



Fair go on fee\$

choice

The **Fair Fees** campaign is a joint campaign of CHOICE and the Consumer Action Law Centre and was launched in June 2007. The Fair Fees campaign is designed to empower consumers to fight bank against unfair and potentially illegal bank penalty fees. The Fair Fees website (www.fairfees.com.au) contains information for consumers about how to seek refunds on penalty fees charged by financial institutions. The site also provides information about penalty fees on standard and concession accounts. Since launching the campaign more than 30,000 consumers have used material on the site to challenge unfair penalty fees.

**CHOICE and
Consumer Action Law Centre
Submission to the
Review of the Code of Banking Practice 2007-2008**

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Review of the Code of Banking Practice: Achieving good practice in penalty fees

CHOICE and Consumer Action support and endorse the joint consumer submission to the Review of the Code of Banking Practice (the **Review**). This submission concentrates on the issue of bank penalty fees in more detail.

The *Code of Banking Practice* (the **Code**) seeks to promote good banking practice for banks to follow when dealing with customers, but it's failing to achieve good practice in the area of bank penalty fees.

Bank penalty fees are a major consumer issue. Penalty fees are often charged in circumstances outside of the consumer's control and can result in hundreds of dollars in lost income for relatively minor defaults. The fees have increased rapidly in recent years and bear little relation to the underlying cost of the transaction.

The Code currently requires that fees are disclosed to customers. But disclosure isn't sufficient to protect consumers when fees are exorbitant and are charged in unreasonable circumstances.

We believe that banks could do more to minimise the impact and incidence of penalty fees. Fewer and lower penalty fees will deliver a more efficient banking system and a fairer society.

We do not consider that the interim recommendation on this issue in the Issues Paper to the Review will deal effectively with the problems surrounding bank penalty fees.

As part of our Fair Fees Campaign against unfair bank penalty fees, we call for the following changes to the Code to enshrine good banking practice regarding penalty fees:

- 1) Disallow unavoidable fees – including deposited or 'inward' cheque dishonour fees (third party dishonour fees) and penalty fees triggered by the bank's own fees and charges
- 2) Seek customer approval for transactions exceeding the customer's credit card limit
- 3) Do not process account over-draws without the customer's consent
- 4) Exclude penalty fees from concessional bank accounts
- 5) Ensure the level of fees is referable to the direct costs involved in processing the default and set out what can be considered direct costs
- 6) Ensure customers are given a real-time warning that a penalty fee will be imposed if a particular transaction goes ahead
- 7) Establish standard penalty fee names.

Background

What are bank penalty fees?

Bank penalty fees, also called default or exception fees, are charged when a customer breaches a requirement of their bank account terms and conditions. On credit card accounts, penalty fees apply for late payment or exceeding a credit limit. For transaction accounts, penalty fees apply for over-drawing an account and transactions where there are insufficient funds to process a cheque, direct debit or periodic payment. These fees can be as high as \$50.

According to the Reserve Bank of Australia (**RBA**), banks' total fee income from households increased by 9 per cent to \$4.4 billion in 2006-07, similar to the average pace of growth in recent years.¹ Credit card penalty and foreign exchange fees grew even faster, soaring 16% in 2006-07. The RBA data does not currently disaggregate penalty fee income but may do so in the future.

For customers in financial difficulties, penalty fees can contribute to the debt cycle, as explained by one consumer:

“Over the last year I lost my part time job so now only rely on my fulltime job to cover all my rent bills and so on...I explained to them that at the moment that \$250 each fortnight was all I could pay but they kept calling and every fortnight not only would they add on interest but a \$30 late payment fee and a \$30 over limit fee. So over a fortnight I would pay \$60 just in fees. As a result of this my credit card has got worse not better...”

Since launching the Fair Fees campaign in May 2007 a number of banks have adjusted down their penalty fees and improved their penalty fee policies. These measures have been welcome improvements but fees nevertheless remain high and continue to be charged in dubious circumstances. Under the current Code, consumers have no effective avenue of redress to challenge unfair bank penalty fees.

