CREDIT CARDS: IMPROVING CONSUMER OUTCOMES AND ENHANCING COMPETITION

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INTRODUCTION

About this Submission

Financial counsellors assist low-income and vulnerable Australians who have financial problems, often involving issues with credit and debt. These problems often related to unemployment, illness or relationship breakdown or because many people struggle to make ends meet because Centrelink benefits are so low. Credit card debt is a major issue financial counsellors see in their practice.

Our submission responds directly to questions asked in the consultation paper.

We also support the submission to the consultation, including all recommendations, by Consumer Action Law Centre (Consumer Action) and Financial Rights Legal Centre (FRLC).

About Financial Counselling Australia (FCA)

FCA is the peak body for financial counsellors in Australia. We support financial counsellors and provide a voice on national issues. We advocate on behalf of the clients of financial counsellors for a fairer marketplace that will prevent financial problems in the first place.

What Financial Counsellors Do

Community based financial counselling services provide free assistance, information and advocacy to people experiencing financial difficulty including problems with debt. Financial counsellors have knowledge of a range of areas of law and policy, including consumer credit law, debt enforcement practices, the bankruptcy regime, industry hardship policies and government concession frameworks. Financial counsellors are required to hold (or to be studying for) a Diploma in Financial Counselling.

Financial counsellors also document their experiences and highlight issues that have a negative impact on their clients. Either individually, or through FCA, they advocate for change with industry, government and other stakeholders to benefit their client group and encourage practices that prevent financial and consumer problems.

We draw our recommendations in this consultation from constant feedback and discussion with financial counsellors about their practice and emerging trends.

Q 1: FOREWORD

As noted in the joint submission by Consumer Action Law Centre & Financial Rights Legal Centre, financial counsellors see a great deal of credit card debt in their practice, and credit card debt is one of the main reasons for people to seek financial counselling. We are therefore well-placed to comment on the reforms proposed in the consultation paper.

Overall, we support **all** the proposals (both those proposed and those 'not preferred') as careful implementation of them is likely to result in better outcomes for consumers. Furthermore, now that there has been plenty of time to observe the operation of the *National Consumer Credit Protection Act 2009* and how those protections have benefited consumers, we believe that amending and strengthening the poorly functioning and poorly observed (or technically observed, but unfairly implemented) parts of the Act will result in better outcomes for consumers with credit cards.

Credit cards are one particular product in which there is great variability. Financial counsellors often report there is a wide interpretation of the responsible lending provisions in the Act, and it is not unusual for a client to have credit cards whose aggregate limits exceed their yearly income. Furthermore, many creditors have found ways around the prohibition on unsolicited credit card limit increase offers, such as having tellers or phone staff be the ones to broach the question instead. Compounding this issue is the tendency of banks to use recent or prior credit applications for the assessment of new credit, instead of asking customers to re-apply, and this results in poor outcomes for consumers.

The comparatively low repayments for credit cards versus personal loans can lead consumers to seek out an inappropriate product for their requirements, and the long length of time it would take to repay a credit card by just paying the minimum repayments should ring alarm bells for regulators. For example, financial counsellors commonly see clients paying the minimum amount of 2% on a credit card balance, where at that rate, it will take 40 years or more to clear the debt.

When a credit card—which consumers overwhelmingly perceive as short-term credit—takes longer to pay off than a mortgage, there are clear regulatory issues that need to be addressed. We are pleased this topic is broached as part of the consultation, and we are pleased to comment on other proposals as well.

Q 1: DEFINING ‘REASONABLE PERIOD’

How should ‘reasonable period’ be defined in the framework?

As noted in the consultation paper and above, consumers see credit cards as short-term credit. Most consumers expect (sometimes erroneously), that they will pay off purchases within the statement period. Regulation should reflect consumer expectations of the product they are purchasing and ensure customers are being provided with exactly that: short term credit.

We therefore believe an appropriate length of a ‘reasonable period’ is three years.

We also believe that this proposal should be considered in conjunction with, and not in isolation from, the consultation note on whether or not credit card payments should be increased from 2%, as this disproportionately low minimum repayment is what leads to credit cards taking 40+ years to pay off in the first place.

A suitably defined ‘reasonable period’ in the regulation **and** an increase from the currently inappropriately low minimum repayment will lead to more appropriate lending and better consumer outcomes.

Q 2: MAKING IT EASY TO LIMIT/CANCEL ACCESS TO CREDIT IN A TECHNOLOGY NEUTRAL WAY

How would this option [the option for the consumer to easily limit/cancel access to credit] be implemented to be consistent with the government’s commitment to ensure regulation is technology neutral?

Creditors already have the facility to cancel credit cards and reduce credit limits immediately. The reason they do not make this facility available to customers directly, is presumably because it is more profitable if consumers do not reduce their credit card limits or close their credit cards. The more onerous a card provider makes the process of closing a credit card (for example, requiring customers to first speak to a ‘retention specialist’, or asking customers to present at a bank branch), the less likely a consumer is to go through with it.

