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CUTTING CREDIT CARD CONFUSION

Submission to the Australian Treasury's 'Credit cards:
improving consumer outcomes and enhancing
competition' consultation paper

ABOUT US

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. By mobilising Australia's largest and loudest consumer movement, CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

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INTRODUCTION

CHOICE appreciates the opportunity to provide the following feedback on the Treasury's consultation paper *Credit cards: improving consumer outcomes and enhancing competition* (May 2016). CHOICE welcomes and strongly supports the Federal Government's proposed reforms to deal with clear consumer detriment in the credit card market.

At a time when the cost of providing credit is decreasing, card providers are charging consumers more than ever. Costs for consumers are increasing across the board through higher interest rates, higher annual fees and balance transfer deals with high costs. Very few card providers have passed on reductions in interest rates and rewards points are confusing and often of questionable value.

The consultation paper provides a suite of recommendations that, if designed and implemented effectively, will dramatically improve credit card users' experiences.

CHOICE particularly welcomes proposed reforms to tighten responsible lending obligations, prohibit unsolicited credit limit offers and enable cancellation of credit cards through online platforms.

CHOICE also supports consumer testing of the proposed reforms. New technologies present an opportunity to reform the way in which consumers interact with credit card providers and an independent, government-led testing phase of the suggested measures is critical to their success. The feasibility of simplified switching and 'tick-and-flick' options with new and emerging technology platforms should also be explored.

Lastly, CHOICE requests further refining of the impact analysis to properly quantify the cost to consumers if no change or inadequate changes are implemented.

1. Comment on proposed reforms

CHOICE strongly supports all reforms proposed as part of Phase One. Additional comments are provided to guide Treasury in drafting legislation.

Tightening responsible lending obligations

CHOICE fully supports the proposal to amend responsible lending obligations to prescribe that a credit card contract or limit increase is assessed as unsuitable if it is likely that a consumer will be unable to repay the full credit limit within a reasonable period. As noted in the consultation paper, card issuers currently calculate a consumers' ability to repay based on the minimum repayment amount (2% of the outstanding balance) not the full credit limit. This puts at risk those consumers who can least afford large interest charges.

While we remain open to other options, we support defining a 'reasonable period' in a similar manner to the United Kingdom, where lenders must have regard to the typical repayment period required for a fixed-amount unsecured personal loan. This measure would best support consumers who use credit cards as forms of medium-to-long-term credit.

Prohibition of unsolicited credit limit increase offers

CHOICE supports this measure but suggests that it could be expanded to better protect consumers. Credit card providers should be required to ask consumers what credit limit they are seeking, and should not offer limits in excess of that suggested by the consumer.

Electronic card cancellation and reduction of credit limits

CHOICE welcomes the proposed measure to introduce simple, electronic cancellation and credit limit reduction. Any electronic request should bypass the need to write, call or visit a branch or to mail the physical credit card to the bank to complete the cancellation. Currently, card providers have little incentive to offer this to consumers, instead requiring most customers to have a sales discussion where they may be subject to aggressive marketing tactics pushing consumers to retain cards.

In order to ensure that the cancellation measure is technologically neutral, legislation should specify that one-step cancellation options are provided on any platform through which the card provider offers card services, such as at the point of balance checks, limit increase applications and card applications. Cancellation should be available at any point where a

customer can obtain information about their credit card product, including websites, apps or other technologies that may emerge in the future. This approach may also reduce any compliance burden for smaller card providers that offer services exclusively offline or by phone.

Online methods of card cancellation will markedly improve the consumer experience for many card holders. However, there will still be consumers wishing to cancel their cards in a bank branch or over the phone who should be protected from the culture of aggressive and persuasive marketing conversations. To reflect the spirit of the proposed changes, proposed reforms should ensure consumers are protected from these conversations when cancelling credit cards.

Cancellations occurring in a physical branch or over the phone should be a one-step process. Consumers should not be asked to complete any additional actions (such as mailing their card or making a second phone call) to cancel their card. Monitoring of marketing and sales practices should be undertaken by ASIC and if problems persist for consumers who do not wish to use online methods of cancellation, guidance should be provided to improve industry practice.

