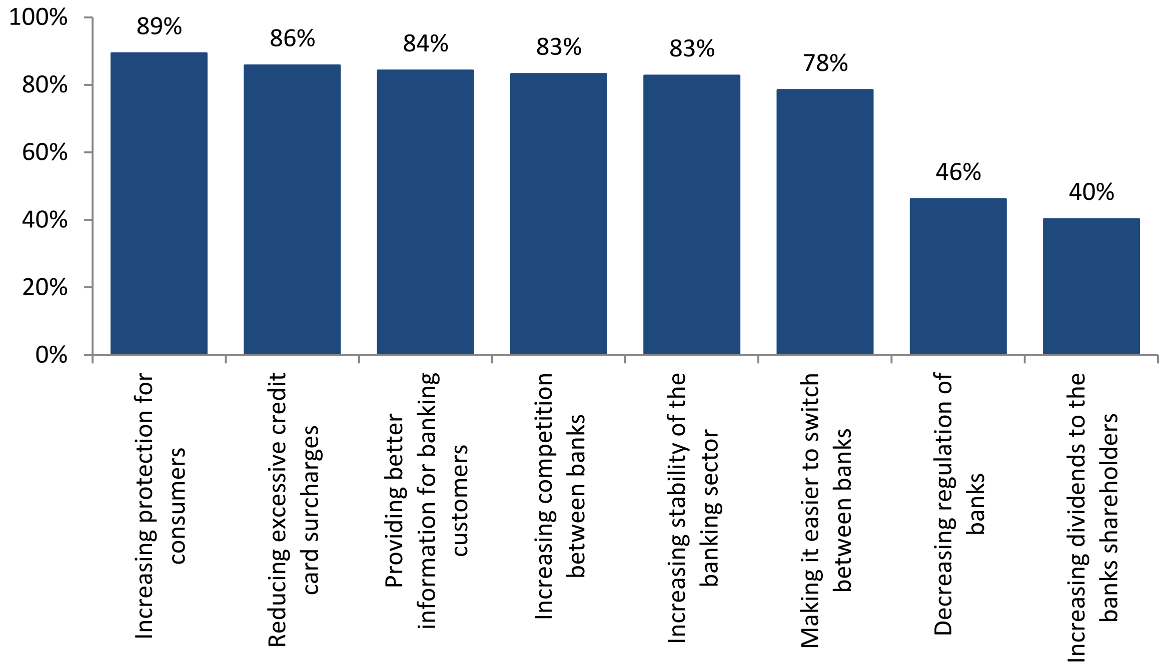
While CHOICE appreciates that the FSI has a range of issues before it, and many stakeholder views to consider, we would emphasise that the consumer experience of Australia's financial system is overwhelmingly one of essential and everyday products and services. In this context, the concept of a trade-off between consumer protection and competition sets up a false opposition, one that ignores that some of the very best consumer protections also serve to enhance competition.

---

[1] Rutledge et al., 2010, *Good practices for consumer protection and financial literacy in Europe & Central Asia: a diagnostic tool*, World Bank

[2] European Commission, 2009, *Commission Communication: 'The return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules'*, 22 July 2009 http://ec.europa.eu/competition/state_aid/legislation/ restructuring_paper_en.pdf

Figure 3: Consumers' priorities for the FSI



Source: CHOICE 2014 survey data

2a. Current consumer attitudes and perceptions

In March 2014, CHOICE commissioned a nationally representative survey of more than one thousand consumers in order to better understand their current attitudes, behaviours, concerns surrounding Australia's financial sector. CHOICE would be happy to discuss the findings of its survey in greater detail with the FSI.[3]

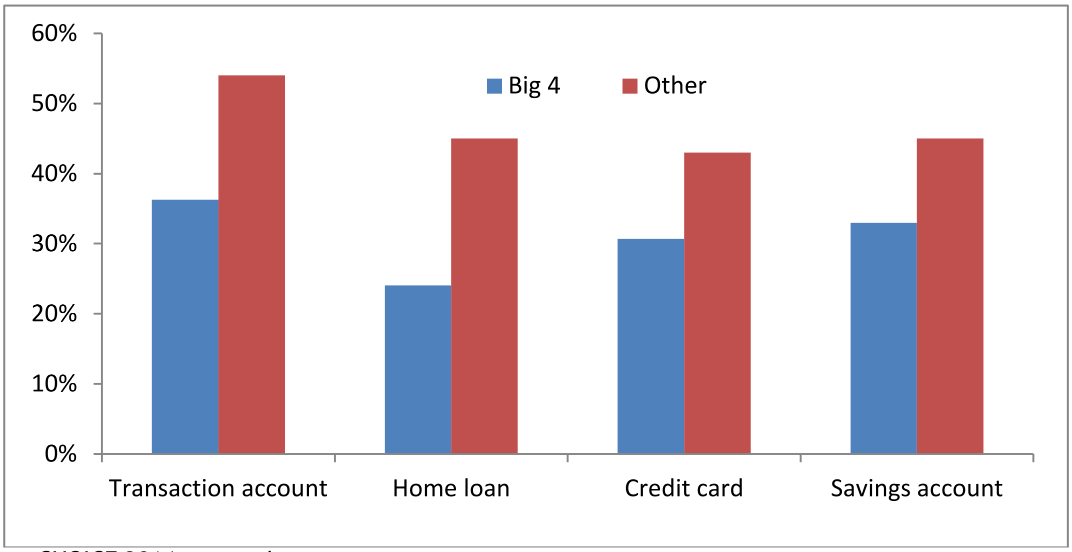
The survey found that across the board, those who bank with the Big Four and their sub-brands experience lower levels of satisfaction than customers of smaller institutions.[4] This is true across everyday transaction accounts, home loans, credit cards and savings accounts.

---

[3] The survey was conducted between 20-23 March 2014 with 1048 Australians aged 18+ from a permission-based panel (Pureprofile). Of these, 1005 indicated they had at least one of the following: everyday transaction account (and/or any offset account used for everyday transactions), home loan, credit card and savings account or term deposit. A nationally representative sample was drawn based on population data sourced from ABS Census 2011, and the final sample was weighed by age group, gender and location.

[4] Unless otherwise indicated, CHOICE has chosen to report its survey data in relation to Big Four banks combined with their various subsidiaries and sub brands, i.e. Big Four data includes responses related to UBank, Aussie, St George, Bank of Melbourne, BankSA and Bankwest and RAMS.

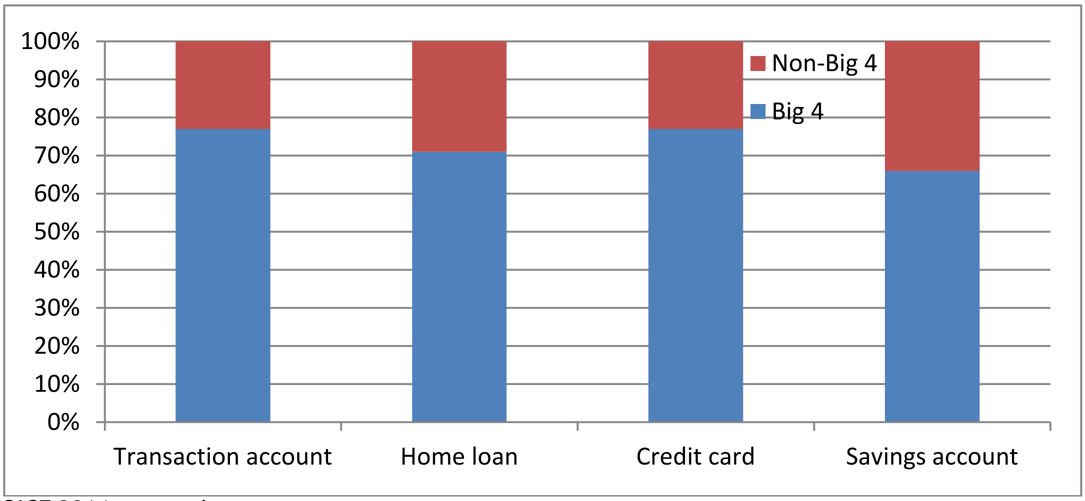
Figure 4: Consumer satisfaction with their financial institution (Respondents indicating they were "very satisfied")



Source: CHOICE 2014 survey data

This is consistent with the results of past CHOICE member bank satisfaction surveys.[5] Yet despite the major institutions ranking below their rivals in customer satisfaction, they continue to dominate the market for consumer banking products.

Figure 5: Share of each product category for Big Four and non-Big Four



Source: CHOICE 2014 survey data

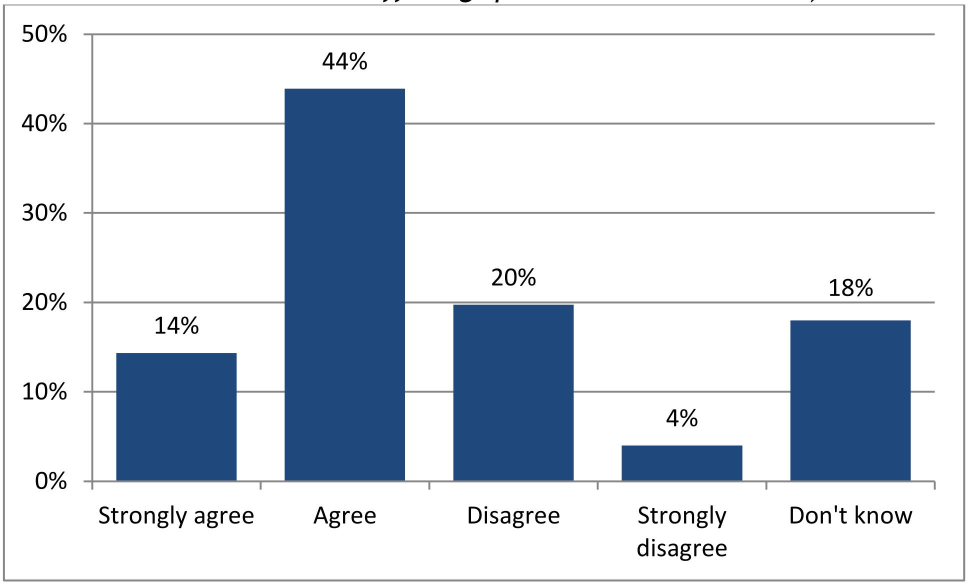
---

[5] CHOICE, 2011, '*You can't bank on satisfaction with the big four*', available at http://www.choice.com.au/media-and-news/media-releases/2011 per cent20media per cent20releases/you-cannot-bank-on-satisfaction-with-the-big-four.aspx

As CHOICE has observed regularly, particularly since the so-called 'Melbourne Cup-day interest rate rises' of November 2010, the pricing decisions of major banks often appear to take their customers for granted.[6] Behind the concerted public relations campaigns blaming overseas costs of funding for domestic pricing decisions – even as these factors have reversed and bottom lines have increased – there seems an assumption that consumers will not switch to smaller institutions despite for example being denied the full benefits of interest rate cuts to mortgages or increases to deposits. CHOICE's survey results appear to bear out this assumption.

Survey respondents were asked their perception of competition in the Australian banking sector. Perhaps unsurprisingly, 58 per cent of those surveyed agree that the Australian banking sector lacks competition on the services and offerings provided to consumers (Figure 6). Those aged 25-34 are the most likely to hold this view (63 per cent).

Figure 6: Consumers' perception of competition in the Australian banking sector
(Response to the statement: "The Australian banking sector lacks competition on the services and offerings provided to consumers")



Source: CHOICE 2014 survey data

To the extent that Australia's major banks may sometimes take their customers' preferences for granted, this provides an indication of their market power, and a lack of competitive pressure in the sector. Critically, it raises the question of whether there are entrenched barriers to consumers acting on their preferences, switching between institutions and thereby increasing competition overall.

