20 June 2016

[By email: CreditCards@treasury.gov.au]

Principal Adviser
Financial System Division
The Treasury
Langton Crescent
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Dear Treasury,

Credit Cards: improving consumer outcomes and enhancing competition

Consumer Action Law Centre (**Consumer Action**) and the **Financial Rights Legal Centre** (**FRLC** is pleased to comment on the proposed reforms outlined in *Credit cards: improving consumer outcomes and enhancing competition* (**Reform Paper**). We believe the proposed reforms are positive, long overdue and will make a significant difference for vulnerable consumers.

We have long held the view that responsible lending standards in Australia's credit card market are extremely poor, and this results in significant—and often crippling—over-commitment for many credit card users. Similarly, (and despite the 2011 reforms), unsolicited offers of credit card limit increases remain common and can lead consumers into unsustainable debt.

Lax lending standards and aggressively marketed unsolicited credit offers often work together to create extremely poor outcomes. It is not uncommon for Consumer Action's financial counselling practice, MoneyHelp, to receive calls from consumers with unsustainable levels of credit card debt. Nearly 50% of callers to MoneyHelp hold credit card debts exceeding $10,000, while nearly 10% have debts exceeding $50,000. Every week we receive at least one call from a consumer with credit card debt exceeding $100,000—it is not unknown to receive calls from consumers with up to $200,000 owing on credit cards. Credit cards also top the list of consumer finance products motivating calls to FRLC's Credit and Debt Hotline, and have done every year for the past 3 years. Unsurprisingly, we concur with the Reform Paper statement that for some consumers, credit cards pose a "*substantial burden on financial wellbeing*", and this financial stress "*can have a significant impact on other indicators of wellbeing*" (these other indicators include physical and mental health, and family wellbeing).

The scale of Australia's credit card industry is well known and well noted in the Reform Paper, and is likely to continue to grow in the short to medium term. We note that the Reserve Bank of Australia (**RBA**) recently identified fee income from credit cards to be the largest earner for major banks,

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compared to fee income from other banking products. Fee income from credit cards grew by 6.6% between 2014 and 2015, the second consecutive year in which the category experienced significant growth.[1] It is therefore necessary, and urgent, that credit cards be reformed to protect vulnerable consumers and to engineer greater competition and efficiency in the market.

We are pleased that Phase 1 of the reforms will attempt to directly address these issues through prohibiting unsolicited offers, and improving responsible lending obligations. Prohibiting unsolicited offers is important, as current constraints have been shown to be less than entirely effective. Provided consumers are aware that it is open to them to proactively seek and apply for credit if they wish to do so, there should be no need for credit providers to make unsolicited offers. Unsolicited offers of new cards or credit limit increases on existing cards tend to cast credit cards as an expandable loan product, rather than as a payment tool. This in turn leads to revolving, rather than purely transactional use—which in turn fuels over-commitment and financial distress.

In relation to responsible lending, we believe the assessment of a "reasonable period" in which a consumer can repay the maximum available credit available on a card should be no longer than three years. A three year assessment rule should provide a sufficient amount of credit for consumers to use credit cards for necessary purposes, while at the same time preventing debts from growing to the point where they become an unmanageable long term debt obligation.

We also believe that simplifying credit charges, and requiring card providers to establish online cancellation and credit reduction tools will be helpful reforms.

The Phase 2 reforms speak less directly to our core concerns around credit cards—although we welcome their testing, and trust that credit providers will engage positively with the process to ensure that testing is robust.

There is no doubt that Australia's credit card market is heavily concentrated. As the Reform Paper states, over 75% of credit card transactions are made on cards issued by the four major banks. Further, and as has been increasingly commented on in the mainstream press, the huge disparity between the official cash rate and credit card interest rates is increasingly hard to justify.[2]

We are pleased that the testing of Phase 2 reforms will be conducted by the Behavioural Economics Team, although we note that the Phase 2 reform proposals are based on improved disclosure—and we have reservations about the effectiveness of disclosure as a means to drive positive consumer outcomes. Information overload, and the tendency for consumers to stay with banking products as relatively "sticky" products means that advising consumers of the terms of their product may not be sufficient to prompt behavioural change.

