

*In this issue*

Alternative providers are profiting with specialized services to credit- and convenience-hungry consumers

Market smarts

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Advance of the Alternatives

WE'VE SEEN an explosion of new retail banking alternatives in recent years, beginning with the launch of ING DIRECT and Citizens Bank in 1997 and Ubiquity Financial in 2000. These financial institutions, along with President's Choice Financial, are among the best-known newcomers to the marketplace. However, other suppliers have quietly followed, filling specialized niche roles such as providing payday loans and cheque cashing services, private label ATMs and mortgage brokerage. Whether wanting to finance a mortgage, purchase mutual funds, open a chequing account or even withdraw cash from an ATM, consumers today have extensive choice beyond mainstream banks and credit unions.

This issue of *Market Smarts* examines a lineup of new financial services and alternative suppliers that Canadians wouldn't have considered a decade ago. We look at research suggesting that banking habits in Canada are undergoing change, together with reasons why this is occurring. □

Payday Loan and Cheque Cashing Outlets

Money Mart a market leader

One of Canada's larger providers of payday loans and cheque cashing services is Money Mart, based in Victoria. The company has nearly 300 outlets across the country, serves more than one million registered users and exceeds \$4 billion in total transactions annually. The company has been a complaint-free member of the Better Business Bureau for more than 18 years and is acknowledged for maintaining the industry's best practices. This is evident in that Money Mart does not allow rollover financing, a practice that concerns many consumer advocates.

Money Mart was formed in Edmonton in the early 1980s. At that time, the company's founders believed consumers were not being adequately served through traditional financial service channels. To accommodate rising needs for improved convenience and service Money Mart opened branches outside regular business hours and positioned them in easily accessible locations.

Money Mart does not provide the range of services offered by credit unions or banks; rather, it has chosen to focus on a basic necessity: *immediate access to cash with minimum frustration*. Money Mart holds a 60 percent market share by maintaining high consumer satisfaction ratings.

Money Mart's growth has been continuous. By 1994, the company had over 100 franchised and corporate branches. By 2000, it exceeded the 200-outlet mark and currently has close to 300 branches. Revenue from payday loans, which now account for 37 percent of the company's sales, has increased much faster than fee revenue from cheque-cashing. The decline in the latter is likely due to the growth of direct-deposit for payroll and government pension cheques.

Who uses alternative banking services? And why?

According to Money Mart, its customers typify the average Canadian. Statistically, that means the company's average customer is age 34 and employed, with an annual income of \$34,000. The majority of Money Mart customers are male (60 percent) and most have bank accounts. This profile coincides with research conducted in 2002 by the Public Interest Advocacy Centre, an Ottawa based consumer group, which studied alternative banking services from a customer's point of view. The research reveals that people who use alternative banking services feel comfortable doing business in these places, while they do not feel comfortable dealing with banks. Included in the report are results of a random survey of Canadian households on use of payday loans. Of the 4,200 households contacted, 5 percent – representing more than 1 million Canadians – had used the alternative-banking sector in the past three years. The research also found that only 15 percent of users would fall

under Statistics Canada's definition of low income and only 4 percent of users were under age 21. In fact, most of the alternative banking customers did not fit the commonly-applied profile of the disadvantaged. They have jobs (although they are less likely to be university educated professionals) and they are similar to the Canadian population in age, gender and income.

Aside from the differences in comfort levels cited above, why are these people using the services of a retail money store rather than a bank or credit union? In the Public Interest Advocacy Centre's random survey, only 9 percent said it was because they had a poor credit rating. The main reason given was simply that money was tight and payday loans were needed for "day-to-day expenses." Other reasons, and their relative importance, are shown in Figure 1.

For cheque cashing in particular, many cite the convenience of receiving instant cash rather than enduring a four-day or longer clearing period at a bank or credit union. Others consider extended opening hours a benefit along with the friendliness of staff and a welcoming atmosphere. Historically, credit unions were deemed to be industry leaders in customer service. Perhaps customer service has become a casualty as traditional financial institutions introduce new technologies and sales initiatives?

Credit culture lures today's consumer

A major indication of changing attitudes and habits is the reluctance of consumers to set aside funds for a rainy day or financial emergency. The patience and discipline required to save for future needs have been eroded by ever expanding reliance on credit. The executive director of Credit Counseling Service of Toronto states that credit has replaced savings as a means of surviving a financial crisis. Previous generations saved for a rainy day while today's consumer reaches for a credit card, dips into a line of credit, or turns



to an alternative such as a payday loan. In fact, Millward Brown Goldfarb reports in *Consumer TrendZ 2003* that the proportion of Canadians who maintain a line of credit has increased for the last five years to 43 percent. With this rise in LOC use, it might be expected that personal loans would decrease – but this is not the case, as the percentage of Canadians with personal loans remains steady.

CIBC World Markets recently reported that household borrowing is rising by an inflation-adjusted rate of more than 7 percent annually – the highest rate in more than a decade. This means that household borrowing is rising five times faster than growth in household income. In other words, people are borrowing to support their spending at a time when their incomes aren't increasing proportionately. This theory is backed by the Vanier Institute of the Family; an Ottawa based social policy think-tank. "A growing number of Canadian families are living on the edge financially and will be pushed over when interest rates eventually rise." The Institute claims "over the past 15 years, household spending has jumped 17.4 per cent, disposable incomes have only increased 2.9 per cent, contributing to a 35 per cent surge in their debts".