---

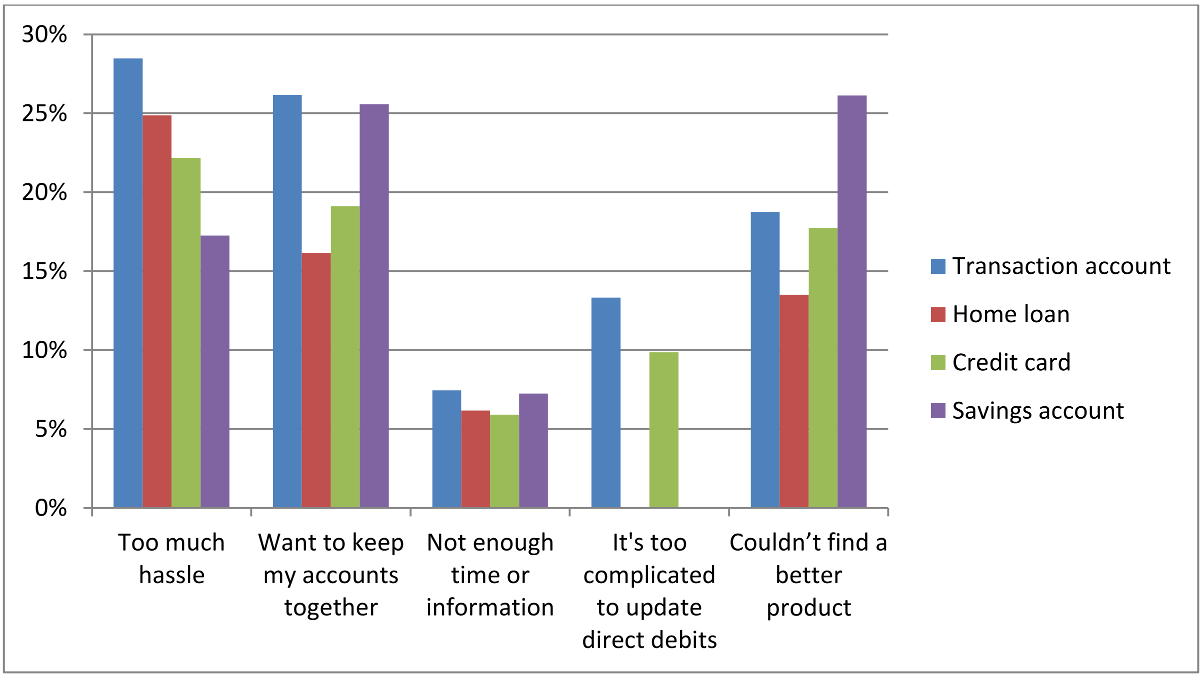
[6] For example, see CHOICE, 2011, '*Time for banks to hand back windfall from out-of-cycle increases*', available at http://www.choice.com.au/media-and-news/media-releases/2011 per cent20media per cent20releases/time-for-banks-to-hand-back-windfall-from-out-of-cycle-increases.aspx ,CHOICE, 2012, '*Memo to the big four banks: Pass it on*', available at http://www.choice.com.au/media-and-news/media-releases/2012-media-releases/memo per cent20to per cent20the per cent20big per cent20four per cent20banks per cent20 per cent20pass per cent20it per cent20on.aspx , and CHOICE, 2012, '*ANZ rate rise another reason to move your money*', accessed at http://www.choice.com.au/media-and-news/media-releases/2012-media-releases/anz-rate-rise-another-reason-to-move-your-money.aspx

For example, CHOICE's survey shows that while 13 per cent of respondents with home loans say they changed banks in the last two years, a further 25 per cent say they considered switching but did not actually change. This figure is even higher for customers of the big four banks, at 28 per cent. This indicates there is a sizeable segment of the market that is actively predisposed to switching, but for various reasons do not change.

Across the four product types surveyed, a consistent reason given by those who did not switch at least one of their accounts in the last two years was the perception it was "too much hassle". This reason was given by 36 per cent of respondents overall. It was highest for those who considered switching but did not change transaction accounts, at 44 per cent, suggesting that measures aimed at streamlining this process may have failed to make an impact.

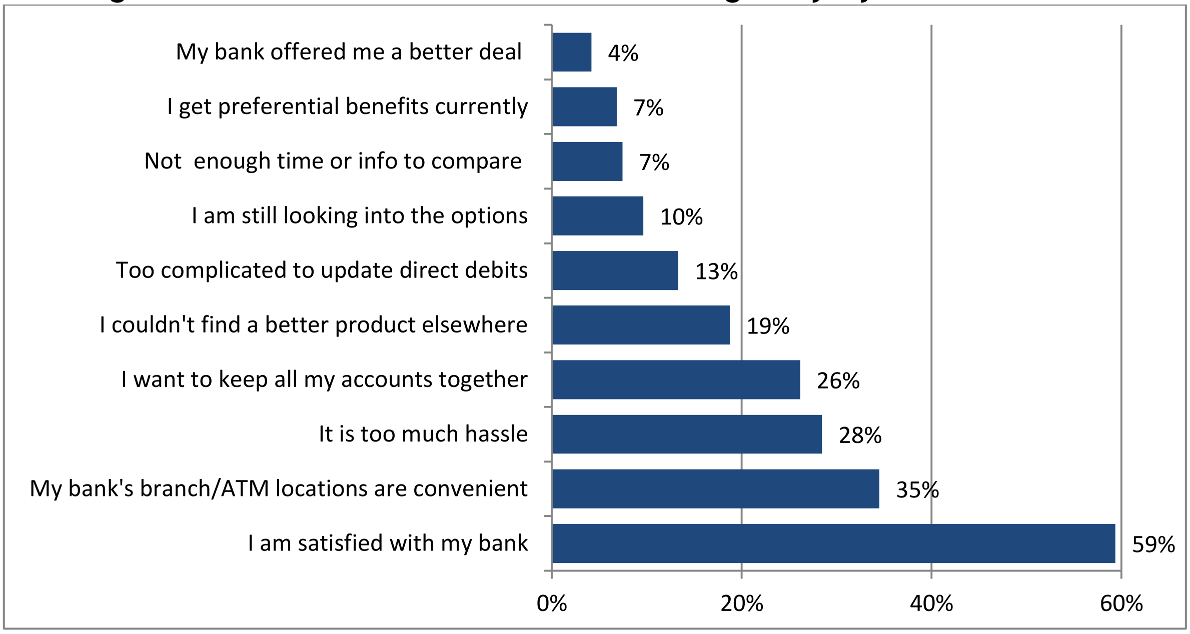
Another consistent reason given by those who did not switch at least one product was the desire to avoid splitting accounts between different banks, identified by 32 per cent of respondents overall. This was highest for transaction accounts and savings accounts, both at 26 per cent, and lowest for home loans, at 16 per cent. This suggests that home loans are often the product that 'anchors' a consumer to an institution, creating reluctance to 'un-bundle' and split accounts, even when switching is actively considered. This suggestion is reinforced by the fact that almost half of those surveyed with a transaction account, home loan and credit card had all three products with the same institution (48 per cent).

Figure 7: Key impediments to consumers switching service provider for various products



Source: CHOICE 2014 survey data

Figure 8: Consumers' reasons for not switching everyday transaction account



Source: CHOICE 2014 survey data

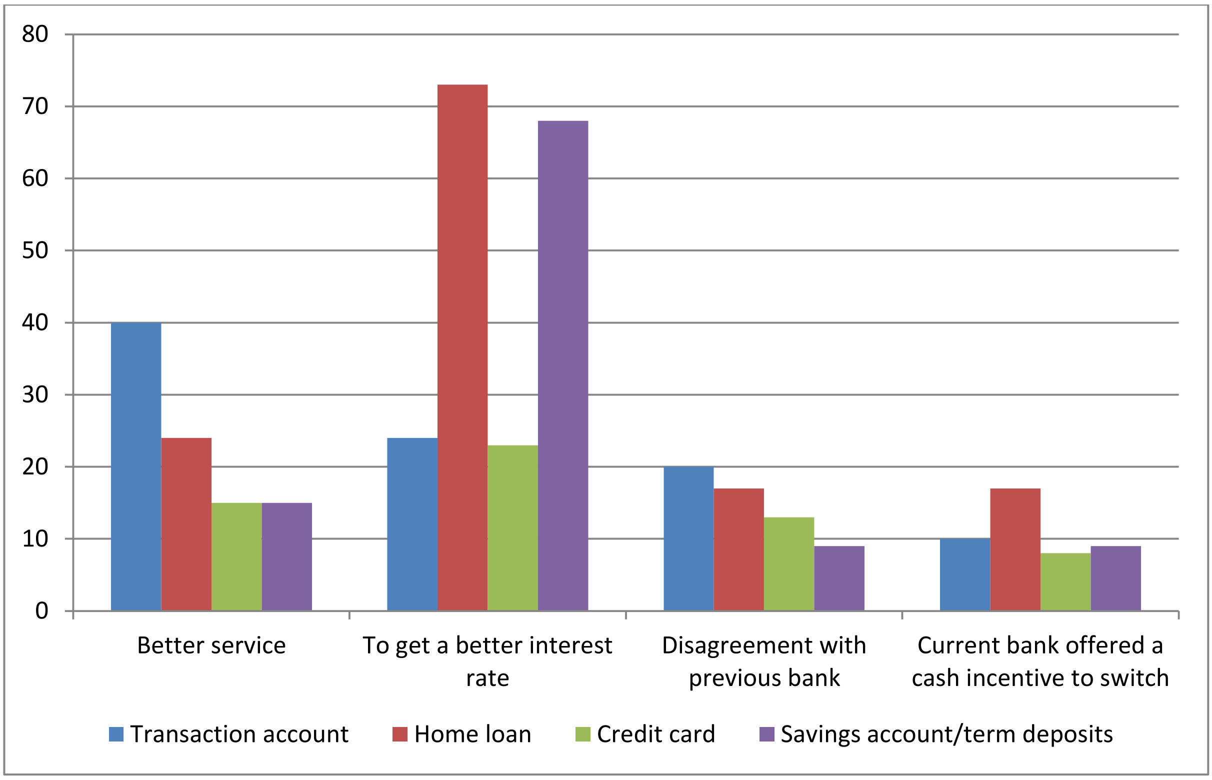
In addition to making consumers less likely to switch banks, the practice of 'bundling' products may also make it more difficult or less likely for consumers to compare the qualities of individual products from other providers, at least beyond their home loan.

Other prominent reasons given by those who did not switch products were the inability to find a better product (26 per cent for savings accounts, 19 per cent for transaction accounts and 18 per cent for credit cards) and not wanting to pay an exit fee (21 per cent for home loans).

From these results, it is clear that if the objective is to make it easier for those consumers who consider switching banking products to actually change providers, then measures addressing the perceived hassle of switching along, the practice of product bundling and the ability to compare products on their merits would have the greatest potential impact.

Interestingly, the strengths of 'incumbency' are clearest in everyday transaction accounts, where a total of 35 per cent who did not switch identified convenience of their banks' branch and ATM locations as a reason. Similarly, 28 per cent of those who did switch transaction accounts identified a desire to pay lower ATM fees, the fourth-highest reason behind paying lower monthly account fees (52 per cent), getting better service (40 per cent) and having opened a new account elsewhere and wanting to keep products together (31 per cent).

