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Principal Adviser
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The Treasury
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Dear Sir/Madam,

Consultation Paper Credit Cards: improving consumer outcomes and enhancing competition

The Australian Bankers' Association (**ABA**) appreciates the opportunity to provide comments to the Government Consultation Paper *Credit Cards: Improving consumer outcomes and enhancing competition* (**Consultation Paper**).

With the active participation of its members, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

The ABA provided a submission to the Senate Standing Committee on Economics inquiry into matters relating to credit card interest rates in August 2015;[1] appeared before the Committee on 22 September 2015, and provided a supplementary submission to the Committee on 11 November 2015.[2]

General comments

The vast majority of credit card customers manage their credit cards and debt responsibly. The ABA acknowledges, however, that there is a small group of credit card customers who experience financial stress.

The ABA strongly supports the implementation of workable and effective solutions to address the challenges faced by these customers. In putting in place suitable solutions, it will be important to consider the following:

1) **Demographic** – There needs to be a clear understanding of the target group of credit card customers who may require particular solutions, otherwise there is a risk these solutions will not deliver the results being sought. Over the past year around 3 to 4 per cent of credit card customers made only the minimum monthly payment in any given month, and around 0.1 per cent of credit card customers paid only the minimum monthly repayment over the past year.[3] This group of customers would not be static. Only a very small proportion of credit card customers can be considered to potentially be in financial difficulties.

[1] ABA Submission to the Inquiry into Credit Cards (Aug15)
[2] ABA Supplementary submission to the Senate Economics References Committee on 22 September 2015 (copy can be provided on request)
[3] *Ibid* (p. 2)

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2) **Change in circumstances** - There needs to be a clear understanding of the circumstances and behaviours that lead customers into financial difficulties and the nature of the financial problems they face, which are often relatively complex. Financial stress often results from a change in circumstances, including unemployment, illness, relationship breakdown, or natural disaster. There is no legislative or regulatory solution to these events.

3) **Existing efforts** - Banks have dedicated financial hardship teams to assist their customers who are experiencing financial difficulties and to help manage their debts. These teams assess situations on a case-by-case basis and consider specific personal and financial circumstances for the customer. With the agreement of their customer, banks can put in place alternative arrangements,[4] such as repayment plans.

   All credit providers are required by law to have in place a process for dealing with financial hardship. The banking industry has gone beyond legal obligations with commitments contained in the ABA's Financial Hardship package, released in 2013.[5] This package demonstrates the industry's commitment to working with customers experiencing financial difficulties and promotes best practice.[6] Industry data[7] suggests that less than one per cent of all customers are in a hardship arrangement with their bank. Most customers experiencing financial difficulties have their financial situation restored within three to six months.

4) **Existing resources** - There is an existing suite of regulated disclosures and material published by banks, including Key Fact Sheets, which could be leveraged to further improve the information provided to customers. This would be preferable to the creation of new reporting requirements as customers are already familiar with the existing material, and any additional information or documentation could overwhelm the customer. The objective should be to improve outcomes for consumers rather than the mandating of new reporting or disclosure requirements.

The ABA believes that targeted and effective solutions are required but does not believe the proposed actions are effectively aligned with the challenges faced by this target consumer group. There are concerns that the Government's reforms do not adequately recognise the circumstances which lead to financial hardship and the existing efforts of credit card providers to assist customers in financial difficulties.

Further, the proposed changes will run the risk of increasing the price of credit, or reducing its availability for all credit card customers. The ABA considers this could create significant risk; will not address the underlying policy intent, and will lead to adverse and unintended consequences for the credit card market and consumers.

The ABA advises that any changes to improve the operation of the credit card market should apply to all credit providers so consumers do not face additional confusion.

[4] The types of alternative arrangements that banks might offer credit card customers include:

- Moratorium on repayments – stopping or deferring payments for a period of time,
- Temporary reduced repayments,
- Variations to repayments (generally on non-commercial terms),
- Restructuring the debt – closing the credit card and converting the debt into a personal loan,
- In certain circumstances a debt reduction or debt waiver,
- In other circumstances, such as a natural disaster where customers may not have access to supporting documentation, streamlining arrangements and not requiring evidence, and
- Referring customers to other support services, including professional financial counsellors

[5] http://www.bankers.asn.au/Consumers/Are-you-experiencing-financial-difficulty-

[6] The ABA's financial hardship package consists of:

- Industry guideline on financial hardship. This guideline provides practical guidance on how banks can support customers in ways that meet and, in some areas, exceed their existing legal and Code of Banking Practice obligations.
- Consumer fact sheet on financial hardship. This fact sheet provides consumers with information about what to do if they find themselves in financial hardship, including the options available and the steps involved in seeking hardship assistance.
- Doing It Tough consumer website (www.doingittough.info). Through this dedicated website consumers can find information about how banks can help with temporary financial difficulties and can access a list of phone numbers for the financial hardship teams at each bank.