We believe that proposed reform number 9, whereby at risk consumers would be identified and offered repayment tools to bring their outstanding balance down, could be a very powerful tool if used well. In particular, the example offered on page 24 of the Reform Paper (where some or all of the balance of a credit card could be moved onto a personal loan type product and paid down

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[1] Wilkins, Kelsy. *Banking fees in Australia*, Reserve Bank of Australia Bulletin, June 2016.
[2] Yeates, Clancy. *How banks make a packet from credit cards*, Sydney Morning Herald, May 15 2016 (http://www.smh.com.au/business/banking-and-finance/how-banks-make-a-packet-from-credit-cards-20160511-gos7v6.html)

over a fixed time at a lower interest rate), could be a very positive way of assisting consumers to clear their credit card debt.

Ultimately, reforms around repayment options should be geared towards shifting consumer behaviour to using credit cards as transactors, rather than revolvers holding an outstanding balance.

For that reason we believe that a mandatory increase in minimum repayments should still be considered, despite being discounted at this stage by the Reform Paper. Currently, very low mandatory minimum repayment amounts tend to encourage consumers to carry balances over from month to month. In behavioural terms, the invoiced figure on credit card statements is often perceived as the “bill” amount due for that month, rather than as a payment towards clearing a debt. As the Reform Paper notes, this is generally described as the ‘anchoring effect’.

While we understand the logic of excluding higher minimum repayments at this stage (such a measure shouldn’t be required if responsible lending obligations are already being tightened), we believe that the measure could drive behavioural change and go some way to shifting consumers perceptions of credit cards. We also contest the assertion that implementing this measure need necessarily result in a wave of consumer defaults—particularly when hardship variations, and the other proposed reforms are taken into account.

Our further thoughts are outlined below.

About the contributors

Consumer Action Law Centre is an independent, not-for profit consumer organisation based in Melbourne. We work to advance fairness in consumer markets, particularly for disadvantaged and vulnerable consumers, through financial counselling, legal advice and representation, and policy work and campaigns. Delivering assistance services to Victorian consumers, we have a national reach through our deep expertise in consumer law and policy and direct knowledge of the consumer experience of modern markets.

The Financial Rights Legal Centre (formerly known as the Consumer Credit Legal Centre NSW) is a community legal centre that specialises in helping consumer's understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the Credit & Debt Hotline, which helps NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies. Financial Rights took over 26,000 calls for advice or assistance during the 2014/2015 financial year.

1. Phase One Reforms

1.1 - Responsible lending proposal – “reasonable period”

This is a positive reform, with the capacity to substantially reduce over borrowing by credit card consumers.

As identified by the Reform Paper, the current practice of determining whether a credit limit is 'not unsuitable' by assessing the consumers' capacity to make the minimum repayment (as opposed to the total card limit) can result in substantial ongoing credit card balances, with consumers accruing significant interest charges. This model of assessment tends to lead to consumers using credit cards as 'revolvers', rather than as a 'transactors'. This in turn leads to higher levels of household debt, exacerbates financial distress—and has a strongly negative impact on quality of life. The below case study demonstrates how this model of assessment can quickly lead to a consumer taking on excessive credit card debt, leaving them in a position where they are likely to be servicing a high interest debt obligation for years to come.

Case Study

Mark* works intermittently as a painter, earning between $3800 to $5800 per month. He has mental health concerns, and is sometimes eligible for disability support payments (DSP) (depending on his income). Mark also has a gambling addiction.

Over the course of five months between August and December 2015 Mark successfully applied for six credit cards through his bank, with a collective credit limit of $79,000. Mark did not provide a complete picture of his finances when applying for the new cards – although the bank has a legal responsibility to enquire into and verify his financial position. All six cards were applied for and approved online. Details of Mark's application dates and limits are:

12/8/15 - $14,200
20/9/15 - $11,800
26/10/15 - $11,800
9/11/15 - $11,800
18/11/15 - $14,400
7/12/15 - $15,000

After Christmas 2015 Mark fell into hardship and is now unable to work. He is currently fighting depression, and has suicidal thoughts.

* Name changed for privacy purposes.

By basing the assessment on whether the consumer can repay the entire credit card limit within a "reasonable period" (not just the minimum repayment amount), consumers are less likely to obtain an unmanageable level of credit. This will encourage use of credit cards as a transactional tool, rather than an ongoing loan facility with a long term outstanding balance. Apart from resulting in more sustainable debt levels, this reform could also help to shift consumer perception of how credit cards are best used—provided the assessment approach is clearly communicated to the consumer at the time.

A three year period would constitute a "reasonable period" upon which to base this kind of assessment. By way of comparison, personal loans must generally be repaid within one to five years. Any longer than three years and the credit card could not be regarded as a short term debt

obligation—and the available credit would push consumers into using their cards as revolvers, as opposed to encouraging use as transactors.