Figure 9: Consumers reasons for switching various products



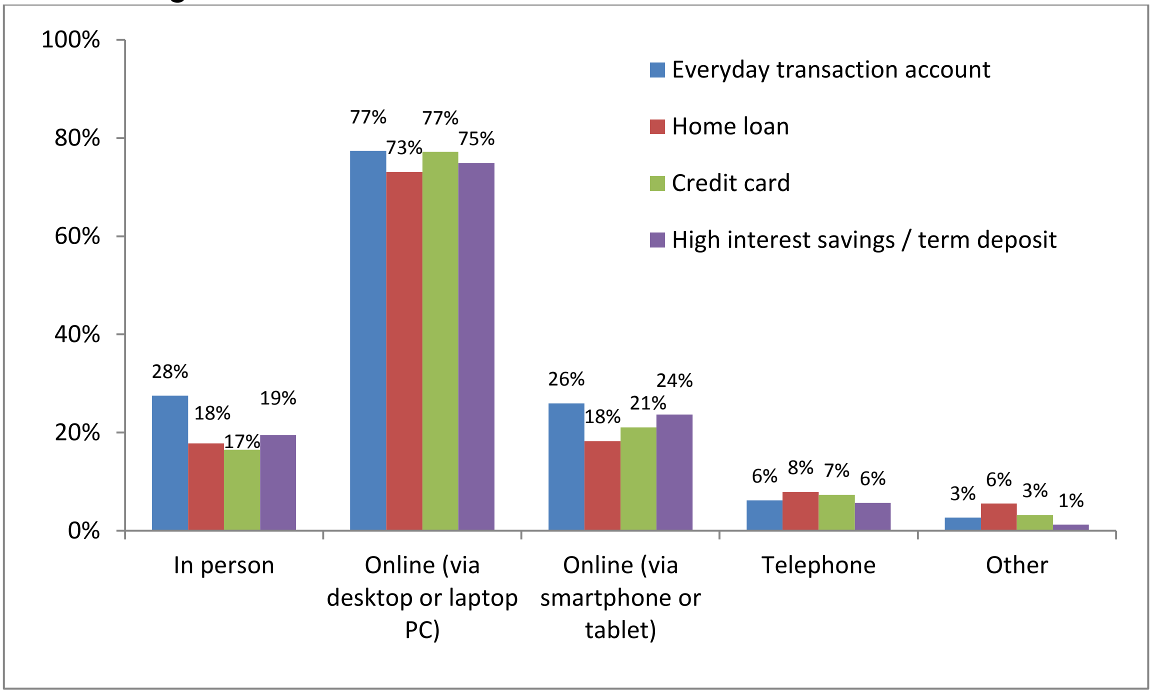
Source: CHOICE 2014 survey data

The convenience of branch and ATM locations is much lower for those who did not switch credit cards (16 per cent) and savings accounts (14 per cent). This suggests that when it comes to the most essential banking product, transaction accounts, the presence of on-the-ground branches and ATMs remains significant. This would obviously be a consideration for potential new entrants in the banking sector, and underlines the strength of those institutions with established networks of branches and ATMs. It also suggests that because consumers bear the brunt of 'foreign' ATM fees that are out of all proportion to the underlying transaction cost, they may be reluctant to switch providers for fear of paying more of these charges.[7]

For all four major types of accounts considered, online banking using a computer is the most common way for Australian consumers to engage with their financial institution (Figure 10). For those who have a credit card or high interest savings account or term deposit, conducting banking online via a smartphone or tablet is more common than visiting a branch in person.

[7] The Australia Institute and CHOICE, 'The Price of Disloyalty: why competition has failed to lower ATM fees', February 2011, accessible at http://www.choice.com.au/~/media/Images/Reviews/Money/Banking/ATM per cent20fees/PB per cent2023 per cent20THE per cent20PRICE per cent20OF per cent20DISLOYALTY.ashx

Figure 10: How consumers interact with their financial institution



Source: CHOICE 2014 survey data

Based on these survey findings, CHOICE believes there are several indicators of inadequate competition in banking services:

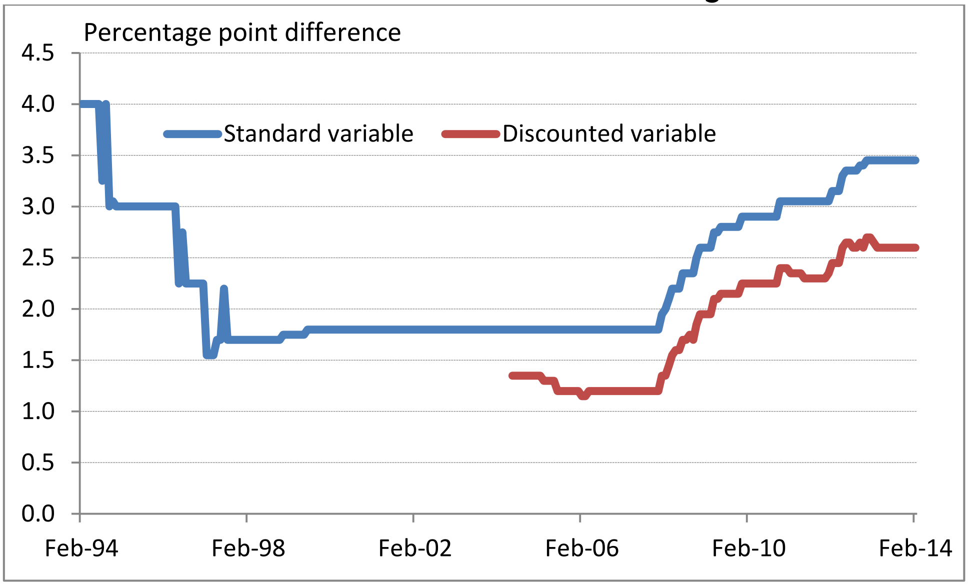
- Lower levels of satisfaction with major banks compared to smaller institutions, contrasted with their significant market share in key consumer banking products.
- The perceived barriers to consumers switching providers, in particular the perception that it is 'too much hassle', coupled with the impact of product bundling (reflected in the consumers' desire to want to keep all of their accounts with the one institution); and
- The difficulty consumers face in identifying 'better' products from other providers.

In addition to these survey results, CHOICE believe that further evidence of the major banks' market power – that is, a lack of constraints imposed by consumers and competitors – can be found in analysis of developments in interest rate margins.

As Figure 11 below shows, the interest rate margin of the banks' standard variable home loan over the Reserve Bank's official cash rate target trended sharply down over the second half of the 1990s, levelling out at around 175 basis points. This margin compression is likely attributable to various factors, one of which is increased competition in the mortgage lending market.

This low margin was sustained for an extended period, until late 2007 – coinciding with the onset of the GFC. The margin has risen back to around 350 basis points. It does not seem unreasonable to think that concerns over the perceived 'safety' of financial institutions – perhaps in conjunction with other factors, such as the consolidation that occurred since the GFC - have helped push consumers back towards larger institutions (notably the Big Four), giving them a degree of market power and allowing them the opportunity to take back some of this margin compression.

Figure 11: Standard variable home loan interest rate margin over official cash rate

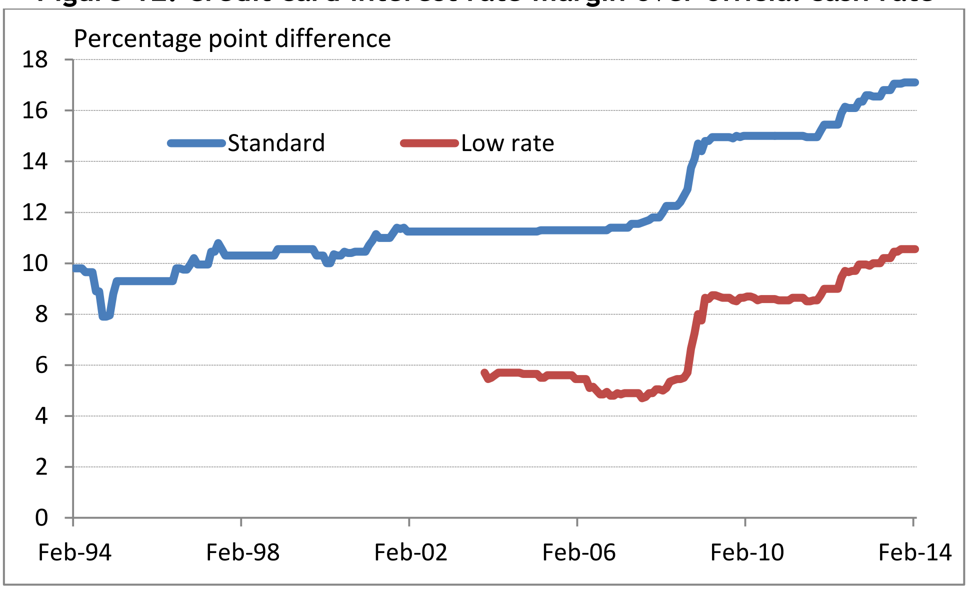


Source: RBA data

Analysis of trends in the margin between credit card interest rates and the official cash rate shows a similar, disturbing, recent trend (see Figure 12). The interest rate margin on a standard credit card gradually drifted up to around 11.25 percentage points in late 2001/early 2002. A period of stability then followed, through to around mid-2007 when the up-trend resumed.

The margin increased sharply in the second half of 2008, rising from 12.25 percentage points in June to 14.70 percentage points in December. Following another period of stability where the margin remained at around 15.00 percentage points (April 2009 – October 2011), the margin has now widened to above 17 percentage points.

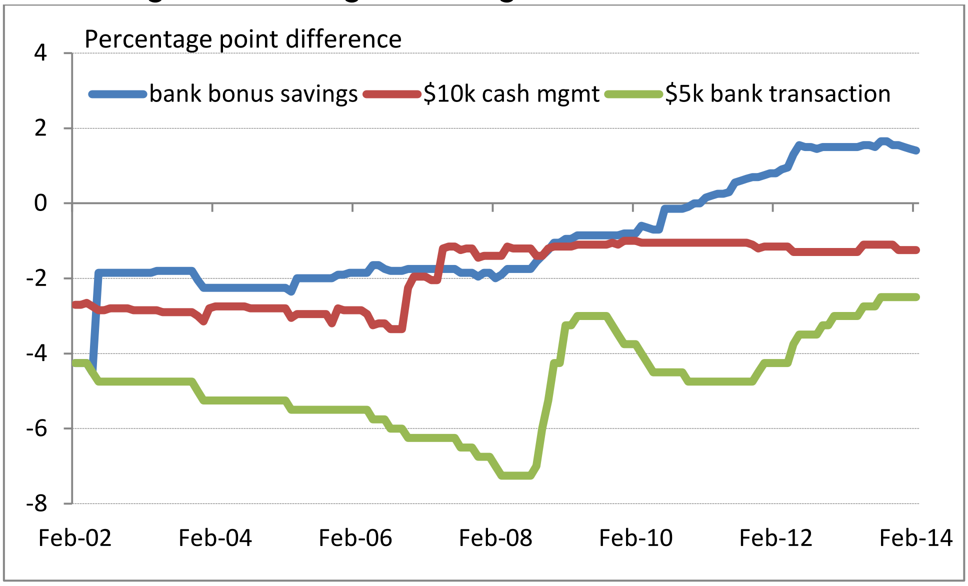
Figure 12: Credit card interest rate margin over official cash rate



Source: RBA data

CHOICE continues to have concerns at the asymmetric pass through of official interest rate cuts and increases to various savings and loan products. For example, rate cuts are regularly applied to savings products more quickly than mortgages, and it is not unusual for the full cut to impact savings accounts but a lesser amount to be passed on to the mortgage products. The converse holds in relation to official interest rate increases. Credit card interest rates appear to be out of step with other measures. A CHOICE survey in 2013 found that almost half of Australians who had used their credit card recently did not know or were unsure of the interest rate that applied, confirming the often confusing and complex nature of these products.[8]

Figure 13: Savings rate margin over official cash rate



Source: RBA data

Turning to the margin between various savings/deposit accounts and the official cash rate, the analysis becomes somewhat more complicated. A negative interest margin highlights the extent to which the interest rate applied to the savings products is below the cash rate. In a competitive market and under 'normal' circumstances, one could reasonably expect that this 'negative' margin might be eroded over time - leading to an upward trend to the line, such as that shown in Figure 13.

