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The use of sneaky fees by service companies is growing

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One of the top 25 songs on the British charts this month was "I Fought the Lloyds," a homemade lament by a fellow called Dan Oystar. Set roughly to the tune of the 1965 hit "I Fought the Law (and the Law Won)," the song chronicles Oystar's long but ultimately successful battle to have his bank, Lloyds TSB, remove fees for overdrafts and routine transactions.

Judging by a case moving through the British courts, there are a lot of Dan Oystars out there. The Office of Fair Trading, the government consumer and competition authority, has brought a test case over unauthorized overdraft charges against the seven largest British banks, including Barclays, Royal Bank of Scotland and Lloyds. Moneysavingexpert.com, a consumer group supporting the suit, claims on its Web site that more than 1 million Britons have reclaimed an estimated £1 billion, or \$1.9 billion, in bank charges.

Add this to the list of secondary effects of the global credit bubble: Consumers are paying more in fees and, in many cases, doing so without their knowledge or consent. It's a phenomenon that Bob Sullivan, who runs the consumer blog "Red Tape Chronicles" for MSNBC, calls "Gotcha Capitalism" - the title of his recent book, which catalogues the growing use of sneaky fees by service companies from banks to hotels to airlines:

In early February, United Airlines began to charge customers \$25 for an extra bag.

Some rental car companies charge an airport concession fee if the lot is conveniently located near the airport.

A hotel in Las Vegas now bills customers for any item they take out of the minibar for more than 60 seconds, even if it is not consumed.

Some bank gift cards lose part of their value if not used by a certain date.

Sullivan attributes the fee phenomenon to two main drivers: The Internet gives consumers power to compare prices or rates, thus motivating companies to keep their basic price down while inventing profitable fees; and the lack of regulation.

The result is that a growing number of people are paying fees. According to a 2006 study by the U.S. Government Accountability Office, one out of three credit card users had been charged a penalty of some sort in 2005. A survey by a consumer watchdog group in Britain found that a similar percentage of people in Britain were charged unauthorized overdraft fees by their banks over the past six years.

In Britain, fees for bounced checks, or so-called unauthorized overdrafts, can run to £30, no matter what the size of the transaction. Such fees brought £3.5 billion in income to banks last year, according to Which?, and have set off a groundswell of protests.

"Banks are saying that it is a service charge and they are saying it is a courtesy to customers," said a representative of the Office of Fair Trading, which would not make an official statement because the case was still in court, and it did not expect a ruling until April or May. The office is arguing that unauthorized overdraft charges are penalties, which by law must reflect the cost to the bank.

When the agency announced the test case last July, by mutual agreement all ombudsman and court cases against unauthorized overdraft fees were put on hold. David Black, principal analyst for Defaqto, which compiles financial databases, expects that whoever wins the case, there will be years of appeals.

Meanwhile, rhetoric around the issue is running hot. Banks are warning consumers that if they lose the case, it will open the door to a host of new fees.

Over the past decade banks "have become very dependent on fee income, and it serves to drive the income stream," said Greg McBride, a senior analyst at Bankrate.com, a Florida-based company that compiles and publishes surveys of bank rates and fees.

McBride does not go so far as to link the rising fees to the banks' current write-down problems, but he acknowledges that fee income can be "a great stabilizer when interest rates are volatile." In the United States, bank and credit card fees jump around so much it is difficult for consumers to track them, but it is widely acknowledged that such fees have increased. SNL Financial, an information and publishing company in Charlottesville, Virginia, reports that the amount charged depositors for maintenance on their deposit accounts jumped from \$32 billion in 2005 to \$35.43 billion in 2006, to \$29 billion in the first three quarters of 2007 - a figure that indicates another 10 percent jump last year. Penalties constituted about half that amount in 2006, or more than \$17 billion, according to the Center for Responsible Lending in Washington.

The multiplication of charges may even be getting ahead of bank staff. Just last month, for instance, HSBC notified its U.S. customers that they would be charged 25 cents every time they checked their bank balance on an ATM machine with an ATM card and did not simultaneously make a transaction. Asked to explain the charge, an HSBC spokesperson said it referred to a 25 cent charge on retail purchases made with the bank's ATM card. However, a branch representative said the 25 cent fee was to check the balance.

Bounced check fees have climbed year after year "until it is now an expectation," said McBride.

Adding to the pressure on consumers is the fact that, on credit cards, the law allows issuing banks to change the interest rate and fee terms with as little as 15 days notice.

Cardholders are feeling the brunt of that now, as banks and credit card companies cut back credit limits and charge penalties to higher-risk consumers, while expanding credit limits to customers with better payment records without seeking prior approval.

When it comes to financial services, Sullivan said, "Credit limits have turned into fee triggers. You can actually spend more, and you will be charged for it."