To that end, the example offered in Box 1 of the Reform Paper (highlighting the approach taken by the UK's Financial Conduct Authority), provides a useful model on which to base reforms in Australia. Assessing credit suitability on the basis of a 'three year rule' would still provide consumers with an adequate level of credit to absorb unusual and unexpected expenses (such as an emergency flight, for example), while at the same time capping available credit at an amount that can be managed. Even if the consumer does need to hold an outstanding balance on their card for the short or medium term, they would still be in a position to pay down the outstanding balance—rather than being caught in a loop of making minimum repayments, without the capacity to clear their debt.

We are conscious that this reform will only be as effective as the credit provider's capacity to conduct a full and accurate assessment of the consumer's financial position, and for that reason we do not believe that this reform should be 'traded off' for the potential reform of increased minimum repayments.

While the responsible lending reform is strong in principle, practical implementation and enforcement of these measures can be difficult. Credit providers can experience genuine difficulty in obtaining the information they need to make the required assessment—even if they are genuinely seeking to comply with their obligations. Information asymmetries do exist, and while comprehensive credit reporting may go some way towards addressing this issue—anomalies are likely to continue. Income and expenditure information, for example, can only be sourced directly from the potential borrower. Responsible lending reform will make it more likely consumers have the capacity to pay off their debt within a reasonable time, but increasing minimum repayments will make sure that they do.

On that basis, we believe that responsible lending reforms should be accompanied by the more 'bright line' measure of a mandated increase to minimum repayment levels. This would be a powerful tool for reframing credit cards so that more consumers move away from ongoing revolving balances towards transactional use of the card or cards—holding little, if any, outstanding debt. This would be good for consumers, good for the economy, and would be easy to implement. We discuss the minimum repayment measure in more detail later in this submission, in section 3.2.

1.2 - Prohibition on unsolicited credit limit increase offers

Both Consumer Action and Financial Rights frequently assist clients who have been offered credit limit increases in situations which appear to be contravening existing restrictions on unsolicited credit increase offers.

As noted in the Reform Paper, sometimes these offers have been made by means which technically comply with the provisions of the *National Consumer Credit Protection Act 2009* (**NCCPA**), but certainly break the spirit of the legislation. Typically, these offers are made by non-written means—such as by phone, via online banking portals, or through text message prompts. For example, we have seen unsolicited text message prompts sent to consumers to ask them if they would like to receive written offers of credit limit increases. While not technically an offer of

increased credit, we would argue that this approach still breaches the existing provisions of the NCCPA.

The risk of unsolicited credit limit increases is that consumers take on more debt than they initially intended to—and more than they would have otherwise, had the offer not been made to them by their provider. When combined with lax lending standards predicated on minimum repayment levels rather than overall balances, unsolicited offers have the potential to tip consumers into significant debt and naturally lead to use of credit cards on a revolving basis, rather than a purely transactional basis.

Our position on this issue is simple. If consumers want a credit card, or to increase the credit limit on their existing card, then the consumer is in a position to make the approach and actively apply to the credit provider, for that product. Credit providers are able to advertise their products and furnish consumers with the information they need to make a choice that best suits their needs. Theoretically, this is how a healthy consumer economy operates—and it should operate to produce strong completion which optimizes consumer outcomes, and delivers economic efficiency. Unsolicited offers tend to distort these outcomes by ‘capturing’ consumers through an overly assertive sales process that often short circuits the consumer’s decision making process and leads them to take up a product offer without full exploring the alternatives—or without needing or even wanting the product in the first place.

When one considers the potential impact on consumers of making an unwise choice, (in terms of the financial distress this can cause, and the flow on impacts to mental and physical health, and family relationships, and a whole host of other life factors), then there seems very little justification to continue to allow credit providers to make any form of unsolicited credit increase offer.

On that basis, we strongly support this reform. We believe it will have a significant and positive impact, and will help keep vulnerable consumers out of the kinds of tenuous financial circumstances that we commonly see, and which all too often have been driven by the unwise uptake of unsolicited credit limit increase offers. When considered in conjunction with the proposed reforms to be tested under Phase Two, this measure could also be important in promoting stronger competition in Australia’s credit card market.

A prohibition on unsolicited credit limit increase offers will encourage consumers to inform themselves and proactively seek out the product that is best for them—rather than being ‘sold’ a product which may or may not suit their needs.

