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TITLE: **Despite your fears, dumping your bank won't end in tears**

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Treasurer Wayne Swan is fond of telling anyone who will listen how much he wants bank customers to "walk down the road and get a better deal".

This sums up the government's vision for reforming the banking sector: relying on consumers to drive change.

Unfortunately, as a senior executive from the Bank of England, Andrew Haldane, recently observed, someone is more likely to leave their spouse than their bank, at least in statistical terms. (Of course some people are much more fond of their partners than any financial institution you could name.)

So why do such a small number of customers actually make the effort to change banks, even when they know or suspect they are being ripped off? Late last year, the government commissioned Former Reserve Bank Governor Bernie Fraser to examine how to make the process of switching banks easier.

Fraser's report, released by the government a week ago, describes how patently unsatisfactory the present system is.

Under this scheme, established three years ago, to start the process of switching people are required to visit their old bank to tell them that they are "breaking up". Just 6,000 people did so – far fewer than the number of people who have switched banks under their own steam.

The Fraser report makes a number of sensible suggestions, including putting the onus for taking action onto a customer's new bank rather than the old one. It also recommends that consumers need only give their consent to switch once, rather than dealing with each of their direct debits separately.

At face value there is nothing wrong with this approach. Banks seem to be generally happy with it, since they have avoided the allegedly prohibitive cost of complying with a scheme in which account numbers (not just bank accounts) are portable.

But banks being happy with banking policy can be a bad sign for consumers, because it probably means that not much is likely to change.

The Fraser report acknowledges a fact that bewilders many financial types, observing that low rates of switching “may have more to do with motivation and perceptions, rather than real barriers.”

In suggesting this, the report draws attention to a phenomenon that banks continue to exploit with abandon, but that policy-makers find it very difficult to acknowledge, let alone respond to sensibly.

In banking, as in many other areas of behaviour, consumers are what could be called “selectively rational”. In other words, we sometimes make decisions that are in our own interests, but not all the time.

For policy-makers who are used to assuming that people respond predictably to the right incentives, this can be downright frustrating. Even the best switching arrangements in the world will do nothing for competition if consumers don’t make use of it.

In banking, there are several reasons why consumers don’t vote with their feet as much as we would expect them to in a world with perfect competition between banks. Contrary to Fraser’s view, these perception problems are themselves the “real barriers”.

The first perception problem is that the process of switching is an administrative nightmare, akin to filling out a tax return but without the threat of coercion if you don’t. In the absence of a compelling reason to move, many people delay the task until the day they get around to it. Which many don’t.

The second perception problem is that there is no point in switching, because banks will find some way to rip you off whichever one you choose.

This perception is reinforced by the utter bewilderment that many people feel when faced with a choice between different financial products that are difficult to compare. As the Fraser report asks, “if the transaction accounts on offer from different institutions are broadly the same anyway, why change?”

The third perception problem is the one which actually poses the greatest threat to real competition, but is scarcely mentioned in the Fraser report and yet to be acknowledged at all by the government. This is the notion that changing banks is infinitely harder because of all the other products that consumers have with the same bank.

The bundling of multiple financial products – transaction accounts, credit cards, home loans, insurance and even investments – is the key to securing a customer’s long-term patronage. It makes consumer choice in banking much more “sticky” than it would otherwise be.

Bank advocates would call this kind of bundling “financial innovation”; it is after all a relatively recent phenomenon. But from a consumer’s perspective, it undermines the kind of competitive pressure that most players in the debate about banking reform say is necessary.

However bundling is interpreted – as legitimate business practice or fundamentally anti-competitive – it is undoubtedly in the interests of the dominant players in banking to reinforce the public perception that switching is too hard or not worth the effort.

The more they can discourage people from taking the first step towards getting a better deal, the more the big banks can protect their own, highly profitable customer base.

This is why any action to promote switching needs to start with an admission that perceptions are in fact the "real barriers" - and that the banks want to keep it that way.

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