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By email: christian.mikula [at] treasury.gov.au

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Dear Mr Mikula

Interest-free disclosure methods

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the interest free disclosure discussion paper.

Briefly, we are of the view that:

- the proposal to describe different interest free methodologies by using the descriptors 'restricted' or 'modified' is unsatisfactory, as it will be unlikely to help consumers understand the method of calculation being used;
- a short phrase (such as those used in the discussion paper) will be a better way to describe the different methodologies; and
- different interest free periods should be described with short phrases similar to those used in the discussion paper.

Our comments are detailed more fully below.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

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We also operate MoneyHelp, a not-for-profit financial counselling service funded by the Victorian Government to provide free, confidential and independent financial advice to Victorians experiencing financial difficulty.

Part A: Description of different interest free methodologies

The problem and the role of the regulation

The stated objective of proposed regulation 78A "is to allow consumers to more readily distinguish" between different types of interest free periods. Underlying that objective (in our view) is a broader objective of allowing consumers to make informed decisions by ensuring that credit contracts with interest-free elements are not advertised in a way which is misleading or incomprehensible. The regulation aims to achieve these objectives by requiring credit providers who advertise products as "interest free" to use prescribed words explaining when interest will (or will not) be debited.

In our view, credit cards that make claims about interest free periods are in particular designed to cause consumer confusion. Indeed, we are concerned that credit card providers, through competition, are incentivised to exploit and even profit from consumer confusion. Recent research argues that that sellers, operating in a competitive market, will design their products, contracts and pricing schemes in response to consumer misperception, resulting in both efficiency losses and harm to consumers.¹

Statistics from the Reserve Bank of Australia confirm that \$36.2 billion or over two thirds of credit card debt in Australia is interest bearing.² Further, we understand that interest-bearing credit card debt is held by around one-third of card holders. This suggests that many millions of Australian consumers may not be making the most cost efficient purchasing decisions.

Research also demonstrates that the average annual cost of running a basic credit card (that is, cards marketed as low-rate) is \$793.³ The average cost of running other credit cards with more features is significantly more. This average cost calculation included all costs, including annual fees, interest and other cash advance fees, minimum payment fees and over-the-limit fees. Given that the annual fee of most basic credit cards is in the vicinity of \$0—\$100, we would suggest that most of the cost of running a basic card is the interest. If only around one-third of consumers are paying interest on credit cards, many consumers are paying significant amounts of interest to banks.

It is reasonable to assume that very few consumers would choose a credit card if they knew it would cost them hundreds or even thousands of dollars a year in interest. However it appears that the profitability of credit cards as a product relies on this "interest-paying" proportion of the

¹ Oren Bar-Grill, 'Competition and Consumer Protection: a Behavioral Economics Account', NYU Center for Law, Economics and Organization, Law & Economics Research Paper Series Working Paper No. 11-42, available at: <http://ssrn.com/abstract=1974499>

² Reserve Bank of Australia, *Credit Card and Charge Statistics*, available at: http://www.rba.gov.au/statistics/tables/index.html#payments_system

³ Centre for Social Impact, *Measuring Financial Exclusion in Australia*, May 2011, available at: http://www.csi.edu.au/assets/assetdoc/3c1698bd3334ed55/NAB-Financial-Exclusion-Report_Final.pdf.

market doing just that. In our view, this is the purpose of the qualified "interest free" offer—to attract customers by making a card seem less expensive than it is.

More data is required to determine whether consumers who purchase credit cards based on marketing claims about interest free periods actually benefit in accordance with those claims. Given the above, we would think it is likely that many consumers are lured into choosing a credit card by these claims and do not benefit. To inform the extent of this problem, we think that the Australian Securities and Investments Commission should obtain information from credit card providers about what proportion of customers benefit from claims that credit cards have interest free periods—that is, lenders should be required to report how many consumers have not paid interest (in accordance with the claim) in the previous 12 months. Without such information, we can only conclude that it is likely that many consumers are easily confused by claims about interest free periods and that the proposed regulation should operate to reduce confusion.

Responses to questions in the discussion paper

Stakeholder views are sought on the advantages and disadvantages of using terms such as 'restricted' or 'modified' to describe the operation of different interest free periods, rather than using a short phrase.