What does the Code currently say about penalty fees?

The Code requires that all standard fees and charges are fully disclosed to customers. The Fair Fees campaign does not dispute that fees should be disclosed, although we do believe that greater consistency in fees nomenclature would improve the usefulness of disclosure.

While better disclosure of fees is welcome, focusing on it as a solution to the penalty fees problem misses the point. There is little competitive pressure on financial institutions to keep fees in check and so market forces alone will not bring penalty fees in line with their true costs.

Penalty fees are not subject to effective competitive forces. Unlike transaction and account keeping fees, consumers don't expect to pay penalty fees at the time they open an account or take out a loan or credit card.² As a consequence, consumers don't shop around for the best deposit account or credit card on the basis of penalty fees offered. And because they don't expect to pay penalty fees, there's little that could be done to promote competition.

¹ Reserve Bank of Australia, *Banking Fees in Australia*, Reserve Bank Bulletin May 2008

² This is due to well known cognitive biases such as overconfidence and difficulty with estimating low probabilities. Cognitive biases are now being studied to understand how they affect the way consumers behave in markets through the field of behavioural economics. See, eg, OECD Committee on Consumer Policy, *Roundtable on Demand-side Economics for Consumer Policy: Summary Report*, 20 April 2006; Productivity Commission, *Review of Australia's Consumer Policy Framework - Productivity Commission Inquiry Report: Volume 2 – Chapters and Appendixes*, No. 45, 30 April 2008, pp.373-388.

The Code reviewer's interim recommendation on penalty fees is discussed further below. We don't believe the recommendation goes far enough to codify good banking practice in respect of penalty fees. Better information will always be welcome but if financial institutions were really serious about helping customers to avoid fees, they would implement changes to their operating systems and procedures to limit the number of the fees they issue and the amount imposed by those fees. The Code reviewer's interim recommendation is:

Interim Recommendations:

That reference to 'standard fees and charge' in the code is replaced by 'fees and charges'.

That Clause 40 be amended to delete reference to 'standard fees and charges' and replace it with 'fees and charges' and include in the definition of 'fees and charges' reference to the reasonable recovery of costs incurred by the banks when customers default on their repayments, exceed their overdraft limit or are overdrawn on their account.

That the ABA regularly updates the facts sheet on exception fees which is published on the ABA's website.

Fair Fees Campaign Recommendations

1. Disallow unavoidable penalty fees

Consumers generally understand and accept that in reasonable circumstances additional penalty fees will apply to some types of transactions. But a great frustration for consumers is the application of penalty fees in situations that cannot be avoided, including

- Penalty fees for third party defaults, such as 'Inward' cheque dishonour fees, and
- Penalty fees incurred as a result of the bank's own fees and charges

Inward cheque dishonour fees are charged when a customer deposits a cheque from a third party into their account, which is subsequently dishonoured by the third party's bank. It's clearly not your fault if someone writes you a cheque when there isn't enough money in their account to cover it, but some banks persist in charging a penalty fee to the depositing customer.

Most Australian Bankers' Association (**ABA**) members have scrapped this fee in response to the Fair Fees campaign but both HSBC and Adelaide Bank continue to charge inward cheque dishonour fees. We believe the Code should explicitly exclude inward cheque dishonour fees and other third party default fees.

A large number of customers have contacted the Fair Fees Campaign after incurring fees as a result of the banks' own fees and charges. One consumer told us her story:

"In March last year, I was due to pay my monthly fee of \$5, plus another \$1.50 for Internet and visa debit card fees. This took my account to \$0.84 overdrawn, for which I was charged a \$30 overdrawn fee, and \$0.60 in interest."

In other cases, customers have been frustrated when their annual credit card fee triggers a \$30 charge for exceeding their approved credit limit. Customers cannot seek alternative payment arrangements where they do not have sufficient funds to cover transaction fees that are due to be charged to their accounts. Situations like these see customers penalised for paying unavoidable transaction fees on their bank accounts.