However these are not 'normal' circumstances. Two factors in particular mean that we cannot be confident that the trends shown are a reflection of a competitive marketplace:

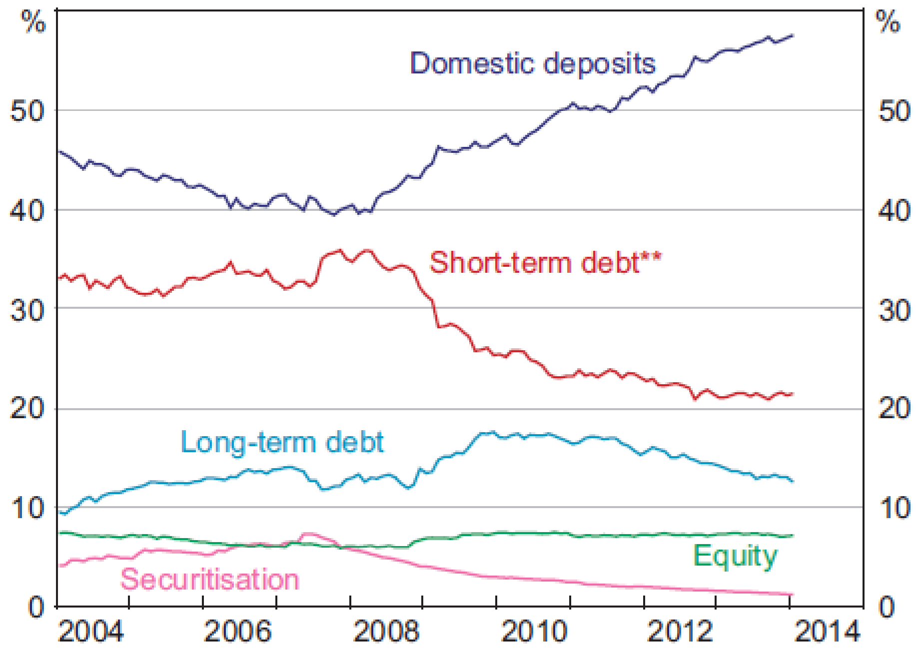
- Firstly, the interest rate offered on the $5000 banks' transaction account has been zero since December 2001, so the fluctuations in the green line in Figure 13 above simply reflect changes in the official cash rate which has fallen from a peak of 7.25 per cent in mid-2008 to just 2.50 per cent now.
- Secondly, one impact of the GFC was that the availability of funding for Australian banks in the wholesale market effectively shut down. Consequently, banks were forced to fund a greater proportion on their operations from deposits. Before 2008, deposits accounted

[8] CHOICE, 2013, 'Almost half of Australians do not know their credit card rate', accessible at http://www.choice.com.au/media-and-news/media-releases/2013-media-releases/almost-half-of-australians-do-not-know-their-credit-card-rate.aspx

for around 40 per cent of the banking sector's funds. They currently account for closer to 60 per cent, as shown in Figure 14 below.[9] In order to attract these funds, banks have had to offer more attractive interests rates to consumers. The RBA data shows that since early 2011, banks have been offering an interest rate above the cash rate on their bonus savings accounts. CHOICE has little confidence that as global financial markets normalise, this situation will be maintained.

CHOICE would welcome the FSI's consideration of these trends and recommendation of measures that address the need for further competition, as revealed by this analysis and the consumer CHOICE survey.

Figure 14: Banks' Funding*: domestic books, share of total



***Adjusted for movements in foreign exchange rates**
****Includes deposits and intragroup funding from non-residents**

Source: RBA Financial Stability Review, March 2014, p. 27 (APRA; RBA; Standard & Poor's)

2b. Overview of recent changes affecting consumers

There have been a number of recent changes to the legislative and regulatory regime for financial services in Australia. Some of these have reflected changes stemming from the GFC, but a number, pleasingly, reflect the natural evolution of regulation in response to development of the industry.

[9] From the RBA *Financial Stability Review* (March 2014, p27) available at http://www.rba.gov.au/publications/fsr/2014/mar/pdf/0314.pdf

In December 2010,[10] the Treasury announced a package of measures aimed at empowering consumers to get a better deal, positioning smaller lenders as safe and competitive alternatives to the big banks, and securing the long-term safety and sustainability of the financial system so it can continue to provide reasonably-priced credit to Australian households and small businesses.

CHOICE strongly supported the intent of these measures, and we believe they should be viewed as a positive step towards putting power back in the hands of banking consumers and enhancing demand-side competition. However it is not clear the extent to which the reforms have delivered on their intended goals. Indeed, we note that some of the measures were not implemented at all.

The key elements of that reform package include:

- **Mandatory key fact sheets for people looking for a home loan, a ban on mortgage exit fees (for new variable rate mortgages) from 1 July 2011, and a review into transferability of Lenders Mortgage Insurance (LMI).** While the ban on mortgage exit fees has had a positive impact, CHOICE's shadow shop of home loan fact sheets found a disappointingly low level of compliance[11] – raising questions as to the effectiveness of this reform in achieving its intent – while the LMI review resulted in very few changes.

- **A review into the feasibility of portable bank account numbers.** The review resulted in no changes, and it is unclear whether fall-back arrangements for streamlined transaction account switching were effectively implemented, and perhaps more tellingly, have been in any way promoted to consumers. This issue is revisited in further detail in section 3b.

- **A public education initiative to promote consumer financial literacy and mobility in banking.** It is unclear the impact, if any, of this initiative.

- **Fast tracked credit card reform legislation.** This package contained a number of reforms welcomed by CHOICE, including making it mandatory for credit card application forms to include a clear summary of key account features, banning unsolicited credit limit extension offers unless pre-agreed and requiring lenders to inform consumers about the implications of only paying minimum repayment amounts on their statements. Furthermore, CHOICE notes that Reserve Bank's decision to scrap the need for the banking regulator to oversee credit card issuers by the end of 2014 should make it cheaper for a host of competitors to bypass local banks' card transaction fees by issuing cards directly. This may bring additional benefits – via increased competition – to consumers.[12]

---

[10] See http://archive.treasury.gov.au/banking/content/default.asp

[11] See http://www.choice.com.au/reviews-and-tests/money/borrowing/your-mortgage/home-loan-key-facts-sheet-shadow-shop.aspx

[12] We note that the RBA has conceded that regulations introduced in 2004 to increase competition with banks (the then sole credit card issuers and acquirers) had been unsuccessful were now restricting competition.

- **A review of ATM reforms.** This reform delivered long overdue and welcome reforms in remote Indigenous communities but no changes elsewhere. We note that in the UK most bank customers pay nothing for their ATM cash withdrawals.[13]
- **A range of support measures for credit unions and building societies to enable them to better challenge the major banks.**
- **Finance measures to enable all lenders to access new wholesale funds for mortgage lending.** Again, the extent to which these initiatives have had their intended impact is unclear.

In assessing these measures, CHOICE recognises that increased competition means more than just smaller institutions taking on the major banks. For example, the majority of consumers would clearly benefit from increased competitive pressure between the Big Four. However, we also share the concerns of some of smaller providers in relation to 'bank multi-branding', in a sense a form of 'craftwashing'. Many consumers are unaware that the major banks own various sub-brands[14] and consumers' attempts to 'vote with their feet' and shift away from the big four are curtailed by this multi-branding, with a consequent impact on competition.

Despite these concerns, the above-mentioned package of reforms provide an indication that regulators and government may see the regulatory regime in the banking and finance sector as ongoing or evolutionary in nature – a view that CHOICE supports.

There is limited data in relation to the efficacy of these or other reforms since the Wallis Inquiry. As such, we see the FSI as an important opportunity to extract evidence from the industry, regulatory authorities and government agencies about the degree to which these reforms have successfully met their intended goals and their impact in terms of facilitating changes in consumer behaviour and outcomes.

2c. Is there a need for further reform at this time?

The Wallis reforms heralded a new regime in Australian financial services, providing an overall framework that CHOICE believes has overall proven positive and well considered. As noted above, the current regulatory regime allows for flexibility to respond to developments in the marketplace. CHOICE considers this to be a hallmark of good regulation.

The broad appropriateness of the current system of regulation and regulators is evidenced by the robustness of the domestic financial system during and since the global financial crisis.

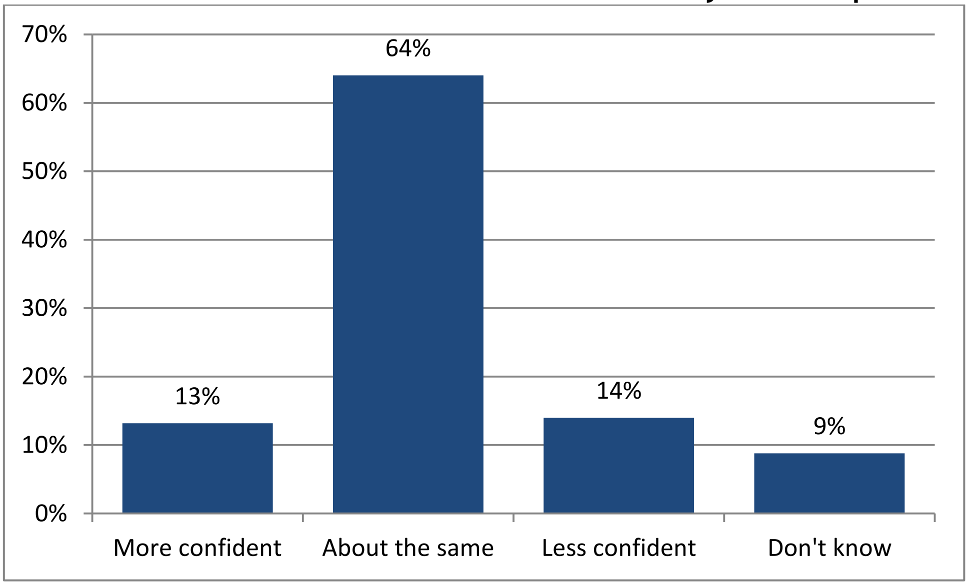
CHOICE's recent consumer survey found that following the GFC, most respondents (64 per cent) feel a similar level of confidence in the strength of Australia's banking sector as before. 13 per cent feel more confident and 14 per cent feel less confident (Figure 15). This finding is

[13] Over 97 per cent of UK cash withdrawals are free of charge and at the majority of cash machines in the UK there is no charge for cash withdrawals when using a debit card or ATM card. See http://www.link.co.uk/Cardholders/Pages/Charging.aspx

[14] The recent COBA survey (Essential Media Communications, 2014) found very low general public awareness that smaller competitors such as Aussie Home Loans, Bankwest, RAMS, St George and Ubank are owned by one of the big four. While 52 per cent knew that St George is owned by another bank, around 20 per cent thought Aussie Home Loans and RAMS are owned by independent shareholders.

significant given the scale of the GFC and its negative impacts on consumers internationally, particularly in Europe and the United States. It also suggests that the underlying strength in Australia's financial sector is perhaps to some extent taken for granted by end-users.