Credit and debit card habits differ geographically, with continental Europe most accustomed to "delayed debit" cards which are paid off at the end of each month, the British to credit cards and Americans to both.

But many banks, particularly in Anglo-Saxon countries are urging consumers to maximize the use of their credit and debit cards by purchasing small everyday items.

For instance in New York City, J.P. Morgan Chase is offering credit and debit card holders a \$10 discount if they use their Chase cards for \$150 worth of fares for taxis or subways. While the promotion is temporary, a Chase spokesperson said the bank hopes to get people in the habit of using their cards for local transportation after the reward expires.

Small, everyday items like subway fares, fast food meals and convenience store purchases are the "final frontier" for credit card issuers, according to David Robertson, publisher of the Nilson Report, which has tracked the credit card industry for over 30 years. "It is the last untapped market."

According to Robertson, the number of transactions made with debit cards in the United States outnumbered those made with credit cards in 2004 or 2005.

A current Bank of America promotion promises to round off each purchase a client makes with his debit card to the next dollar and puts the extra change in his savings account. The promotion has been in effect since 2005, and a Bank of America spokesperson, Tara Burke, said it was motivated by customers who said they wanted help to save more. However, a branch representative in Florida, who did not want to be quoted because she was not authorized to discuss bank policy, said it was also an incentive to swipe the card more.

Promotions encouraging consumers to swipe cards bring more money to banks' bottom line from the other side of the transaction: fees charged to merchants. In fact, the \$10 bank taxi and subway promotion being run by Chase only applies to credit cards and debit cards that require a signature. ATM or debit cards users that enter an electronic PIN number do not qualify.

That is because banks collect up to a 3 percent processing fee for third-party credit transactions. Most of that 3 percent is called the "interchange fee." That fee has outraged merchants in continental Europe, where credit card use is sparse and consumers are accustomed to debit cards. In December the European Commission won a case against Mastercard that requires it to eliminate interchange fees within the next six months.

Originally interchange fees compensated banks for taking the risk of paying the merchant. As Robertson describes it, if a customer finds a \$2,000 raincoat at Harrods and does not have the cash, she can charge it to her Barclays card. Harrods will receive the \$2,000 minus about \$60 from the processing bank, which will send \$40 of that \$60 over to Barclays, because Barclays is taking the risk.

"The bank is saying: 'Now I am owed the money, and if she doesn't pay it, I am the one who loses,' " Robertson said. In return the merchant is paying the bank 2 percent.

The EU decision to get Mastercard to eliminate its interchange fees has been lauded by Eurocommerce, a Brussels-based lobbying organization composed of some 6 million retailers across Europe. "Processing is getting a tape with data on it and sending it out to the banks that issue the cards," said Xavier Durrieau, secretary general of Eurocommerce. "If people spend €100 or €500, the cost of processing is the same."

The Eurocommerce group also argues that the 3 percent interchange fee is inflationary. But a similar decision against card issuers in Australia did not result in lower retail prices, according to Robertson.

More worrisome is that by promoting the urge to swipe cards, people are seduced into spending more and racking up more fees. That may be especially true of the most vulnerable group, the poor. But it is also a

temptation for university students who are often inexperienced in using their first checking accounts, and for graduates, who are increasingly leaving school saddled with large education loans.

The problem, said Leslie Parrish, senior researcher at the Center for Responsible Lending, is the flat fees for debit card overdrafts. If you bounce a \$900 rent payment, the size of the fee may be fair. But if it is \$3 for a cup of coffee, \$30 is a huge interest rate."

When The Center for Responsible Lending did a survey recently, said Parrish, "an overwhelming majority of folks said 'If I have a \$5 or \$10 or \$20 purchase, I would rather have it declined and use another payment method.' " That is generally what is done in Finland and other Scandinavian countries when people try to access more than is in their accounts.

Certainly the lesson is for consumers to make an effort to read the fine print. But it is also profitable to understand one's spending habits. For people who pay down their charges each month, it is best to find a card that gives the longest period before payment is due. For those who habitually run a balance, the best bet is the card with the lowest interest rate.

Those who choose a card based on reward programs should understand that the rewards are subject to change.

For those who rely on primarily on debit cards, but also have a credit card, Parrish advised that when the account nears empty, it may be better to buy small purchases on a credit card than to risk additional overdraft fees.

Another technique to avoid accidental overdrafts is to have a savings account at the same bank and arrange for money to be transferred automatically to one's checking account in case one gets overdrawn. That may cost another fee, but it is lower than the bounced check fee. It may also be possible to ask the bank to eliminate the overdraft courtesy service.

Certainly free market purists take the position that the responsibility lies with consumers not to overspend their income. But after a period when banks have taken so little responsibility for risk, it is hard for many experts to justify their nickel and diming behavior.

"The bottom line," said Sullivan, "is that consumers have to be on their toes."