23 August 2017

By email: CreditCards@treasury.gov.au

Principal Adviser
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam,

Credit cards: improving consumer outcomes and enhancing competition

The Consumer Action Law Centre (**Consumer Action**) is pleased to comment on the exposure draft Treasury Laws Amendment (2017 Measures No. 8) Bill 2017: Credit card reforms (**the Bill**) and National Consumer Credit Protection Amendment (Credit Cards) Regulations 2017 (**the Regulations**).

We are supportive of the reforms outlined in the Bill and Regulations. We believe the proposed reforms, particularly the prohibition on unsolicited credit limit increase offers and tightening of responsible lending obligations, would significantly improve consumer outcomes in the credit card market. However, we have a suggested a number of technical amendments below that we believe would avoid credit card providers exploiting potential loopholes and circumventing the intent of the proposed reforms.

Australians owe a staggering amount on their credit cards: around $32 billion, an average of around $4,200 per card holder.[1] The risks of excessive credit card debt to both consumer well-being and the stability of Australia's financial system are significant. 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 and paying

[1] Australian Securities and Investments Commission, *Credit card debt clock,* accessed 22 August 2017, available at: https://www.moneysmart.gov.au/borrowing-and-credit/credit-cards/credit-card-debt-clock.

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significant amounts of interest. In our view, the proposed reforms are an important step towards achieving this goal.

Our responses to the Bill and Regulations are detailed more fully below.

About Consumer Action

Consumer Action 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.

General comments

We are pleased that Reform 2 (prohibiting unsolicited credit limit offers) will apply to both new and existing credit card contracts from 1 January 2018. However, the remaining proposed reforms will not apply until 1 January 2019. In our view, this transition period is overly generous. For example, we are aware that some credit card providers 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, meaning transition should be relatively straightforward. Given the importance of these reforms, we would prefer that all of the proposed reforms in the Bill are applied from 1 January 2018.

In terms of penalties for non-compliance, we are unsure why the financial penalties for criminal offences (50 penalty units) are so much lower than the civil penalties (2000 penalty units). We recommend that the Australian Securities and Investments Commission (**ASIC**) Enforcement Taskforce review these penalties to ensure appropriateness and consistency across the *National Consumer Credit Protection Act 2009* (Cth) (**the Credit Act**).

Recommendation 1: Apply all proposed reforms in the Bill from 1 January 2018.

Recommendation 2: ASIC Enforcement Taskforce review the financial penalties for criminal offences and civil penalties to ensure appropriateness and consistency across the Credit Act.

Reform 1: Tighten responsible lending obligations for credit card contracts

We support the tightening of responsible lending obligations for credit card contracts by requiring affordability to be assessed in accordance with the consumer's ability to repay the credit limit of the contract within a period determined by ASIC. We strongly support the new responsible lending requirements applying to both new and existing credit card contracts.[2]

[2] Treasury Laws Amendment (2017 Measures No. 8) Bill 2017: Credit card reforms, Schedule 1, Item 24.

Repayment period for affordability assessments

However, in our view, the Bill should specify a maximum repayment period of three years for the purposes of the affordability assessment, and empower ASIC to mandate a lower period if appropriate. 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. 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.

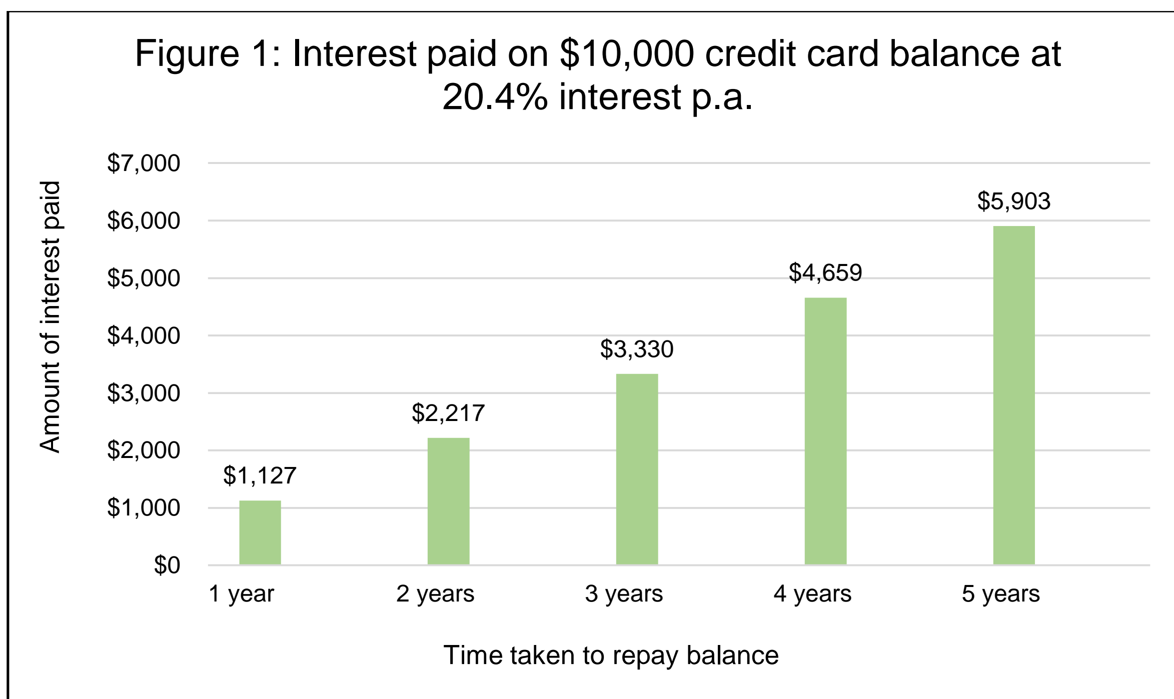
We believe that this requirement would significant improve outcomes for people like Jenny (below), who may have avoided becoming overwhelmed by debt had this assessment rule applied.

