GAZDASÁGI
VERSENYHIVATAL

HUNGARIAN COMPETITION AUTHORITY

EXECUTIVE SUMMARY

of the report on the inquiry into retail banking (examining the possibilities of bank switching)[*]

Budapest, 5 February 2009

1.1. Conditions under which the sector inquiry was opened

1. The appropriate functioning of markets and the optimum use of the resources of the society is generally ensured by **effective** market **competition**. As a precondition of effective competition consumers are required to have appropriate information and make, based on that information, rational decisions on the utilization of particular services, i.e. choose the products that are most suitable for them.

2. When making their decisions, the **freedom of choice** is an important guarantee for consumers really to get products they will find to be optimum products for them. Should this freedom be restricted, this may distort the decisions of consumers, which may, in turn, influence the functioning of the market.[1]

3. The freedom of choice prevailing **only at contracting** may adversely influence the beneficial effects of competition in **long-term** business relationships. Though also in contractual relationships of this kind are parties to the contract obliged to bear the consequences of the decisions they made at contracting, and the law of contracts ensures that this obligation is fulfilled, it may nevertheless be disadvantageous when these decisions result in significant asymmetry in contract-based long-term business relationships (asymmetry in contracts). This may have namely the consequence, even if certain conditions exist that will later be described in detail, that service providers have to compete for consumers only at the time of signing the contracts and, furthermore, that welfare-effects of competition adequately prevail only as long as market circumstances remain unchanged. In case that better offers for consumers appear during the contractual period, for the market to function efficiently

* Prepared by the Hungarian Competition Authority (GVH)

1 As factors restricting consumer decisions, quantity limitations linked with the consumption of certain products or consumption taxes/benefits reducing/promoting, respectively, the consumption of certain types of products should be mentioned here.

consumers must necessarily **have the possibility to** reconsider their earlier decisions and **switch over** to the alternative they find to be the most favourable for them.

4. In practice, the possibility of switching is often limited as a consequence of the costs connected to it. In the report on the sector inquiry, every element contributing to making a consumer utilizing currently a product or a service utilize, at all other elements being unchanged, the same product or service in the future, is considered to be **switching cost.** It is natural that switching generates switching costs, as switching means the termination of an existing contractual relationship, which compels service providers to rethink, where the termination is initiated by the consumer, the expectations they had at the time of contracting. At the same time, if the level of the switching costs is artificially high, an unjustified asymmetry arises in the contracts in favour of the providers. Switching costs being high may have an adverse effect in itself on competition not depending on whether that high level is justified or not. The existence of switching costs has the consequence, that from the perspective of consumers, their existing contractual relationships have a competitive advantage over the other products. For a switching decision to be made it is not enough namely that those other products are more advantageous for consumers but they have to be more advantageous to an extent which exceeds the sum of their advantage + the cost of the switching (i.e. the switching costs have to be lower than the otherwise realizable saving resulting from the switch).

5. As a distinction from the term switching costs used in the report as a general term, **closing charges** (or exit fees) are charges to be paid by consumers directly when they leave a service and utilize a new one (i.e. change suppliers). Apart from closing charges, other important components of switching costs are **searching costs**, i.e. the costs arising in connection with the selection of the best offer and with the related administrative costs.

6. Taking into account switching costs, providers may sell their products to their existing customers, as a profit maximizing strategy, at a price, which is equal to the sum of the *competitive price* and the *switching costs*. It is a *precondition* for such a strategy to be successfully applied that providers are able to differentiate between old and new customers and charge different prices to them (i.e. high prices to old customers and low prices to new ones) or, when only one single price is charged, that the higher profit on providers' current customer base outweighs the loss originating from the possible losing of new customers.

7. On **financial services** market, many examples for **long-term contractual relationships** can be identified: by their one-time decision consumers typically utilize the product chosen of the given financial service provider for a long period of time. As **market signals** received by the GVH **show**, on some of the financial markets such long-term contractual relationships impose **serious constraints on consumers' freedom of choice**, which can exert harmful effects on financial market competition.

8. Taking into consideration already existing contractual relationships in Hungary, of them most likely relationships relating to **loan products** are those in relation to which the constraints put on switching possibilities hinder the efficient functioning of the market and inflict serious harm to consumers interests. Price-discrimination techniques to be observed on SME's markets, the outstanding role played by the product in bank relationships and also international tendencies moved the GVH to examine also in relation to **current accounts**, whether constraints imposed on switching and suitable to restrict and distort competition exist.