A best practice approach to banking would not see customers incurring penalty fees where they are a result of the bank's own fees and charges, as indeed the ANZ has recognised in its

*Exception Fees Policy.*³ We recommend the Code be amended to exclude the application of transaction account over-drawn and credit card over-limit fees triggered by the bank's own fees and charges.

2. Seek customer approval for transactions exceeding the customer's credit card limit

Credit card over-limit fees are a relatively new invention of the banking system. The fees did not exist in 2000, and in 2001 averaged just \$6. Today customers can pay as much as \$35 for exceeding their credit card limit.

The frustration for consumers is not just the level of the fee, but also the fact that the use of an electronic credit card payment system means the bank could stop the transaction but instead chooses to process the transaction which incurs the additional fees.

We see little justification for the existence of credit card over-limit fees in cases in which the customer has not agreed to the ability to spend over their limit. Credit card limits are set with the approval of both bank and customer according to the needs of both parties. The bank retains the capacity to decide whether to accept or reject transactions that exceed a credit card limit. A conflict of interest arises because the decision to accept the transaction generates fee income for the banks.

Further, the bank retains its right to charge interest on such payments, so it already generates income out of the transaction. The nature of the payments system means that for the large majority of transactions (those that are electronic) the bank has a low-cost automated process for accepting or rejecting transactions, thus any costs involved in deciding to accept the transaction would be nominal.

We believe that where a bank elects to accept a transaction that exceeds a credit card limit, it must do so without the incentive of additional fee income.

CHOICE and Consumer Action recommend the Code be amended to exclude the charging of fees where a bank proceeds with a transaction that exceeds a customer's credit card limit, unless the customer has given prior consent to allowing their credit card limit to be exceeded.

3. Do not process account over-draws without the customer's consent.

Similar to credit card over-limit fees, banks impose a fee when a customer's account is overdrawn, in addition to charging interest on the over-drawn amount. Again, there is consumer frustration because the bank could stop the transaction but instead chooses to process the transaction, even if the customer has not consented beforehand to an overdraft facility on their account. For example, ANZ's *Exception Fees Policy* already states that ANZ gives its customers the option to switch off the ability to overdraw their account via ANZ Phone and Internet Banking, EFTPOS and ATM, indicating that banks have the technology to ensure customer accounts are not overdrawn.

The frustration with honour fees is clear in this consumer's story:

"After once over-drawing my cheque account...I got [the bank] to disallow over-drawing on that account. Twice since then, I inadvertently and unknowingly overdraw my account, only to find that I got charged \$30 each time. When I approached [the bank] with these charges, the banker with whom I spoke acknowledged that I had indeed successfully requested for my account to be disallowed from being overdrawn, but that "sometimes if you pay by EFTPOS, and there are not enough funds in your

³ ANZ, *ANZ Exception Fees Policy: Consumer Transaction and Savings Products*, available at www.anz.com/Documents/AU/Aboutanz/270807ExceptionTransAcc.pdf.

account to cover the charge, [the bank] still has to honour the transaction. That's just the process. You should just be more careful next time."

The bank also generates income from the interest charged on the over-drawn amount and, once more, any other costs in deciding to accept or reject these transactions is nominal given the low-cost automated process for electronic transactions. We therefore see little justification for the existence of honour or account over-drawn fees.

Banks should instead ensure that customers cannot overdraw their account unless this ability is agreed to beforehand. It is even clearer that this is good banking practice considering that section 7(2) of the *Consumer Credit Code* makes clear that it does not give any protection to consumers who have their accounts over-drawn:

This Code does not apply to the provision of credit if, before the credit was provided, there was no express agreement between the credit provider and the debtor for the provision of credit. For example, when a cheque account becomes overdrawn but there is no expressly agreed overdraft facility or when a savings account falls into debit.

CHOICE and Consumer Action recommend that the Code be amended to exclude the charging of fees where a bank proceeds with a transaction that over-draws a customer's account, unless the customer has given prior consent to allowing their account to be over-drawn.