1.3 - Standardisation and simplification of interest calculation

This is a fair and sensible reform. As the Reform Paper identifies, the reform has a clear precedent in the US under the *Truth in Lending Act*. The reform will bring interest charges on outstanding balances into line with consumer expectations and understanding, and will reduce costs for consumers who do carry a credit card balance over from one statement period to the next. The reform will play a role in assisting consumers to pay down existing debts and work towards using their credit card(s) as transactors, rather than revolvers.

1.4 - Online card cancellation and credit limit reduction tools

We are aware that some credit card issuers already provide online tools which allow consumers to reduce their credit limit. These tools are provided through the online banking portals routinely offered by bank-based credit card providers, and there is no reason why such portals could not also offer consumers the option to close off their credit card account. Implementing the reform would be a positive step towards giving consumers control over their finances and move towards a financially healthy transactor approach to credit card use—rather than revolving an ongoing balance, incurring high interest charges.

This reform should not be difficult to implement—and would not be inconsistent with the Government's commitment to ensure regulation is technology neutral. The technology to execute this reform exists and is already used by the vast majority of credit card providers. It would not require a new 'build' of online infrastructure, but simply an augmentation of existing systems. In some cases, the reform has already been partially implemented.

2. Phase Two Reforms (Reforms for Testing)

2.1 - Regular summary information disclosing of annual costs of card use and annual fees

While this reform has some potential, it will only be truly effective if the information is provided in a form and format which is easily digestible for the consumer, and if the consumer base is sufficiently informed and financially literate to appreciate the import of the information with which they are provided. We are conscious that behavioural economics has shown that disclosure, if not managed properly, can be a relatively poor form of consumer protection. Historically, approaches to disclosure have been predicated on the relatively illusory notion of the 'rational consumer'.[3]

In our view, simply informing consumers of the cost of their product is not likely to encourage better management of that product—we believe that consumers should also be provided with information they can act on immediately, in a practical manner. Informing consumers of the ongoing interest rate of their card and applicable fees is important—but repayment options, and the relative impact of those options, should also be provided.

Many consumers are currently influenced by the minimum repayment amount on their credit card statement (the so called 'anchoring effect').[4] It is as if the amount is interpreted as the required 'amount due', akin to the bill amount due for a utility bill, or a fine. This is a category error, but understandable given the similarity in appearance of a credit card statement to those other documents—in a sense, consumers are generally conditioned to view statements as bills, and the compulsory amount needed to pay the bill on a credit card statement is the minimum repayment. It is not surprising, therefore, that many consumers fall into a pattern of revolving credit card use by only making the minimum repayment.

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[3] Johnston, Kirtsy; Tether, Christine; Tomlinson, Ashley. *Financial Product Disclosure: Insights from Behavioural Economics,* Ministry of Business, Innovation and Employment (New Zealand), February 2015, p. 4.

[4] Stewart, Neil. *The cost of anchoring on credit card minimum payments*, Psychological Science, Vol.20 (No.1).(2009) pp. 39-41.

In order to break this perception of credit card statements, we believe there could be some advantage is setting out a range of payment options—statements could resemble donation forms, with a range of payment levels to choose from. This reform could build upon the existing minimum payment disclosures. While there is some research that suggests that minimum repayment warnings may lead to disengagement,[5] our experience is that some consumers like this information. Our services have received calls from people with credit card debt informing us that the minimum repayment warning (for example, warning them that it was going to take 50 plus years to repay their credit card debt) motivated them to seek debt assistance.

If there is to be reform, improved information could be provided to consumers in such a way as to disrupt the anchoring effect played by minimum repayments, but presenting the minimum as simply one option to choose from. This could empower consumers to exercise their own volition, and break the nexus between minimum repayment and 'compulsory' repayment. For example, statements could set out a minimum repayment level; a 'suggested' payment level (which would be calculated for the outstanding balance to be cleared within three years, if the payment rate was maintained), and an 'express' payment level—which if maintained would see the card cleared in twelve months.

In each case, the options should clearly state how much the consumer would save in interest, (in dollar terms), if the chosen payment level is maintained. The statement should also make it clear that these are simply *suggested* options—and the consumer is free to choose between them, or a different amount, (perhaps between the minimum and recommended payment options, if they're not able to afford the recommended payment for that month).

By presenting payment options in this manner, credit cards may possibly be reframed in the consumer's mind as a tool for them to manage—rather than simply another bill obligation that must be met. Donation forms operate on the principle of donor volition, the donor is very much in control and can choose between a range of suggested donation amounts—or choose their own. Bills, on the other hand, are paid on the basis of necessity—often grudgingly.