9. In order to get acquainted with all these market phenomena, the President of the GVH launched a **sector inquiry** on 7 February 2007. The sector inquiry examined bank switching in relation to current accounts and certain loan products. Aim of the inquiry was to uncover

the factors hindering bank switching on the markets under investigation and get knowledge on how the process of switching could be promoted in order to make these markets function more efficiently.

10. According to surveys and analyses made by the GVH, **decisions of consumers** about the utilization of banking services or about bank switching are in certain cases **not governed by price-related aspects,** or to put it another way, demand-related consumer decisions are not necessarily closely oriented by price movements. This phenomenon can be explained based on consumers' attitudes and preferences on the one hand and on market characteristics, on the other.

11. As far as the **attitudes of consumers** are concerned, the low level of financial literacy can play a major role in shaping them and it can significantly hinder the making of correct decisions. Where consumers do not have the knowledge based on which they would be able to process the information transmitted to them, their decision-making may seriously be distorted through the lack of this knowledge. Another reason, originating from the characteristics of consumers, for price aspects being pushed into the background may be the fact that consumers have the abilities needed to reach correct decisions and based on these abilities they attach less importance to the price of the product (contrary to other aspects such as the easy accessibility of a bank's branch office).

12. Switching costs belong to **market characteristics** influencing consumer decisions in these cases, such market characteristics are closing charges (or exit fees), the comparability of offers, the characteristics of the regulatory background and, concerning certain products, state subsidies. The sector inquiry was carried out with the objective in mind to clarify the extent to which these factors govern consumers' decision about bank switching and the role price-related aspects play in making that decision.

13. When doing so we tried, in addition to the quantifying of the rate of closing charges, to survey the effects of switching costs to the market and identify the factors that contribute to those effects. As findings of the inquiry show, consumer decisions made relating to bank switching are in many cases different from those, as a result of the difficulties of the switching, which would be made in the absence of those difficulties. Distorted consumer decisions put *banks under decreasing competitive pressure,* so that *they get a broader scope of action vis-à-vis consumers.* For markets to function appropriately **changes are needed which would ensure that market characteristics do not hinder the demand side (i.e. consumers) from promoting appropriate competitive pressure to prevail.**

1.2. Data and methodology

14. To be able to analyse the level and effects of switching costs, the sector inquiry carried out by the GVH relied on data obtained from different sources. Consumers supplied information directly in 2006, in the framework of a consumer survey using questionnaires. Through that survey the GVH tried to reveal *consumers' perceptions* of the bank switching.[2] Based on the results of that survey, a complementary analysis was performed in 2007 in order to get a deeper insight into consumers switching preferences).[3]

15. As a follow-up of market signals and the consumer survey (by questionnaires) *questionnaires to retail banks* were prepared. In the course of this work, banks in Hungary,

[2] While this survey featured a residential sample, a similar survey conducted by the GVH in 2007 featured a sample of SME's.

[3] The consumer survey was conducted by Millward Brown Hungary Ltd., while the complementary analysis was performed by Scale Research Kft.

namely the ten largest of them in terms of market share in relation to each market segment, were requested to provide stock-related, price-related and other data by means of which switching costs and their effects could be examined.

16. Based on the data available, the GVH examined the rate of closing charges and the effects of the switching costs. In addition to closing charges, also questions in connection with market transparency, the comparability of offers and regulatory intervention were raised and analysed in detail.

1.3. Findings of the inquiry relating to loan products

17. In the period under investigation, the loan markets examined by the GVH were characterized by dynamic growth and though decreasing but, compared to either the EU-average or the so-called „Visegrád-countries", high net interest margins. One of the factors generating that dynamic growth was certainly the growth of the retail mortgage market due to the transformation from 2001 on of the subsidized loan system (and its further changes since then); as another of those factors, the broad spread of foreign currency loans should be mentioned here. As a consequence of this shifting towards foreign exchanges, the share of foreign currency loans (typically: Swiss franc denominated loans) became dominating within the stock of new loans and got a majority within the total sales of loans.

18. As the findings of the inquiry of the GVH show, due to **problems related to switching a significant asymmetry in favour of the providers** can be observed, typically **in long-term contractual relationships,** on the examined loan markets. Providers have the possibility to exploit, within their existing contracts, this asymmetric situation and price their products above the competitive level to their consumers.

19. This behaviour accumulating profit to providers is a reasonable behaviour from the perspective of the latter, it causes, however, a significant efficiency loss on the society level, as it distorts competition and hinders the optimum allocating of resources. In order to prevent **effects harming competition** from being created, asymmetry arising in such situations needs to be reduced.