Borrowing has become a way of life. Instant gratification and materialistic attitudes fuel the need for more credit for some people, while desperation to pay phone bills or buy groceries drive others. Putting motives aside, the trend today is to borrow for the things we want or need; it is less common to save and wait until we can pay without incurring debt.

According to the Public Interest Advocacy Centre, credit cards are often the initial culprit that forces people to use payday loan companies. Credit card suppliers flood consumers with attractive low rate options and easy access to credit. Even before students have jobs, they are able to apply for credit cards and it is common for those who carry balances on their cards to receive offers to increase

their limits. The report indicates that many people who have found themselves in trouble with payday loan companies had initially abused the availability of credit through improper use of credit cards. For these people, the convenience factor was "a bit too convenient".

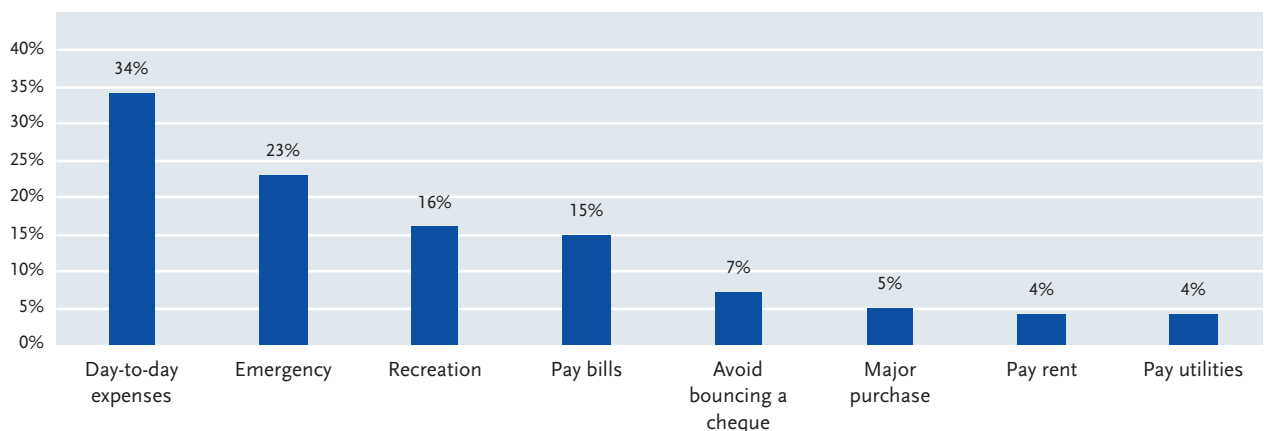
Payday loan outlets battle backlash... but they're here to stay

With the recent proliferation of payday loan and cheque cashing outlets it was only a matter of time before their profile increased to a point where they gained attention from consumer advocates. As their lending practices have come under scrutiny, the attention has not been positive. Several are being sued in BC and Ontario. The basic complaint is that companies like Money Mart and its competitors (e.g. Cash Money Cheque Cashing Inc., Unicash) charge customers "criminal rates of interest" on loans. If a loan is paid on time and does not incur additional fees, then the customer pays interest outstanding of 59 percent – just under the legal limit of 60 percent. However, if the loan incurs fees – such as a cheque cashing or late payment charges – then the true cost of the loan may be higher than the legal 60 percent limit on an annualized basis. Under section 347, a "criminal rate" is defined as "an effective annual rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds sixty percent on the credit advanced under an agreement or arrangement".

In defending their practices, payday loan companies take the position that processing charges, late fees or other fees should not be considered along with interest in the final cost of repayment. They say that their "fees" do not constitute "interest" and are therefore not offenses as defined by section 347. The Public Interest Advocacy Centre has published excerpts from recent court decisions that indicated "fees" were considered "interest" under



Figure 1 Use of Funds Obtained by Payday Loan



section 347. This publication (*Fringe Lending and Alternative Banking: The Consumer Experience*) also notes “payday loans have the effect of ‘capturing’ this market (low income) in a form of debt treadmill, while generating fees to the industry with interest rates in the thousands percent.”

Proponents of the industry naturally disagree with the argument that payday loans draw customers deeper and deeper into debt and claim; “the highly structured and high cost of payday loans may have a disciplinary effect.” The case is currently before the courts.

Dismissing payday loan companies as bankers or service providers to the financially disadvantaged may be more convenient than considering them to be competitors. In the short-term, it is easy for credit unions to ignore these upstarts as they deal with larger more established rivals.

However, despite the current legal troubles payday loan companies are experiencing, they continue to grow and continue to expand their product lines. They form an industry sector that is still in its infancy and Canadians will likely become increasingly aware of them in the future. In fact, Royal Bank used a cheque-cashing outlet model to serve the needs of a low-income neighbourhood of Toronto.



RBC's Cash & Save – no-frills service meets neighbourhood needs

In 2002, Royal Bank converted its former branch in Toronto's lower income Parkdale neighbourhood into an operation similar to a cheque-cashing outlet. The branch had been losing money since the mid-1990s and the bank either had to close it or find a way to deliver services more economically. The ultimate solution was Cash & Save – a no frills, bare bones facility that offers basic banking necessities to community residents.