We believe this is an unfair process, and creditors have a responsibility to assist customers in their attempts to use credit safely.

Requiring creditors to provide their customers with the option to cancel a credit card or reduce a limit would be technology neutral, as there are many ways creditors could make that option available to consumers.

Q 3 & 4: INCREASING KNOWLEDGE ABOUT THE COSTS OF CREDIT CARD USAGE

[Apart from information about the APR and fees] are there other types of information that could be present to increase customer's knowledge about the costs of their credit card usage? What aspects of the presentation and distribution of the information would be important in ensuring that it is seen and has the intended effect?

We agree with the proposal to clearly state the APR of credit cards as well as annual fees in advertisements. As we also set out in our submission into the inquiry on credit card interest rates, we are also concerned about balance transfer cards (also called 'honeymoon rate' cards) and their propensity to be attractive and dangerous to consumers already carrying high credit card balances.

We also propose therefore, that any balance transfer advertisements should also display the regular APR of a credit card in the same font as the honeymoon/balance transfer rate.

Q 5 & 6: PROVIDING PERSONALISED INFORMATION ABOUT MORE SUITABLE PRODUCTS

To what extent would the information provided under this proposal [to provide consumers with personalised information about more suitable products] induce consumers to switch to lower cost cards? What aspects of the presentation and distribution of the information would be important in ensuring that it is seen and has the intended effect?

It is hard to predict how consumers will respond to an inducement to switch to a lower rate card, because as noted in the consultation paper, "present bias" frequently encourages consumers to consider what they perceive to be immediate rewards, such as a waived annual fee for the first year, or a rewards program, as more important than total cost over the life of the card.

Instead, it might be useful to provide a comparison of cards at their maximum limit (the limit offered to the customer), with information such as interest paid over 12 months, fees paid, and a table of 'costs saved' on the low interest rate card. Concrete examples and comparisons can be helpful decision-making tools for consumers, who may find it difficult to imagine how cold hard facts (like '21.99% APR') may play out in real life on their purchases.

Q 7 & 8: CREDIT USAGE TRIGGERS

What are the most appropriate triggers to provide [notifications of credit usage], or should these notifications be periodic rather than tied to specific events? What is the most appropriate method for card issuers to provide these notifications?

It is worth noting that due to recent changes in the Telecommunications Consumer Protections Code (TCP Code), telcos are now required to provide timely (within 48 hours) warnings by text message to customers when they reach certain amounts of usage: 50%, 85% and 100%. This has been a well-received addition to the Code, and according to the Telecommunications Industry Ombudsman, 'bill shock' is in steep decline.

We do not believe however that periodic reminders of credit balances (as a percentage of limit used) would be an effective way of communicating with customers about their usage. Instead, we recommend following the same warning patterns as the TCP code, either by using the same percentages, or specific trigger-point percentages, such as 75% and 100% of limit. This information is best presented in real-time as a text message. However, some users may prefer to receive an automated telephone call or email.

We welcome this proposal as a useful way to assist consumers to manage their expenditure and balances.

Q 9 & 10: MAXIMISING THE TAKE UP OF REPAYMENT TOOLS

What factors would maximise the take up of repayment tools by consumers who are subject to under repaying? 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 proposal to legislate that creditors make useful tools and resources available to consumers who repeatedly pay only minimum repayments is a very welcome one. In particular, we note that having these tools available will help consumers see that even making fractionally larger repayments every month, substantially decreases the length of repayment times and the interest paid. Consumers who are <u>not</u> in financial hardship, but simply paying the minimum repayment for whatever reason, will certainly benefit from having a better understanding of the repayment choices they are making.

It is worth noting however that for many people making the minimum repayment per month, access to repayment tools and information would not assist as they are in financial hardship already and have no capacity to pay more. These customers could benefit from early access to a bank hardship program and/or financial counselling. Having said that, we recognise that proactive contact by creditors offering assistance can be sensitive and may not always be welcomed by consumers. Imposing a mandatory requirement to contact all consumers making minimum repayments therefore might be problematic. A more general obligation on credit providers to have in place systems to identify consumers who appear to be in financial hardship would be a middle ground.

Lessons from a Churchill Fellowship

In 2014, FCA's CEO Fiona Guthrie, undertook a Churchill Fellowship, visiting the UK and the USA to look at debt advice services and the regulation of consumer credit. The following comments, partly based on Fiona's report, as well as some UK research cited below, are relevant to a discussion about early identification of consumers in financial hardship and the importance of providing information and tools to consumers about credit card usage.

From "Working Households' Experiences of Debt Problems":[1]

> "In the face of increasing credit balances, working people in the depth interviews felt they were managing their credit use as long as they could pay at least the minimum contractual amount each month on credit and store cards, and were able to make personal loan repayments. The continued offer or availability of credit (including automatic credit increases) was also a tacit signal to them that things were okay."