20. The findings of the GVH's inquiry enable the lesson to be drawn that the asymmetry in contracts having adverse effects on competition can be traced back, **to a significant extent, to difficulties related to the switching**. **Oeconometric analyses performed** prove **switching costs (switching difficulties) to play a significant role in consumers' decision-making**. Based on empirical data, it can be concluded that potential consumers react though on differences in (changes of) prices when choosing their first bank, but an already existing customer of a given bank reacts less strongly on a price change of the same extent. These effects are clearly detectable for foreign currency based home loans and for foreign currency/HUF based unrestricted loans; moreover, in the case of foreign currency based home loans these effects make a bank switching practically impossible.

21. The exploitation, on loan markets in Hungary, of contractual asymmetry existing due to switching costs is promoted by the fact that there are though **natural barriers** in the way of the exploitation of the **contractual asymmetry**, deficiencies in the nature and regulation of the market **prevent** however **those barriers from exerting their effects**.

22. **Primary** natural **barrier** in the way of the exploitation of contractual asymmetry are consumers who are though customers on a contractual basis but switch from their current loan product (contract) when they observe that the bank tries to exploit its situation to its own advantage (consumers terminating their contract). A **secondary barrier** constitute potential customers who, given their knowledge of the efforts of the bank to exploit contractual

asymmetry, decide for not entering into contract with the bank in the future (lost future sales). This group consists of both consumers who have already utilized a loan product of the given bank earlier, but after repaying their loan, at a next time they are willing to raise loan only form a different bank, and also consumers who were no customers of the bank in question but are informed from any other source about its behaviour.

23. For the **primary barriers** to function it would be first of all necessary that consumers for whom more favourable loan products become available on the market and who intend therefore to switch from their current loan product to an alternative one, do not face **switching costs that are high enough to discourage** them from their intentions to switch. Switching costs block the making of an otherwise rational decision, if they are higher than the realizable savings resulting from the switch.

24. For the **secondary barriers** to exert their effects it is necessary that consumers should be appropriately **informed** when reaching decisions that will better suit their preferences. It is an essential precondition for both primary and secondary barriers to function appropriately, that the consequences of the decision are predictable to an adequate extent.

25. Based on the results of the sector inquiry of the GVH, of the natural barriers **neither the primary barriers** (customers terminating their contracts)**, nor the secondary ones** (lost future sales) cannot be seen to work properly on the loan markets in Hungary**.** The description below shows in detail the problems, which distort the functioning of effective competition on loan markets.

1.3.1. Unilateral contract modification

26. The current practice of **unilateral contract modifications** makes the functioning of natural barriers, which exist in connection with the exploitation of contractual asymmetry, almost entirely impossible.

27. The current system of the application of the modifications is too broad regarding its **content**; on the other hand, it does not ensure consumers, as far as its **form** is concerned, appropriate possibilities to react on the merits to modifications they find possibly unacceptable.

28. Under the current practice followed by financial providers in relation to loan contracts, it often happens that providers use various terms under which to **reserve themselves the right unilaterally to modify** contracts in a practically **unpredictable and uncontrollable manner.** Though the lawfulness of this practice has been disputed under the effective civil law rules, the terms and conditions having been in force for years without any change in their content and the modifications carried out based on those terms and conditions suggest that the regulation relating to the content of possible modifications would need a refinement in order to avoid disputes about the interpretation.

29. In practice, not only the too broad content of unilateral modifications, but also the **form of information supply** and the fact that **consumers only have limited time to react**, can cause serious problems. According to applicable law, modifications are published as late as only 15 days before operative date, through announcement. In the case of complex contracts, this period is often not long enough to search for an appropriate alternative offer or possibly conclude a new contract. A factor further worsening the situation is that as a consequence of being informed through announcements rather than by means of personalized information giving, the length of the time period available for consumers is much shorter.

30. The possibility unilaterally to modify contracts not only hinders the functioning of primary barriers, but also impedes secondary barriers to exert their effects. In a situation namely, in which consumers intending to raise a loan can *only* take *guaranteed (*by law) *for 15 days that the conditions remain unchanged* and after the expiry of that period they face the possibility of uncontrollable modifications not depending of the identity of the bank with which they will conclude their respective contracts, they cannot be expected really to take into account, when making their decision, the risk of unjustified exploitation of the banks' right unilaterally to modify their contracts.

1.3.2. High closing charges

31. As the sector inquiry of the GVH found, *bank switching* on the examined loan markets *involves the payment of a considerable amount of closing charges*. In the course of its analysis the GVH quantified that *on these markets, switching costs are very high;* their minimum level is, not considering the last 2-3 years of the loan period, 4-8 % of the present value of the loan for home mortgage loans and 4-10 % for personal loans, comparing to the present value of the given maturity.