2. Comment on further reforms for testing

CHOICE supports consumer testing of the following suggested measures as part of Phase Two:

- That issuers provide information on the annual cost of a consumer’s credit card use and prominently display annual fees.
- That issuers clearly disclose in advertising and marketing material a card’s interest rate and annual fee.
- That issuers provide information about potential savings from switching to lower-cost products.
- That issuers provide consumers with timely electronic notifications regarding the expiry of introductory offers and credit use.
- That issuers provide consumers with alternative payment tools and proactively contact consumers who are persistently making small repayments.

CHOICE expects that the testing will be planned in partnership with, and the results released to, all key stakeholders, including consumer representatives. CHOICE also expects testing to be led by the Federal Government, with an independent agency for support if required.

CHOICE particularly welcomes testing of notifications for how much credit consumers have used. CHOICE suggests the Treasury look to similar measures implemented in other Australian markets, such as the notification requirements for mobile phone providers under the Telecommunication Consumer Protection Code (the TCP Code). Looking at the experience of notifications in the mobile phone market, it is vital that notifications are timely (delivered in real-time or with minimal delay) and have consistent triggers that apply to all products (for example, all card holders receive notifications when they reach 50, 75 and 90% of their credit limit rather than different notifications levels set by different providers). Notification methods need to deliver messages to consumers immediately, making SMS or app-based notifications the most appropriate options.

While not considered in the consultation paper, CHOICE recommends that any assistance for consumers constantly making small repayments includes referral measures to independent financial counselling services. Based on the volume of consumers referred to financial counsellors, further thought should be given to additional industry or government funding for these services.

The role for the Federal Government in implementing further reform

The Federal Government has an important role to play in ensuring reforms are implemented consistently by credit card providers. The consultation paper notes that a “small number of card-issuing institutions are showing leadership in this area... If more card-issuing institutions were to follow their lead, the need for Government action may become less compelling.”¹ The value of many reforms relies consistent application across all products and this is unlikely to be achieved without some level of government involvement, if only to standardise presentation. For example, the clear display of annual fees is an important reform to let consumers compare the cost of credit cards. This information will only truly be useful for comparison purposes if it is provided in a consistent format by all card providers for all products. CHOICE’s preference is that testing is initiated by the Federal Government and any reforms are implemented by legislation or regulation that applies consistently across all products.

¹ Consultation paper, p. 19.

Other options to test

CHOICE recommends that Phase Two also includes tests of ‘anchoring’ measures that will provide consumers with information to understand the value of their product compared to the rest of the market.

Most consumers say that low costs are the most important feature for them in choosing a credit card, however, many consumers are not actually choosing cards with the lowest interest rates and annual fees.² Information about the value of certain products in relation to others would better assist consumers in finding a good value product and drive greater competitive focus on interest rates and annual fees.

CHOICE recommends that testing includes options which would:

- Provide information about the general credit card market, such as highest and lowest interest rates and highest and lowest annual fees.
- Display other useful data such as average market interest rates, repayment behaviour and the bank’s lowest interest rate.

Testing for all measures should also consider the best format to deliver information to consumers which may be credit card statements, direct email, notifications through an app or SMS or other channel with which a consumer has regular contact.

3. Further investigation needed into account switching

The consultation paper recommends against further investigation into account switching assistance for consumers. CHOICE thinks this conclusion is premature given the upcoming changes to the Australian payments system that may open up options that were previously considered unfeasible. In 2011, former Reserve Bank Governor Mr Bernie Fraser provided a report to government recommending against account portability on the grounds of technical difficulty as the current payments system is based on numerous bilateral linkages (electronic connections between individual financial services providers). However, since 2011, the payments industry has commenced work on the New Payments Platform (NPP) to facilitate

² See CHOICE submission to the Senate Economics References Committee (2015), *Inquiry into matters relating to credit card interest rates*.

real-time payments. Account portability measures should be reconsidered in light of this new investment in payments infrastructure, with a view to incorporating portability in the design state of the NPP. Mr Fraser foreshadowed this opportunity in 2011:

One of many issues expected to be canvassed in this process is the possible greater use of centralised architecture. Should moves in this direction eventuate, that would appear to be an appropriate context in which to review the question of account portability.³

CHOICE also believes that this previous investigation discounted potential benefits of account portability, including savings to small business from not having to regularly update payment details of consumers switching between cards and institutions. The primary benefit of account portability is that of increased competitive pressure. Twenty-two percent of consumers who said they did not switch cards said it was because of the perceived hassle of switching. Ten percent of people said they did not switch because they believe it is too complicated to cancel or update direct debits.⁴

Although the Government has recommended against instituting a 'tick and flick' option for the transfer of direct debit payments in this set of proposed reforms, reform in this area would allow the 10% of consumers to switch to a better deal card with ease. A 'tick and flick' process for direct debit transfers was introduced for transaction accounts in 2012. It is rarely used as it is not promoted by banks.⁵ Consumers would also benefit from the ability to cancel direct debit payments directly with their credit card provider as well as via their merchant.

4. Comment on impact analysis

The impact analysis fails to properly quantify the cost to consumers if no change or inadequate changes occur. The lack of competition in the credit card market is affecting all consumers with credit cards who don't pay off their balance in full, even if that's just one month in the year.

³ Commonwealth of Australia, 'Banking Services: Switching Arrangements', 2011, p. 10, accessible at http://banking.treasury.gov.au/content/reports/switching/downloads/switchingarrangements_aug2011.pdf

⁴ See CHOICE submission, to the Senate Economics References Committee (2015), *Inquiry into matters relating to credit card interest rates*.

⁵ <https://www.australianbankingfinance.com/banking/bank-product-apathy--why--tick-and-flick--failed/>

In July 2015, CHOICE used industry data provided by Mozo to calculate the cost to consumers of market failure in the credit card sector. The failure of card providers to move interest rates in line with Reserve Bank of Australia cash rates was used as a base line to demonstrate failure of card providers to compete on core card costs (interest rates and annual fees). If credit card interest rates had moved in line with the Reserve Bank cash rate over the between 2011-2015, Australian credit card holders would have paid \$2.07 billion less in interest.⁶ Based on an average of all card holders, each card holder has paid an additional \$281 in interest charges since 2011 because of unnecessarily high interest rates. Looking at only the 42% of people who pay interest on credit cards, an average consumer who has paid interest since 2011 has paid an additional \$669.44 because credit card interest rates. CHOICE expects similar costs to continue should no change occur.

Looking at some of the specific net benefit calculations, CHOICE recommends that Treasury re-examines some cost estimates. For the measure to provide consumers with better information about annual costs of credit card use and to clearly display annual fees, the consultation paper suggests an \$8.4 million cost to consumers per year for “additional time taken to read and understand the new information.” It is unclear how this has been calculated. Assuming that the measure is tested and implemented in a consumer-focused manner, any information-provision reform should save consumers time compared to the status-quo. There should be no material compliance cost to consumers for this measure.

Similarly, costs for the measure to provide consumers with personalised information on potential savings from alternative credit card products appear questionable. The consultation paper suggests that consumers will face an \$8.4 million cost per year as some card holders may lose rewards and other benefits by switching to a lower cost card. This assumes that any rewards would have been used. The \$8.4 million estimate seems excessively high given the known poor value of rewards points and the assumption that consumers who highly value rewards are going to switch to a product without using existing accumulated points. Moreover, this calculation would seem to ignore the status quo whereby high-cost rewards schemes are cross-subsidised by all consumers, including those who use lower-cost payment options such as cash, eftpos and non-rewards credit cards. Unless merchants adopt consistent cost-reflective surcharging, this cross subsidy will continue. For as long as it persists, any reduction in the number of high-cost rewards cards will produce benefits for the vast majority of consumers who do not use them.

⁶ For full details behind this calculation, see the CHOICE submission to the Senate Economics References Committee (2015), *Inquiry into matters relating to credit card interest rates*.