



Australian Government

Banking Services SWITCHING ARRANGEMENTS



**Banking services:
cost-effective switching
arrangements**

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ISBN 978-0-642-74726-6

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4 July, 2011

Mr Wayne Swan MP
Deputy Prime Minister and Treasurer
PO Box 6022
Parliament House
Canberra ACT 2600

Account Switching Arrangements

Dear Treasurer,

I attach my report on options to encourage greater account switching by customers of banks and other financial institutions.

As requested in your letter of engagement (attached), I have consulted quite widely with representatives of financial institutions, regulatory bodies and other interested organisations, all of whom have been cooperative and constructive in their inputs.

I would also like to acknowledge the assistance provided by Treasury officers — particularly Kate Preston and Phillip Hawkins — in the preparation of this report.

Thank you for the opportunity to report on these matters.

Yours sincerely,



B W Fraser



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Feasibility study — account portability

Dear Mr Fraser

Thank you for agreeing to conduct a comprehensive feasibility study into the issues surrounding Australia's progress towards full account portability, and alternative options for providing greater transferability for banking customers. This study is an important component of the Government's *Competitive and Sustainable Banking System* reform plan which will examine the technological options, the potential timeline and processes for implementing account number portability or other measures to assist consumers to switch more easily.

There is strong evidence that the difficulty of switching accounts between banks acts as a significant barrier for customers both in relation to deposit accounts and mortgages. Whilst the challenges in achieving full deposit account portability should not be underestimated, with no other country in the world having introduced this technology, I believe there is merit in exploring potential options further.

I ask that you work closely with the Reserve Bank of Australia, which has primary responsibility for the Australian payments system, to explore the benefits, costs, risks and impediments associated with the range of options to facilitate account portability and in doing so examine:

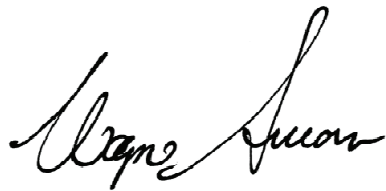
- The costs of implementing possible options and related timeframes.
- Relevant local and international options which are currently being explored or have been implemented.
- Current technological limitations to achieving full account number portability and possible developments which could facilitate a greater level of account portability.
- Necessary changes to infrastructure to implement account portability, whilst preserving the regulatory integrity of bank payment systems for consumers.
- The potential role of a Central Account Registry in supervising relevant account information to ensure appropriate security and privacy for consumers.

I ask that you work with our other financial regulators, as well as consulting with industry, technical experts, consumer groups, and all other relevant stakeholders.

The Gillard Government is committed to making it easier for customers and small businesses to walk down the road and get a better deal if they are not happy with their current provider.

I look forward to receiving your report by 30 June 2011.

Yours sincerely

A handwritten signature in black ink, reading "Wayne Swan". The signature is written in a cursive, flowing style with a large initial 'W'.

WAYNE SWAN

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Chapter 1: Account switching and competition

Overview

- 1.1. The proposal to explore options to assist customers to more easily switch banking service providers was included in the Government's package of measures for *A Competitive and Sustainable Banking System*, which was announced on 12 December 2010. The presumption seemed to be that improved arrangements for switching accounts — deposit accounts and mortgages were mentioned specifically — would spur competition among providers and deliver lower prices and other benefits to customers.
- 1.2. Competition in banking services has been the subject of repeat inquiries over the past thirty years, with the most recent report — by the Senate Economics References Committee (the Senate Committee) — released in May 2011. The Senate Committee's report (Chapter 7) also addresses various aspects of account switching; given the overlap of the parties consulted, it is hardly surprising that many of the issues raised — and some of the sentiments — expressed in the Senate Committee's report should have echoes in this report.
- 1.3. Views differ on what constitutes appropriate competition in the market for banking services. Ideology aside, most people would be comfortable with arrangements which delivered desirable services at fair prices to customers and reasonable profits to providers and which, at the same time, avoided reckless behaviour by borrowers and/or lenders of the kind that could lead to meltdowns in the financial system. Australia has moved towards such a situation over the years, based on policies that see market forces as generally the best determinants of lending and deposit interest rates but which also recognise the need for firm prudential regulation to override these forces when they stray out of control.
- 1.4. The relevance of bank concentration and bank profits as measures of competition in banking services are subjects for debate. Banking in Australia is relatively concentrated but that is not necessarily a barrier to active competition, either among the major banks or between those banks and the smaller players. The major banks do earn good profits but, viewed as a return on equity these have been fairly steady over the past three decades (averaging around 16 per cent) and below comparable returns of many other large companies. But these are in part debating points and they downplay the significance of stability — as well as prices and profits — in a sustainable market for banking services. Seen in that broader context, the global financial crisis (GFC) has provided perhaps the best test of all — and Australian banks passed that test rather better than most. This is not to suggest that Australia has arrived at its 'Goldilocks' market for banking services: there is always some scope to enhance competitiveness, as well as some risks to guard against.
- 1.5. Of the major drivers of competition in banking services some are within the direct reach of domestic policy makers, others are much less so. The former include policies on bank amalgamations and new entrants, measures to help level the playing field for accessing funds (such as those in the December 2010 package), and the whole gamut of prudential and other regulatory requirements. Drivers which are largely external include structural and cyclical shifts in global financial markets (for example, the rise and then demise of international securitisation markets and the GFC), and on-going innovations in products and processes (for example, internet banking).

- 1.6. Central to this review is the issue of how significant policy measures to enhance account switching are likely to be in boosting competition in banking services and delivering worthwhile benefits to customers. Three questions suggest themselves. First, are current obstacles to switching a major barrier to customers pursuing their desired banking relationships? Secondly, would easier switching arrangements contribute to increased competition among financial institutions and deliver worthwhile benefits to customers? Thirdly, can easier switching arrangements be implemented at modest cost to industry and with zero or negligible flow-on charges to customers?
- 1.7. Publicly accessible data bearing on these questions are rather limited but a number of general points can reasonably be made:
- (i) Current avenues for switching banking products (most notably transaction accounts) can involve hassles which are likely to discourage some potential switchers, but large numbers of switchers are able to get the job done. These numbers suggest that customers who are sufficiently motivated to switch find it reasonably easy to do so, and that the problems encountered by others may have more to do with motivation and perceptions, rather than real barriers.
 - (ii) Switching arrangements hardly rank as a major direct driver of competition in the market for banking services, but they are relevant to facilitating access by customers to the benefits of increased competition arising from innovations, and other sources; and
 - (iii) Given the observations in (i) and (ii), it would be reasonable to infer that any new arrangements for easier switching should come with modest price tags.

