16th June 2016

Principal Advisor
Financial System Division
The Treasury
Langton Crescent
Parkes ACT 2600

Email: CreditCards@treasury.gov.au

Re: Credit Cards: improving consumer outcomes and enhancing competition

FBAA welcomes the opportunity to make submissions in relation to improving consumer outcomes and enhancing competition in the Credit Card market.

Since 2011, FBAA made submissions to Government over concerns with the behaviour of participants offering credit cards and pricing inequity. For your reference, we attach a PDF copy of our submission dated 16th February 2011 the to the Senate Economic Reference Committee noting the comments on Credit Cards at the end of the said submission.

The main issues FBAA wishes to ensure receive adequate attention through this consultation process are these:

1. **Compliance with Responsible Lending obligations**
   Participants offering credit cards must be made to comply with the same responsible lending requirements imposed on, and enforced against, lenders, mortgage brokers and other credit assistance providers. FBAA is concerned that entities offering credit cards are subjected to lower standards of assessment and record keeping than other licensees in consumer credit.

2. **Careful consideration of solutions involving additional disclosure**
   Solutions that contemplate additional disclosure as a means to address concerns must be thoroughly scoped. At times, disclosure is not the most effective risk mitigant and can be used to transfer risk from product providers onto consumers.

3. **Credit card serviceability to be modelled off principal and interest loan repayments**
   To protect against over-commitment, capacity to service credit card repayments must be calculated against a reducing principal and interest model. Credit cards are a useful tool for cashflow management and managing unforeseen expenses but should not be used as a proxy for responsible consumption.

t: 1300 130 514 f: 07 3041 0350
First Floor, 386 Logan Road, Stones Corner Qld 4120
PO Box 234, Stones Corner Qld 4120
www.fbaa.com.au ABN: 22 094 784 040

Finance Brokers Association of Australia Limited

The FBAA is generally supportive of the proposals contained within the consultation paper. We will provide our comments in relation to the Proposed actions numbered 1-9 in the consultation paper detailed under the headings of *Phase 1 and Phase 2 (for consumer testing).*

Before providing our response to each proposal, we will provide our comments in relation to the observations made in the analysis of the credit card market.

FBAA comments in relation to Treasury's analysis of the credit card market

The FBAA agrees that the credit card market has been immune to competition and that this has led to a lack of genuine competition and pricing disparity between cost and risk.

Whilst discounted introductory rates and honeymoon periods ("bait offers") present some benefits to consumers if used to their advantage, they are being offered by issuers for the main purpose of winning market share and are neither offered, nor managed in a manner consistent with the consumers' best interests. We see it a superior consumer outcome and one better aligned with the goal of ensuring responsible lending and borrowing to remove bait offers rather than impose further disclosure requirements. The consultation paper rightly identifies consumer behaviour as a significant contributor to the misuse of such offers and further disclosure will not be as effective as preventing it.

We recognise that there are many behavioural biases that impact consumer decisions in relation to accessing credit, not just through credit cards, but through other forms including personal loans. It is important for consumers to be given clear, accurate information however Government needs to take care not to confuse *more* disclosure with *more effective* disclosure.

Disclosure solutions must be fully tested to understand their impact on the consumer and their potential financial impact on the provider since additional costs imposed on providers will ultimately find their way through to the consumer. We want to avoid a situation where consumers end up paying more for information they do not want or need. Some additional disclosure requirements may be perceived as relatively minor in nature yet carry significant cost to implement. Higher regulatory costs will only raise barriers to entry.

For those consumers that are focussed on obtaining credit and disengaged with the financial consequences, more disclosure is less likely to alter their behaviour.

Phase 1

Proposed Actions 1 & 2

1. **Tighten responsible lending obligations to ensure card issuers assess suitability based on a consumer's ability to repay the credit limit within a reasonable period**
2. **Prohibit issuers from making unsolicited credit limit increase offers including the ability to seek prior consent**

Problem addressed: Over-borrowing contributing to financial distress

Question – How should a 'reasonable [repayment] period' be defined in the regulatory framework?

Proposed Action 1

The FBAA supports this proposed action.

Credit card issuers should be made to conduct the same degree of inquiry and assessment as other credit providers, and should be able to substantiate having made such enquiries through their written assessment of unsuitability.

The FBAA recommends assessments be conducted on the basis that the maximum amount of credit is accessed and repaid on a principal and interest basis over a reasonable time period. The FBAA tenders two possible approaches for consideration regarding the reasonable time period.

1. One single time period for all contracts
   For simplicity of administration, it may be possible to impose a singular time period over which to calculate capacity to make repayments. Should the single time period be preferred, FBAA submits that the maximum period should not exceed five years.

2. Tiered timeframe relative to the amount of credit
   Where a single time period is not considered feasible, an alternative approach would be to increase the timeframe for the repayment calculation period in step with the maximum credit limit. For example:

   - Three years for amounts of up to $5,000
   - Five years for any amounts over $5,000

Proposed Action 2

The FBAA strongly supports a total ban on unsolicited offers including a prohibition on credit providers securing prior consent.

