



Industry Canada Industrie Canada

Office of Consumer Affairs

CONSUMER QUARTERLY

APRIL 1996 • VOLUME 1, NUMBER 2

TECHNOLOGY CANADA LIBRARY

NOV 1 1996

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Focus on Financial Services

It is not surprising in these hard economic times that consumer concern about financial services is focused on basic pricing issues: low savings-account interest rates, high credit-card rates, climbing service charges and billion-dollar bank profits.

Less attention has been paid to the fundamental transformation under way in the financial services sector and its impact on consumers. Recent changes in financial services have brought consumers more products and services, more flexibility, more convenience, more complexity and, for some, more confusion.

This issue of the *Consumer Quarterly* looks at how the markets for financial services are changing, at how consumers have responded and at some key consumer issues.

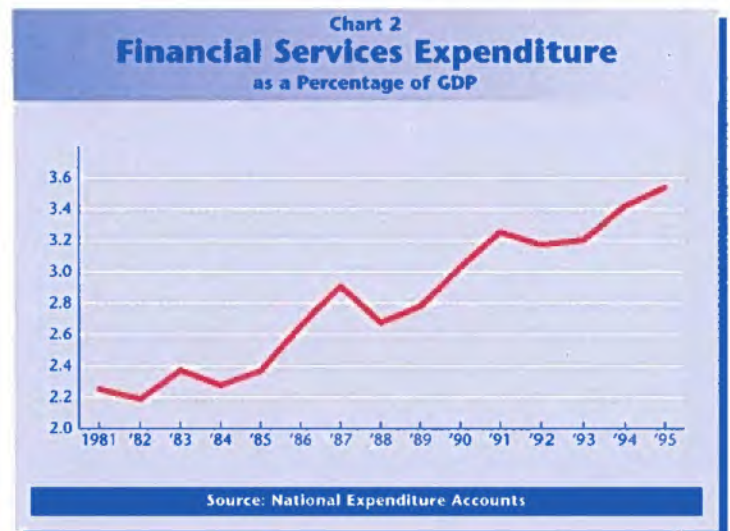
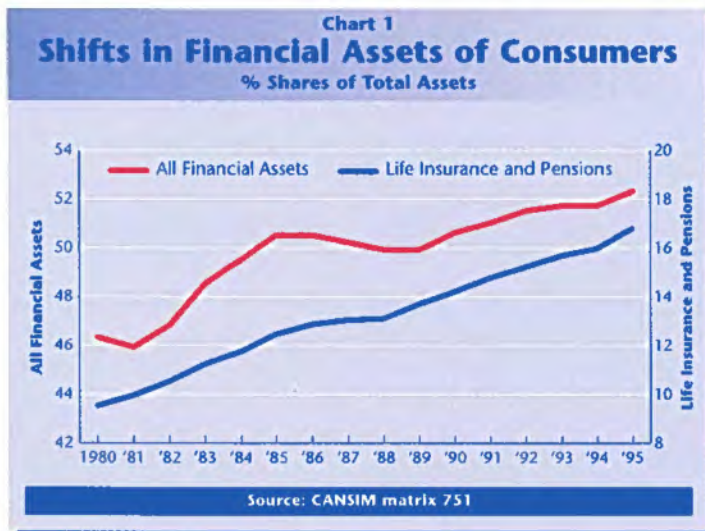
Financial Services in the Canadian Economy

During the last 15 years, there has been a significant shift in the composition of Canadians' personal assets — away from holdings of real assets towards holdings of financial assets. The shares of all major components of real assets, except housing, have declined as a proportion of total assets. Housing's share rose slightly from 21.3% of total assets in 1981 to 22.1% in 1995.

The growth in the share of financial assets among personal assets is largely attributable to increased savings in the form of life insurance and pensions, which now account for almost 17% of total assets, compared to slightly less than 10% in 1981 (Chart 1).