1.3.3. Deficiencies in price comparison

32. Besides switching costs, another additional factor working against the effects of primary barriers is that transparency, as it is required by the sectoral regulation, does not sufficiently facilitate the comparison of competing products. At the same time, the **lack of comparability of prices** restricts the functioning of competition not only in connection with bank switching, but it also can be observed at the conclusion of contracts.

33. The deficiencies in price comparison **make the assessment** of banks' behaviour **difficult** for consumers; moreover, as a consequence of this, the **dividing of the market into segments often becomes easier for financial providers**. With regard to the fact that banks offer a great number of differently named products with the content of them also being very different in many cases, new consumers probably do not face the disadvantageous consequences of the behaviour of banks (because they will buy a new product, or possibly a product having a new name, marketed in the meantime rather than *the* product under changed conditions). In addition to their direct dissuasive effect,[4] deficiencies in price comparison also weaken the preventing power of the reputation effect,[5] because consumers are often unable properly to assess the behaviour of a given financial service provider. Therefore, not only the increases in prices, but also the weakening reputation are reasons for the fact that there is no need to expect lost future sales.

34. As experience gained in Hungary shows, in the case of the examined loan products *non-price related aspects have higher importance* in consumers' decision-making. Though this is partly due to the fact that the financial culture of consumers is limited, nevertheless it can be established that there are significant barriers to price-based ranking, as a consequence of which the price information, on the basis of which prices could be compared, is not directly available for an overwhelming majority of consumers. In the 2007 research commissioned by the GVH **46 % of consumers** who obtained housing loans **said offers had been difficult or**

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4 I.e. the effect that price increase could dissuade new consumers from purchasing. As they possibly face other prices than old consumers, this dissuading effect of the price increase may happen not to function.

5 Namely the power of bad reputation preventing consumers from purchasing from banks at which, as they may know, consumers often had „bad luck" in the past. In the absence of market transparency, this effect does not function either, so that banks can do what they whish vis-à-vis contracted old customers as their behaviour has hardly any influence on the behaviour of new customers.

very difficult to compare while a further 27 % of them thought it had not been either easy or really difficult to do so.

1.3.4. State subsidized housing loans

35. The rapid growth of the retail banking market and in particular the frequent **transformation of the subsidized loan system** (in relation to housing loans) encourages financial service providers *to differentiate between their customers.* Mainly as the result of frequent changes in the regulation relating to state subsidies and the lack of portability of subsidized loans, there are several groups of consumers for whom products are no more available, when they refinance their HUF based loans, that would be offered under the same conditions as their counterparts at the first utilization of the service. Due to the **lack of portability of subsidized loans** consumers have not only to prepare themselves for the paying of the switching costs but also to reckon with the losing of the state subsidies, which clearly speaks against the making of a refinancing decision.

36. By promoting the differentiation between customers by the time of signing their contracts, state subsidies hinder the functioning of the secondary barriers of contractual asymmetry, too. Financial institutions granting loans do not necessarily need to fear the possibility that their potential customers will punish them through their future consumption decisions when they carry out modifications of the loan contracts they entered into with their existing customers, which are unjustifiably disadvantageous for the latter; they do not need to fear that possibility because potential customers do not necessarily directly perceive the modifications in question. If no differentiation could be made between various groups of consumers, the charging of prices by the contracts that are higher than those prevailing on competitive markets would mean that the bank makes, at the same time, less competitive offers to new customers through the very same offers. However, if it is possible to differentiate between groups of customers, offers given to new customers may be more favourable. (Just to give an example, if customers could be divided into the groups of those having contracted for HUF-based subsidized loans and of new customers utilizing foreign exchange based loans, it is worth to charge prices over competitive market prices to the first group and submit competitive offers to the second.) As a consequence of this situation, changes of the subsidized loan system and each factor, which **promotes market segmentation by consumer groups**, hinder secondary natural barriers from exerting their effects.

1.4. Recommendations relating to switching between loan products

37. Given the problems mentioned above, there are **four areas in which it would be necessary to improve the regulation**, the GVH believes, in order to improve the conditions of effective competition on loan refinance markets and markets of loan granting. The following table shows the four areas and summarizes the related recommendations of the GVH.