The discussion paper notes that previous attempts to develop proposed regulation 78A have uncovered two difficulties:

- that "it is not easy... to accurately or succinctly describe the different calculation methodologies" in a short explanatory phrase; and
- "the length of the explanatory phrase may be cumbersome or difficult to include in television advertising".

We accept that Treasury would want to address the first point—we agree that the explanatory phrase should be accurate and as brief as possible. However, in our view, the second consideration (difficulties credit providers may face in advertising their product) is irrelevant to the objectives of the regulation.

If it is not possible to explain in a television advertisement why an 'interest free' product is actually interest free without being misleading, then that product should not be advertised in those terms on television. It should not concern the Government that credit providers would like to advertise a product as interest free but are prevented from doing so because of the peculiarities of the advertising medium.

It appears to us that consideration of this irrelevant factor has been a strong influence on the development of the discussion paper, in particular the proposal of using 'restricted' and 'modified' to describe different types of interest free offers. While this response will make marketing of 'interest free' products very simple, it may fail to achieve the object of proposed 78A (ensuring consumers understand the product on offer). If the Government favours using a single word description (such as 'restricted' and 'modified'), we urge Treasury to consumer test the proposed wording to ensure that consumers understand the meaning of the terms. If consumer testing is not done, then we feel that a short phrase is more appropriate. In our view, the phrases used on

page one of the discussion paper and in the draft regulations (pages two and three of the discussion paper), are suitable.

Method one is described on page one as:

Interest free: interest must not be debited to the outstanding balance (so long as the consumer is meeting their repayment obligations under the credit contract).

Method two is explained on page one as:

Interest free provided the consumer repays the outstanding balance in full by each due date: interest will not be debited if the consumer repays the closing statement balance in full by the due date.

and in the draft regulations as:

If you do not make the full monthly repayment by the due date, interest will be backdated and charged against the amount of each purchase from the date of purchase.

Method three is explained in these words on page one:

Interest free on amounts repaid by each due date: interest will not be debited on amounts the consumer repays by the due date.

and in these words in the draft regulations:

If you do not repay the statement balance in full by the due date, interest will be charged from the due date on the amount that is not repaid.

These descriptions are concise, fairly easy to understand and, in our view, far clearer than the unfamiliar terms 'restricted' and 'modified'. We see no reason why the regulations cannot require disclosure to be made in these terms.

Part B: Application to new credit card contracts only or all credit card contracts

Stakeholder views are sought on whether the disclosure requirement in relation to the phrase 'interest free' should apply to both new and existing contracts, or only to new contracts, taking into account the matters set out above, and whether or not applying it to existing contracts would present particular compliance difficulties.

We agree with Treasury's assessment that all advertisements including an interest free claim should be regulated consistently. We see no reason why there should be a distinction between advertisements for new or existing contracts.

Marketing of credit contracts does occur primarily in relation to new credit contracts, but could occur for existing credit contracts; for example, through unsolicited limit increase offers. Whether the offer is made in relation to a new or existing contract, the policy objective remains the same—to ensure that the offer is made in accurate and understandable terms so the consumer can make an informed decision of whether or not to accept it.

Part C: Application to credit providers only or to third parties

Stakeholder views are sought on whether or not third parties (including point of sale retailers) who publish advertisements in relation to 'interest free' periods would need, in all cases, to seek approval of the credit provider prior to publication, or whether they would have the discretion to publish the publication without obtaining their approval.

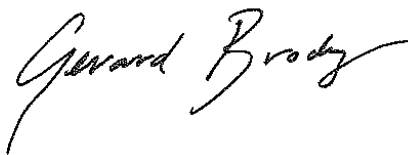
Assuming there are situations where third parties can publish advertisements without having to seek the approval of the credit provider, stakeholder views are sought on the impact on their compliance procedures if these third parties were also required to meet the disclosure requirements.

We agree that the obligation should be extended so that it applies more broadly to any person engaging in credit activities who publishes or causes an advertisement to be published, and, in particular, whether or not the restriction should apply to retailers at the point of sale. Consumers should be provided with the same level of information about interest free claims, where ever and who ever is making the claim. However, this extension should not limit the liability of the relevant credit provider—it is our view that credit providers should have ultimate responsibility for claims relation to credit products that they issue.

Please contact David Leermakers on 03 9670 5088 or at david@consumeraction.org.au if you have any questions about this submission.

Yours sincerely

CONSUMER ACTION LAW CENTRE



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