Consumer spending on financial services (Chart 2), not surprisingly, has grown commensurately. Consumer expenditures on financial

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Financial Services

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services comprise interest charges (paid and imputed), stock and bond commissions, bank service charges (paid and imputed), and the service costs for mutual funds, life insurance, pension funds and credit unions.

The National Expenditure Accounts show that financial services, which accounted for about 2.2% of GDP in 1981, had a 3.5% share of GDP in 1995, or 11.3% of all consumer spending on services. While bank service charges have shown sustained growth since the middle of the last decade, they maintained a roughly constant 25% share of consumer spending on financial services during that period.

Banks and Insurance... Not Yet

Federally regulated financial institutions are allowed to own insurance companies in Canada. They are also allowed to sell limited types of insurance to their customers through their branches. The institutions have lobbied to be able to sell more types of insurance directly to customers. However, in his recent budget, Finance Minister Paul Martin announced that the government will not consider this in its 1997 Review of Financial Institutions.

This issue is unlikely to go away. Consumers are ambivalent about the banks' entry into the insurance business. They recognize the benefits from increased competition. However, they are concerned about the adequacy of safeguards to protect personal information, and fear that, in the long term, banks may come to dominate too broad a range of financial services. The banking and insurance industries have each put forward their positions on the issue.

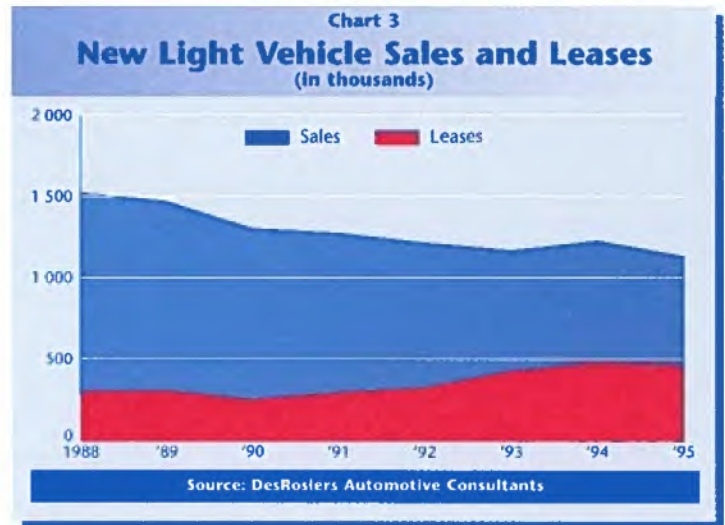
Forthcoming work by professors Ignatius Horstman, Neil Quigley and Frank Mathewson to be published by the C.D. Howe Institute should provide a starting point for future analysis of this issue. Among other things, their study looks at the experiences of New Zealand and Australia which, in the late 1980s, both allowed banks to sell insurance directly from their branches. It appears that the entry of banks into the retail insurance market in these countries has led to greater competition, lower prices and increased product choice for the consumer, while the effects on market structure, concentration and the overall size of the industry have been modest.

Although Australia's financial services industry and regulatory structure appear to be quite similar to that in Canada, more analysis is needed to ascertain whether the favourable results experienced there would likely occur here.

Auto Leasing Booms... But It's Not Trouble-free

Auto leasing is booming. Caught with flat incomes, zero discretionary savings, aging family vehicles, rising automobile prices and loan repayment periods approaching the expected life of a new vehicle, consumers are increasingly turning to auto leasing with its relatively low monthly payment requirements.

According to DesRosiers Automotive Consultants, between 1988 and 1995, the market for leasing, both fleet and retail, doubled to a 41% share of sales (Chart 3). At the retail level, a 4% market share in 1989 exploded to 32% by 1995. Clearly, auto leasing has taken off as a new financial product for consumers. Federally regulated financial institutions are keen to see their business powers extended to enable them to compete in this growing market.