Factors limiting the effects of restrictive market factors	Recommended solutions
Unilateral contract modification rights	Restricting unilateral contract modification rights Applying transparent pricing techniques, which deliver predictable results

High closing charges	Maximizing closing charges
Limited price comparability	Methods to develop transparency: developing comparative indicators, developing personalized information systems, applying transparent pricing techniques
System of state subsidies distorting competition	Revising state subsidies from the perspective of competition

38. As it can be established based on recommendations made in the practice of other countries and the European Union, the refinancing of loans raises problems not only in Hungary and it has generated and still generates regulatory initiatives on both member-state and Union-level. The inquiry of the GVH has found that, with regard to these initiatives but not awaiting fully their results, it would be worth to remedy these competition problems. Certain characteristics of the Hungarian loan markets suggest that the **recommendations** concerning the comparability of offers and concerning the bank switching would **need to be realized** on these markets **as soon as possible**, given the fact that the current situation causes serious efficiency loss on social level.

39. It is not only worth to intervene as soon as possible in order to reduce losses, but it would also be important **concurrently to realize the recommendations** as their effects mutually reinforce each other. For instance, the limiting of closing charges enable consumers to adapt easier to the changing market environment, while the better comparability of offers would obviously lead to a narrowing of net interest margins and to an intensified competition.

40. **Of the recommendations**, **an outstanding importance should** nevertheless **be attached** to that which relates **to tackling the current practice of unilateral contract modifications,** since **in the absence of this, the other recommendations can only achieve limited success**. It would be useless for the consumer to have the possibility of choosing the offer which he considers the most favourable and to be sure he will be able to refinance it at lower costs at an other provider, should he nevertheless be unsatisfied with the conditions of that offer, if he can take guaranteed (by law) only for 15 days, when signing the related contract, that the favourable conditions of the new offer remain unchanged; this situation seriously undermine confidence in efficient functioning of the system. Therefore, without prejudice to the importance of the other recommendations, the GVH considers the realization of this recommendation to be a top priority.

1.4.1. Rights of unilateral contract modification

41. **1. recommendation: The GVH initiates the creation of a regulation that would only allow banks to modify unilaterally their existing contracts if such a modification of the individual contracts is objectively justifiable by external events, which are beyond the reach of the bank's operation.**

42. The recommendation of the GVH on an amendment of the law relating to the general terms and conditions of banks concerns both already existing and future contracts of banks and urges that

1. credit institutions (loan providers) should not be allowed to apply clauses that enable them to modify unilaterally, independently from any external circumstances, the terms of their contracts with customers;
2. unilateral contract modifications carried out based on external circumstances should become predictable and controllable in terms of both their timing and extent, while the one-sided advantages enjoyed by banks in particular in relation to the delaying of changes favourable to consumers and to the direction and extent of deviation from what is considered to be accepted, should be eliminated;
3. customers should be put into a real decision position (i.e. into a position in which they can make well-founded decisions about the acceptance or refusal of the contract modifications of banks) by being provided with information, in a reasonable form which is adjusted to the features of the given product of the bank and well in advance, so that the balance of relationships within the contracts is restored (or at least improved).

43. Unilateral contract modification is a speciality of the currently existing legal environment the regulation of which, both in general and within the financial sector, has already been attempted; moreover, even currently, there is an ongoing revision of the regulation both in the law of the Union and in Hungarian law. This means that the amendment of the regulation relating to the rights of unilateral contract modifications does not constitute the opening up of a new regulatory area or a further intervention in market processes. The limiting of the rights of unilateral contract modification will be a contribution towards **preventing market players from abusing the possibilities offered by the regulatory framework**.

44. As the experience gained by the GVH shows the current practice of unilateral contract modifications adversely influences market competition. Modifications performed by financial service providers are among the factors that make the *natural counter-balances (the self-regulatory mechanism) of the market not to function appropriately*, as the result of which the decisions of consumers will be distorted and the public interest attached to competition may be injured. The **uniformly applied rights to modification, which depend only on internal conditions and around which no real barriers are put,** lead namely to a situation in which a subjective risk factor originating exclusively from the activity of the bank appears in the financial decisions of customers that **may seriously distort consumers' financial decisions**.