Switching for better deals — mortgages and deposits

- 1.8. It is apparent that large numbers of customers currently switch providers when the potential financial gains are sufficiently attractive to justify the effort involved. This is most obviously the case for those products which seem to be of most concern to governments, namely mortgages and deposit accounts, which are mentioned specifically in the terms of reference for this review.
- 1.9. So far as mortgages are concerned, several points can be noted. To begin with, not all existing mortgage holders are likely switchers; many will be quite content with their present provider. Some may have considered switching only to be discouraged by exit fee imposts. Others again will have been persuaded by their existing provider's retention team (and the offer of better terms) to stay, rather than switch. The bottom line, however, is that the housing mortgage market over the past couple of decades has seen significant switching by borrowers who have been motivated to change providers to gain a better deal:
- In the 15 years or so preceding the GFC, competition from regional banks, credit unions, building societies and other non-bank lenders attracted (new and existing) customers away from the majors, doubling their market share to around 40 per cent of new housing loans and reducing net interest margins on these loans in the process. Much of this growth, occurred on the back of burgeoning securitisation markets (particularly in the US and Europe) where smaller banks and non-banks could borrow much of their funding needs at rates comparable with those paid by the major banks for their wholesale funds.
 - Inappropriate pricing of risk in overseas securitisation markets led to its virtual closure in 2008, which contributed mightily to the GFC. With the demise of the securitisation

markets the majors (and their acquisitions) regained their dominant market share of the housing mortgage market, with close to 80 per cent of new loan approvals in recent years.

- In the more subdued post-GFC credit environment, competition remains keen and considerable switching is occurring. Many banks, for example, have been offering discounts of 70-100 basis points on their standard variable mortgage rate to new customers and some have abolished exit fees ahead of the Government's ban taking effect.
 - Offers of discounts and other inducements, together with the active involvement of mortgage brokers, are contributing to considerable refinancing of mortgage loans. ABS data suggest that roughly one third of new housing loan approvals in 2011 to date are refinances of earlier loans with a new lender. In other words, considerable switching is still occurring, notwithstanding the successes of bank retention teams in retaining many customers. (Customers who are retained through the offer of a better deal effectively receive a benefit comparable with that which they would otherwise obtain by switching to a new provider, without having to make the switch.)
- 1.10. In the case of deposits, investors have been receiving 'market' interest rates on most deposit products since deregulation gathered momentum in the 80s, and they have actively switched funds between accounts to take advantage of this situation. The intense competition to lend for housing (and other purposes) in the years of easy credit prior to the GFC has given way in the past few years to intense competition for deposits, as global securitisation and other funding sources have dried up or become too expensive. As rates for term deposits and internet deposits have risen customers have moved in large numbers to those institutions offering the most attractive terms.
- 1.11. None of this is surprising. The financial benefit of switching term and internet deposit accounts is easy for customers to calculate, banks actively market 'special rate' deals, and switching itself is straight forward; unlike mortgages, there are no exit fees, credit checks or transfers of mortgage documents to worry about, and no need for identity checks where funds are transferred from established transaction accounts with other institutions. Transfers can be executed by phone or over the internet, which opens up the field to players without branch networks. ING Australia, which focuses on internet and phone banking services, is understood to have acquired 100,000 new customers in 2010.
- 1.12. In short, considerable switching of mortgage and deposit accounts is occurring and appears to have been increasing over recent years. (Similar comments can probably be made about credit card accounts where, for example, balance transfers are commonplace and actively marketed by some institutions.) These are big ticket items for the customers who have them. They are competitively priced and the process of switching from one provider to another to gain a better deal seems to be largely free of serious impediments for most customers.

Switching — transaction accounts

- 1.13. The situation in respect of transaction accounts is less clear cut. The popular focus tends to be on mortgages but the potential barriers to account switching are probably most pronounced in the case of transaction accounts.
- 1.14. Transaction accounts are the accounts into which individuals and businesses channel their incomes and cash flows and from which they fund a variety of payments. In general, net balances in these accounts attract minimal or zero interest but on-going administration fees also tend to be quite low. Offers of lower fees and charges are always welcome but compared

with the often substantial gains to be had from switching home loans or term deposits the potential gains from switching transaction accounts would not loom nearly as large for most customers. This suggests a lesser financial incentive for customers to shop around for better deals in transaction accounts per se. (In shopping for a better deal on their mortgage loan some customers may end up switching their transaction accounts as a condition of gaining the mortgage deal). It is probably also the case that non-financial considerations, such as access to the most convenient points of contact (physical or electronic) for conducting their banking, and dissatisfaction with the service provided by their existing provider, weigh more heavily in the decisions of customers moving transaction accounts than they do for mortgage and deposit accounts.