Despite its apparent cash flow advantages, however, leasing is more expensive for many consumers than taking out a loan to buy a new car. Moreover, auto leasing is not a trouble-free alternative. A recent study by the Automobile Protection Association on automobile leasing practices in Quebec suggests that consumers are not always given complete and accurate information about leasing costs. According to the study, 14 of the 18 dealers surveyed made disclosure errors, all of which involved substantial costs to the consumer. The results of the survey point to the need for consumers to be more cautious and to inform themselves fully before entering into automobile leasing agreements.

Federal and provincial governments are addressing this issue by developing harmonized disclosure laws for all areas of consumer credit and lease financing, including auto leasing. The legislation, which will come into force in 1997, will require creditors to fully disclose costs in a standard manner. This should allow consumers to more easily compare alternative financing arrangements, such as the cost of leasing an automobile versus the cost of borrowing the funds to purchase it. Meanwhile, automobile manufacturers and dealers are cooperating to make lease agreements more transparent and comprehensible through the development of plain-language contracts.

Hot Plastic in a Cold Economy

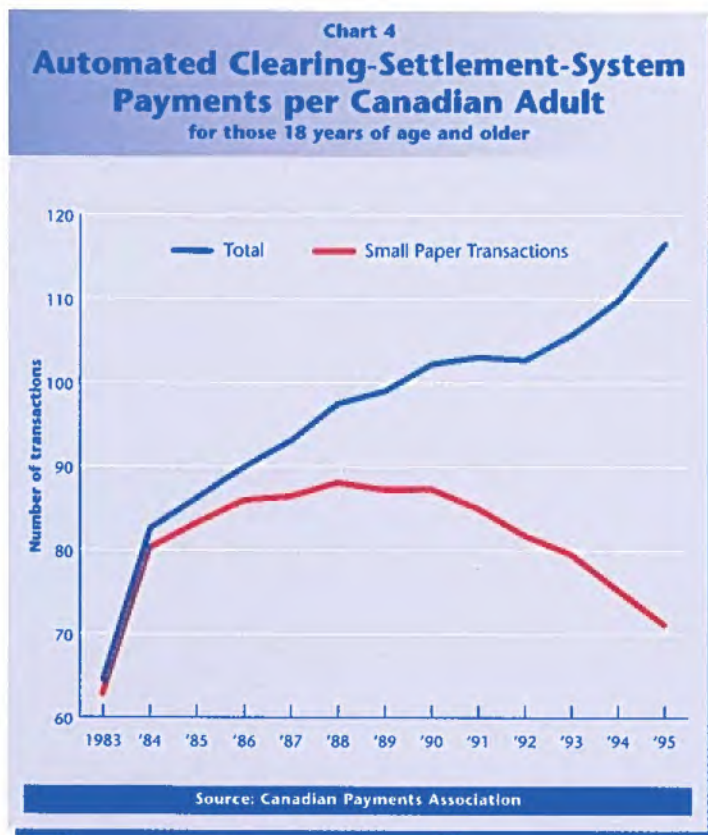
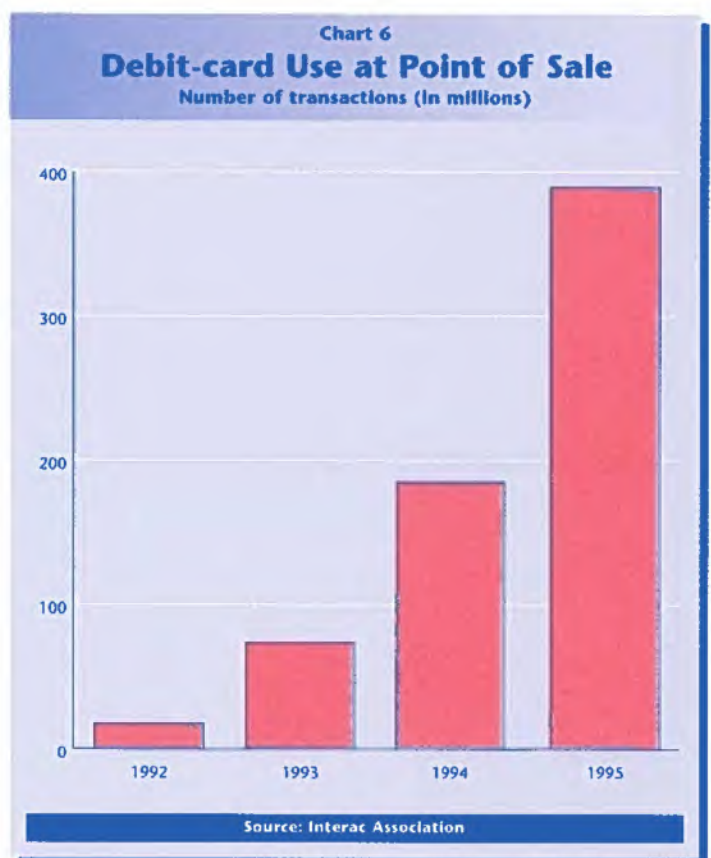
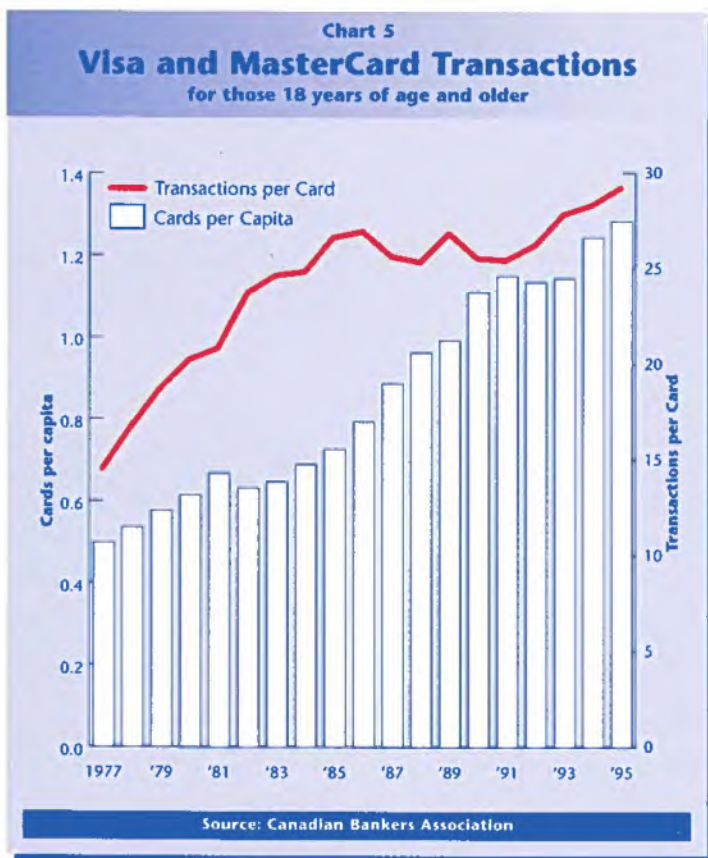


Chart 4 shows the shift in personal banking transactions between 1983 and 1995. The number of small paper transactions per capita declined during this decade. These transactions are mostly in the form of personal cheques, a relatively expensive item for banks to process, the use of which has been discouraged by high fees. At the same time, however, total transactions per capita, which include debit-card, point-of-sale and automated-banking-machine transactions, have been rising firmly.

Canadians have more credit and debit cards combined per capita than do the residents of any other country, and they continue to use their cards more and more. There are about the same number of major credit cards per capita today as in 1991, roughly 2.6 per adult. However, transaction volumes for Visa and MasterCard continue to expand (Chart 5). Meanwhile, the average monthly unpaid balance on Visa cards has risen from about \$1 000 per card in 1990 to about \$1 500 in 1995, an increase of more than 34% when the effect of inflation is removed.