Royal Bank could easily have walked away from the area but chose to partner with St. Christopher House, a United Way agency with a well-established history in Parkdale. Through this partnership, augmented by a firm that provided free research, they discovered that residents needed basic financial services, rather than loans, mortgages and wealth management. These included wire transfers to foreign countries, bill payment, immediate cheque cashing and inexpensive money orders.

While Royal Bank expected to be dealing with lower income residents who lacked bank accounts for one reason or another, this turned out not to be the case. On the contrary, research shows that 70 to 80 percent of Cash & Save customers already have bank accounts – and they are not required to maintain those accounts with the Royal.

Cash & Save has extended hours (open until 9 PM on weekdays and 6 PM on Saturdays) and employees who have lived in the area. The bank has gone out of its way to ensure the operation is, as “non-bank” as possible. To keep from being associated with other cheque cashing outlets, Cash & Save does not offer payday loans and charges much lower fees than those of its competitors.

Since Cash & Save opened in October 2002, it has become an integral part of the community. It has been successful enough to justify a second location in Toronto and more are being considered.

MONEY MART
SERVICES

Fast Cash Advance. As noted, payday loans are the core of Money Mart's business. When applying for a Fast Cash Advance, the customer must write a personal cheque for the amount of the advance, including the appropriate interest charges, plus a \$12.99 item fee and a 1st party cheque-cashing fee equal to 4.99% of the entire cheque value. The customer has the option of repaying the advance with the personal cheque and incurring Money Mart's cheque cashing fees, or returning to the branch to repay the advance in cash on or before the advance due date. For customers paying off loans in cash, there is no cheque-cashing fee.

Cheque Cashing. Most cheques cashed at Money Mart, including payroll, government and travelers' cheques, carry a fee of 2.99% of the amount of the cheque along with a \$1.99 transaction fee. For instance, a \$750 payroll cheque will cost \$24.41 to cash. Fees for cashing a 1st party cheque are higher. That is, fees for the same \$750 cheque would be 4.99% of the value, plus \$12.99 for the transaction, for a total cost to the consumer of \$50.41.

Foreign Currency Exchange Service. Money Mart buys and sells foreign currency at slightly less attractive rates than banks and credit unions. Money Mart charges \$1.99 per transaction.

Bill Payments. Bill payments cost \$1.99 each and can only be paid using cash or Interac direct debit.

Electronic Funds Transfer. Customers can transfer funds electronically to more than 165,000 agents around the world. Fees depend on amount and location.

Money Orders. Using the services of Western Union, fees are \$1.99 for Canadian funds, and \$3.99 for US funds.

Other services include Easy Tax™, which provides the customer with 85% of the first \$300 and 95% of the remaining tax refund. For example, for a \$500 refund the customer would receive \$442 cash the same day. For refunds less than \$75, or when the customer owes money, Money Mart will prepare and electronically file a tax return for \$29.99, plus tax.

Money Mart Card. Once a person has secured a payday loan or cash advance they can use a debit card to access cash at ATMs and point of sale terminals. It is also used as an identity card at Money Mart locations.

Fees to use this card are:

Point of Sale	\$0.25
ATM debit	\$1.50
Declined transactions	\$0.10
To load funds to account	\$1.99
Monthly account fee	\$2.00

Traditionally, Money Mart Fast Cash Advances were dispensed in cash or transferred to the customer's existing account at a bank or credit union. The Money Market Card is a new option, currently being tested, which provides access to funds held in a Money Mart deposit account after a customer has received a payday loan or cashed a cheque. This service eliminates the need to transfer funds to the customer's account at another institution. As well, Money Mart accepts cash deposits from customers who wish to use the debit card instead of carrying cash. Both the card and ability to make deposits provide a degree of safety for marginalized Canadians who live in areas where crime is a constant worry. These two services brings Money Mart one step closer as a competitor to mainstream financial institutions.



Mortgage Brokerage – An Industry on the Upswing

While payday loan companies battle the court of law and public opinion, another industry is starting to shine with a vastly improved image. Mortgage brokers have worked extremely hard to improve their own reputation and that of the industry in general.

It wasn't long ago that the mortgage brokerage industry was misunderstood – often looked upon as a vehicle of last resort for people with weak credit histories who couldn't get a mortgage through regular channels. Many consumers also believed they would have to pay a fee to the broker and would wind up dealing with a financial institution they'd never heard of.

The role of the mortgage broker is to obtain, assist in obtaining or attempt to obtain a mortgage for a borrower from a lender, in return for a fee or commission (paid by the lender). To fulfill the promise of this concept, the broker must maintain a sufficiently broad base of relationships to ensure that client needs can be matched to available products for the best fit. In general, mortgage brokers function as an independent sales force to banks, credit unions, trust companies and other financiers and receive commissions from these lenders to negotiate loans.

According to the Canadian Institute of Mortgage Brokers and Lenders (CIMBL), 26 percent of mortgages in Canada now originate through mortgage brokers. Just two years ago the total was only 14 percent. CIMBL predicts that 50 percent of residential mortgage business in Canada will originate through brokers over the next several years. This forecast may seem overly optimistic to some, but there is no denying that the use of mortgage brokers is on the way up.