- 1.15. Motivations aside, switching transaction accounts is somewhat more demanding than switching mortgages or deposit accounts. Additional identity checks are likely to be required, and for many customers there will be a number of direct debits and credits to be transferred. The perceived hassles involved in these processes by prospective switchers are usually greater than the problems experienced by people actually making switches. Nonetheless, such perceptions, combined with the absence of clear financial incentives to offset the effort required, would suggest a certain amount of inertia when it comes to switching transaction accounts. Why bother if the hassle of switching is likely to outweigh the potential benefits? And if the transaction accounts on offer from different institutions are broadly the same anyway, why change?
- 1.16. Against this background it is a bit of a surprise that transaction accounts are also an area of considerable switching activity. In its submission to the recent Senate Committee inquiry, the Commonwealth Bank Group reported that it '... opens and closes over a million personal transaction accounts a year in the context of having over 5 million personal transaction accounts.' Other banks and the Australian Clearing and Payments Association (APCA) indicated to the same inquiry that they considered '... there is substantial switching and effective competition in transactional banking services.' At a CEDA function last week the CEO of National Australia Bank indicated that its campaign of clearly differentiating its products terms from those of the other major banks had yielded approximately a quarter of a million new customers since February 2011. APCA and Choice provided separate estimates to the Senate Committee inquiry which pointed to switching rates of around 8-10 per cent of transaction accounts per annum.
- 1.17. These numbers of 8-10 per cent, which are comparable with estimates of switching rates in some European countries with more formal switching mechanisms, raise again the threshold question of the seriousness of current impediments to switching transaction accounts. Clearly, those impediments should not be exaggerated. At the same time, to argue that every customer who wishes to switch transaction accounts can do so without difficulty would also be an exaggeration: for some customers, switching does raise problems which might be alleviated if simpler and more effective formal switching arrangements were available.
- 1.18. Some arguments in support of this latter judgement are:
 - while the numbers of customers switching accounts are quite large, the stock of such accounts is many times larger (currently around 34 million);
 - while not themselves a direct driver of increased competition, simple and cheap switching arrangements could help to facilitate the flow-on to more customers of the benefits of spurts in competition whenever they occur and whatever their source — these spurts (for example, from lower funding costs or technical innovations) mean the best deals are likely to come from different institutions (or groups of institutions) over time, making switching a more common and frequent activity; and

- effective formal switching arrangements might not only encourage more customers to switch, but also assist those who currently switch under their own steam.
- 1.19. The recurring emphasis here is on the attractiveness of ‘simple’, ‘cheap,’ and ‘effective,’ switching arrangements — arrangements that might assist both in nudging hesitant switchers across the line, and accommodating serial switchers. Given the thrust of the analysis in this Chapter, more elaborate proposals, with likely costs out of proportion to their potential benefits, have little appeal. A couple of options of the latter kind are considered briefly in Chapter 2 while Chapter 3 details a relatively simple, cheap and effective alternative.

Chapter 2: Full account portability and central account registry

- 2.1. The terms of reference for this review mention specifically notions of full account portability and a central account registry as worthy of examination.
- 2.2. In approaching the review, the starting point has been to gain a reasonable understanding of the nature and extent of the problems involved in switching banking accounts. Chapter 1 sought to do that. The conclusion reached was, in brief, that costly solutions were not required — and could not be justified — to address the kinds of problems being encountered. This Chapter elaborates that view in respect of suggestions for moving towards full account portability and a central account registry in Australia.

Full account number portability

- 2.3. Full account portability is a deceptively simple concept. In essence individuals (and businesses) would be issued with a unique account number(s) which would be passed to the new institution when the customer decided to move so that existing direct debits and credits associated with that account could be moved automatically to the account with the new institution. This contrasts with the current arrangements for switching accounts which require the creation of a new account number at a new institution, and the additional task of redirecting direct debits and credits to that new account number.
- 2.4. Implementation of full account portability, however, would be far from simple, and not at all analogous to telephone number portability as sometimes suggested. It would involve the replacement of the bank, state, branch (BSB) system of numbering, and wholesale revamping of the existing payments infrastructure and the systems of all the financial institutions which interface with it. It would be a major and costly undertaking.
- 2.5. The Australian payment system is essentially a mix of various different payments systems. These systems work to effect the transfer of funds between banks, non-banks, consumers, merchants and government agencies and facilitate, inter alia, the payment of direct debits and credits, EFTPOS transactions, ATM withdrawals and settlement between institutions. The particular payments system for making direct credits and debits is called the direct entry system and facilitates the transfer of \$45-50 billion of direct payments every day — equivalent to 80-90 per cent of all non-cash retail payments. Any material changes to such a vital piece of payments infrastructure could hardly be contemplated in advance of extensive consultation and due diligence on the need for such changes and their cost-benefit profiles.
- 2.6. Making payments through Australia's direct entry system requires two sets of separate numbers; a BSB number (identifying the bank that the payment is directed to), and a customer account number (identifying the specific account to which the payment is directed). This dual-numbering system does not lend itself readily to full account number portability:
 - The BSB number is required to identify the particular institution the payment is being made to and cannot currently be switched among institutions — full portability would require an alternative numbering system to identify the relevant customer's institution.
 - Existing customer account numbers are not necessarily unique — customers at different financial institutions could have the same customer account number but are

differentiated by their BSB numbers. In short, a precondition for effective full account portability would be the replacement of the present dual numbering system with a new system of truly unique customer account numbers. Like many analogies, the comparisons with phone number portability have their short-comings. Unlike phone services, which require only a single connection, payments require the coordination of messaging, clearing and settlement between many parties. The task of maintaining and accessing databases of telephone numbers by a small number of providers bears no comparison with that involved (in cost, security and other terms) in establishing bank account number portability.