45. The GVH made the experience in the course of its inquiry that on retail loan markets, in place of the usually marketed fixed interest rate and variable interest rate products **adjustable rate products** became dominating. As a consequence of adjustability, customers are generally not able to foresee the changes, which may happen in their legal relationship with the bank. This means after all that, by accepting the adjustability, customers not only bear the risks of the loan transaction but they also take over risk elements, which are only based on the operation of the bank – they take over the latter at least to the extent of the switching costs.[6]

46. With all these in mind, the GVH believes that, instead of adjustable interest bearing, it would be reasonable that variable rates and fixed rates function in relation to variable interest rate products and fixed interest rate products, respectively. As far as fixed interest rate products are concerned, loan providers would only be allowed to carry out changes in cases,

[6] This acceptance of risks can be still better observed when risks appear on the level of the whole banking system rather than only individually on the level of the bank granting the loan – in this case they can be passed on to customers practically without being controlled by any control mechanism.

which meet the conditions mentioned in the recommendation of the GVH relating to unilateral modifications.

1.4.2. Closing charges

47. **2. recommendation: The GVH initiates the creation of a regulation that would maximize early repayment charges in the case of retail banking loan products. The new regulation should maximize early repayment charges in the case of both mortgage loans and loans not secured by mortgage.**

48. With regard to the role switching costs play in consumers' decision-making, it seems to be necessary to amend regulation in a way that **restricts the applicability of closing charges** that represent a significant part of the switching costs. A professional consensus should be reached in the regulatory process; at the same time, it can be stated that the present level of closing charges is unacceptably high from a competition perspective and it has seriously adverse effects on competition on the mortgage loan market.

49. In determining the regulatory directions to be followed when the applicability of closing charges will be restricted, the GVH attaches high importance to the maximizing of the exit fees i.e. of the early repayment charges.[7] Regarding early repayment charges it is important that in the cases when banks do not suffer from any losses connected to re-investments because of early repayments, only the administrative costs of the early repayment should be charged.[8]) **As an alternative, the new regulation could maximize the overall closing charge rather than only closing charges (exit fees)**.[9] When choosing the best option, decision makers should take into account, to an increased extent, the public interest attached to competition.

50. The provisions of Directive 2008/48/EC deserve a special attention of regulators; according to the Directive, in the case of credit agreements for consumers, early repayment charges **may not exceed 1 % of the amount of credit repaid early**, if the period of time between the early repayment and the agreed termination of the credit agreement exceeds one year.[10] This provision would need to be applied also in the case of mortgage loans, furthermore, the related provisions of the Directive would need, with regard to the market problems disclosed through the sector inquiry, to be transposed into Hungarian law within the shortest possible time, the GVH believes.

1.4.3. Comparability of offers

51. In order to promote the decision-making of consumers, the aim of the recommendations of the GVH is to initiate, on the one hand, the *developing of indicators facilitating comparisons* and. on the other, the creating of a system that provides *personalized basic information,* which is also absolutely indispensable to the decision-making of

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7 "The consumer shall be entitled at any time to discharge fully or partially his obligations under a credit agreement", Article 16(1) of Directive 2008/48/EC (on credit agreements for consumers and repealing Council Directive 87/102/EEC) provides.

8 Naturally, banks may also suffer certain losses in these cases, because of losing already acquired customers, but in these situations the proper method of keeping customers is the convincing of them through more favourable offers rather than the raising of administrative barriers.

9 When, for instance, the regulation would prohibit exit and entry fees from being charged, in order to encourage switching.

10 If the period does not exceed one year, the compensation may not exceed **0,5 %** of the amount of credit repaid early.

consumers. In order to improve the comparability of offers, the GVH makes the following recommendations.

52. **3. recommendation: The GVH recommends that in calculating the APR, foreign currency risks should also be taken into account and/or represented.**

53. **4. recommendation: In order to improve the provision of personalized information, the GVH recommends that a continuously updated consumer information system (a product comparison website) should be set up. This would create the possibility for individual offers to be compared.**

54. The **most important requirements** relating to the website are the following:

- **Reliability.** The fundamental question in relation to the provision of information facilitating the decision-making is whether the information is correct. The first step towards the ensuring this correctness is the setting up of the system of data supply, but also the related accountability issues need to be settled. It would be an illusion to suppose the website could be operated without the existence of an efficient mechanism of incentives to supply accurate information.
- **Being kept up to date.** The data need a regular updating. In addition to the reliability requirement, it is of crucial importance that really the data relating to the given decision situation are available. This can only be guaranteed by setting the shortest possible deadlines for data supply so that the conditions are uploaded as soon as possible.
- **Interactivity.** Reasonably, the product-comparison website should be operated in a manner which also enables consumers having only limited information/knowledge to use it easily. A rational way to ensure this is to make the calculations be performed by the website rather than by consumers and make the latter only answer the questions surveying their consumption habits.
- **Availability.** In addition to the easy accessibility of the product-comparison website, it should be ensured, as a further requirement, that not exclusively consumers having Internet-access enjoy the benefits offered by the website. This could be achieved by making the website possibly available in branch offices of banks too.
- **Comparability**. The basic idea behind creating the website is to make the costs of products comparable with each other. Moreover, it would naturally be reasonable that the website makes references to other factors connected with the service (such as the density and location of branch offices and the ATM-network), helping in this way the decision-making of consumers. [11]

55. Efficiently functioning markets require consumers to reach rational decisions and for such decisions *consumers need correct and comparable information.* As far as the range of the loan products examined by the GVH is concerned, signs suggesting the existence of a *limited comparability of loan products* can be observed.