Among Canada's Big Five chartered banks, only the Royal is a hold out; to date, the bank has shunned the brokerage industry, preferring to deal with clients on a more holistic basis rather than handle just one aspect of their business, such as a mortgage.

In Canada, it is estimated that brokers generated 250,000 deals in 2003. The *2003 Products & Services Study* produced by Credit Union Central of British Columbia found that 17 percent of British Columbians used a mortgage broker when applying for their most recent mortgage. This is up slightly from the previous year. The study also reported that only 59 percent of mortgage seekers actually visited a branch to apply in 2003, compared to 83 percent in 2000. Clearly, this points to decreasing dependence on bank and credit unions branch networks for this purpose. This is noteworthy because the fewer branch visits made by members and prospective members, the fewer opportunities the credit union has for relationship building and cross-selling.

It is the function of the mortgage broker to ensure that both the homebuyer and financial institution are satisfied

with the terms of the mortgage. Recently, mortgage brokers have become more prominent in ensuring homeowners are satisfied during the application and funding process. CMHC has found that 30 percent of first time homebuyers used a mortgage broker. Brokers are also active in generating pre-approvals. In fact, in 2003, 22 percent of requests for brokerage services were for pre-approvals.

Brokers get boost from gaps in service

Some suggest the current combination of low rates and a hot real estate market is driving rapid growth in the mortgage brokerage industry, but this is only partially accurate. A more important and often overlooked reason may be service – or, rather, lack of service by traditional lenders.

Among traditional institutions, service issues may include too many confusing mortgage products and tenuous relationships with clients due to technological advances that draw traffic away from the branches. Also, the negotiations involved in achieving the best rate can be a highly stressful process, which many would like to avoid all together.

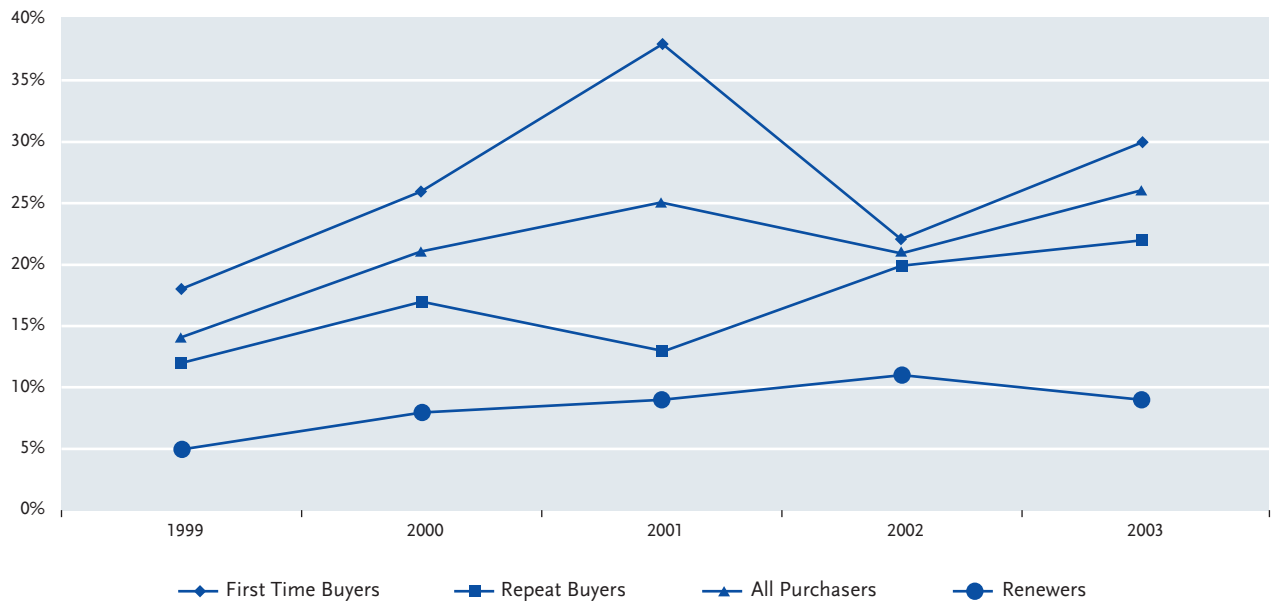
As the competitive climate for mortgage lending has increased over time, so has the competition to develop new products and services that attempt to attract mortgage seekers. The result, however, is that the market is now flooded with new mortgage products boasting an array of options, features and benefits that can confuse buyers as much as attract them.

When a customer begins to shop for a mortgage, it's unlikely he or she will have time to analyze product from all the various lenders. For instance – Bank of Montreal offers a Six-Year Flexible Below-Prime Mortgage; CIBC offers ten unique mortgage products, including the Better-Than-Posted Mortgage; Royal Bank has the Rate Capper Mortgage and TD Canada Trust offers the Discounted Variable Rate Interest Mortgage. Throw in cash-back options, Air Miles or HBC Rewards and it is difficult to tell which mortgage may be best for the consumer. To complicate matters, mortgages are also available from institutions such as Manulife Financial and Mortgage Intelligence Inc. In fact, Mortgage Intelligence has just introduced the iadjust mortgage, with a rate based on the 90-day Bankers' Acceptance market rate. What ever happened to a simple 3 year fixed rate mortgage?