[7] ABA Opening Statement to the Senate Economic References Committee on 22 September 2015

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Proposed reforms

The ABA notes that the proposed reforms are presented in two phases. Phase 1 reforms will be developed into draft legislation following suitable consultation, and Phase 2 recommendations will undergo testing with consumers with a view to assessing behaviours. It is also noted that decisions on implementation of Phase 2 reforms will, in part, be dependent on the extent to which industry presents solutions of its own accord and a possible additional set of options not currently being put forward by the Government.

The ABA supports the phased approach to evaluating and, where appropriate, implementing the reforms. However, the reforms proposed in Phase 1 would require significant changes to processes and would lead to substantive changes in the operation of the credit card market. The ABA believes it would be appropriate for the impact of these changes to be fully evaluated, and the cost to industry validated in terms of the benefits to customers, before considering the further round of reforms proposed in Phase 2.

It is critical that market and consumer testing identifies if the initial reforms are appropriate and are cost effective solutions that will *not* inadvertently lead to undesirable outcomes, such as restrictions to access mainstream credit products, financial exclusion, implications for financial hardship and higher product and transaction costs.

There is a need for further consideration of these reforms and the ABA would welcome further engagement with the Government on the proposed actions.

Comments on recommendations

This submission considers the recommendations in terms of the phases proposed by the Government.

Phase 1

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

Question: How should a "reasonable period" be defined in the regulatory framework?

Credit card providers are required to comply with the responsible lending obligations of the *National Consumer Credit Protection Act 2009*. This requires credit providers to assess if a credit product is "not unsuitable" for the consumer, which includes assessing the ability of the consumer to comply with their financial obligations. There are many factors which a provider considers in assessing if a credit product is "not unsuitable".

In considering this issue, it is relevant to distinguish between the attributes of different credit products. Credit cards offer a revolving credit facility, with the ability to draw down and repay amounts on a recurring basis as required. This contrasts with amortising credit products, such as personal loans or housing mortgages, which predominantly offer a 'once off' set credit amount with the obligation of repayment via standardised payments over a specified time frame. The majority of credit card customers use the revolving nature of the facility to smooth cash flows and take advantage of convenient payments and do not use it as a long-term credit facility.

In broad terms, the ABA supports the inclusion of an additional requirement that should be based on a consumer's ability to repay the credit limit within a reasonable period. The ABA understands the intention is to *prevent* customers committing to an amount of credit that cannot be comfortably repaid, which would lead to an undesirably prolonged period of revolving credit.

However, there is no consensus on what constitutes a 'reasonable period'; specifically what this would look like in practice, and what it will mean for existing and future credit card customers.

There are a number of variables in the credit card market that would need to be considered in determining a 'reasonable period', including the size of the loan. For personal loans, a typical repayment period is from 1 to 7 years, with some personal loan products up to 10 years. For a housing loan, a longer time frame of 30 years is not untypical, although many are paid off or refinanced within shorter time frames.

Potential consequences of proposed action

A credit limit that is materially lower than sought by the customer could limit a customer's ability to smooth cash flows. It could also result in customers seeking access to alternative sources of credit, including non-mainstream credit products with less favourable interest rates and conditions.

In addition, there are implications for the minimum repayment and whether that minimum repayment would be set at a level that could be paid within a 'reasonable period'. If the minimum payment was set such that credit was repaid within the specified time frame, it could lead to higher monthly minimum payments and increased financial stress for those potentially most vulnerable. It could also impact on the offer of credit, with some customers unable to access mainstream credit products. This negative outcome is noted in the Consultation Paper on pages 5 and 40 and is one reason why the Government does not propose to set higher minimum repayment amounts at this time.[8]

Alternative action by industry

The majority of Australian consumers manage their credit card debt prudently, but a subset of credit card customers are carrying higher credit card debt, which for some may be unmanageable.

As an alternative action and a more targeted solution, the ABA proposes that additional support could be provided through an alternative credit product. For example, a form of amortising loan which may be a more appropriate solution for the customer to help them regain control of their finances. This approach is preferable to the imposition of new and restrictive conditions on all credit card customers. This alternative credit product could be made available to the market as a whole, but primarily offered as an additional measure for customers experiencing financial difficulties and to assist them in gaining control of their debts.