But the major growth story of the 1990s is debit cards (Chart 6). Point-of-sale debit-card use exceeds early projections by 40%, and transaction volumes are doubling annually. The success of debit cards in the marketplace appears to be the result of their convenience, of close-to-universal access and of consumer confidence in the reliability, security and privacy of transactions.



Banking on Basic Services

The trend toward higher bank service charges has renewed interest in a long-standing concern: low-income Canadians have problems accessing basic banking services at affordable prices. Consumer groups such as the *Association coopérative d'économie familiale du Centre de Montréal* (ACEF-Centre) and coalitions of other interest groups are working to address the issue. However, the variety of personal banking options and the increased use of individually tailored packages make it difficult to compare the cost and availability of basic banking services.

Table 1 shows estimated monthly charges on chequing accounts for some of the major banks and lists the resulting costs for a basic user and for an average user of banking services.

The calculations for the table are founded on the basic banking consumer making two deposits per month, writing only four cheques to cover rent and utilities and making five automated-banking-machine (ABM) transactions. The average account holder writes eight cheques per month and has six point-of-sale (POS) transactions and five ABM transactions, one of which is through another bank's network.

While many financial institutions waive transaction fees if a customer maintains a minimum balance of \$1 000 or more, consumer advocates judge this amount to be too high for those with low incomes. So, the calculations for the table assume that this requirement is not met.

The results underline the importance of knowing one's own banking habits in choosing a basic account

A Budding Tale of an Ombudsman

This year, Canada will join Great Britain, Australia and New Zealand in having a banking industry ombudsman. A number of Canada's commercial banks already have an internal ombudsman service for their small-business clients, and several have extended this service to individual consumers.

Last November, the Canadian Bankers Association announced that it would establish an independent industry ombudsman. The service to small business is to begin early this summer and a service for consumers should follow within a year. This is a welcome move, especially for those consumers who do not have the resources to use the courts to settle their complaints.

However, public confidence in any industry-funded dispute settlement mechanism will depend on the courage of the industry to provide the scheme with sufficient independence and clout. A recent study by the Quebec consumer group ACEF-Centre proposed that, among other requirements, the consumer banking ombudsman should be demonstrably independent and have the power to make binding decisions when dealing with consumer disputes. The study pointed to the example of Great Britain, where the banking ombudsman has binding powers, but does not deal with credit decisions.

Canadian banks will be defining the role and scope of their consumer ombudsman position in the next few months. In doing so, it will be important that they consult fully with consumer representatives so that user needs and perspectives are taken into account at the outset.

Table 1
Examples of Monthly Chequing Account Charges¹

	Monthly fee	Number of free transactions per month ²	Cost of electronic transactions POS/ABM	Cost of cheques	Basic use	Average use
Bank of Montreal	N	2	\$0.30/\$0.50	\$0.75	\$4.50	\$10.20
Royal Bank	N	2	\$0.30/\$0.50	\$0.60	\$3.90	\$9.00
CIBC	N	0	\$0.45/\$0.50	\$0.60	\$4.90	\$10.50
Toronto-Dominion	\$1.00	0	\$0.40	\$0.60	\$5.40	\$10.80
Scotia Bank	N	6	\$0.85	\$0.85	\$2.55	\$11.20
National Bank	N	2	\$0.30/\$0.40	\$0.55	\$3.40	\$8.20
Laurentian Bank	\$1.00	0	\$0.50/\$0.40	\$0.45	\$4.80	\$10.20

1. All banks allow unlimited free deposits.

2. The free transactions each month are assumed to be the cheapest ones.

Account offerings as of April 18, 1996.

Suggestions and requests

for additional information about the *Consumer Quarterly* may be sent to Bernard A. Keating, Senior Economist, Office of Consumer Affairs, Industry Canada, Ottawa K1A 0H5

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