Competition Authority Submission to the Central Bank of Ireland

Code of Conduct on the Switching of Current Accounts with Credit Institutions

September 2012

The Competition Authority
An tÚdarás Iomaíochta

Question 1: To what extent do you consider that we have identified the potential barriers to switching? Are there other barriers that we should take into consideration in reviewing the Switching Code? Are you aware of any other research or evidence of barriers to switching that we should consider?

Competition works best when consumers actively search for better offers and make informed choices to secure value for money. While a high level of switching is not an essential prerequisite for competition, a credible threat that enough consumers are able to switch should incentivise credit institutions to offer consumers the desired level of service at reasonable cost.

It is striking that despite the well publicised troubles of the Irish banking sector, so few customers have decided to switch to other providers. This contrasts sharply with the other sectors of the economy such as retail electricity, gas, insurance, mobile telecoms and airlines where customers regularly switch provider in search of better value. The low level of switching activity is all the more surprising given the rising number of complaints about the banks to the financial Services Ombudsman.[1]

The taxonomy of possible barriers to switching, both real and perceived, contained in the Discussion Paper identifies in very broad terms the most likely reasons why customers are reluctant to switch even though it might be in their interests to do so.

However it will be interesting to monitor switching data over the coming months as Irish consumers' reluctance to switch may be tested by the decision by the two largest pillar banks to charge customers higher fees on personal current accounts.[2]

The causes of what is collectively known as "consumer inertia" are complex and often interact. To focus on each component individually, or assume that only one problem is responsible for the inertia, is likely to miss these interactions and may misdiagnose the problem. Financial services is a sector where consumers are well known to exhibit a range of behavioural biases which affect their ability to make optimal choices.[3]

All of us tend to exhibit a "status quo" bias and when faced with making a difficult financial decision, we do our best to avoiding making one. Even if we have to, we tend to place greater value on the avoidance of losses more than any financial gain from a switch.

Consumers may feel that a bank is giving them a substandard service but never get round to changing to a better bank or service. They may also be prepared to accept a poor standard of service because they fear losing the banking relationship that has evolved over many years or they value the physical proximity of a bank branch.

The growing volume of research in the field of behavioural economics provides useful insights into the cognitive biases that influence human decision making

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[1] Financial Services Ombudsman - Bi-Annual Review, September 2012.
[2] Ryan, V. BoI follows AIB in changing rules over account fees, *Irish Examiner*, 24 September, 2012. Retrieved from: http://www.irishexaminer.com/business/boi-follows-aib-in-changing-rules-over-account-fees-208580.html.
[3] European Commission, Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective Final Report, November 2010. Available to download at: http://ec.europa.eu/consumers/strategy/docs/final_report_en.pdf

and why we sometimes make choices that are economically speaking, sub-optimal.[4]

In recent years there have been many investigations into retail banking markets. These include: the European Commission *Sector Inquiry into Banking*;[5] the Competition Authority's study into *Competition in the (non-investment) Banking Sector in Ireland*[6]: the Office of Fair Trading Personal Current Account Study in the UK[7]; and, most recently, the Independent Commission on Banking (the ICB) Final Report[8] on reforms to improve stability and competition in the UK banking market. These studies have all found that competition in retail banking is weak and that switching between banks remains low.

All these studies point to the role of public policy in discouraging activities that increase consumer switching costs such as breakage fees and so-called "loyalty schemes" and encourages activities that reduces switching costs such as cost comparison tools and clearer information on transaction fees.

The Discussion Paper ignores one important contributing factor to consumer inertia which is the difficulty that consumers encounter when trying to open an account for the first time. New account holders must present a considerable amount of documentation just to set up what is a basic banking service. If consumers find the experience of opening a current account to be time consuming and cumbersome, they may well be discouraged from switching in order to avoid a similar experience in the future.

Question 2: Should enhancements be made to the Switching Code in the area of requirements for training for credit institution staff on the Switching Code and the switching process?

Yes, enhancement should be made to ensure that bank staff are well trained in the switching process. The mystery shopping exercise carried out by the Central Bank suggests that further enhancements in the area of staff are required. Consumers need to be confident that bank staff are helpful and are aware of the steps involved in the switching processes.

Question 3: Should the banks be required to raise awareness of the switching process among their customers in view of the low level of switching in the Irish banking system? If so, what steps should they be required to take, individually and/or collectively? Could this be done effectively via conduct of business rules?

Yes, banks should be required to raise awareness of the switching process. Banks themselves cannot be relied upon to take measures to reduce consumer inertia on their own if it is not in their economic self interest to do so. The mystery shopping exercise carried out by the Central Bank suggests that the banks are not making customers aware of the switching process. Therefore the burden of responsibility must fall to the regulators to address factors which reduce consumer mobility such as the administrative burden, information asymmetry, bundling and tying of products and, in some cases, closing charges.

[4] For an accessible discussion on judgement and decision making see *Thinking fast and slow*, by Daniel Kahneman.
[5] http://ec.europa.eu/competition/sectors/financial_services/inquiries/retail.html
[6] http://www.tca.ie/EN/Promoting-Competition/Market-Studies/Banking.aspx
[7] http://www.oft.gov.uk/shared_oft/reports/financial_products/OFT1005.pdf
[8] http://bankingcommission.independent.gov.uk/

However, customers themselves will also need to be more engaged with their banking services. And it may be difficult for rival banks and new entrants to attract customers from their existing bank if those customers perceive that their banking is "free", or to use a different charging model when the 'free if in credit' model prevails across the sector.

Regulators will have to remain vigilant regarding the pricing of financial services and the design of financial products as even the most active of consumers face great difficulty in ascertaining the true cost of banking services.

Question 4: Are there other measures that we should consider in reviewing the Switching Code to increase switching levels and reduce consumer inertia? Are you aware of any research or evidence/experience of measures taken elsewhere to increase consumer awareness and encouragement with regard to switching?

The Central Bank should consider incorporating consistent rules regarding what steps a banks will take if a customer suffers a loss or a loss of credit rating due to a bank's error or delay in switching.

The lack of switching in the banking sector appears to be a widespread phenomenon. In its work on personal current accounts, the OFT agreed initiatives with the industry to improve the transparency of charges (such as the provision of annual statements) and to improve the switching process.

Question 7: At the time of actual switching, should the obligation or onus be placed on the bank (old and/or new) to ensure that the switching process works successfully for the consumer, particularly with regard to direct debit and/or credit transfers? If not, where should the obligation be placed?

One aspect of the switching process that deserves further examination is the level of risk that consumers perceive in switching banks. If a switch goes wrong consumers appear to bear a significant proportion of the resulting costs. For example, consumers may face penalties for the non payment of direct debits which may lead to an impaired credit score. The allocation of risk in the switching process may be a significant barrier to switching.

The onus of ensuring the successful switch should be placed on the banks involved and all measures should be taken that the customer is not financially disadvantaged because of an error on the part of the banks.

Question 8: Should the consumer be made aware that an impaired credit rating has been recorded against them as a result of a declined direct debit arising from the switching process?

Yes, the consumer should be informed of any adverse credit reports. An impaired credit score can have a significant detrimental effect on a consumer's long term financial well being and impairment recorded against them as a result of a mix-up in the switching process should be rectified free of charge.

Question 9: Should the provisions of the Switching Code be extended beyond current accounts and include demand deposit and/or savings accounts?

It is not apparent that the barriers to switching that exist in the personal current account sector also exist to the same extent in deposit and saving accounts such that a statutory code would be required.

vigorous competition drives productivity growth, innovation and value for all consumers in the economy

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