2) Prohibit issuers from making unsolicited credit limit increase offers including the ability to seek prior consent

There are two parts to this recommendation. The first is to broaden the prohibition on unsolicited credit limit increase offers to all forms of communication. The second is to remove card issuers' ability to seek consumers' prior consent to receiving offers.

The ABA supports the first part of the recommendation on the basis that it will ensure consistency in the intention of the legislative requirements that customers should not receive unsolicited credit limit increase offers. The ABA does not support the second part.

Under current arrangements customers have two options; they can opt out of invitations to increase their credit limit or elect to receive offers. This approach preserves the ability of customers to be made aware of their options, and allows them access to credit if their circumstances change.

It is important to note that there are already legislative restrictions to ensure an offer of credit must be responsible and prudent. Specifically, the responsible lending obligations must be met before a credit card or credit limit increase is approved.

[8] Consultation Paper, Credit cards: improving consumer outcomes and enhancing competition (May 2016), page 1

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

It is unclear what problem this recommendation is trying to address or that the proposed solution is appropriately targeted to assist the challenge faced by customers experiencing difficulties.

The ABA does not believe it is appropriate for government to determine the pricing policies of credit providers. Competition in pricing policies is a core element of a competitive financial system and differences in pricing is one way in which financial institutions can distinguish their product and service offerings and achieve a competitive advantage.

The ABA acknowledges that explaining how interest is charged can be complex. If the problem which the Government wishes to resolve is a perceived lack of awareness or understanding by customers about interest rates, that would be best addressed through greater transparency and education, including through the provision of appropriate explanatory material and tailored statements in existing regulated disclosures.

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

Question: How would this option be implemented to be consistent with the Government's commitment to ensure regulation is technology neutral?

The ABA believes that the ease of accepting and exiting financial products is a key element of a competitive financial system. One area of competition is the technical sophistication of product offerings.

Most banks provide online access to a form for cancelling a credit card. Many banks also have tools available to assist customers manage their finances, including tools to freeze the use of a credit card, the use of a repayment calculator to understand how much interest is being paid, how to more quickly repay the debt, and the ability to set up an autopay functionality so funds are deposited against a repayment, which avoids missing a repayment and incurring interest charges.

Technology is constantly evolving and the industry is focused on providing innovative solutions to assist customers to manage their credit card account. Improved technological solutions for managing credit products should be a decision of credit providers to differentiate their product offerings rather than being mandated by regulation.

The ABA does not believe it is appropriate for the Government to determine the technological strategies of credit providers, especially given this product is not mandatory and customers are free to choose whether they want a credit card or not.

Potential consequences of proposed action

Mandating a particular technological solution on all credit providers will have implications for competition, as smaller providers will not be able to absorb the costs and larger providers will have to deal with system complexities. The development of technological solutions takes times, is costly and banks will need to assess whether these solutions are effective.

The Consultation Paper states that an electronic request should "…reduce the opportunity for consumers to be dissuaded from cancelling their credit card or reducing their credit limit". In contrast to this view, the ABA believes it beneficial for credit providers to be able to engage with customers to assess why an account is being closed and to provide an opportunity to identify and offer an alternative and more appropriate product to their customer.

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For further consideration

The ABA would like to better understand the Government's intention in this proposed action, particularly whether this is to protect customers who are in debt and wish to block their account to prevent further debt accrual.

If this is the underlying intent, the solution is not one of simply 'click and close' as any outstanding balance will need to be cleared before the account can be closed.

In this situation, the customer will need to talk to their bank about the options available to help them to manage their debt. For example, banks can put a 'stop' on the account so that the card can no longer be used, but the outstanding debt will need to be repaid before the account can be closed.

Additionally, the customer must ensure they have cancelled any direct debits with a service provider or merchant, and where applicable put in place alternative payment arrangements, otherwise the customer could face other complications. This can involve ceasing the service or payment for the receipt of goods, or putting in place an alternative payment method.

Phase 2 (for market and consumer testing)

The ABA suggests that consideration of Phase 2 of the proposed reforms be put on hold until Phase 1 reforms have been implemented, and adequate time has elapsed to fully consider the impact of the reforms and the subsequent need for further reform.

The ABA also concurs that Phase 2 reforms should first be tested with consumers in terms of their efficacy in achieving more desirable behaviours. This testing should also be accompanied by an assessment of the impact on the broader credit card market and consumers.

In addition, there needs to be further consideration of whether a regulatory solution to the perceived problems is the best response. The ABA believes that a highly competitive market is most likely to lead to innovations that maximise consumer choices and facilitate the best matching of financial and technological solutions to consumer needs.