56. On the market, consumers have a number of methods to carry out the comparison of offers; their related activity can be facilitated by the use of the annual percentage rate (APR) that characterizes different types of costs by a single numerical value. As one of the features of APR, it gives the value, which serves as the basis of the comparison, in terms of a *selected representative loan* that do not necessarily meet the conditions of the loan utilized by the

[11] A system comparing banking products operates currently on the homepage of the Hungarian Financial Supervisory Authority, but it does not completely meet the requirements mentioned above.

consumer. As a consequence of the application of the representative value, APR can play an **only orienting rather than deciding role** in financial decision-making

57. In its present form, APR **does not take currency risks into consideration** at all. In view of the fact established by several studies that Hungarian people do not correctly estimate the risks attached to foreign currency loans, it seems to be reasonable further to develop or to complete the APR index by the inclusion of information of the kind that assist customers in estimating the currency risks.

58. Granting an only orienting assistance to consumers' offer-comparing activity will not necessarily prove a good idea. As it could be established in the course of the inquiry, there is low correlation between the rankings of offers by APR with the rankings of them by other forecasts (e.g. by discounted cash flow forecasts). To put it another way, in addition to the creation of orienting indexes/indicators, it is advisable to set up an information system **identifying the constructions that would best suit the personalized needs of consumers**.

1.4.4. State subsidies

59. **5. recommendation: The GVH initiates that state subsidies linked with housing loan products secured by mortgage should become portable.**

60. The rapid growth of the retail mortgage loan market between 2002 and 2004 happened in great part because of the transformation of the *subsidized loan system*. Due to changes in the system of subsidization, there was a decline in the sales of subsidized loans and, in the subsequent period, *foreign exchange loans* became dominating.

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61. The fact that in the case of state subsidies of a certain kind that play a very important role on the market, the **switching decision comes together**, from the perspective of the consumer, **with the losing of the subsidized interest rate**, may significantly restrict the freedom of consumers' decision, as it **may convert the decision** of the consumer **about the raising of a** loan to a one-time **decision**, which is nevertheless **relevant for the full loan period**. Hence, consumers may be unable to turn the positive changes of the financial market into their advantages, because loan refinancing of HUF based loans technically does not exist for them and is limited, as far as foreign currency based loans are concerned, because of its significantly increasing risks.

62. This market situation **considerably facilitates the dividing of the market into segments** and strengthens the possibility that contractual asymmetry will be exploited; therefore, a revision of the regulation with the aims of no more linking subsidies to particular selected products and of ensuring their portability.

63. The basic concept of the Government Decree on subsidized housing loans does not favour the optimum allocation of resources, which would be required to be ensured by competition, in so far as it links the subsidy the certain types of products in certain cases. By the decision saying that subsidies can only be utilized in the case of certain types of products, the regulation of state subsidies not only serves the objectives declared by the regulation, but also strongly intervenes in the development of the market of credit institutions.

64. Without examining the regulatory considerations behind the intervention in the development of the market of credit institutions, it can be concluded that the intervention in question is not necessarily favourable from a competition perspective. Goal of the subsidization is namely that members of the target group intended to be supported obtain loans under more favourable conditions than those achievable on the market. The decision of

consumers about the products they would chose should, however, be determined by market effects and rules since this would ensure the efficient allocation, on a system level, of the resources.

65. The ***portability*** of subsidies could be ensured by making state subsidies fully portable **within each product type.** This would mean that HUF based loans remain further on preferred to foreign exchange loans; at the same time, within the particular contracts, the situation would improve in favour of consumers with a real possibility of refinancing being created in the case of HUF based loans. This can be presumed to increase competitive pressure on banks in connection with their contracted customers.