Reframing credit card statements to appear more like donation forms could potentially encourage a push towards positive credit card management, and an increase in the transactor approach to credit card use. This information would have to be very clearly set out, in bold font, and there should be no emphasis or priority given to one payment option over another. One problem with the existing minimum payment warning is that it is generally quite separate from the more prominent minimum payment due. Further, as noted in the Reform paper, it is also very important that this information be communicated through online banking tools as many consumers do not routinely view their statements, and instead manage their credit card through online tools—often by using an app on their smartphone.

In conjunction with clear information about costs, this information may assist consumers to proactively manage their credit cards—and reframe consumer perceptions of how credit cards are best used. This in turn will enhance competition in the sector, and significantly improve consumer outcomes. We believe this would be a useful reform to test during Phase 2 of the reforms.

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[5] Stewart, Neil. *The cost of anchoring on credit card minimum payments*, Psychological Science, Vol.20 (No.1). (2009) p. 40.

2.2 - Prominent advertising of interest charges and annual fees

Consumers cannot be expected to make informed, rational choices if they are not first provided with the relevant information on which to make those choices. The fundamental consideration in choosing a credit card should be the relative cost of the credit being obtained, and other costs associated with the card.

Interest charges and annual fees should be required to be disclosed in the same manner by all card providers, prominently in bold font and in a standardised format to facilitate ease of comparison between products. Furthermore, this information should be required to be provided as the ‘headline’ information associated with the card—ahead of any other features it may have (such as rewards programs, or frequent flier points etc).

As noted by the Reform Paper, providing this information should help to enhance competition in the sector—although as we have stated in our response above, disclosure alone is not always enough to drive positive consumer outcomes. Interest rate information, and annual charge information will only spur better decision making if consumers are sufficiently well-informed and financially literate enough to receive that information and act on it in an objectively rational manner.

Fundamentally, consumers will only drive effective competition once a sufficient proportion of consumers feel empowered and are engaged enough with the market to exercise strong, informed choices. We suspect the credit card market in Australia suffers from its close alignment with the highly concentrated banking sector, which is a notoriously ‘sticky’ market. Consumers are prone to choose a bank, (and by extension a credit card, or cards) and stay with it. This is both a practical consideration (changing banks can be administratively onerous), and also a cultural, or behavioural one.

It may be that—as with energy providers—many consumers wish to simply select their bank (and by extension, credit card), and then ‘set and forget’. The card itself is not necessarily viewed as a product in its own right—with its own unique product features, to be compared to other similar products—but rather as a tool with which *other* products can be bought. In that sense, many consumers are simply not interested in engaging with an ongoing process of product comparison—consumers have other interests or priorities, or pressures in their lives, which occupy their thoughts and time. Accordingly, reforms to be tested in Phase 2, and the manner in which information is provided to consumers, should be couched to address this natural inertia and activate consumers to become more active and engaged in their own choice of credit card product.

The current dynamic is unlikely to shift quickly, but by improving the standard of information provided through credit card marketing, prohibiting unsolicited offers of credit, and also enhancing the information required to be provided to the consumer once they have obtained their credit card, consumer perception and use of credit cards may shift over time. Once this occurs, competition will improve as a result.

2.3 - Requirement to advise consumers of cheaper alternative products

The more engaged and informed consumers are, and the more they feel empowered to take control of their own finances, the more likely they are switch to cheaper alternative products. If

used well, this can be an effective way for consumers to manage their debt and move towards a transactional use of credit cards, without carrying significant ongoing debt.

That being said, balance transfers can also be poorly used. It is not uncommon for consumers to take up a balance transfer option, but then fail to cancel the previous card. Over time, this can lead to *both* credit cards becoming maxed out, leaving the consumer with a significant ongoing credit card debt. This can be exacerbated if the consumer takes up yet another balance transfer option, and extends their credit card debt across three cards. This practice is indicative of poor financial literacy and speaks to consumer perceptions of credit cards as ongoing loan facilities, rather than useful payment tools. While some consumers seek out balance transfers as an effective debt management tool, others seek them out due to a level of financial distress—and then deepen their already poor financial position.

Given this dynamic, we believe that providing consumers with information about cheaper alternatives may be useful for some consumers—but potentially dangerous for others.