4. Exclude penalty fees from concessional bank accounts

Low income households suffer disproportionately from penalty fees. The holding of a bank account is effectively mandatory for these households given that an account is required to receive pension and benefit payments. This leaves households on low and fixed incomes very vulnerable to bank penalty fees given they typically do not have the ability to leave a buffer of funds in their account to cover additional or unexpected transactions.

Since launching the campaign, our organisations have been inundated with stories of punitive fees charged to households on low and fixed incomes. In one case, a pensioner lost more than a third of her week's income in penalty fee payments. Another pensioner told us how an ATM withdrawal put her account \$1.87 in the red and resulted in over \$100 worth of fees. Others have told us how penalty fees (in one case about \$2900 worth) have caused further disadvantage when the customer was already experiencing severe financial hardship.

Since our Fair Fees Campaign was launched in June last year, some banks have reduced or eliminated penalty fees on their concession bank accounts, which we have publicly welcomed. But until penalty fees are removed from all concession bank accounts, many low income households will continue to be charged penalty fees that are inappropriate and punitive given their financial circumstances.

We strongly recommend that the Code require banks to eliminate penalty fees from concessional bank accounts.

5. Ensure the level of penalty fees is referable to the direct costs involved in processing the default

The major problem with bank penalty fees is not that they are hidden and need better disclosing, but that they are excessive, and punish low-income households in particular.

The interim recommendation on this issue proposes to change the definition of 'fees and charges' in the Code so that it is clear penalty fees are covered and must be disclosed to consumers, but disclosing these fees will not do anything to change the unfair way they are imposed on consumers.

This is because, as we point out above, consumers don't expect to pay penalty fees at the time they open an account or take out a loan or credit card, so they simply don't make their choice about which is the best deposit account or credit card on the basis of the penalty fees that might be charged. This means there is no reason for the banks to compete down the amount of these fees, and they don't, as is shown by the latest RBA figures we quoted above.

The interim recommendation also proposes that the new definition of 'fees and charges' should include a reference to 'the reasonable recovery of costs incurred by the banks when customers default on their repayments, exceed their overdraft limit or are overdrawn on their account'. It is good to see this principle acknowledged, but it is not going to have any effect on penalty fee practices if it is only included in the definitions clause of the Code. The Code has to actually *require* members to change their practices on penalty fees, or unfair penalty fees will continue to be charged.

We recommend that the Code be amended to require banks to limit penalty fees to a fair and reasonable amount, referable to their directly related costs for processing the relevant default. The Code can also give guidance to the banks about what are the direct costs that they can include in determining what is a fair and reasonable amount for a penalty fee.

We note that Abacus, the industry association for credit unions, building societies and friendly societies in Australia, is currently consulting on a new draft *Mutuals Code of Practice* for its members. This new code proposes, at section 5 on fees and charges, that its members 'will make sure any exception fees we charge (including credit card late payment fees, account overdrawn or dishonour fees, direct debit dishonour fees, cheque dishonour fees, and ATM failed transaction fees) are reasonable having regard to our costs'.

Another example of a code prescribing some reasonable requirements for penalty fees is the Victorian *Energy Retail Code*, which at clause 32 regulates the agreed damages terms, including late payment and early termination fees, that Victorian electricity and gas retailers can charge customers. Similar to Abacus' draft code, the *Energy Retail Code* provides that the amount of these fees must be 'a fair and reasonable pre-estimate of the damage the retailer will incur if the customer breaches their energy contract, having regard to related costs likely to be incurred by the retailer'. Importantly, the *Energy Retail Code* also sets out what sorts of costs are direct costs, in the case of early termination fees. This sort of practical guidance in the code ensures its requirements are clear and fair for business and consumers. For example, the costs of terminating a contract generally are *not* direct costs of early termination – only the additional costs involved in an *early* termination of a contract are direct costs that can be taken into account by the energy retailers. Some pro rata costs are also included as direct costs.