- 2.7. The architecture of the direct entry system is based on a series of bilateral (electronic) linkages between financial institutions which are used to make and request direct payments on behalf of their customers. This infrastructure has evolved since its introduction in 1994 but its bilateral character has remained intact and, notwithstanding the rapid growth in payments the direct entry system remains a cheap, efficient, secure and reliable system for making electronic payments (The number of users of the system has grown from almost 40,000 in 1994 to almost 280,000 in 2010). A system of full account number portability that requires an alternative numbering system (without a BSB) would not work — certainly not cost effectively — within the existing infrastructure. Rather than using bilateral linkages and BSB numbers, a centralised payments system would be required, with all direct payments routed through a central hub or, potentially, a central clearing house.
- 2.8. This, in turn, would require the creation of a central account registry to hold relevant details of all customers' accounts, including the institution where the account is held, given the BSB number would no longer be available for that purpose. The central clearing house would, in effect, tap into this register to identify the financial institution to which to direct payments. The central account registry would need to be updated every time an account was opened, closed or switched.
- 2.9. The purpose of the clearing house and the central registry in the context of full account portability is as a mechanism to reroute payments efficiently without the use of a BSB number. In theory this approach could be de-centralised, by requiring institutions to redirect the payments (rather than a clearing house) or to maintain their own registry of switched account numbers which other institutions would need to access. Just to mention these requirements is sufficient to indicate that this (theoretical) approach would be even more expensive than the centralised approach to implementing full portability.
- 2.10. In short, moving from where we are now to centralised arrangements to accommodate full account portability would require massive changes to existing payments infrastructure. But there is more. The direct entry system is not the only payments system that utilises BSB numbering to direct payments: it is also used in the systems for clearing cheques and for making high-value payments between financial institutions (including through the RBA's payment settlement arrangements). Any changes to the way payments are transferred in the direct entry system would probably have to be replicated in these separate payments systems.
- 2.11. Not surprisingly, no other country has full account portability. There are no benchmarks, therefore, for assessing the performance of actual arrangements of this kind. The Netherlands examined the feasibility of full account portability in the late 1990s but it was not pursued because of the prohibitive costs involved. The cost of implementing such arrangements was estimated at between €300 and €500 million for banks alone — about \$400-700 million at today's exchange rates. This decision should be seen in the context of a country already in possession of an important part of the necessary infrastructure, namely a centralised payments clearing house, which the Netherlands has had in place since 1967. Establishing a

central clearing house would be a substantial addition to the cost of implementing full account portability in Australia.

- 2.12. The UK Office of Fair Trading also considered the costs of full account portability in 2001 as part of an inquiry into the *Supply of Banking Services by Clearing Banks to Small and Medium Enterprises*. The review concluded that introducing portable account numbers would 'require major investment and significant changes to the operation of the current clearing systems. As the inconvenience of changing account numbers is only one of many constraints on switching, the costs of such a development are very likely to exceed the benefit'.
- 2.13. Sweden does have in operation arrangements which deliver what might be called a 'Clayton's' account number portability. What are equivalent to the customer's BSB and account number are not portable, but a separate and unique number (called a bankgiro number) can be issued to customers which allows them to make and receive the equivalent of direct debits and credits to that number; the relevant third-party needs to know only this customer number. In essence, the unique customer number is linked to a customer's account; a customer who wishes to switch institutions can de-couple this unique number and attach it to a new account number provided by the new institution.
- 2.14. Viewed in the Australian context, Swedish-type arrangements would enable payments to be made using the existing payments infrastructure. It is likely, however, that separate infrastructure would be required to sit over the top of the payments system, to facilitate the switching of the unique customer numbers between institutions, together with modifications to the IT systems of financial institutions, to enable them to make and receive payments with the new numbers. A central registry of new customer numbers would also need to be developed and maintained to ensure that banks are able to identify the account to which payments would need to be made.
- 2.15. Without going into the detail of such arrangements, it seems clear that account number portability — including a watered down Swedish model — would be a massively expensive undertaking in Australia. It would be akin to taking a gold sledge hammer to crack what is really quite a small nut in the broader scheme of competition and account switching in banking services in Australia. The experience with major, new infrastructure and IT system projects in the financial sector in Australia often has been an unhappy one, with spectacular cost over-runs and benefit short-falls. Smaller players in the banking services market — who are often viewed as potentially significant drivers of increased competition — are inevitably the ones least able to participate in costly major new developments of this kind (even where the benefit/cost numbers are reasonably attractive.)
- 2.16. By way of a brief diversion, suggestions have been made that if a central account registry is not to be pursued as part of new infrastructure required to underpin full account portability, then consideration might be given to the creation of a central 'credit' registry. Banks would be required to submit information on all their loans (especially mortgages) to this registry from which it could be accessed (in aggregated form and with attention to security and privacy considerations) by policy makers and others. It could be used, for example, to obtain up to date readings on hot-spots in the housing market, emerging problems and so on.
- 2.17. The short response to such suggestions is that while information of this kind might be valuable to some people, it delivers nothing to customers of banks and other financial institutions. Moreover, policy makers like the Reserve Bank and APRA, should they require information additional to that they already receive, could obtain it in better targeted and less expensive ways (for example, specific surveys within their own networks of clients).