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Proposed Action 3

3. **Prohibit issuers from backdating interest charges and charging interest on the portion of the balance that has been paid-off**

Problem addressed: Complex application of interest charges

The FBAA strongly supports this proposed action. We agree with the basis of the proposal that credit providers should only be permitted to charge interest on the amount outstanding at the end of the statement period from the end of the statement period in which a consumer loses their interest-free period.

Proposed Action 4

4. **Require issuers to provide consumers with online options to initiate a card cancellation or reduce their credit limit**

Problem addressed: Over-borrowing through accumulation of multiple cards
Question – How would this option be implemented in to be consistent with the Governments' commitment to ensure regulation is technology neutral?

The FBAA supports this proposed action.

We suggest consideration be given to requiring credit card issuers to provide various methods of cancelling cards. As identified in the consultation paper, providers have developed processes intended to frustrate a consumers' attempts to cancel a card and the proposed measures should also address these practices.

Providers should be required to provide consumers with the ability to initiate a cancellation or limit reduction without having to speak to a staff member. For example, a consumer could send a text to cancel, be advised of their payout figure by return text and then confirm the instructions to cancel the card. This is not dissimilar to services provided by telecommunications companies for users to check their current data consumption.
If alternative methods such as telephone, email or website cancellation options are provided, the simplicity of the SMS solution should flow through. That is, providers should be prohibited from frustrating the process or deploying retention techniques. Providers should be restricted to requesting and providing only the factual information required to process the request.

Phase 2

see over …

Phase 2 - Proposals 5, 6 & 7

5. **Require that issuers provide information on the annual cost of a consumer's credit card use and to prominently display annual fees**
6. **Require issuers to clearly disclose in advertising and marketing material a card's interest rate and annual fee**
7. **Require issuers to provide information about potential savings from switching to lower cost products**

Problem addressed: Lack of competition on ongoing interest rates; consumers in unsuitable card products; over-borrowing and under-repayment

5. Require that issuers provide information on the annual cost of a consumer's credit card use and to prominently display annual fees

Question - Apart from those detailed in the consultation paper, are there other types of information that could be presented to increase consumers' attention to the costs of their credit card usage?

The FBAA supports additional meaningful disclosures in credit card statements however recognises, as does the consultation paper, that many consumers have little to no engagement with the information presented in their statements.

The FBAA supports the proposal for providers to disclose a consumer's annual cost of their credit card use and to disclose the annual fees.

Question - What aspects of the presentation and distribution of the information would be important in ensuring that it is seen and has the intended effect?

Consideration must be given to which type of disclosure has the most impact and focus groups may assist. FBAA considers that the most effective disclosure involves comparisons and pictorial representation.

Information about annual cost of use and annual fees could be included in an information box at the top of monthly statements. The information could include year to date interest paid and the date of the next annual fee.

Card providers could also seek positive consent from a consumer for payment of the annual fee at the time of offering a card rather than, as they do now, making it a part of the application process.

6. Require issuers to clearly disclose in advertising and marketing material a card's interest rate and annual fee

The FBAA supports this proposal.

Question - How prominently should the required information be presented to ensure its effectiveness?

Disclosure of the annual rate and fee should be at least as prominent as the disclosure of any other parts of the advertising. In particular, the FBAA considers it necessary to ensure the interest rate and annual fee is as prominent as and discount rate or other enticement offered.

Disclosure of costs would be more effective if the expression of the fee and annual rate were expressed as a percentage against a set amount – say $1,000. Disclosure could inform a consumer that $1,000 borrowed on a card with an annual fee of "x" and an annual rate of "Y" equates to paying an effective interest rate of "Z".

For example:

Did you know, if you put $1,000 on this credit card, you will pay $XXX in fees and interest over 12 months. This equates to an interest rate of XX%!

Require issuers to provide information about potential savings from switching to lower cost products

Question - To what extent would the information provided under this proposal induce consumers to switch to lower cost cards?

Question - What aspects of the presentation and distribution of the information would be important in ensuring that it is seen and has the intended effect?

This suggestion has merit and the FBAA encourages further testing.

We believe a graphic representation is most likely to have strongest impact as well as side by side comparisons. Along this line, Treasury may wish to explore:

- A Graph showing current repayment trajectory vs superior trajectory if additional payments were made
- Alternately, a ranking system – "our card is currently ranked third most expensive" or "3rd most expensive out the top 25 cards in Australia by size" etc

Phase 2 - Proposal 8

8. **Require issuers to provide consumers with timely electronic notifications regarding the expiry of introductory offers and credit use**

Problem addressed: Over-borrowing and under-repayment

The FBAA strongly supports this measure. Electronic notification of the impending end of an interest free period or other introductory rate would be highly beneficial. We suggest that SMS (text) would be most effective for this, followed by email.