Figure 15: Consumers' confidence in the Australian financial system compared with pre-GFC



Source: CHOICE 2014 survey data

With these considerations in mind, CHOICE believes that wholesale changes to the present regulatory arrangements are not necessarily warranted – indeed there are many elements of the current system that CHOICE believes should be maintained. The Wallis reforms have delivered increased competition in products and services, more choice for consumers, better consumer protections and less red tape for businesses. The licensing system is sound and its relative flexibility has meant it has applied effectively to new products as they emerge, while external dispute resolution (EDR) arrangements provide a critical safeguard for consumers.[15] However, we do believe that there is scope for improvement, as discussed in the following section. In particular, we would urge a focus on enhancing the current competitiveness of Australia's financial system - from both the supply and demand perspective - in the interests of consumers.

It is timely to review the current regulatory arrangements to ensure their ongoing relevance and appropriateness in the dynamic and increasingly global financial services sector. CHOICE concurs that an important focus of this Inquiry should be about ensuring a 'future-proofed' regulatory regime, building and strengthening on a foundation which integrates competition with consumer protection.

---

[15] From CHOICE's perspective, EDR represents a very positive outcome of the Wallis Inquiry – not only from a consumer perspective. EDR is a good example of economically efficient self-regulation that has driven changes in industry practice, for the benefit of all stakeholders and participants in the financial system.

choice

3. Key issues and discussion

CHOICE does not advocate regulation for its own sake. Rather, we believe that there are a number of considerations that should underpin any measures which relate to the protection of consumers in the financial services sector. These include:

- Transparency – consumers should be able to readily understand their rights and obligations, with the provision of certain types of information being mandatory for service providers;
- Accountability – responsibility for consumer protection measures and their enforcement should be clearly understood and readily identifiable;
- Flexibility – regulatory measures should be designed to be able to respond appropriately to changes in the market or industry, or various shocks that may occur from time to time; and
- Competitive neutrality – functionally equivalent products and services should receive equivalent regulatory treatment, regardless of service provider.

3a. Role of the consumer in a competitive market

We believe that consumers play an important role in the competitive process – and indeed, that the best consumer protections actually increase competition. As noted previously, all consumers depend on a stable financial system and it is appropriate that governments intervene to secure financial stability. But the very dependence of consumers on banking is a key reason for regulators to ensure there is also effective competition. The UK's Office of Fair Trading provides a useful definition of competition in terms of the relationship between supply and demand:

> *Markets work well when there are efficient interactions on both the demand (consumer) side and the supply (firm) side. On the demand side, confident consumers activate competition by making well-informed and well-reasoned decisions which reward those firms which best satisfy their needs. On the supply side, vigorous competition provides firms with incentives to deliver what consumers want as efficiently and innovatively as possible. When both sides function well, a virtuous circle is created between consumers and competition.*[16]

Where firms have market power or where market failures exist (such as the information asymmetry noted above), the role of the consumer in delivering competitive market outcomes can be undermined. In a genuinely competitive market, where a level playing field exists, banks that offer the best value to consumers would win the greatest market share. Yet in Australia, as

[16] UK Office of Fair Trading, 2010, '*What does behavioral economics mean for competition policy?*', available at http://www.oft.gov.uk/shared_oft/economic_research/oft1224.pdf

CHOICE's members have regularly observed, banks that consistently rate bottom in customer satisfaction surveys are the biggest and sometimes among the most expensive.[17]

3b. Issues and discussion

This section presents a brief discussion of several priority issues CHOICE urges the FSI to consider in further detail.

(i) Support capacity for consumers to switch service providers easily

The ability to move between financial services providers is an important element of encouraging consumer-led competition. As CHOICE's survey results indicate, there is a sizeable segment of consumers who have considered switching providers for various products within the last two years, but not done so for a variety of reasons. Where these reasons relate to barriers in the way of consumers' preferences (rather than simply being satisfied with the current provider or being offered a better deal to stay put), CHOICE believes there is a case for considering measures to address these barriers and increase competition.

For example, mortgages are a major financial asset of many consumers, and there is unsurprisingly a tendency for consumers to make decisions about other financial products based on where their mortgage is. Enhancing consumers' ability switch mortgage providers can have positive 'knock-on' effects for competition more broadly. Conversely, stickiness around mortgages has a negative impact on competition across a range of products.

Despite recent reforms, substantial barriers to switching clearly remain, particularly in the perceived 'hassle factor'. Our recent survey found 44 per cent of respondents considered but did not switch their everyday account because 'it was too much hassle'.

CHOICE notes the findings of former RBA Governor Fraser that full account portability would involve major costs, which would ultimately be borne by payments system users, for relatively minor benefits and that no other country has full account portability. However, with ongoing technological advancements and constant shifts in both the market and industry, further steps to reduce the consumer 'hassle factor' in switching products (both real and perceived) are worth investigation. For example, CHOICE notes that we are yet to see the second phase of the account switching service which facilitates online switching using electronic signatures.

A related factor is the common practice of 'bundling' financial products and services. While bundling offers obvious benefits in terms of convenience, it also makes it more difficult for consumers to compare individual products on their merits and make informed decisions. A common example is the bundling of offset accounts and wealth packages.

26 per cent of transaction account holders in CHOICE's recent consumer survey indicated that the reason for not switching service provider was a desire to 'keep all my accounts together'. In response, we believe it is worth investigating measures that reduce the information asymmetry between consumers and financial services providers. This may include steps that make it easier

---

[17] CHOICE, 2011, '*You can't bank on satisfaction with the big four*', available at http://www.choice.com.au/media-and-news/media-releases/2011 per cent20media per cent20releases/you-cannot-bank-on-satisfaction-with-the-big-four.aspx

for consumers to assess and compare the value of individual products that meet their needs, for example through access to their own consumption data, as discussed below at 3b (iii).

Consumers are also wary of problems that may arise in the process of switching. For example, CHOICE's 2013 shadow shop of direct debits found poor compliance with the voluntary code of conduct: three-quarters of the 16 banks surveyed had trouble following the code's direction to promptly process a direct debit cancellation at the customer's request.[18] Difficulties with changing direct debits was also a reason cited by 13 per cent of transaction account holders in CHOICE's recent survey for not switching to a different provider.

Recent developments[19] in the UK in relation to switching may be instructive. The Report of the Parliamentary Commission on Banking Standards notes that a commitment was secured from the industry to 'introduce a 7 day Current Account Switching Service (CASS)'. It notes:

> *The new switching service will be free to use, come with a guarantee to protect customers in case anything goes wrong and will redirect any payments mistakenly sent to the old account for 13 months. Customers will also be able to choose the precise day on which they switch once they have opened a new account. For the first time, personal and SME current account customers will have a real option to move their accounts easily, quickly and without any inconvenience.*

The Commission recommended that the UK Government initiate an independent study of the technical feasibility, costs and benefits of full account portability. The UK Government has been clear that if the CASS does not deliver the expected consumer benefits, it will consider more radical options, including full account portability.

Finally, CHOICE would also emphasise that streamlining processes addresses only part of the problem. There is clearly a pervasive assumption that moving between financial institutions is too hard and time consuming, given that many consumers who did not even consider switching in the past two years still regard the process as too much hassle (25 per cent for transaction accounts and 24 per cent for mortgages). Dealing with this assumption requires actively promoting measures that improve consumer mobility, beyond those consumers who are already engaged enough to actually embark on the process.

Recommendation 1: Recognising the role of consumers in generating demand-side competition, investigate options to promote reforms to enable to consumers to easily make choices between service providers.

(ii) Product information and disclosure

CHOICE believes there is a need to reassess product information and disclosure across the range of financial services products and services. Disclosure in and of itself has clear limitations, and the volume of information disclosed should be secondary to its relevance and usefulness to the consumer. Behavioural economics provides insights that emphasise the "importance of making

[18] See http://www.choice.com.au/reviews-and-tests/money/banking/saving-money/banking-code-revised.aspx

[19] See, for example, http://www.which.co.uk/money/bank-accounts/guides/switching-your-bank-account/how-to-switch-your-bank-account-/

use of 'smarter information' – thinking carefully about its framing, the context in which information is read, and the ability of consumers to understand it."[20]

In some cases, technology may offer solutions for providing more meaningful, personalised and engaging information to consumers. In other cases, the most effective emphasis may be on plain language and more meaningful presentation.[21] In all cases, we believe government should draw on insights from behavioural economics, and work with regulators and industry to reassess the types of product information that are most useful to and easily understood by consumers, including at what points in the decision-making process and in what formats they are best delivered.

Recent credit card reforms are a case in point; statements are now required to inform consumers how long it would take to pay off their debt and how much estimated interest they would incur if they only made the minimum monthly payment. CHOICE believes these reforms have positively impacted consumer behaviour in relation to their debt repayments in a product category that is typically complex and confusing. It also serves as an example of how, used appropriately, personalised disclosure can change behaviours, and builds the case for broader reforms like the United Kingdom's *midata*, discussed further below.

Recommendation 2: Reassess current approaches to product information and disclosure across the range of financial products and services in order to improve the level of transparency within the sector and enable consumers to better engage with service providers on a more equal footing.

(iii) Open data

The amount of consumer data collected by retailers and service providers, both public and private, is increasing exponentially. This has transformed transaction histories into valuable databases, with application in product design and marketing, and implications for privacy and security. This also presents a significant, largely untapped opportunity to provide benefits for consumers – giving consumers access to their own data can drive better market outcomes, including via increasing competition and stimulating innovation.

CHOICE believes a key way to drive greater efficiency in complex retail markets is by giving consumers access to the data collected about them. This builds on the priorities identified in the preceding sections regarding easier product switching and better product information.

By liberating transaction and consumption data from closed networks, and making it sharable in a secure digital format, CHOICE believe that opportunities can be created for third-party innovators to provide services that help consumers. It can also create pressure for product innovation and price-based competition from the businesses that hold this information.

Conversely, if left unaddressed, the rapid increase in data collected will lead to *anti-competitive* outcomes, making it easier for financial service providers to tailor their offers

[20] UK Office of Fair Trading, 2010, '*What does behavioral economics mean for competition policy?*', available at http://www.oft.gov.uk/shared_oft/economic_research/oft1224.pdf

[21] Just one example is this proposed redesign of mortgage statements based on the information that is most meaningful to consumers: http://www.choice.com.au/media-and-news/consumer-news/news/intelligent-design-for-your-mortgage-data.aspx

to existing customers in a manner that competitors will be unable to match, and in a way that makes it even more difficult for consumers to compare offers on the market.

CHOICE believes that three steps are required to ensure consumers and the competitive process benefit from increased data:

- Recognising consumers have the right to access their own transaction and consumption data in a useful format.
- Identifying the barriers to making this data available, especially in retail markets that are difficult for consumers to negotiate.
- Taking targeted action in markets to remove these barriers and drive genuine competition.

Combining open data with insights around consumer behaviour could provide transformative tools to assist consumers to navigate complex markets and decisions.[22] For example, consumers could search for the best credit card based on their past spending and repayment records. This might provide personalised information on the likely benefits of moving to a low-rate/low-fee card, a potentially powerful insight given CHOICE's 2013 survey findings that almost half of Australians who had used their credit card recently did not know or were unsure of the interest rate that applied.