Growth in the brokerage industry may also reflect a weakening of personal relationships between clients and lenders in traditional institutions. As automation of services continues to drive consumers to the Internet and ATMs, an obvious side effect is a decline in customer relationships. Direct payroll deposits, ATM cash withdrawals and online bill payments are conveniences that eliminate the need



Figure 2 Use of Mortgage Brokers



SOURCE: Canadian Institute of Mortgage Brokers and Lenders

for branch visits and human interaction. In fact, once a client has opened an account at a bank or credit union, there is almost no need to return to conduct face-to-face transactions. And, if an individual doesn't develop some degree of loyalty toward his or her financial institution, there may be little incentive to expand the relationship or make referrals.

When ING came on scene and started offering mortgages below posted rates, without negotiation, consumers began to realize that posted rates are for people who can't or won't – for fear or other reasons – negotiate with a lender. Also, the possibility that others may be getting a better deal on mortgage rates may be driving consumers to independent brokers, whose job is to represent their clients first and match them with the most advantageous lender.

Brokers and bargain-seekers

Clearly, specific service factors such as confusing products and declining relationships are contributing to the increased use of mortgage brokers, but more general trends in consumer behaviour are also worth noting.

In *Consumer TrendZ 2003*, Millward Brown Goldfarb reported that when selecting retail stores, 72 percent of Canadians rated “price” very important. Next was “quality of products sold” with a 59 percent rating. Also considered very important were “after-sales service” and “reputation”,

which, surprisingly, ranked fourth and fifth at 38 percent and 32 percent, respectively.

As further evidence that Canadians are searching for bargains, 34 percent report they never pay full price for anything. Consumers have come to expect sale prices and generous financing to be the everyday standard – and, if the goods they want aren't on sale today, next week they'll likely be discounted.

Auto financing is a precedent-setting example. Over the past few years it's become common to see new vehicles advertised with 0 percent financing. So, in a market where consumers expect bargains on even small items and inexpensive financing on big-ticket purchases like cars, the same pattern applies to mortgage shopping. And because mortgages can be confusing – as to rates and terms, as well as features – it makes sense that smart consumers would look to a professional to stickhandle the arrangements.

New respect for the role of brokers

In addition to responding to market trends, the industry has largely engineered its own success through disciplined efforts to gain public acceptance. With the establishment of the Canadian Institute of Mortgage Brokers and Lenders in 1994, the brokerage industry in Canada began to re-shape its public image.

CIMBL's objective is to see mortgage brokering evolve into full professional status supported by the highest standards

of professional practice. In fact, CIMBL is working on a program that may see a professional designation available for brokers in the near future.

Along with increased professionalism and the service and market issues discussed earlier, there are other factors contributing to the growth of mortgage brokering as a specialty. They include:

- Lack of time for consumers to shop around for best rates
- Inability of consumers to analyze confusing mortgage offerings
- Realization that financial institutions do not offer the lowest rate unless pushed
- Fear of negotiation
- Need for independent advice
- Increased consumer trust in financial service providers beyond the mainstream
- Referrals from satisfied customers
- Financial institutions themselves entering the brokerage market

And this could be just the beginning for Canada's mortgage brokers because they have yet to tap into the country's \$400 billion mortgage *renewal* market. Unlike the trend in arranging new mortgages, only 15 percent of borrowers currently use brokers to find the best deal when a mortgage is up for renewal.

In the CMHC/CIMBL survey previously cited, only 63 percent of mortgage holders reported they planned to renew with their current lender. Actions, however, are somewhat different, as records show 87 percent of those who renewed



in 2003 did so with their existing lender. While intentions and actions are not quite in sync, the survey shows that mortgage holders are researching options other than those proposed by their current providers.

If the renewal market begins to turn to the brokerage industry, financial institutions may find themselves under pressure to retain the business they have worked hard to attract. They may even lose business they initially gained from one broker if the client decides to work with another when the mortgage has come up for renewal.

Private Label ATMs

Convenience at a cost to consumers

While payday loan companies battle lawsuits and mortgage brokers enjoy new prestige, another group of entrepreneurs is on the move and carving a niche for itself in financial services. Based on total numbers, private label ATM providers now represent a large proportion of the de-regulated ATM market in Canada.

The fact that private label – also known as “white label” – ATM companies have gained such substantial market share in only a few years could indicate that consumer attitudes are shifting away from traditional financial services providers. How else can one explain why a person would pay \$3 to \$5 to withdraw cash from his or her bank account?

Forget the old logic of supply and demand that was preached in Economics 101. White label ATM providers have succeeded in increasing both supplies and prices simultaneously. By installing ATMs in extremely convenient locations, such as gas stations, convenience stores,

restaurants and bars, white label providers have flooded the market to the point where they now operate almost 50 percent of all ATMs in Canada.

At the time of deregulation in 1996, there were 18,426 ATMs in Canada; by the end of 2002, Canadians could access close to 40,000.