These findings - that consumers think that they are managing credit, even as their financial situation deteriorates - would be consistent with the experience of financial counsellors in Australia. There is eventually a tipping point however and that point can be devastating and action can by then, be too late. Early identification of financial hardship and stress is therefore critical.

We also note that research from the UK suggesting that early identification can be effective.[2] Professor Collard investigated the experience of customers who had been contacted by the Barclays Customer Review Team (CRT). This is a pre-arrears service for customers with personal loans or overdrafts, who are showing signs of

[1] Sharon Collard, Andrea Finney and Sara Davies, *Working Households Experiences of Debt Problems, A research report prepared for StepChange debt charity*, Personal Finance Research Centre, University of Bristol, 2012, p 11.

[2] Sharon Collard, Personal Finance Research Centre, University of Bristol, *Understanding financial difficulty: Exploring the opportunities for early intervention.* The research paper is undated but is from 2013. (The research was funded by Barclays with the independent support of the Money Advice Trust.)

financial difficulty, even though they may not be in arrears or have missed a payment. The main research findings are below:

- The causes of financial difficulty were unemployment, physical or mental health problems (often associated also with the loss of a job) or the breakdown of a relationship;
- Customers in financial difficulty reported considerable stress and anxiety;
- Around 80% of people proactively contacted by Barclays about their financial situation went on to work with them to address these issues. The remaining 20% did not engage, primarily because they felt they were not in financial difficulty;
- The majority of customers welcomed contact from the CRT;
- The impact of the CRT for customers was a feeling of relief at getting their financial situation sorted out. Some customers also reported changes in the way they managed their finances. The majority of customers also resolved their financial issues or were well on the way to do doing so;
- An effective early identification strategy has three elements: contact occurs very early with customers, staff are polite and friendly and the customer continues to interact with the same person and staff have the authority to make decisions and will keep in touch with the customer over time.

Finally, we also see no reason why repayment management tools should not be made available to *all* customers rather than just those subject to low repayments, and recommend that they be available across all credit card products.

Q 11 & 12: IS THERE MERIT IN RAISING MINIMUM REPAYMENTS?

Taking into account the potential benefits and costs discussed above, is there merit in further investigation of this policy option [raising minimum repayments]?

We have long advocated a rise in the minimum repayment amount for credit cards, and most recently recommended this in our submission to the inquiry regarding credit card interest rates.

Low repayments are incentive for customers with less money to spend more, and an incentive for creditors to lend more money to customers than they should.

Having the default payment at 2% actively traps consumers in a ‘revolver’-style of usage, where consumers with high balances may take many years to pay off the balance of their credit cards and pay back many times the value of their credit in

high interest rates. This is a very unfair and one-sided arrangement creating profit for creditors at the expense of consumers who are least able to protect themselves from ending up in this situation.

Credit cards should not be long-term debt like mortgages, and keeping minimum repayments at 2% allows creditors to profit from a relatively low balance over many decades. For these reasons, the minimum repayment amounts on new credit cards should be increased.

In implementing this change, we recommend a phase-in period on new credit cards and a 'grandfather' clause that protects people with existing debts, so consumers who are already carrying a high balance are not negatively impacted by changes in the future.

Q 13 & 14: OTHER POTENTIAL BENEFITS OR COSTS ASSOCIATED WITH THE REFORMS

In addition to those detailed below, are there other potential benefits or costs associated with the proposed reforms? Are the estimates detailed below a reasonable reflection of the likely costs faced by industry to implement the proposed reforms?

FCA is well-placed to comment on the cost to industry of implementing the reforms.

We will comment, though, on the very large net benefit that implementing **all** of these reforms (including those listed as 'not preferred') would have on the wellbeing of consumers.

The fact that credit card debt is one of the number one reason struggling Australians seek financial counselling should be a clear indication to the regulator that something is amiss with how credit cards are provided. Financial counselling clients can present with multiple credit cards with a spread of balances: that these balances could take a lifetime to repay demonstrates there is a problem.

Consumers expect credit cards to be short-term credit and regulation should adequately reflect this, by insisting that a 'reasonable period' for a debt to be repaid is three years, and by raising the minimum repayments to reflect this.

Furthermore, the proposed policy option of requiring creditors to facilitate the transfer of direct debits when a customer transfers to a different creditor is an excellent competition-promoting strategy of significant benefit to both consumers and industry. We note that in the consultation paper a quote from Bernie Fraser suggesting that people who do not switch credit cards simply lack the motivation to do so: we respectfully point out that the harder and more onerous it is to switch,

the less people are likely to have ‘sufficient motivation’ to do so. Removing barriers to changing providers can only increase competition between creditors and benefit consumers.

Also of significant benefit to consumers is the simplification of the calculation of interest (as financial counsellors can even struggle at times to figure out how interest was calculated on clients’ cards!) and regulation in the transparency of advertising interest rates.

We welcome the proposed reforms, are pleased to have an opportunity to be involved in the consultation on the reforms, and hope these and the ‘not preferred’ regulatory options are all implemented.