This would be negated if the offer to switch to a lower rate card was made contingent on the consumer cancelling the previous card at the same time as making the transfer. This would require a full balance transfer, and would send a positive message to the market regarding effective use of credit cards. Without this caveat, the measure is likely to have little positive benefit—and may actually worsen the position of many consumers. Without requiring consumers to cancel the previous card, the offer would simply constitute an unsolicited credit offer—albeit at a lower rate than that which they are already paying. The measure could only be regarded as a genuine exercise in consumer education and responsible debt management if it served to reduce the consumer's outstanding debt obligation.

In terms of presentation and distribution, (and provided the offer was being made on the above basis), then it would be sensible for all communication channels to be used—be it post, text message, online message through an online banking portal, or by direct email. Consumers should have the option to opt out of receiving such messages at any time, if they choose to do so.

The messages should be couched not as a sales offer, but as an offer of customer assistance. In essence, the measure would be a good deal for consumers and would afford genuine savings while also encouraging a more sustainable use of credit. For credit providers, it would also have the benefit of promoting positive customer relations and would shore up customer loyalty. By adopting this measure, credit providers could present themselves as a genuine partner with consumers—assisting them to manage their finances in a sustainable manner, thereby retaining a positive relationship with the consumer into the future.

2.4 - Requirement to provide consumers with timely electronic notification of balance transfer expiry periods

This would be a positive measure and would help consumers to manage balance transfers positively, to ensure they gain the maximum benefit from the product. At the very least, providing consumers with this information should raise consumer awareness of how their credit card debt is tracking. These notifications should be accompanied with clear advice regarding the interest charges that consumers will incur if they fail to clear the debt before the expiry of the balance transfer period.

As discussed above, balance transfers run the risk of driving consumers further into debt if they fail to close off their previous card. On that basis, we believe that requiring balance transfer offers (at least those made by the consumer's existing credit card provider), to be contingent upon closing off the previous card, would be a more powerful tool to ensure that balance transfers serve their desired purpose. Without this caveat, balance transfer offers made by a consumer's credit provider amount to little more than an unsolicited offer for more credit.

Further, balance transfer cards could be enhanced by ensuring the zero or low-interest period is sufficiently long to enable consumers to pay off the balance while taking advantage of the rate. To align with our proposal that a "reasonable period" for a responsible lending assessment is three years, we submit that the benefit period on balance transfer cards should be a minimum of three years.

2.5 - Requirement to provide consumers with notification of how much credit they have used

This could be a useful measure, and is likely to be more effective if triggered by certain events—or thresholds—rather than on a periodic, routine basis. If periodic then such notifications are likely to lose their effectiveness over time. Consumers could become numb to them and effectively 'tune them out'.

Strategic notifications based on certain debt thresholds will help consumers to remain mindful of their credit card use, and may help to shape attitudes towards credit cards—prompting consumers to become proactive money managers, taking charge of their own payment tool—rather than being passive consumers of credit.

In our view, text message would be the most appropriate means to deliver these notifications—which could also be mirrored by messages through online banking platforms. Mobile phone providers currently use text messaging to advise consumers when they are approaching their data limit for the month, and this provides a useful corollary. To this extent, consumers have been already been conditioned to receive such text messages as a warning—which naturally prompts consideration of ongoing use, and may promote 'evasive action', by making additional payment (if the consumer is able to do so).

It is also important that consumers have the option of ceasing such notifications if they choose to do so. If the consumer is not in a position to address the rise in their debt levels, they may begin to feel harassed by the notifications—which will only serve to exacerbate their distress. To ameliorate this, the notifications should also include advice to contact their credit provider if they are having difficulty—to arrange a hardship variation, or take up some form of debt consolidation and reduction strategy (as discussed in 2.7 below).

2.6 - Issuers to proactively provide consumers with the option of committing to higher repayments, and contact consumers persistently making small repayments

As discussed earlier in our submission, making a range of repayment options clear to consumers may be an effective way to counter the anchoring effect that currently occurs with minimum repayments. At the very least, we believe this should be tested as a potential Phase 2 reform.

Consumers already have the ability to make higher and more frequent repayments if they are able and choose to do so. That being said, there could be significant benefit in credit providers proactively contacting consumers and suggesting that higher ongoing repayments may be beneficial. This would allow credit providers to operate as genuine partners with consumers in responsibly managing their finances, and over time could help to empower consumers through greater understanding of credit cards—and the potential savings of making higher repayments. That being said, we also believe that mandating higher minimum repayments could also be extremely useful. Simply put—it may be more effective to work *with* the anchoring effect, than attempt to work against it. Please see section 3.2 of our submission for more on this point.