Several factors have played a role in growth of this industry sector. Prior to de-regulation, participation in the Interac Association was restricted to traditional financial institutions. Deregulation opened the market to a new breed of smaller, independent ATM suppliers. These new operators were willing to pay retailers a larger fee to install ATMs on their premises. Over time, more and more ATMs appeared in retail locations. Initially, consumers took little notice of the additional fees charged for use of these machines – and their response to the convenience offered by private label ATMs fuelled further growth of the sector.

Banks jump on the bandwagon

Early public acceptance of fees and the increased number of white-label ATMs in the market forced Canada's major banks to take notice. They responded by jumping on the fee bandwagon. It's now common to pay a service fee at most major bank ATMs unless you are a customer of the institution.

Under the project name Cashworks, Royal Bank is expanding its ATM network in the same fashion as the non-bank providers.

The Royal Bank and Esso ATM partnership has become the largest banking/gasoline convenience store alliance in Canada. In the last 18 months, the network has expanded by 20 percent, with 75 new machines added in 2003 alone. All non-Royal Bank customers pay a convenience fee to withdraw cash at these locations. Over the next three years, the bank expects to install 100 additional ATMs. You may also see Royal Bank branded ATMs in McDonalds restaurants.

In addition to its branch machines, CIBC customers have ATM access at over 1,800 sites, including, 7-Eleven stores, participating Mac's Convenience Stores and Petro-Canada stations. CIBC also allows its customers fee-free access to cash withdrawals at any President's Choice Financial bank machine in Canada. Like Royal Bank's ATMs, non-CIBC customers pay a convenience fee for withdrawals at these locations.

ATM fees and fraud – downsides of deregulation

A convenience fee is a surcharge made by the Interac Association member responsible for the ATM. The fee is in addition to any service charges the cardholder may pay to his or her own financial institution for using the Interac shared services.

Until 1996, traditional financial institutions (banks, trust companies and credit unions) held the monopoly on cash dispensing machines. But, with deregulation of the industry, government made it possible for private companies to provide ATM services.

Side effects, such as increased user fees and banks developing private label networks, were not foreseen when the government forced Interac to open its network to private companies. This shortsighted strategy is illustrated in excerpts from a letter written by Paul Martin in 1999 to one of his constituents who complained about fees charged by private-label ATM providers.

The Honourable Paul Martin P.C., M.P wrote:

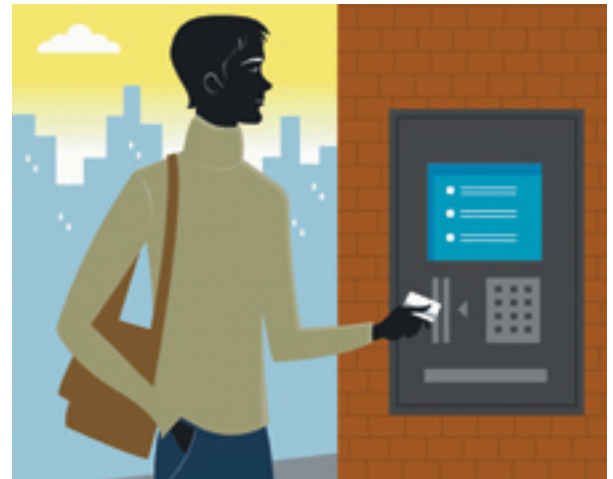
“As you know, surcharge fees for ATM usage are a relatively new concept in Canada, and stem from the Competition Tribunal's Consent Order to Interac in June 1996. Among other things, the Consent Order allowed non-financial institution entities to gain limited membership in Interac and removed the Interac prohibition on surcharge fees. The objective was to encourage installation of ATMs in locations where transaction

volumes are not high enough to justify their installation otherwise. This, in turn, would benefit consumers by allowing them to access funds from a wider range of locations.

To ensure consumer awareness of surcharge fees, Interac requires all members to provide consumers with prior notification of surcharges associated with the use of the ATM, and an opportunity to cancel the transaction. Notification must be provided on-screen. This allows the consumer to decide whether the convenience associated from being able to access funds from these machines outweighs the surcharge fee charged for using them.

Your letter notes that ATM surcharge fees are not regulated and suggests that this could result in exorbitant fees being charged. It is worth recalling that Canada, with more than 24,000 ATMs (the vast majority of which are directly owned by deposit-taking institutions), has one of the highest densities of ATMs per person in the world, giving consumers unparalleled accessibility. The wide availability of ATMs with no surcharge fees should serve to inhibit the ability of white-label ATM owners to charge excessive surcharge fees. If a surcharge at a white-label ATM is perceived to be unreasonable, the consumer is likely to terminate the transaction and use a “financial institution-labelled” ATM, rather than pay an excessive fee.

You suggested that the Financial Consumer Agency (FCA) be given the authority to develop regulations in this area, to protect consumers and promote fair access to banking services for all Canadians. As indicated in the June policy paper, the government will undertake a number of measures to improve access to basic banking services, including requiring banks to open accounts and cash federal cheques for individuals meeting minimum requirements and provide a standard low-cost account and implementing a process to govern branch closures. The FCA will have responsibility for the enforcement of these and other consumer-oriented provisions of the federal financial institution statutes. Beyond these compliance activities, the FCA will also be tasked with monitoring developments and trends in the financial area for the purpose of promoting consumer education.”