Considering the relatively large number of CHOICE survey respondents who identified an inability to find a better product as their reason for not switching (26 per cent for savings accounts, 19 per cent for transaction accounts and 18 per cent for credit cards), open data would allow for easier and more meaningful comparisons across the market, helping address perceptions that all institutions are the same and/or that the rewards of searching do not justify the costs in time and effort.[23]

Australia has been slow to realise the potential of open data.[24] The UK Government is more than two years into its *midata* program, aimed at stimulating economic growth and innovation by allowing "consumers to access their data in a safe and secure way and make better decisions reflecting their personal wants and needs."[25]

The UK has introduced legislation mandating data access in the 'core' sectors of energy supply, credit cards, financial transaction accounts and mobile phones, and setting out principles for future interventions in 'non-core' sectors if required. It also provided £10 million in seed funding

---

[22] For more detail on these and other similar examples, see https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/34747/12-983-midata-company-briefing-pack.pdf

[23] As past analysis has shown, there are many competitive products across categories beyond the Big Four banks, suggesting that perceptions of all institutions being the same and/or there not being 'better' products available are not accurate. For example, see CHOICE, 2012, '*Thousands set to farewell big four banks and save*', accessible at http://www.choice.com.au/media-and-news/media-releases/2012-media-releases/thousands-set-to-farewell-the-big-four-banks-and-save.aspx

[24] We note the Victorian Government has recently taken a significant step with the launch of its My Power Planner online tool for comparing energy retail offers. See https://mpp.switchon.vic.gov.au/

[25] See https://www.gov.uk/government/news/the-midata-vision-of-consumer-empowerment

for the Open Data Institute[26] with the mission of encouraging data to be shared, including by helping to develop business cases.[27]

The UK experience also shows that simply the prospect of intervention, through enabling legislation, may be enough to spur cooperation. This is important because open data is essentially about market-driven solutions.

There is, however, an important role for government: to ensure that consumers who wish to share their data trust in the process and have recourse where they believe their personal information has been used inappropriately. There may also be a role for government to fund the creation of tools for navigating complex markets, particularly where there is not a business case for commercial participants to provide these solutions.

Recommendation 3: Consider ways in which government can work with industry to provide consumers with safe and secure access to their own personal data in order for them to gain insights into their own use of products and services, and to make better choices about the products and services which best suit their needs.

(iv) Maintain changes to the removal of exit fees

CHOICE strongly supported the ban on mortgage exit fees as part of a broader agenda to increase consumer welfare through enhanced competition in Australia's banking sector. We believe the reform has gone some way to achieving its primary objectives of increasing the mobility of Australian consumers in the mortgage market and improving transparency in products. These regulatory changes should be maintained.

In CHOICE's recent survey, 21 per cent of mortgage holders cited incurring an exit fee as a reason for not switching their home loan to a different service provider in the past two years. This outcome is perhaps not surprising given that the ban on exit fees was prospective from 1 July 2011 and applies only to variable rate mortgages. However it does serve to reinforce the importance of the ban in promoting consumer mobility in the mortgage market.

The ban is consistent with an important principle of consumer protection, which is that consumers should not be locked into ongoing contracts for products through exit fees or penalties in circumstances where the supplier or retailer reserves the right to vary the price of the product at any time. When consumers are locked into such contracts, the result is a lessening of pressure on providers to continue competing on price and customer service over the duration of the contract. In this way, the removal of exit fees illustrates an important point – that measures to enhance consumer protection can be consistent with increasing competition in the marketplace.

CHOICE notes the following analysis by APRA: 'The industry is dominated by the four major banks, which together account for around 80 per cent of key lending and deposit markets.

---

[26] See http://www.theodi.org/about

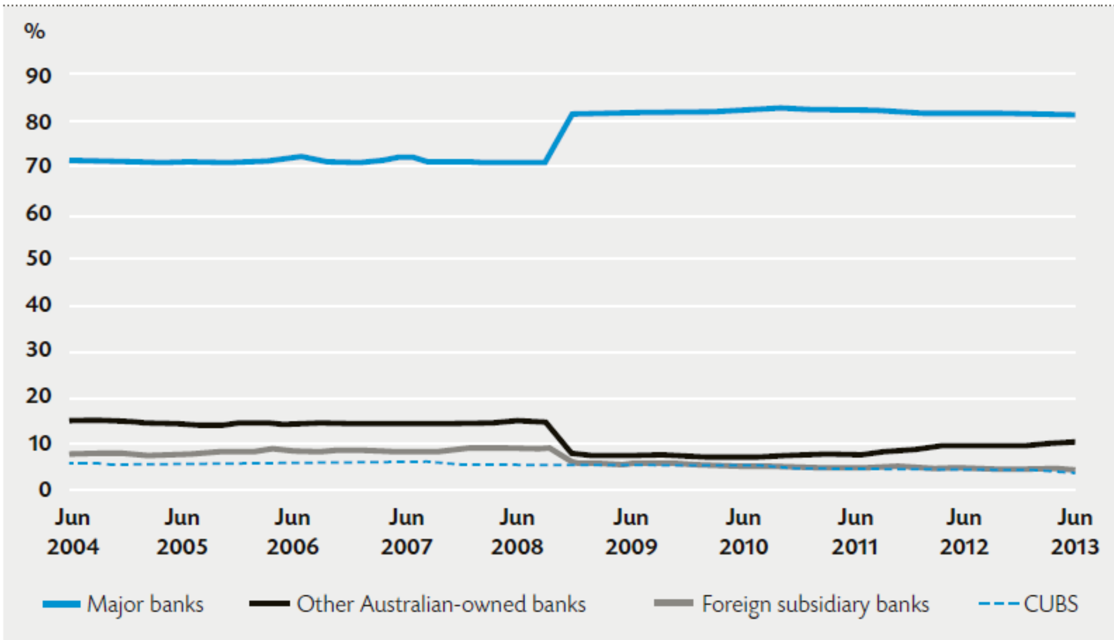
[27] In a similar way, the US Government's Green Button initiative (see http://www.data.gov/energy/ page/welcome-green-button) is giving millions of US utility customers access to their electricity data in a portable and sharable format. This is part of a growing 'smart disclosure' agenda that aims to "increase market transparency and empower consumers facing complex choices in domains such as health, education, energy and personal finance."

Beyond the major banks, there has been a sustained consolidation within the industry, with the number of credit unions and building societies (CUBS) steadily reducing over the past decade due to mergers and, more recently, conversions to mutually owned banks (Since 2011, 9 credit unions and 1 building society have converted to mutual banks).'[28]

This consolidation and figure 16 below show the dominance of the four major banks in the housing loan market. The shift to the perceived 'safety' of the large lending institutions in the turmoil and uncertainty of the GFC is clearly evident in late 2008. While the other institutions have not recovered this ground, we note the gradual uptrend in housing loan market share from Other Australian owned banks in the more recent period.

This analysis is relevant to the issue of exit fees as, while there are a number of contributing factors (including the conversion noted above), it is reasonable to acknowledge that the ban on mortgage exit fees from 1 July 2011 has also been a factor. Certainly, the ban has not destroyed the smaller players as some suggested would be the outcome in the lead up to the introduction of the ban.

Figure 16: Housing loans



Source: APRA Insight Issue 2, 2013

CHOICE recognises that providers will incorporate the ban on mortgage exit fees into their product pricing. However, this outcome is preferable to the previous situation where products appeared cheaper but included fees that were, due to the limitations of a disclosure-based approach, effectively hidden until the customer tried to switch to a better deal. Transparency allows customers to make an informed decision regarding their choice of product up front.

Recommendation 4: Maintain the ban on mortgage exit fees given the positive outcomes of this initiative for enhancing competition, choice and informed consumer decision making.

---

[28] APRA *Insight, Issue* 2, 2013 available at http://www.apra.gov.au/Insight/Pages/default.aspx

(v) Overall regulatory arrangements

Overall, CHOICE believes that the current (post-Wallis) regulatory arrangements have proven robust through the massive financial market shock of the GFC. We reaffirm our position (discussed previously) that the specifics of the financial system are such that industry-specific regulation is required. In turn, this points to the need for an industry-specific regulator or regulators.

The current regulatory framework of three agencies established along functional lines – the RBA (system stability, payments system regulation), APRA (prudential regulation) and ASIC (market integrity and consumer protection) – has served Australia well in the post-Wallis era.

The role of ASIC is particularly important for consumers. CHOICE believes that in general, the current regulatory and legislative arrangements that apply to ASIC work well to safeguard consumers and help enhance competition in the market.

We note that there have been increasing anecdotal suggestions of risks rising in the mortgage market, with the re-emergence of high LVR loans, evident in late 2013.[29] The RBA[30] also notes that there are 'signs of an increase in high-LVR lending among some institutions' and 'there are indications that some lenders are using less conservative serviceability assessments when determining the amount they will lend to selected borrowers'.

RPData[31] observe that in the December quarter of 2013, 34.4 per cent of all new loans had an LVR of more than 80 per cent. While down from pre-GFC highs, the proportion of higher LVR lending remains quite high. That said, the RBA[32] points out that, overall, 'the share of loan approvals with loan-to-valuation ratios (LVRs) greater than or equal to 90 per cent has been fairly steady since 2011, at about 13 per cent' (see Figure 17 below). This suggests that potential concerns may be more relevant from a consumer perspective rather than posing a threat to system stability.

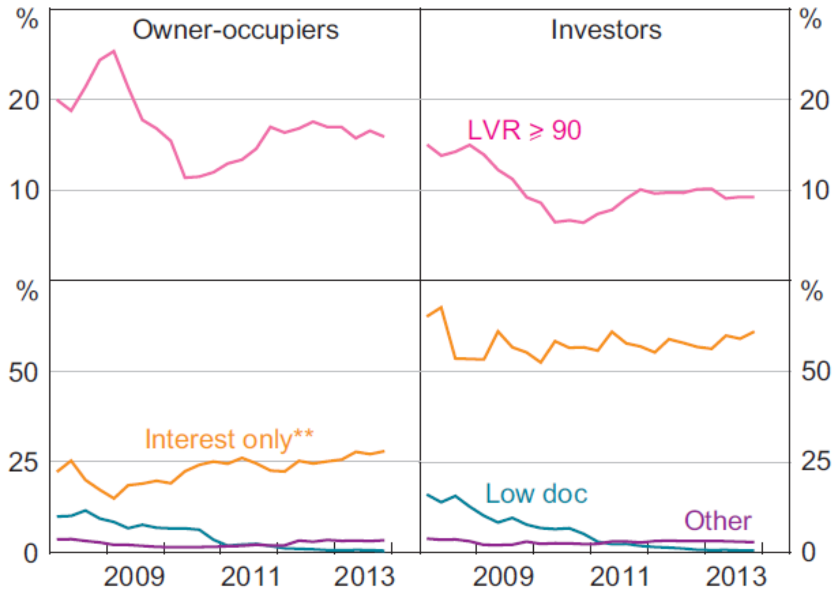
[29] See for example, http://www.bloomberg.com/news/2013-12-01/australian-banks-risky-loans-fueling-house-price-gains.html; http://www.macrobusiness.com.au/2013/11/high-lvr-lending-accelerates/; http://www.macrobusiness.com.au/2013/11/high-lvrs-make-a-come-back/; www.smh.com.au/business/lax-lending-standards-put-consumers-at-risk-20140124-31e4a.html; http://www.smh.com.au/business/banking-and-finance/low-deposit-home-loans-on-the-rise-20130924-2ubmx.html; http://australianpropertyforum.com/topic/9961708/1/; http://www.theadviser.com.au/breaking-news/29347-lender-launches-97pc-lvr-product

[30] Reserve Bank of Australia, 2014, *Financial Stability Review*, March, available at http://www.rba.gov.au/publications/fsr/2014/mar/pdf/0314.pdf

[31] *APRA's domestic ADIs property exposure data for the December 2013 quarter*, 25 February 2014, available at http://blog.rpdata.com/2014/02/apras-domestic-adis-property-exposure-data-december-2013-quarter/

[32] RBA, *ibid*

Figure 17: Banks' housing loan characteristics*: Share of new loan approvals



LVR = loan-to-valuation ratio;
'Other' includes loans approved outside normal debt-serviceability policies, and other non-standard loans
****Series is backcast before December 2010 to adjust for a reporting change by one bank**

Source: RBA Financial Stability Review, March 2014, p. 39 (APRA; RBA)

This discussion is topical, given that the Reserve Bank of New Zealand recently introduced macroprudential reforms which limit the amount of total lending for loans with a high LVR (>80 per cent) to 10 per cent for NZ banks.