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

Questions: Apart from those detailed, are there other types of information that could be presented to increase a consumer's attention to the cost 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?

The ABA notes the proposal that the summary information provided to consumers should include year-to-date interest charges, ongoing annual fees, and average balance and repayment behaviour. We also note the requirement that the relevant information be displayed in the electronic tools offered by the credit issuer.

The banking industry is committed to ensuring customers are making 'informed choices' and also supports the communication of this information through appropriate mediums, including through financial literacy resources and tools.

It is important to note that there are existing requirements for a range of information to be included in Key Fact Sheets. This is an adaptable document and it would be preferable for any additional information to be incorporated in this existing document, rather than for new disclosures or technical solutions to be mandated. As previously noted, this proposed action would result in additional costs and adequate time would be needed to make any changes.

Alternative action by the Government

The ABA proposes the Government conduct consumer testing of existing and proposed information, to determine the content, form and prominence of information which consumers respond to positively. The findings of the testing should inform updated requirements for the Key Fact Sheets.

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

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

This recommendation has strong parallels with recommendation 5.

Credit card issuers are required to comply with the *National Consumer Credit Protection Act 2009* and the good practice *Regulatory Guide 234: Advertising financial products and services (including credit)* [RG 234] in relation to advertising and marketing material.

RG 234 provides in relation to interest rates that:

> *Under the National Credit Code, an advertisement for a credit product does not need to include an interest rate, but must do so if the advertisement states the amount of any repayment. The advertisement must also include references to any fees and charges: s150, National Credit Code.*
>
> *Depending on the nature of a credit product, the cost to a consumer may involve a combination of interest charges and other fees and costs.*
>
> *Where an advertisement refers to interest rates and/or fees and charges, it is important that the advertisement gives consumers a realistic impression of overall costs.*

With the above in mind, the ABA seeks clarification whether it is the intention to further extend the credit providers' obligations to include an interest rate and annual fee in all material relating to credit cards? If this is the case, which interest rates must be displayed, for example, headline rate or promotional rate?

Overall, the ABA supports considering measures to increase the prominence of key features to improve awareness of customers. However, we consider that any additional disclosures must be tested to assist the customer in better understanding the features and not cause any customer confusion (or information overload). There is a need for further consideration of the practical aspects of this recommendation and the banking industry would welcome further engagement with the Government on this issue.

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

Questions: To what extent would the information provided under this proposal 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?

Banks already offer, and extensively advertise, a wide range of credit card products, some with higher interest rates and full service offerings, and others with lower interest rates and less features. There is also extensive information offered through independent online credit card comparison sites and similar tools. It is likely that customers who are seeking this information will act on information that they perceive to come from an independent source.

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The ABA supports, in principle, disclosure of relevant features of products, including the relative costs of different product choices. However, we note that relative costings are critically dependant on the assumptions used including the average balance drawn, likely repayment schedules, use of interest free periods, etc. It would be very difficult to model and provide information on all the potential choice sets.

The ABA notes that the analysis in the Consultation Paper asserts that those who choose a higher interest rate and full service cards are subject to behavioural biases in their choices with the implied assertion that the choices are not fully rational and not necessarily in the customer's best interests. This seems to be something of an unproven assertion. The choices facing consumers are also broadened through the availability of alternative credit products, such as personal loans, and products to facilitate payments, such as debit cards, and products to assist in making purchases when travelling overseas, such as a travel money card.

It is also unproven whether the provision of additional information in the manner envisaged by the Consultation Paper would correct these behavioural biases, should they in fact exist.

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

Questions: What are the most appropriate triggers to provide these notifications, 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?

This recommendation is broadly supported by the ABA. Some banks already employ electronic alerts for impending financial milestones, such as sms alerts for late payments, credit limits, due dates, etc. Apart from the commercial incentive for banks to provide products that suit their customers' preferences and needs, there is a commercial incentive in ensuring consumers are utilising the product best suited to their financial needs.

As noted above, there needs to be consideration given to the cost of providing the technological solution and an assessment of the cost to the credit card provider versus the benefit to the consumer. These solutions are best left to evolve in response to competitive market forces and the desire to offer attractive features, rather than be mandated by the Government.

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

Questions: 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 ABA believes that flexible payment tools should be an option which credit card providers offer to their customers as part of a suite of features. The ABA does not view mandating such tools as appropriate as it would lead to a greater standardisation of features and higher costs for credit card providers, thereby increasing costs for all customers. The development of such tools should be part of the offerings available in a competitive market.

Thank you for taking our comments into consideration.

Yours faithfully

Steven Münchenberg
Chief Executive Officer