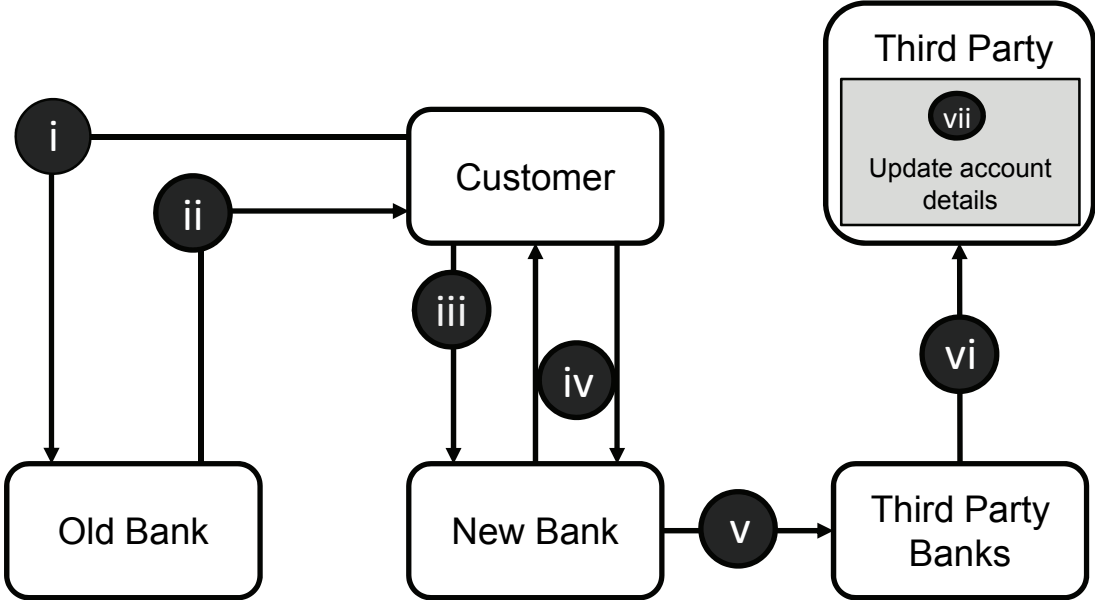
- 2.18. While on diversions, passing mention might be made to a project to develop a new retail payments system known as MAMBO. The project is still being developed by the major banks but MAMBO is designed to facilitate easier payments between individuals and businesses and has been suggested as a potential route to account portability. If developed MAMBO, as envisaged, could facilitate switching by certain groups, but it is intended as a separate payment mechanism to direct debits and credits and is not expected to address what is presently the main barrier to switching, namely, moving these direct debits and credits across to a new account. The other reason for mentioning the MAMBO project is to again illustrate the very hefty price tags attached to major IT undertakings in the banking services sector: current estimates of the likely cost of MAMBO are understood to be upwards of half a billion dollars.
- 2.19. In summary, full account portability is not the peg on which to re-engineer Australia's retail payments system infrastructure — it would involve major costs, which would ultimately be borne by payments system users, for relatively minor benefits. Any review of the on-going adequacy and efficacy of Australia's payments systems and the architecture which underpins it, needs to be focussed on bigger issues than account portability. As it happens, The RBA has just released a document — *Strategic Review of Innovation in the Payments System* — which effectively launches an extensive consultative process for reviewing obstacles to more efficient and innovative payments systems. One of many issues expected to be canvassed in this process is the possible greater use of centralised architecture. Should moves in this direction eventuate, that would appear to be an appropriate context in which to review the question of account portability.
- 2.20. Any such developments, however, are at least several years away. In the meanwhile, some simple and cheap switching arrangements could be implemented fairly quickly which, at the margin, would make it easier for customers to move accounts. A proposal to this end is outlined in Chapter 3.

Chapter 3: Cost-effective switching arrangements

Existing switching arrangements

- 3.1. Although not widely known, a formal switching scheme was established in Australia in late 2008. Its stated aim was to make it easier for customers to switch their transaction accounts among financial institutions, and provide a boost to competition in the process.
- 3.2. The scheme covers the transaction accounts of banks, building societies and credit unions. As noted earlier, these accounts hold readily accessible funds and can be used to make payments of various kinds, as well as to make direct debits and receive direct credits. The scheme does not extend to term-deposits, and nor does it bear directly on the switching of mortgages. (To the extent customers find it convenient to keep all their banking products with one provider, easier switching of transaction accounts might indirectly assist some customers to switch mortgage accounts also.)
- 3.3. Other features of the current scheme are that it applies only to retail customers and not to small business customers. Its monitoring and governance arrangements are also somewhat vague and it has not received much promotional effort.
- 3.4. As discussed in Chapter 2, considerable switching of accounts has occurred since 2008 but the schemes' contribution has been miniscule — less than 6000 switches have been executed through the scheme since its inception.

Diagram 1: Current account switching arrangements¹



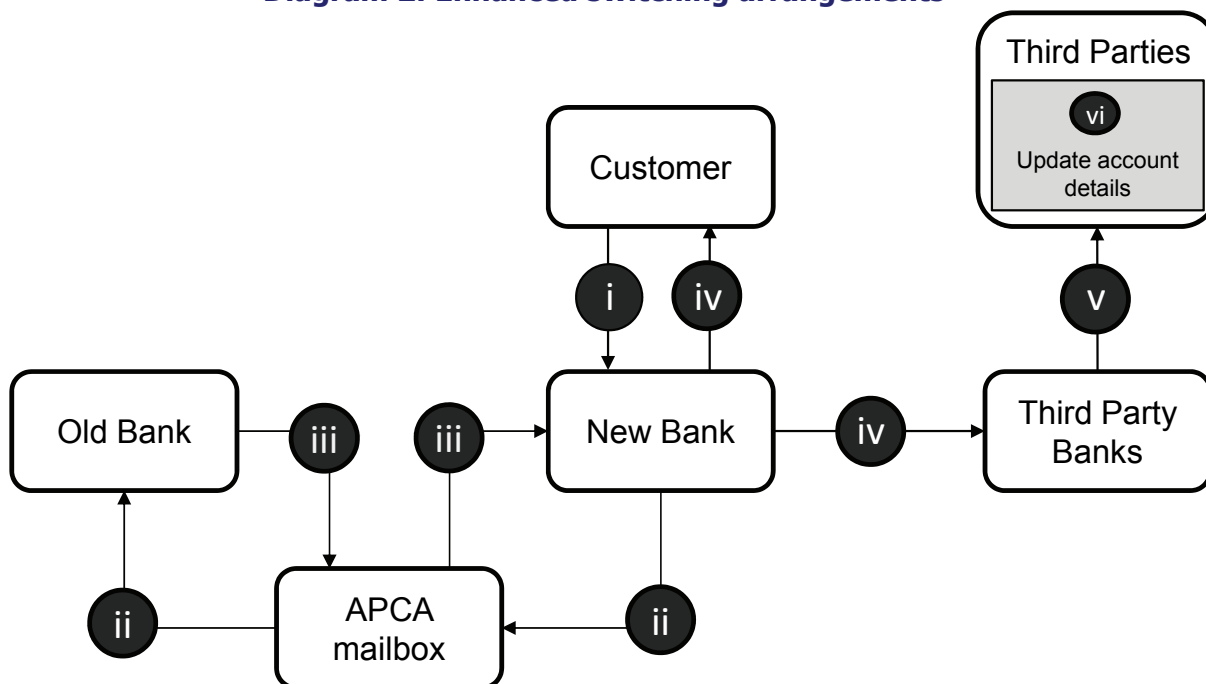
¹ In the diagram 'bank' also refers to credit unions and building societies.