We also reiterate our position that we consider it preferable that bait offers be banned altogether as the purpose for which they are offered is in direct conflict with the purpose for which consumers take them up. Bait offers are a loss-leader for credit providers. Bait offers are made to procure new clients and credit providers rely on a significant portion of those consumers not repaying the credit before the introductory period expires to then remain as long-term, profitable customers. Conversely, consumers take up bait offers in an attempt to gain relief from existing over-commitment and difficulties making repayments. Often, consumers that gain relief from reduced payments during introductory offers then commit themselves to further credit or expenditure, placing them in a worse position once the introductory offer terms cease.

In addition to the points made above, the FBAA would like to encourage further work to be done on several related issues.

Warning statement (pop-up) for consumers that choose minimum re-payment as automatic repayment option

Consideration should be given to the introduction of a warning statement given to consumers who select automatic minimum repayment options. Consumers can set and forget minimum balance as a monthly auto-pay option (i.e. effectively choose the most harmful option because of behavioural biases causing them to select lowest repayment commitment).

Slow reinstatement of Interest Free Period

Currently, where a customer loses their interest free period through not paying off their card balance in full at the end of a cycle, the interest free period does not immediately recommence after the card balance has been paid out to zero (or even positive). The card must remain in positive balance for one full credit cycle before the interest free period is re-instated. Many consumers who pay their card balance to zero then commence using their card as a credit card again believing the interest free period had been restored. This issue could be addressed if card providers were required to reinstate the interest free period immediately after a consumer has paid their card balance back to zero, rather than requiring them to keep the card to zero or positive balance for another full billing cycle. The complexity of how such interest free periods are applied and reinstated causes confusion and causes consumers to make mistakes to the benefit of the card provider.

Question - What are the most appropriate triggers to provide these notifications, or should these notifications be periodic rather than tied to specific events?

We support a notification trigger being set to when 80% of the card balance is reached. Additional notifications should be sent whilst a consumer is only making minimum payments on their cards and the balance remains above 80%.

Question - What is the most appropriate method for card issuers to provide these notifications?
We consider SMS and email to be the most effective communication methods.

Phase 2 - Proposal 9

9. **Require issuers to provide consumers with alternative payment tools, and proactively contact consumers who are persistently making small repayments**

   Problem addressed: Under-repayment; consumers in unsuitable card products

The FBAA suggests consideration of using a pop-up warning if the consumer sets minimum balance as their auto-pay option.

We also support exploring concepts that give consumers greater flexibility and more engagement with their financial affairs such as the Blueprint tool devised by JPMorgan and deployed in the US. We consider it important to stress we would not support any self-imposed consumer repayment plan causing late/default fees if the consumer doesn't meet their target (i.e. model used in India).

Question - What factors would maximise the take up of repayment tools by consumers who are subject to under repaying?
Question - What is the most effective and efficient way to engage consumers who are persistently making small repayments to suggest an alternative course of action?
The FBAA recognises the challenges of re-engaging those who are disengaged. The conduct of under-repaying, itself demonstrates the consumer's low-level of engagement, or alternately inability to deal with the consequences. We consider the most effective way to engage consumers who are persistently making small repayments is electronically. The nature of those communications is to be in line with the suggestions provided elsewhere in this paper.

Other regulatory options considered

Require issuers, acquirers and card networks to facilitate the transfer of recurring payments across cards
The FBAA supports the position advanced in the consultation paper.

Substantially raise the level of minimum payment required
We strongly agree with this objective. We do not believe that raising the minimum payment level will lead to excessive defaults. It is difficult to understand how credit providers that assert this as a likely consequence can be conducting adequate responsible lending assessments unless such assessments are based on a consumer's capacity to make minimum repayments. As we have stated earlier, this approach should be stopped.

Changing The Game

Issuers either know that they have over-committed the consumer (and therefore raising repayments may tip them over the edge) or, more likely, they know so little about their consumers because of flawed assessments they have no real understanding of their positions. Either way, robust action is encouraged in this area.

FBAA notes the potential costs listed in the impact analysis table against this option. Most of those issues listed as costs (i.e. adverse outcomes) are only likely to be present at the time of implementation when a consumer is able to compare their pre and post-change situation. Once new rules come in for minimum repayment amounts, consumers will adjust. Accordingly we believe the benefits significantly outweigh the costs of this proposed action.

FBAA anticipates that any rule changes would only be prospective and apply to new accounts post the date of implementation. This would address the potential risk noted in the impact analysis table that rule changes may push exiting card users into default.

Question – Taking into account the potential benefits and costs discussed above, is there merit in further investigation of this policy option?
Yes. We believe it is possible to leave existing arrangements as they are and base new card issues on a Principal and interest calculation over the timeframes proposed elsewhere in this submission.

PJ White
On behalf of the Finance Brokers Association of Australia Limited (FBAA)