CHOICE would welcome this Inquiry's consideration of the NZ experience in light of current developments in the Australian mortgage market and whether the current domestic regulatory arrangements provide ASIC and APRA with sufficient power to address these issues.

It is CHOICE's view that the current regulatory arrangements should be sufficient to manage such developments on both a prudential and consumer protection level, but that adequate resourcing of regulators is necessary to see this role fulfilled. In particular, preserving the budget funding of ASIC and APRA will be important to ensuring that consumers remain appropriately protected.

Finally, and as discussed previously, CHOICE would highlight the importance of the EDR arrangements within in the current regulatory regime, which benefit all stakeholders, not just consumers. The EDR governance model ensures that industry has a strong role and the funding model helps to promote efficiency, by providing incentives for industry to resolve complaints at the earliest opportunity. EDR is one of the most important and effective mechanisms of consumer protection, ensuring that consumers not only have rights but receive the benefits of those rights in practice. We believe that consumer complaints schemes provide an important consumer protection, and implement the fundamental consumer right to redress. Ultimately, consumers endure the burden both of failed regulation or failure to regulate, either as victims of market failure or increased prices resulting from compliance costs. CHOICE is supportive of as little regulation as possible – but as much as is needed. In this context, EDR plays an important role in keeping regulation to a minimum.

Recommendation 5: Maintain the regulatory powers of ASIC, including through adequate funding to enable ASIC to perform its functions effectively. Ensure that ASIC has the capacity to deal with new products and developments in the market.

Recommendation 6: Maintain the important role of External Dispute Resolution schemes in Australia's financial services sector, recognising their substantial benefits for both consumers and the market overall.

(vi) Future regulatory requirements and technological change

As noted previously, the current regulatory regime allows flexibility to respond to developments in the marketplace and to unforeseen industry shocks. In a dynamic sector such as banking and financial services, the capacity for regulation to adapt to changes in the nature, number and types of products as well as delivery mechanisms will remain critical.

One example that is becoming increasingly prevalent is the shift towards global e-commerce, m-commerce and electronic transactions generally, which raises questions of efficiency and efficacy of the payments system, as well as issues relating to cyber security, privacy concerns and the protection of personal data.[33] CHOICE recently published a joint position paper with the Australian Communications Consumer Action Network (ACCAN) on mobile commerce.[34] As that discussion highlights, while mobile commerce generates exciting new opportunities, as a result of convergence in mobile payments and a reliance on technology, some consumers may fall through the cracks.

M-commerce also creates new risks for consumers such as new scams, hardware errors causing incorrect or multiple payments, relative ease of losing or breaking a mobile device and the amount of personal information such devices store. Technology also brings many potential benefits, for example, in terms of increased innovation, responsiveness to shifts in consumer preferences and competition.

Overall, CHOICE believes that any regulatory regime needs to strike the right balance between appropriately low barriers to entry and incentives for competition on the one hand, and robust consumer protection on the other. In fact, consumer protections are critical to unlocking the benefits of new technologies by ensuring consumers can adapt to changes and engage confidently in the marketplace. As a general principle the approach to regulation in this area should be risk-based; the degree of regulatory oversight required will increase in line with the amount of risk that consumers bear in using particular types of products.

Recommendation 7: Have particular regard to recent and potential trends and developments in technology, including the increasing prevalence of e-commerce and m-commerce in developing a suitable framework to 'future-proof' Australia's financial system and ensure consumers continue to be adequately protected in a constantly changing environment.

---

[33] For example, we note the existence of the e-payments code, which regulates consumer electronic payment transactions, including ATM, EFTPOS and credit card transactions, online payments, internet and mobile banking, and BPAY and is administered by ASIC. CHOICE is concerned that compliance with this code is voluntary rather than mandatory.

[34] See http://accan.org.au/files/Position_Statements/accan_mcommerce_policy_statement.pdf

(vii) Implicit government guarantee for banks

The size and impact on the economic system of the major banks means it is inconceivable that any government would allow them to collapse. This implicit government guarantee for banks that are "too big to fail" inevitably distorts the financial services market, and has led to governments and bankers in other major economies contemplating the break-up of the largest banks or the imposition of restrictions on their trading activities.

Recent research has estimated the magnitude of the hidden costs of the explicit and implicit government guarantees of the Australian financial system at $11.1 billion each year.[35] Of this total, around $2.5 billion represents the benefit that the major banks enjoy due to their "too big to fail" status (see Figure 18).

To the extent that these calculations are correct, the outcome suggests the 'level playing field' between institutions may not be so level – a concern from the perspective of competition and efficiency in the industry. It is not clear to CHOICE whether the benefits to consumers of the current approach outweigh the concerns around competition, but this might be a useful avenue of investigation for the Inquiry.

Figure 18: Summary of hidden costs and unintended side effects of explicit and implicit government guarantees of the Australian financial system

Subsidy	Estimated Annualised Dollar Cost
Financial Claims Scheme – absence of ex-ante fee.	$0.5Billion
Committed Liquidity Facility – under-pricing of fee.	$4.5Billion
Too Big To Fail implicit government guarantee (funding advantage).	$2.5Billion
Setting the loss absorbency capital requirement at 1% instead of 3% in line with US, UK and other jurisdictions.	$1.8Billion
Aggressive RWA calculations for competitive advantage.	$1.8Billion
Aggregate tax payer funded subsidies.	**$11.1Billion per annum**

Source: Watson, 2014

Recommendation 8: Have regard to the issue of a 'level playing field' in the provision of banking and financial services, and whether the current arrangements are in the best interests of consumers.

(viii) Financial literacy and counselling

CHOICE believes that improving financial literacy requires a range of ongoing approaches and strategies. Technology is increasingly becoming integral to financial service delivery, changing both the nature of consumer interactions with the sector and the types and availability of products in the market. In this context, financial literacy must be viewed as a work in progress. This is particularly the case in light of Australia's demographic trends, notably the shift towards an ageing population and the need to ensure that no-one 'gets left behind' in their use of everyday and essential financial services.

[35] See Watson, 2014.

CHOICE believes that the current processes and arrangements in relation to financial literacy work well and should be maintained. Furthermore, CHOICE is pleased to be a part of ASIC's Consumer Advisory Panel and looks forward to the forthcoming release of the *National Financial Literacy Strategy* for 2014-17.

CHOICE also recognises that not all consumers have the same capacity to take charge of their finances, including at times of particular vulnerability. While improved product information and education, including through new technologies, may assist to a degree, there is also a critical role for more intensive assistance in some circumstances. We note recent research indicating that every $1 invested in financial counselling services produces a $5 return, not including broader benefits such as improved financial literacy or avoidance of legal action.[36] Providing for specialist intermediaries like financial counsellors to deal with financial services providers on behalf of people facing financial stress aids the efficiency of the industry. A number of financial services providers and industry bodies have recognised this fact through targeted initiatives that seek to improve their relationships with financial counsellors. We would urge the inquiry to consider the benefits of ongoing investments in financial counselling services as a preventative measure, particularly to assist those Australians in vulnerable circumstances.

Recommendation 9: Maintain and bolster initiatives that improve the financial literacy of consumers to enable them to make better and more informed decisions, and reduce the current level of information asymmetry held by the financial institutions. In particular, provide ongoing support for financial counselling services to assist Australians in vulnerable circumstances.

(ix) Future of Financial Advice (FoFA) amendments

In February 2014, CHOICE provided a submission on the Future of Financial Advice (FoFA) amendments.[37] We do not intend to revisit the content of that submission here at length.

In brief, CHOICE strongly supports the objectives of the FoFA reforms, namely to improve the quality of financial advice, build trust and confidence in the financial planning industry and facilitate access through the provision of simple or limited advice.[38] However, CHOICE expressed a number of concerns about the draft bill and regulations, to the extent that they will:

- Dilute the best interests obligation;
- Remove the opt-in requirement;
- Limit the consolidated annual statement of fees to new clients; and
- Water down the ban on commissions

---

[36] Australian Workplace Innovation and Social Research Centre, '*Paying it forward: Cost-benefit analysis of the Wyatt Trust funded financial counselling services*', February 2014

[37] CHOICE, 2014, '*Submission on Exposure Draft: Future of Financial Advice Amendments', accessible at http://www.choice.com.au/~/media/Files/SUBMISSIONS%20AND%20REPORTS/July%202011%20onwards/CHOICE%20 submission_FoFA%20amendments.ashx*

[38] Particularly in light of the fact that the Big Four banks, along with AMP, already control 80 per cent of the market for financial advice.

One example of CHOICE's concerns is the prospect of bank staff being allowed to sell complex financial products in branches without assessing customers' personal needs or situation and earn a commission for doing so. Based on our survey data, we would expect that older consumers with lower household income or attained high school education would be more likely to be at risk of being sold products by bank tellers as these groups of consumers are more likely to conduct their banking activities in person, at a branch.

We note the recent decision by the Minister for Finance to 'pause' the implementation process on the Government's proposed FoFA changes, to 'enable the Government to consult in good faith with all relevant stakeholders'.[39] We will be urging the Government to not proceed with its proposed changes either through regulation or legislation, unless it can be comprehensively demonstrated that the benefits to consumers, in terms of protection and confidence, engagement and savings, outweigh the very real costs of conflicted advice and the payment of fees for advice that is no longer being received. To the extent that the FoFA amendments and related matters are to be considered as part of the FSI, CHOICE would be pleased to provide a copy of its submission to the Committee and elaborate its view on these issues further.

Recommendation 10: To the extent that the FSI considers the FoFA amendments, determine whether the regulatory environment is adequate to ensure consumers have access to quality financial advice, can have confidence in the financial planning industry and facilitate access through the provision of simple or limited advice.

(x) Accessible payment options

Payment systems are fundamental to consumers' use of Australia's financial services system. As discussed at 3b (vi), technological convergence is transforming many consumers' experience of payments, particularly through m-commerce. In addition, the growth of online retail means that consumers are increasingly confronted with situations where there may be few convenient and accessible options other than credit card payments, for example when booking airfares or entertainment tickets.

Given the changing nature of the payments system, CHOICE is particularly concerned that consumers should have access to affordable, transparent and convenient payment options, including online. In practice, this means ensuring that fees associated with various payment options provide accurate price signals to the market and are therefore limited to the reasonable costs of processing transactions; and also that where there is no convenient fee-free alternative to a payment method, relevant costs are transparently and prominently disclosed in the product's headline price.

On this basis, CHOICE strongly supported reforms that came into effect on 18 March 2013 designed to limit credit card surcharges to the reasonable cost of card acceptance. While the RBA provided a guidance note to help the card schemes (American Express, Diners Club, Visa and MasterCard) and merchants apply the reforms, CHOICE has consistently expressed concerns that no government agency or regulator is responsible for enforcing or monitoring these new rules. More than a year later, with no change in the excessive surcharges applied by the most prominent merchants in the marketplace, it is clear that further action is needed to enforce the

[39] See the Minister's media release, MC16/14 of 24 March 2014, *Confirming Our Commitment to FoFA Reforms*, available at http://www.financeminister.gov.au/media/2014/mr_2014-16.html

new surcharging framework. Specifically, a national regulator should be empowered to enforce the test of whether surcharges represent the 'reasonable cost' of processing credit cards.