- 3.5. The steps involved in accessing the service are shown in Diagram 1 and verbalized below:
- (i) a customer intending to switch institutions informs the existing institution of this intent, and requests a list of all direct debits and credits pertaining to the account in question;
 - (ii) the existing institution is obliged to provide that list to the customer within five working days;
 - (iii) the customer takes this list to the new institution and requests that institution to effect the transfer of any direct debits and credits to the new account;
 - (iv) the new institution provides the customer (in person, or by electronic means or mail) with an authorisation form or letter for each direct debit or credit that the customer wants moved across to the new account — the customer is responsible for signing each of these letters and returning them to the new institution for the switch to proceed;
 - (v) in the course of effecting the transfers by the new institution, the various institutions of the third parties associated with the direct debits (for example, billers and merchants) and direct credits (for example, employers) are made aware of the customer's switched transaction account. (These third party financial institutions are involved in this process because of their direct relationships with the third parties. APCA retains a record of all these third parties and their relevant financial institutions, which all financial institutions can access.);
 - (vi) those institutions then notify the third parties (their customers) of the switch in accounts; and
 - (vii) the third parties update their customer details to ensure that they debit or credit the customer's new account.
- 3.6. As noted earlier, this scheme has been poorly patronised. In part, the low take up possibly reflects limited awareness of the scheme among both potential users and counter staff within financial institutions. Perceptions of the hassles involved and doubts about the financial benefits of switching transaction accounts — especially compared with mortgages and high-interest savings accounts — might also be part of the explanation, although the large numbers of customers switching transaction accounts outside the scheme tend to discount that thought. Those large numbers suggest that, whatever the reasons for by-passing the scheme, customers overwhelmingly are able to organise their own switching — they may even prefer to do so because they see greater certainty and control in that approach.
- 3.7. It is clear that the existing scheme contains some serious flaws. In particular, it requires customers contemplating a switch to front their current provider to convey this intention and to request a list of the direct debits and credits attached to the account. This is likely to be a confronting experience for some customers, especially those seeking to escape a ruptured banking relationship. Moreover, while obliged to co-operate, the existing institution has no real incentive to pull out all stops to assist the departing customer to move to a competing institution. Again, the customer may well be required to undergo another identification check at the new institution, with more (at least perceived) hassle.

Overseas switching arrangements

- 3.8. As noted in Chapter 2, no country has implemented full account number portability, predominately because of the substantial costs involved. Several countries, however, have established formal arrangements to assist customers to switch from one provider to another, including the United Kingdom, the Netherlands and some other European countries and, more recently, New Zealand. Data on the usage of these schemes are largely limited. The oft-recycled data from the European Commission in 2009 suggested a switching rate across the European Union of around 9 per cent over two preceding years. The UK Office of Fair Trading noted in its report *Review of barriers to entry, expansion and exit in the retail banking sector* issued in 2010 that the switching rate for transaction accounts was estimated at 9 per cent in 2009, up from around 6 per cent in 2006.
- 3.9. The overseas schemes operate within a variety of different payment system infrastructures and regulatory regimes. Such differences in contexts, together with broader differences in history and culture, call for a degree of caution when considering the transferability of arrangements developed in one country to another country. That said, a review of switching schemes in the countries mentioned has been helpful in firming up likely remedies to the flaws in Australia's current switching arrangements, particularly around the tasks assigned to the customer and the old (losing) institution. The customer is required to sign several forms and to rely heavily upon the old (losing) institution to perform much of the work necessary to effect the switch to the new (acquiring) institution.
- 3.10. In the proposed arrangements customers would sign one form signifying the switch to their chosen new financial institution and authorising that institution to execute the related processing work on their behalf. This is in line with the main thrust of the overseas schemes where the new institution assumes much of the responsibility for effecting the switch (rather than the consumer), and where there is limited inter-action between the customer and the old institution. In the countries observed, industry bodies (rather than governments) tend to be the major players in developing and running switching schemes, and in formulating principles and standards to govern account switching. This makes considerable sense, subject to agreement on appropriate operating principles and monitoring.
- 3.11. The proposal which is outlined in Diagram 2 and the related commentary draws in part on observations on overseas schemes, as well as the experience with the existing Australian scheme. What is proposed could be implemented within Australia's existing bilateral payments system infrastructure, and, potentially at least, encourage more customers to switch (and switch more frequently) in pursuit of better deals. At the margin, this could reinforce underlying competitive pressures in the market for banking services.

Diagram 2: Enhanced switching arrangements²



3.12. The steps involved in the revamped scheme are sketched in Diagram 2. In short:

- (viii) the customer requests the chosen new institution to switch the relevant transaction account from an existing institution, and signs a single form authorizing the new institution to facilitate the switch on their behalf (including the transfer of associated direct debits and credits);
- (ix) the acquiring institution sends a request to switch to the customer's current provider through the proposed APCA mailbox (see below) and requests details of relevant direct debits and credits;
- (x) the current institution provides these details to the acquiring institution, again through the APCA mailbox, within an agreed time frame;
- (xi) as under existing arrangements, the acquiring institution informs the institutions of the third parties (that is, the initiators of the direct debits and credits) and the customer that the switch has occurred;
- (xii) the institutions of the third parties inform those third parties of the switch; and
- (xiii) the third parties adjust their account details accordingly.

3.13. Diagram 2, and particularly steps (i) and (ii), should be viewed in the light of the letter dated 9 June 2011 from the CEO of APCA; a copy of this helpful letter is attached (Attachment 1). APCA manages a number of payments clearing systems and has been discussing with its members (which include banks, building societies and credit unions) possible enhancements to its systems to empower the customer's new provider to better manage switching.

² In the diagram 'bank' also refers to credit unions and building societies.

- 3.14. The APCA proposal envisages the development of a switching 'mailbox', a convenient and secure electronic means through which a customer's new institution could request details of direct debits and credits and the customer's existing institution could similarly provide that material quickly and efficiently. In other words, the mailbox would allow financial institutions to both make and respond to requests for relevant details of direct debit and credit arrangements of customers switching their transaction accounts. APCA estimates that its work on the project would take about six months to complete and cost it about \$250,000; some additional spending — unquantifiable at this time but likely to be modest — would be required by participating financial institutions on changes to their back-office and processing arrangements.