1.5. Findings of the inquiry in relation to current account products

66. Current accounts generally represent a *primary contact point* between the account holder and the account-managing bank. Current accounts ensure the utilization of day-to-day banking transactions satisfying everyday needs of customers and they have an outstanding role in payment transactions. In the case of current accounts, the possibility of switching has a special importance, as current accounts are extremely widespread products; moreover, they often constitute the starting point for the sale of other products. The possibility of switching is a guarantee that consumers, who are not satisfied with the conditions their account-managing bank offers to them, can switch provider when a better offer appears. When barriers are getting in the way of switching, account-managing banks may become able, similarly to what was mentioned in connection with housing loans, to price their products over competitive prices.

67. In the course of its analysis relating to current accounts, the GVH tried to identify mainly those switching costs and closing charges that may influence, on the merits, the functioning of the market. Based on the examination of the practice in Hungary, the GVH believes that **closing charges (exit fees)** in current-account market competition **are not significant,** and the difficulties of the switching can mostly be traced back to the absence of the comparability of offers and problems of the related administration.

68. The analyses of the GVH relating to consumers' decisions showed that in choosing a current account product, price-related aspects do not play a deciding role. The diminished importance of prices in the decision-making of consumers is a consequence of the fact that **some of the offers on the market cannot be satisfactorily compared with each other**.[12] No clearly understandable pieces of information of the kind, which the average consumer could easily compare with each other, are available for consumers utilizing current account services, based on which information-supply he would be able to reach rational decisions. Therefore, the improvement of price comparability is likely to result in significant efficiencies.

69. Based on data obtained from banks, staff members of the GVH tried to determine, in the course of the inquiry, the **bank cost of representative consumers**. In doing so, they created three types of consumers to represent different types of consumer habits; the GVH performed the related price analysis concerning each of the three types of consumers. Though the price analysis availed itself of certain presumptions and made certain simplifications, nevertheless it can be established that there is a considerable dispersion in fees across banks providing the same service and that price differences are likely to be attributed, to a great extent, to the absence of comparability.

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[12] In the survey commissioned by the GVH 13 % or 46 % of the people questioned about bank costs thought the costs of current account services offered by banks to be fully or partly comparable respectively.

70. As it was also found in the course of the investigation, values relating to the representative average consumer do not necessarily govern the selection of the bank; there are namely transactions (e.g. the transfer of a larger amount of money by cheque) the price of which can easily change the order already developed. At the same time, an optimal decision making of consumers can hardly be imagined without consumers obtaining proper information about the price of the service they intend to purchase.

71. In the course of its sector inquiry, the GVH also examined the process of the switching. The most important message of consumers' perceptions of the switching is that in the case of current accounts, *customers find a bank switching not to be too difficult*; this situation can still significantly be improved if customers have related previous experience, i.e. if they switched already earlier or consider the products to be comparable with each other. The inquiry enables the conclusion to be drawn that even *services related to current accounts*[13] *do not necessarily seriously hinder bank switching*.

1.6. Recommendations relating to current account switching

72. **6. recommendation: The GVH recommends that a product comparison website relating to current account products (similar to that the operation of which is recommended in the case of loan products) should be operated.**

73. **7. recommendation: In order to facilitate switching-related administration, the GVH believes it would be justified to realize the transferring of direct debits,[14] possibly within a centralised authorizing system.** The GVH believes it would also be justified for banks to undertake the **transferring**, within a determined period, of payments arriving at closed accounts within a period of limited length beginning at the date of the closing, **to the new accounts**.

74. Given the international experience relating to the switching, it can be established that in Hungary the **rate of current account switching is high** in an international comparison. This in itself makes likely that no serious barriers to the switching exist; hence, there is no need for a serious regulatory intervention to be carried out.

75. **The more** consumers consider current account costs to be **comparable**, **the better is the chance** for them **to become bank switchers**, the surveys have proven. Rational switching is based on comparisons of conditions, and these comparisons presuppose a proper knowledge of the conditions. This means that bank switching may be easier for consumers, who are appropriately informed. The best method for making offers comparable would be the use of a comparison website of the kind described in detail in connection with loans. By means of this website, consumers could get a real picture of the price of particular products, also taking into account their consumption habits.

76. At the same time, Hungarian and international consumer surveys revealed that besides the developing of the comparability of offers, **a number of measures could be taken in order to facilitate the administration**. Taking these measures is completely justified in Hungary too, as they would not only influence market transparency, but also significantly promote switching between banks that are expected to provide continuously deepening

[13] Direct debit, savings accounts, overdrafts and debit cards

[14] Direct Debit (DD): a payment method under which an account holder (payer) authorizes a bank to collect varying amounts directly from customers' accounts at a regular (usually monthly) intervals. A DD can be used to pay regular service provider bills or other regular bills.

services and significantly help the banking sector in increasing its role in efficient financial mediation.