CHOICE believes it should not require the attention of the FSI to resolve the issue of excessive credit card surcharges. The problem facing consumers has already been exhaustively investigated by the RBA, a rule change has been implemented, and the matter has subsequently been referred to the Commonwealth Consumer Affairs Advisory Council (CCAAC).[40] We would hope to see more immediate action to enforce these rules and reduce some of the estimated $800m that Australians pay in surcharges annually.[41] However we believe it is important to raise the issue here because it illustrates the challenges facing consumers across Australia's evolving payments system, and emphasises that payments are in fact the primary means through which most Australians engage with the financial system on a daily basis. When changes in the payments system do not reflect consumers' best interests, the resulting detriment and frustration can be significant, reflected in the fact that 86 per cent of those surveyed by CHOICE thought excessive surcharging should be a focus of the FSI.

Recommendation 11: Identify impediments to consumers accessing affordable, transparent and convenient payment options, including for online payments given the growth in the online retail. As a priority, this should include enforcement of the Reserve Bank of Australia's rules limiting excessive credit card surcharges.

(xi) Superannuation and retirement savings

CHOICE supports the consideration of the superannuation and retirement saving system as part of the FSI. In particular, we welcome an assessment of whether the regulation of the superannuation sector remains appropriate and adequate, given the size and importance of Australia's retirement savings pool.

Recent reforms to support consumers to consolidate their superannuation accounts and find "lost super" are positive developments in the superannuation system. However, given the increasing maturity of Australia's superannuation sector and the size of the savings pool, there are arguably many more innovations in service and consumer protection that could be explored. Further reforms that deliver greater transparency in fees and disclosure of product inclusions, such as insurance products, present significant opportunities for both better service from superannuation funds and improved consumer protection.

CHOICE notes that Australia's superannuation industry suffers from a lack of consumer trust, with key factors behind this including disappointing recent returns, conflicts of interest, costs versus perceived value and policy volatility.[42] This results in negative impacts not only on consumers' retirement income but also on government and industry. CHOICE believes that an important step in addressing these issues would be the creation of a strong and expert consumer voice in the sector. We note that an independent Superannuation Consumers' Centre has been

---

[40] Commonwealth Consumer Affairs Advisory Council, '*Credit card surcharges and non-transparent transaction fees: A study*', last updated November 7 2013, accessible at http://ccaac.gov.au/2013/11/07/credit-card-surcharges-and-non-transparent-transaction-fees-a-study/

[41] CHOICE, 2014, 'The great surcharge price gouge continues', accessible at http://www.choice.com.au/media-and-news/media-releases/2014-media-releases/the per cent20great per cent20surcharge per cent20price per cent20gouge per cent20continues.aspx

[42] Oliver Wyman Global Consumer Survey, 2011

established on a voluntary basis, and that it will be submitting to this inquiry. We believe that this organisation requires a strong funding basis, to allow it to provide a range of essential advocacy, assistance, and education services for consumers.

In the context of the FSI, an examination of whether the regulatory arrangements guiding the allocation of Australia's approximately $1.7 trillion pool of superannuation savings could also prove informative. At present, the allocation appears to be skewed heavily towards equities rather than being more diversified to help reduce risk and volatility of returns – something which would arguably to be in the interests of both consumers and governments (relieving pressure from the pension system). Removing such impediments would also add to the overall allocative efficiency of the sector, with economy-wide implications.

Recommendation 12: Investigate opportunities to continue to improve product disclosure, insurance products and fee transparency in superannuation. Consideration could also be given to any regulatory impediments relating to the allocation of Australia's superannuation savings that can help to diversify the exposure of consumers – particularly those of or nearing retirement age – to global equity markets and, by doing so, reduce the financial risks they face.

Recommendation 13: Fund a centre for superannuation consumers to improve the operation of the superannuation system so that it delivers the best possible income for Australian consumers.

(xii) Insurance

Australians have experienced significant premium increases across a range of insurance products in recent years. Along with growing difficulties in obtaining some types of cover, the availability and affordability of various insurance products suggests further examination of this sector is warranted.

For example, the average home building insurance premium has increased by 57 per cent over the last three years. The average home contents premium increase is 18.2 per cent over the same period.[43] There is a range of factors contributing to these costs, not least of all the experience of fire and flooding throughout Australia in recent years. However if this level of price increases is sustained, it would pose serious issues for the affordability of these insurance products.

We believe there are also issues around consumers' access to information and documentation in a format they can readily understand, given that insurance is a complex product, increasingly transacted through direct sales and renewals by telephone and the internet under a 'no advice' model.

One example of how government can support consumers in the insurance market is the approach recommended by the 2011 Natural Disaster Insurance Review in relation to flood insurance. This

[43] See analysis of Home Building and Contents Insurance premiums by *Equity Economics* available at https://s3-ap-southeast-1.amazonaws.com/onebigswitch/misc/140306EquityEconBriefingNote.pdf. Source data: Insurance Council of Australia, Insurance Statistics Australia (updated February 7, 2014).

proposed limited government intervention to support a market-based process, with the aim of ensuring that consumers in flood-prone areas were not excluded from access to flood insurance.

The FSI might consider whether there is evidence of market failures more generally in this sector that should be addressed via the regulatory regime. Furthermore, consideration could be given to whether there are implications from the failure of HIH which should be taken into account in the current regulatory review.

Recommendation 14: Investigate and seek to address any market failures in Australia's insurance sector to ensure that consumers have access to affordable insurance cover, such that they are able to protect themselves against a range of adverse events

4. Concluding comments

In this submission, CHOICE reaffirms its position that the Australian financial system has proven resilient over the course of the GFC and the period since. In this regard we see the FSI building on the solid foundation that is the Wallis review, recognising its key strengths including the licensing requirements, external dispute resolution arrangements, and industry-specific regulation.

We do think there is a strong case for ongoing reforms to increase consumer-led competition between financial services providers. There is a lack of competitive pressure, evident in the fact that those providers who best meet consumers' preferences are not necessarily rewarded. CHOICE believes the most productive focus in this area would be on measures that increase customer mobility and empower consumers with better information to more easily act on their preferences.

As a starting point, CHOICE believes that the Inquiry should seek, wherever possible, to quantify the costs and benefits of the current regulatory regime in order to provide a solid fact-base for making informed decisions regarding the appropriate way forward.

CHOICE would welcome the opportunity to discuss this submission and its contents in further detail with the Committee.

5. Bibliography and References

Ali, P., McRae, C. and Ramsay, I,2012, Consumer Credit Reform and Behavioural Economics: Regulating Australia's Credit Card Industry, *Australian Business Law Review*, Vol. 40, No. 2, pp. 126-133, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2052615

Asia-Pacific Banking and Finance (AB+F), 2014, *Australians want more bank competition*, 25 February, available at http://www.australianbankingfinance.com/banking/australians-want-more-bank-competition

Australian Government 2014, *Australian Banking Reforms* website, http://www.bankingreforms.gov.au

Australian Securities and Investments Commission (ASIC), 2013, *Shaping a National Literacy Strategy for 2014-2017: Consultation feedback report*, ASIC Report 374, available at http://www.asic.gov.au/rep

Australian Workplace Innovation and Social Research Centre, 2014, *Paying it forward: Cost-benefit analysis of the Wyatt Trust funded financial counselling services*

CHOICE, [various media releases], available at http://www.choice.com.au/media-and-news.aspx

CHOICE, 2014, *Submission on Exposure Draft: Future of Financial Advice Amendments*, February

CHOICE, 2013, *Response to the Treasury regarding Consultation on the ban on mortgage exit fees*, November

CHOICE, 2011, *Better Banking*, CHOICE Report, March

Commonwealth Consumer Affairs Advisory Council, 2013, *Credit card surcharges and non-transparent transaction fees: A study*', accessible at http://ccaac.gov.au/2013/11/07/credit-card-surcharges-and-non-transparent-transaction-fees-a-study/

Drummond, S., 2014, Credit card revolution is on its way, *The Sydney Morning Herald*, 14 March, available at http://m.smh.com.au/business/banking-and-finance/credit-card-revolution-is-on-the-way-20140314-34q2w.html?skin=m

Equity Economics, 2014, *Home Building and Contents Insurance Premiums Briefing Note*, available at https://s3-ap-southeast-1.amazonaws.com/onebigswitch/misc/140306EquityEconBriefingNote.pdf

Essential Media Communications Pty Ltd, 2014, *Attitudes to Banking Competition in Australia*, research prepared for the Customer Owned Banking Association (COBA), February.

European Commission, 2009, Commission Communication: '*The return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules*', 22 July, available at http://ec.europa.eu/competition/state_aid/legislation/restructuring_paper_en.pdf

EY, 2014, *Winning through customer experience, EY Global Consumer Banking Survey 2014*, available at http://www.ey.com

Reserve Bank of Australia (RBA), 2011. “About the Payments System”, available at http://www.rba.gov.au/payments-system/about.html

Reserve Bank of Australia (RBA), *Financial System Stability Report*, various, available at http://www.rba.gov.au

Reserve Bank of Australia (RBA), *Statistical Tables*, various, available at http://www.rba.gov.au

Rutledge et al., 2010, *Good practices for consumer protection and financial literacy in Europe & Central Asia: a diagnostic tool*, World Bank, available at http://worldbank.org

Siegel + Gale, 2013, *Global Brand Simplicity Index 2013; Demonstrating the impact of simplicity on revenue, loyalty and innovation*, available at http://simplicity.siegelgale.com/wp-content/uploads/2013/10/Global-Brand-Simplicity-Index-2013-eBook-spreads-FINAL.pdf

The Australia Institute and CHOICE, 2011, *The Price of Disloyalty: why competition has failed to lower ATM fees*, February, accessible at http://www.choice.com.au/~/media/Images/Reviews/Money/Banking/ATM per cent20fees/PB per cent2023 per cent20THE per cent20PRICE per cent20OF per cent20DISLOYALTY.ashx

UK Government, 2011, *The midata vision of consumer empowerment*, available at https://www.gov.uk/government/news/the-midata-vision-of-consumer-empowerment

UK Government, Department for Business, Innovation and Skills, 2012, *Next steps making midata a reality*, available at http://news.bis.gov.uk/Press-Releases/Next-steps-making-midata-a-reality-67ef5.aspx

UK Government, Office of Fair Trading, 2010, *What does behavioural economics mean for competition policy?*, available at http://www.oft.gov.uk/shared_oft/economic_research/oft1224.pdf

UK Parliamentary Commission on Banking Standards, 2013, *Changing banking for good, Report of the Parliamentary Commission on Banking Standards*, available at: http://www.parliament.uk/business/committees/committees-a-z/joint-select/professional-standards-in-the-banking-industry/news/changing-banking-for-good-report/

Watson, J., 2014, *A review of the hidden costs and unintended side effects of explicit and implicit government guarantees of the Australian financial system*, report prepared for Mòrgij Analytics, available at http://blog.marqservices.com/wordpress/wp-content/uploads/2014/02/research_report-hidden_costs_of_bank_subsidies.pdf

West, M., 2014, Has bank lobbying de-fanged FoFA?, *The Sydney Morning Herald*, 10 March, available at http://www.smh.com.au/business/has-bank-lobbying-defanged-fofa-20140309-34ffk.html

West, M., 2014, Lax lending standards put consumers at risk, *The Sydney Morning Herald*, 25 January, available at http://www.smh.com.au/business/lax-lending-standards-put-consumers-at-risk-20140124-31e4a.html