Proactively contacting consumers who are persistently making minimum repayments (and advising them of the consequences of continuing to do so) could also be a useful consumer education tool, with the potential to re-frame consumer perception of how best to sue their credit card. As with previous measures, this would allow credit providers to become genuine partners with their customers—assisting them to manage their finances wisely for the long term benefit of both parties.

2.7 - Repayment tools for consumers

The proposed measures, as outlined in the main body of text and in Box 2 of the Reform Paper, are all useful tools for consumers who have become over-committed to manage their credit card debt and transition towards becoming transactors, rather than revolvers.

We agree that the simplest form—of essentially allowing consumers to transfer their debt across to a fixed term personal loan type product—could be an extremely effective debt consolidation tool. Again, this would be a positive customer relations measure by credit providers. It is not dis-similar to the balance transfer option discussed above, the difference being that the initial credit card would continue to run as the consumer pays down the sequestered debt. At the same time, the sequestered debt would be fixed—both in terms of quantum and repayment schedule. Any transition to a new product or product with different terms should not enable increased overall debt—for example, transferring to a fixed term personal loan type product should not be associated with higher interest or fees.

On that basis, both options could have a place—and could provide consumers with a choice as to how they wish to reduce their ongoing debt, and avoid financial hardship. For example, some consumers may have accrued a significant reward point balance—and may wish to retain a card with an awards program that particularly suits them, rather than transfer the balance across and have to cancel that card. Another consumer may wish to avoid the administrative burden of re-setting regular payments to a new credit card. In both cases, those consumers may choose to opt for a debt consolidation loan arrangement—rather than a balance transfer. Another consumer may be more concerned with reducing the ongoing interest that they pay for credit—and in that case may find a balance transfer better suits their long term needs.

It would be interesting to test both options through Phase 2 of the reforms, and see which delivers better consumer outcomes—particularly for those consumers who have had persistent, long-term credit card debts.

3. Other Reforms Considered

3.1 - Make 'switching' easier

We partially agree with Bernie Fraser's 2011 analysis of switching arrangements, (as outlined in the Reform Paper), in that a certain level of credit card market inertia can probably be attributed to behavioural factors. It is true that balance transfers are reasonably easy to execute – although we do not think it is accurate to say that there are no practical impediments at all to switching credit cards.

One of the most significant barriers to switching is cancelling recurring direct debit transactions that are set up from a consumer's credit card. Currently, recurrent payments made from a credit card are much more difficult to cancel than payments from a transaction account, and credit card recurrent payments can continue to be made even after the card itself is cancelled.

Consumers commonly establish recurring transactions and standing authorities with third party merchants to pay regular bills, such as insurance, utility bills or fitness club memberships. However, very few consumers would be aware that if they wish to cancel direct debits from their credit card, they must contact each merchant individually.

Problems can also arise when a merchant does not act on an instruction to cancel a regular payment. These problems can also arise when a consumer closes their credit card account but does not arrange with third party merchants to cancel regular payments. In this case, a consumer is generally responsible for establishing and cancelling authorities directly with the relevant merchant. They will also be responsible for any transactions debited to the credit card account, even after the account has been closed.

On this basis, we believe switching could be made easier by requiring the new card provider to make those contacts and arrangements on behalf of the consumer.

We also recommend considering 'account number portability' (**ANP**) to make switching easier, and promote competition. This would allow consumers to change credit card providers without changing their credit card number.[6] It could also remove the need to amend certain direct debits, as discussed above, which is a key area where perceived or actual problems with switching can arise. However, it is important that consumers are informed by their credit card provider that all direct debits will be transferred to the new credit card. We recommend that credit card providers also be required to provide consumers with a list of recurrent payments on their credit card annually or bi-annually to encourage consumers to review.

We note that the 2012 'tick and flick' bank switching reforms only applied to transaction accounts, not credit cards or other accounts. These reforms were designed to assist consumers to switch banks, by requiring the consumer's new financial institution to arrange the transfer of all automatic transactions linked to the customer's account and informing associated creditors and debtors

[6] Account and credit card are the same with some banks, while others have two separate numbers. It is proposed that account number portability would apply to both.

about the new account details.[7] Unfortunately, these reforms were largely considered a failure as consumers still considered it too difficult to switch and the program was not broadly promoted by the banks.[8]

We also note that the Financial Conduct Authority (**FCA**) in the United Kingdom recently looked at ANP and found that being able to keep bank account details increases consumer confidence in the bank account switching process and that a significant number of individual and small business customers would be more likely to switch if they could retain their account details.[9]

Finally, we note that Australia's banking sector is currently developing a New Payments Platform, and this provides an excellent opportunity to facilitate easier switching between credit card accounts.[10]Given this infrastructure is currently being built, it would seem like an ideal window to undertake switching reform.