Implications for stakeholders

- 3.15. The interest in account portability/switching seems to be largely about widening the choices available to consumers of banking products by making it easier for them to move their accounts to take advantage of the best available deals. Many details remain to be settled but arrangements broadly along the lines proposed have the potential to assist customers in this endeavour — and to do so without burdening the industry (and ultimately all customers) with unwarranted costs.
- 3.16. A single form (paper and/or electronic) signed by the customer and authorising the new banking provider to effect the transfer of all direct debits and credits to the new transaction account should enhance the attractiveness of formal switching arrangements, especially for those customers who are reluctant (for whatever reason) to take on the task themselves. Perceived problems with identity verification checks, however, seem to be greater than actual problems. Concerns about the proof of identity test do not appear to be a source of particular complaint for Australians, and the relatively large number of switches which are occurring seems to confirm this. Recent changes to the *Anti-Money Laundering and Counter-Terrorism Financing Act* are expected to assist banks (and other financial institutions) to verify a customer's identity over the internet. This will enable customers and financial institutions to undertake more of their interactions online, and assist particularly smaller institutions (and those without extensive branch networks) to compete more actively.
- 3.17. The current scheme applies only to retail customers: it does not extend to small business customers. The transactions of some small business customers are likely to be more complex than those of retail customers (different business structures and much larger volumes of transactions and direct debits, for example) but in many instances the issues would be broadly the same. Small business generally would welcome more competitive deals, and with some banks showing heightened interest in that area of lending, now would seem to be a good time to start removing impediments to switching. Consideration, therefore, should be given to broadening the proposed scheme to small businesses, commencing with those most akin to retail customers and moving over time to include others as systems and opportunities permit.
- 3.18. For the banking services industry the cost implications of any new proposals are always of great interest, to large and small players alike. The proposal outlined here should not raise serious concerns on that score. It could be implemented with minimal changes to the existing payments system infrastructure and therefore with minimal costs. As mentioned earlier, the estimated cost to APCA of the proposed mailbox enhancement would be quite modest, as would the likely costs of related enhancements of back-office processes for banks, building societies and credit unions. Some additional spending on establishing a dedicated capability to deal with all customer inquiries related to switches could be a good investment in building new customer relationships.

- 3.19. The proposed arrangements do put more responsibility for effecting switches onto the new institution (and less onto the old institution and the customer), compared with the current scheme. For the reasons mentioned earlier, this represents a better alignment of incentives between new and old institutions. Transaction accounts are valuable banking products, bringing with them low interest balances which make up a significant part of the overall funding needs of many institutions. Traditionally they are also 'anchor' accounts to which other accounts can be tied. It is appropriate, therefore, that the acquiring institution should shoulder most of the task of effecting individual switches — all the incentive is with that institution (and none with the losing institution) to nurture the potentially profitable new banking relationship which starts with a successful switch.
- 3.20. In macro terms a lot of churning of accounts is inherent in the market place, with each institution acquiring and losing accounts on an on-going basis. Every institution cannot be a net acquirer all the time but those that gain a competitive edge can reasonably net acquisitions while their competitive edge remains. Institutions which believe they have a competitive edge at any time — be it in price, technology, service, or affinities with particular communities/workplaces — will be keen to capitalise on that advantage as much as possible. In the same way that they have the potential to help spread the benefits of competition among consumers, cost-effective switching arrangements also have the potential to help direct the rewards for successful initiatives to the institutions concerned.

Chapter 4: A way forward and a recommendation

- 4.1. Switching arrangements of the kind outlined in the previous Chapter are practical and relatively straight-forward. They could be implemented within Australia's existing payments system infrastructure, which is likely to remain in place for some years yet. They would be customer-friendly and could help to nudge hesitant switchers into action. They would avoid heavy costs to industry, and deliver a better alignment of incentives between acquiring and losing institutions.
- 4.2. Judging from the views expressed during the consultative process there would appear to be a good measure of support among stakeholders generally to move in the direction proposed, subject (not unreasonably) to the satisfactory resolution of the detail surrounding a number of issues. The list of issues requiring further consideration is quite a long one and includes the following:
 - The design of a single form which the customer would use to authorise the acquiring institution to initiate and conduct the switching process. This is a key part of the proposal and raises several matters. Customers, institutions and billers and other third-parties would all need to agree on a form which would adequately protect their various legal, security and privacy interests. Other countries have got to this point in their schemes.
 - The nature of industry's commitment to the proposed arrangements. If a new scheme is to be implemented there should be a clear commitment from industry participants that they support the scheme and will cooperate to make it work effectively. One option would be to incorporate a section on the new switching arrangements in the codes of practice that are already in place for the banks and (separately) for credit unions and mutual building societies. Alternatively, a separate, stand-alone code confined to the new scheme could be formulated and endorsed by all participating institutions, with inputs from regulators, consumer bodies and biller groups.
 - A compendium of general principles and detailed rules to underpin the operations of the proposed scheme. This could form part of code(s) of commitment, or stand alone. It would cover, inter-alia, the responsibilities of the different stakeholders (including old banks, new banks and third parties' banks) and the risks they carry; the kinds of behaviour, mistakes and delays that might give rise to penalties, and the nature of those penalties; and so on. As well as helping to smooth out the operations of the scheme, the principles and rules should be framed with a view to not only minimising disputes but also assisting in the resolution of disputes that do arise. (In Europe the European Banking Industry Committee has established a set of common principles that all financial institutions are obliged to comply with.)
 - The coverage of the proposed scheme — specifically, the extent to which it might be extendable to small businesses and the time frames involved.
 - Confirmation of the expected costs and time-frame for completion of all aspects of the APCA mailbox enhancement project (including any issues concerning the passage of customer information through the APCA system), and associated changes to members' systems and processes.
 - Appropriate reporting and monitoring procedures for the proposed scheme. These will be important in attaching credibility to the arrangements and giving confidence to customers to use them. One option would be to establish an informal group of the key stakeholders — perhaps chaired by the Treasury — which would meet regularly to

consider the performance of the scheme and discuss suggestions for possible modifications. The group would receive data from APCA on the scheme's usage and from other sources (for example, on complaints), and report to the Treasurer at six monthly intervals.