Mr Martin makes several important statements regarding what was then the relatively new concept of white label surcharging of ATM transactions. The fact that consumers are given prior knowledge of the additional fee before the transaction is completed refutes the argument that these fees are unfair. Plus, there are many other ways to make payments, including credit card, debit card, cash, or, by withdrawing funds from another ATM. In essence, where there is choice, there is the ability to avoid the fee.

There are other observations in this letter, however, that turned out to be inaccurate, including: “The wide availability of ATMs with no surcharge fees should serve to inhibit the ability of white-label ATM owners to charge excessive surcharge fees.” This is not the case. There are far fewer ATMs with no surcharges today than existed five years ago. New ATM installations by the major banks almost universally surcharge all users other than their own customers. As well, many locations where a bank-operated ATM once stood are now served by a white-label version because the latter’s suppliers are willing to share more revenue with the retailer.

The Royal Bank became one of the first casualties of white label providers when it lost the contract to supply ATMs at Pearson International Airport. Mr Martin stated, “The objective was to encourage installation of ATMs in locations where transaction volumes are not high enough to justify their installation otherwise”. However, Royal Bank lost the business at Canada’s busiest airport because the competitor was willing to pay higher commissions to

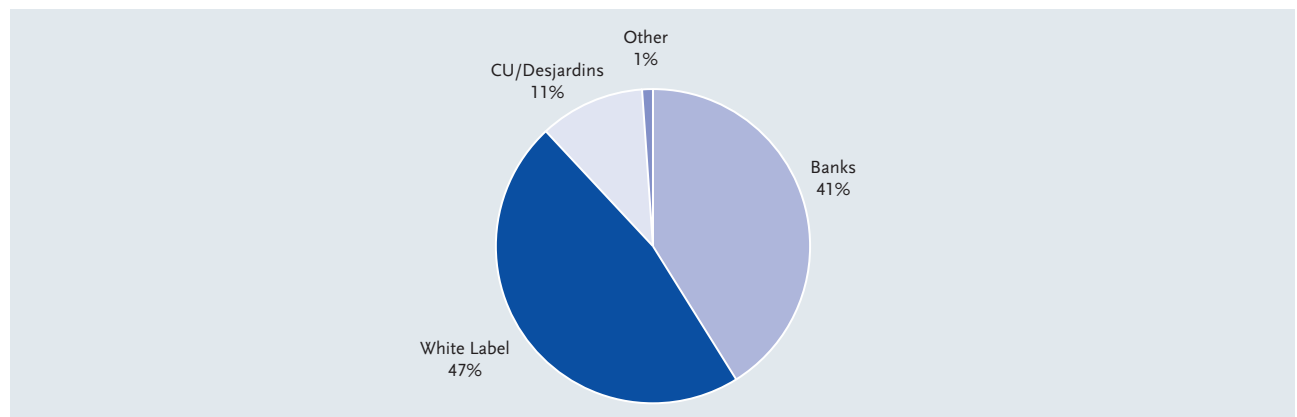
the host. This had nothing to do with providing ATMs in a low transaction environment.

The Interac Association does not set or regulate the dollar amount of surcharges. Nevertheless, its rules require that cardholders be informed of the surcharge on the ATM screen or PINpad, and be given the option of canceling the transaction without cost thereafter. Mr Martin predicts: “if a surcharge at a white-label ATM is perceived to be unreasonable, the consumer is likely to terminate the transaction”. Again, this has proven inaccurate. White label ATM suppliers now enjoy 47 percent of the market. Such growth would be impossible without sufficient numbers of consumers choosing to use the machines, regardless of paying extra for the service.

This suggests the number of ATMs that charge convenience fees may continue to increase, not only because of the proliferation of white-label providers, but because banks will continue to impose surcharges on all but their own customers.

With recent white-label ATM fraud scandals and annoying fees, one might think this sector would begin to lose market share as customers return to their primary financial institutions. Indeed, the 2003 Millward Brown Goldfarb *Consumer TrendZ Report* provides some evidence that the use of ATMs with extra charges may be declining. However, even if this is the case, the legacy of the white-label ATM will be the introduction of surcharging to the Canadian market place.

Figure 3 Share of ATMs in Canada by Provider



SOURCE: Interac Association 2002. Total ATMs 39,996

ING DIRECT



Is this alternative a model for the future?

Since 1997, ING DIRECT has attracted over one million Canadian clients and \$12 billion in assets. From zero to 1,000,000 clients in 8 years – not bad for a bank no one had ever heard of. Add the fact that this is an Internet-based operation with just a few storefronts in Canada's largest cities and the story is even more impressive. ING (which stands for Internationale Nederlanden Group) has also experienced great success in the UK, where it is opening 50,000 accounts per month with an average deposit base of \$100,000.

In British Columbia, ING DIRECT has attracted approximately 130,000 clients. Credit Union Central's 2003 Products & Services Study reports that three percent of British Columbians use ING as their main financial institution for savings or investment accounts.

With its first offering in Canada – the ING investment savings account – the bank essentially reshaped the market with a fee-free, high-rate product for people willing to do business on the phone or Internet. To illustrate its impact, a study conducted in 2001 by Taddingstone Consulting found that 10 percent of Canadian millionaires have accounts

with ING. After the Big Five, ING is the bank of choice for people in this group when looking for a basic savings product. The approach is simple according to Johanne Brossard, CEO of ING's Canadian operations, who explains "we try to do one product at a time and do it very well."