3.2 - Raise the level of minimum required repayment

As previously stated, we believe that this reform option should be seriously considered—and is not necessarily 'cancelled out' by the proposed tightening of responsible lending requirements.

Minimum repayment amounts play an important role in the way many consumers manage their credit cards, and may continue to do so despite the reform options that will be implemented during Phase 1 and tested during Phase 2. By adhering to minimum repayment amounts, and treating the amount not as a suggested payment amount but the amount owing (like a bill), many consumers end up with a significant revolving credit card debt. This is generally described as the 'anchoring' effect.

Minimum repayment amounts play to the 'pay now, think about it later' aspect of optimism bias. They also create a false impression of the true cost of credit card purchases—the cost can be deferred over many years, and quite large purchases can have little to no immediate effect on the consumer, unless they are disciplined enough to pay above the minimum repayment amount. This disconnect between purchase and payment is a cognitive error, but is understandable in behavioral terms.

Lifting the mandatory minimum repayment amount would work against this error and would encourage consumers to manage their credit cards more as transactors than revolvers. Higher minimum repayment amounts would also counteract the false cultural perception that credit cards are essentially 'free money'. The effect of purchases would be more immediately felt, and this in turn could encourage more sustainable spending and debt accrual—and reduce credit card related financial distress. Taking all of these factors into account, the potential of higher minimum repayments to shift consumer perception of credit cards—and therefore consumer behaviour—is

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[7] MoneySmart, 'Switching bank accounts', accessed 10 August 2015, available at: https://www.moneysmart.gov.au/managing-your-money/banking/switching-bank-accounts

[8] Staff writers, 'Reform fails to get customers to switch banks', 29 April 2013, available at: http://www.news.com.au/finance/money/reform-fails-to-get-customers-to-switch-banks/story-e6frfmcr-1226631684082.

[9] Financial Conduct Authority, 'Our review of the Current Account Switch Service and account number portability', 12 March 2015, available at: https://www.fca.org.uk/about/what/promoting-competition/current-account-switch

[10] Australian Payments Clearing Association,
New Payments Platform', accessed 10 August 2015, available at: http://www.apca.com.au/about-payments/future-of-payments/new-payments-platform-phases-1-2.

too significant to ignore. Put another way, if the partial aim of credit card reform is to shift consumer behaviour away from revolving use and towards transactional use, then it would be foolish not to significantly increase minimum repayment amounts.

It is also worth noting that despite the best intentions of responsible lending reforms, they can be difficult to successfully implement and enforce, due to information asymmetries. Responsible lending reforms rely on full and accurate suitability assessments by lenders, which in turn rely on full and accurate information from borrowers or credit rating agencies. These systems do occasionally produce anomalies. Lifting mandatory minimum repayment amounts can work *with* responsible lending reforms by ensuring that even in cases where the responsible lending process has broken down or been circumvented—consumers are protected against generating unsustainable credit card debt, by being required to pay back a higher proportion of the ongoing balance.

We do not accept the argument raised in the Reform Paper that higher minimum repayment amounts need necessarily force consumers into default. If a consumer is at risk of falling into default, then a hardship variation can be put in place by the credit provider to manage that situation. In addition, the balance transfer or repayment options discussed earlier in this submission may assist the consumer to reduce their debt and lower the dollar value of their mandatory repayments—even if it represents a higher proportion of their outstanding credit card debt (this could be the case both if the quantum of the debt has been reduced by using a debt consolidation product, or if the debt has been transferred to a credit card with a much lower interest rate). There could also be a lead up phase where consumers are warned for a 6 months period, for example, that minimum payment percentages are increasing from a certain date and that they should take steps to reduce, or not increase, their outstanding balance in anticipation of these changes. The increase could also be phased in over a period of time in relatively minor increments.

Through any combination of these measures, minimum repayment amounts could be raised significantly without causing the wave of defaults that industry advocates tend to predict. In doing so, they could provide a powerful tool to lower credit card indebtedness and reduce credit card related financial hardship.

Furthermore, even if higher minimum repayments were considered too onerous for existing customers, they could still be implemented for prospective credit card customers - and either way could play an important role in shifting consumer perceptions and behaviour over time. We believe this could, and should, be tested under Phase 2 of the reforms.

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