The Issues Paper sets out the ABA's views on penalty fees and the Code, including that other financial services institutions charge penalty fees, and that a code shouldn't be used as a means of price control because competition and markets will control prices such as penalty fees. We don't think that the fact other institutions also charge unfair penalty fees somehow justifies unfair practices by the banks. Of course, we have strongly argued in other fora that other institutions which charge unfair penalty fees should also stop these practices, and we see examples of progress being made in the draft *Mutuals Code of Practice* and the Victorian *Energy Retail Code*. We've already pointed out that competition will *not* control penalty fees, so this argument by the ABA is also flawed and disingenuous. It is very feasible for codes, including this Code, to put some reasonable limits on penalty fees without engaging in price control, as Abacus's draft code and the Victorian *Energy Retail Code* demonstrate.

6. Ensure customers are given a real-time warning that a penalty fee will be imposed if a particular transaction goes ahead

Even where reasonable penalty fees might be charged, banks could do more to help their customers avoid penalty fees. One of the most effective ways they could do this is by providing a real-time warning to consumers that if they proceed with a chosen transaction via Internet or

telephone banking, via an ATM or in some circumstances via EFTPOS, they will be charged an additional fee and the reason why, for example because the transaction will over-draw their account or be rejected for lack of funds.

It has now been over 7 years since the Parliamentary Joint Statutory Committee on Corporations and Securities recommended that a framework for a real-time disclosure regime on electronic and telephone banking and ATMs needed to be established in no more than two years and implemented within six months that.⁴ After hearing evidence from the banks, consumer groups and ASIC, the Committee made express findings of fact that a 5 year delay in implementing real-time fee disclosure would have an unacceptably adverse effect upon consumer welfare, and that Internet and telephone banking and ATMs already afforded opportunities at that time to introduce real-time disclosure even sooner.⁵

The delay is becoming farcical. We recommend that the Code require banks to provide customers with a real-time warning – that is, at the time of the transaction, for example on the ATM screen for ATM transactions, on the computer screen or on the telephone for Internet and telephone banking, and perhaps via SMS message for EFTPOS transactions – that an additional fee will be imposed if a chosen transaction is proceeded with, and the reason for this, such as because the transaction will over-draw the account or be rejected for lack of funds.

7. Establish standard penalty fee names

The disclosure of an unfair fee does not make the fee any fair. For the reasons outlined above we do not believe that disclosure will solve the problem of penalty fees. However better information is always welcome. The ABA has shown a commitment to improved disclosure of penalty fees. The information provided on its website about penalty fees, for example, has made a useful addition to public commentary on the matter. Improvements in disclosure remain somewhat helpful and we believe the Code is a vehicle to drive better disclosure in banking.

A great challenge for consumers at the current point in time is the great variation in the names given to these fees by different banks, even though the fees are fundamentally the same. For example, a 'direct debit dishonour' fee may be known as a 'reference' fee at another financial institution. A 'periodic payment non-payment' fee may be simply a 'dishonour' fee at other banks. A greater alignment of fees names would contribute to greater clarity in consumers' understanding of fees.

We therefore recommend that the Code provide for standardisation in the names given to these fees across all banking products.

⁴ Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on Fees on Electronic and Telephone Banking*, February 2001, para.7.26.

⁵ As above, para.7.20.

CHOICE is an independent, not-for-profit, non-party-political organisation established in 1959 to provide consumers with information and advice on goods and services, health and personal finances, and to help maintain and enhance quality of life for consumers. CHOICE provides consumer education, conducts surveys into consumer attitudes, lobbies for improved conditions for consumers and distributes unbiased consumer advice.

Independent from government and industry, it lobbies and campaigns on behalf of consumers to advance their interests. CHOICE is primarily funded through subscriptions to its magazines and website, fee-for-service testing and other related expert services. There is no government funding for normal running expenses of CHOICE, and no commercial sponsorship or advertising.

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Consumer Action is an independent, not-for-profit, campaign focused, casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

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