Other services have been added to ING's roster, including RRSPs, lines of credit, business accounts and, most recently, mortgages and mutual funds. ING is "building what may be the most customer-friendly model in the country for selling funds to do-it-yourself investors" (Source: Globe and Mail, January 22, 2004). Customers can purchase 30 different funds through ING DIRECT Funds from six well-known fund companies: AIC, AIM Trimark, CI, Fidelity, Franklin Templeton and Mackenzie. ING also offers about 20 of its own funds. Consistent with its no-fee philosophy, there are no costs or commissions involved in purchasing funds offered by ING Direct Funds. Johanne Brossard also announced that ING DIRECT will "vigorously" market mortgages in 2004.

Customers must be confident they have good reason to justify the risk associated with changing financial services providers. Giving consumers clear and concise incentives to switch is likely the most important aspect of luring them from competitors. Canada has traditionally been perceived as a conservative country; nevertheless, ING has clearly succeeded in breaking down barriers and gaining acceptance of a relatively new way of banking. Perhaps it's the no-nonsense advertising and extremely simple services that attracts customers to ING, or maybe it's just that people want to earn a decent return on their savings. The major benefit advertised by ING – interest rates on savings that competitors were unable or unwilling to beat – was one that couldn't be disputed.

So far, one million Canadians have responded to the ING message. Will more be far behind now that mortgages, mutual funds and a wider array of services are on the menu? Without a doubt, ING will be making every attempt to sell these services to their established clientele as well as to prospective new customers across the country.

WHITE LABEL ATM FRAUD

A well-publicized ATM fraud shook Vancouver in 2002. It began with the purchase and installation of white-label ATMs at several Vancouver retail outlets. These ATMs were equipped with a device that stored the users' debit-card information, including PIN. After the ATMs had been in use for a period,

they were removed from the sites and the information stolen to make counterfeit debit cards. The scheme netted the crooks \$1.2 million. Discovery of the fraud encouraged consumer groups to attack the high user fees associated with private label ATMs, as well as their vulnerability to theft

of card holder information by criminals who could set up similar networks. Only time will tell if the negative publicity surrounding the crime will encourage ATM users back to traditional networks.

Summary



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Non-traditional providers are attracting certain types of consumers with alternative services and delivery channels narrowly targeted to special markets.

Retail storefront outlets like MoneyMart, which specialize in payday loans and cashing cheques, have carved out a lucrative niche among clients who want money on the spot, without a hassle. Despite condemnation by consumer advocates for high fees and alleged “criminal” interest rates, payday loan and cheque cashing outlets continue to increase their business. In a culture where credit has replaced savings, and many working people are stretched thin, these operators offer a convenient “quick-fix” – plus a comfort level that their clients find lacking at banks. Obviously, bad publicity and high costs don’t outweigh the benefits of these services for some consumers.

A similar dynamic applies to the growth of “white label” ATMs, an alternative service that emerged with deregulation and now accounts for almost 50 percent of the market in Canada. In this case, independent operators played into the public’s craving for convenience with ATM installations in almost every conceivable location. But ubiquitous access came with a cost: a service fee attached to every white label transaction. When consumers shrugged off these surcharges, banks got in the act. In partnerships that grant them exclusive ATM placements in retail outlets, banks now charge service fees to all but their own customers. Aside from increased consumer convenience, the effect of white label ATMs has been a gradual, but now almost universal, application of fees to ATM transactions.

To date, there is little evidence that either payday loan and cheque-cashing services or private-label ATMs have had an effect on credit union operations or market share. But the fact that these alternatives have won acceptance (though not necessarily among groups credit unions seek) is evidence that attitudes are changing. In financial services, as elsewhere, consumers are increasingly willing to look beyond the mainstream.

Credit unions should also be aware that their traditional residential lending operations may change as borrowers increasingly turn to mortgage brokers to arrange the best deals possible. This trend emerges in a market where technology has diluted personal relationships between financial institutions and customers – and, where the customer may be overwhelmed by having to choose among too many products and options. Some BC credit unions have recognized this trend to the extent that they’ve launched subsidiary mortgage-brokerage operations. Others have ignored the industry, so far. As these alternate providers are likely to play a larger role in future business, credit unions should cultivate relations with top mortgage brokers and learn how to benefit from the services they can offer.

It’s not surprising that British Columbians have embraced new financial technologies and alternative providers. After all, BC was a pioneer and pilot site for the launch of both Interac Direct Payment and online banking in Canada. Today, with 85 percent of Canadians having debit cards, few can imagine leaving home without one. In 1998, only 23 percent of households had conducted a banking transaction online; by 2002, 57 percent reported online transactions. Overall, nearly 80 percent of all adult Canadians have been online and many are pushing for better and faster access. The Internet is clearly making inroads into our personal lives – which highlights the importance of the ING DIRECT model on the future of financial services delivery.

For those Canadians who grow up in wired households and have never known a time without online resources, the convenience factor of the Internet may influence other decisions. Comfort with technology, combined with service issues, deregulation and a generation that takes the Internet for granted are contributing to a shift in banking habits. Credit unions need to be aware of these emerging trends to ensure they respond accordingly in today’s new financial services environment. □