- Consideration by industry of the desirability of institutions developing a specialised capability to deal with all requests related to switching matters, and by industry/government on possible joint efforts to best promote public awareness of the new arrangements.
- 4.3. The observation was made earlier that in European countries (and in New Zealand) industry groups have been the main drivers or 'owners' of the switching system in those countries. They are 'owners' in the sense that they operate and maintain the infrastructure, and largely the principles and rules which govern the schemes. It is appropriate — indeed essential — that industry be the lead player here also, but within a broad reporting and monitoring framework.
- 4.4. The Government has legitimate interests in the final shape and on-going performance of the proposed scheme, particularly in insuring that:
- there is a firm industry commitment to a simple and cheap scheme;
 - the scheme imposes minimum risks and costs on customers; and
 - appropriate reporting and monitoring arrangements are established.

The preferred way to protect those interests is to have them reflected adequately in the outcomes on some of the detailed issues still to be determined, especially those surrounding codes of conduct, detailed operating principles and rules, and monitoring arrangements. To this end it is proposed that a Working Party of industry and other stakeholders be established to resolve the outstanding issues and submit a final proposal to the Treasurer in time for a scheme to be implemented and operational by 1 July 2012. Given the somewhat disparate mix of interests involved (including within the industry group), it would be appropriate for this Working Party to be led by Treasury.

Recommendation

- 4.5. Against the background of the fore-going discussion, it is recommended that:
- (i) Arrangements be made for the prompt release of this report; and
 - (ii) that release be accompanied by a preliminary response to the effect that:
 - while many details remain to be settled, there appears to be merit in account switching arrangements of the kind proposed in Chapter 3;
 - a Working Party — to be led by Treasury — be established and will consult widely with all stakeholders to consider and resolve the outstanding issues; and
 - the Working Party will be asked to complete its task within nine months so that new arrangements can be implemented and be operative not later than 1 July 2012.

Attachment 1

APCA letter



9 June 2011

Mr Bernie Fraser
Account Portability Feasibility Study Review
Commonwealth Treasury
Langton Crescent
PARKES ACT 2600

Dear Mr Fraser

I would first of all like to thank you for the opportunity of meeting you and your team on 18 May to further discuss your review of account portability.

As discussed, APCA supports the promotion of competition amongst financial institutions and is committed to improving the customer experience when individual consumers switch transactional banking accounts. APCA's members in the retail banking community have listened to concerns over the current switching arrangements and have developed enhancements to address these concerns.

In our May meeting, you indicated a desire for a switching process that empowers the customer's new financial institution to manage switching. We agreed that this would be easier for customers and give control to the financial institution with the strongest incentive to ensure a smooth account switch.

I am pleased to advise that APCA's members have already agreed on a proposal for an enhanced switching framework that will deliver this.

The original account switching package enabled consumers to obtain a list of all their regular payments from their old financial institution. This list could then be taken by the customer to their new financial institution, which would establish replacement arrangements for the customer's new account.

Under the enhancements, customers who wish to switch will not be required to deal with their old financial institution. Instead, they can open a new account and have their new financial institution manage the switch for them. The new financial institution will, with the customer's signed authority, obtain details of regular payments from the customer's old financial institution and work with the customer to establish replacement arrangements. There will be defined timeframes within which this must occur.



You will appreciate that this is an industry-wide project requiring rule changes, some new systems and operational and customer service changes in dozens of institutions, large and small. It will also require privacy and security sign-offs to ensure sensitive customer data is protected. The main project work can commence as soon as the Government's response to your final report is known. If this happens reasonably soon after your reporting deadline of 30 June 2011, the central component of the enhancements could be in place before the end of 2011, with industry-wide rollout during 2012.

Both initial implementation and ongoing costs will be borne by APCA's member community. APCA's own project costs will be relatively modest – about \$250,000 – but the main bulk of costs will be incurred in back office and process changes in every retail banking institution. Unfortunately I cannot provide data on these costs. APCA does not regulate pricing in any form, so we are unable to provide you with any specific information on possible customer pricing for the new service, beyond the observation that in practical terms, it seems unlikely that customers will be separately charged for the new service.

You also indicated that another desirable feature of any switching service would be for the customer to sign (or electronically authorise) only once when setting up new regular payment arrangements, thereby doing away with the need to execute separate notifications to each existing biller or payer. APCA recognises the convenience of this. However, it raises issues of legal responsibility and liability, as well as changes to operational practice, for hundreds of thousands of billers and payers across Australia:¹ including insurance companies, telecommunication providers, energy utilities, schools, employers and share registrars. APCA's members cannot implement this on their own, but we propose to work with our members and the broader biller / payer community towards a "single signature" enhancement. No doubt the support and encouragement of Government would assist greatly in this.

You mentioned the desirability of modification to banking codes of practice to support enhanced switching as outlined above. This is, of course, a matter for the Australian Bankers' Association and Abacus Australian Mutuals to consider in relation to their respective codes. I have kept them informed of APCA's work, and will provide a copy of this letter to them.

APCA recognises that the original switching package had low community awareness. We agree that more can be done in this area. Apart from the additional publicity that will be generated through your report and the Government's response, APCA can play its part by seeking to generate media and public awareness at the commencement of the new service, and agreeing to regular (say, 6-monthly) reporting to Treasury and publication of switching activity and statistics.

¹ APCA's database has over 286,000 registered users of bulk electronic payments, including more than 20,000 debit users (billers) and 266,000 credit users (payers).



APCA looks forward to working with Australia's retail banking community and with the Government to make switching easier for consumers. We will continue to explore additional measures to enhance customer switching convenience.

Should you find it useful to do so, I am happy for you to refer to the information in this letter, in preparing your report.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'CHAM', is positioned above the typed name and title.

Chris Hamilton
CHIEF EXECUTIVE OFFICER

Cc Steven Münchenberg, ABA
Louise

Petschler,

Abacus