Jenny's story

Jenny (name changed) is 23 years old. She was in an abusive relationship with her partner when she took out a personal loan with Commonwealth Bank (**CBA**) of $35,000 in 2013. This loan was paid as $20,000 (as a refinance of an existing loan) and then $15,000. Jenny says that the $20,000 was ostensibly to refinance but that it was actually paid out in cash to her partner. A couple of months later, Jenny's abusive partner took her back to CBA where she successfully applied for a $6,000 credit card. At the time, her only income was from Youth Allowance and a part time job at Woolworths. Her former partner has since gambled the money away. Jenny's dispute with the CBA has now been resolved.

We believe three years is a generous timeframe for the affordability assessment and would still see consumers paying a significant amount of interest, as demonstrated by our analysis in Figure 1 below. This shows that someone who borrowed $10,000 from a Commonwealth Bank Gold Awards credit card with an interest rate of 20.24% per annum would pay more than $3,000 in interest over three years, even if they do not incur any additional debt.[3]

[3] Interest repayments calculated using: Commonwealth Bank, *Credit card repayment calculator,* accessed 22 August, available at: https://www.commbank.com.au/digital/calculators/credit-card-repayments/how-long.



Our concerns about timeframes for repayment are comparable to those expressed by the Centre for Responsible Credit (**CfRC**) and the New Economic Foundation (**NEF**) in the United Kingdom in its response to the Financial Conduct Authority's (**FCA**) proposed new rules to help people in 'persistent credit card debt'. Under the FCA's definition, credit card customers are in persistent debt if they have paid more in interest and charges than they have repaid of their borrowing, over an eighteen-month period.

Under the FCA's proposed new rules, firms would have to take a series of steps to help customers in persistent debt. When a customer has been in persistent debt for eighteen months, firms would be required to prompt them to make faster repayments if they can afford to do so. If a customer is still in persistent debt after a further consecutive eighteen-month period, firms must take steps, such as proposing a repayment plan, to help them to repay their outstanding balances more quickly.[4]

In response to the FCA proposals, the CfRC and NEF said that:

> *Credit cards are suited to short-term borrowing and are… an expensive way to borrow over a long period. Addressing persistent debts which are not being cleared within a reasonable timeframe is therefore an important policy goal.*
>
> *Our concern is that the 18-month period for [the definition of persistent debt] will mean that borrowers will have already paid a high cost for their credit before the lender has any duty even to contact them. Likewise, waiting until 36 months to offer any substantive help to borrowers will result in further costly interest payments, and many borrowers who are*

[4] Financial Conduct Authority, *FCA proposes new credit card rules to help millions of customers get out of persistent debt,* 3 April 2017, available at: https://www.fca.org.uk/news/press-releases/fca-proposes-new-rules-help-customers-persistent-debt-credit-cards.

> *struggling financially are also likely to have incurred additional charges for missed payments in that timeframe.*[5]

We recommend that a consumer be taken to be able to comply with the financial obligations under a credit card contract only with substantial hardship if the consumer could not comply with an obligation to repay an amount equal to the credit limit of the contract within three years, with ASIC empowered to reduce this period if appropriate.

If a three-year maximum period is not adopted, we are concerned that longer periods may be determined appropriate for higher credit limits and rates of interest. In our view, if a higher credit limit or interest rate is only affordable when repaid over a longer period, then it is not a suitable credit card for that person. We also note that even a 'low rate' credit card can result in someone paying excessive amounts of interest if the card is not suitable.

'Unsuitable' and 'suitable' credit card contracts

Schedule 1 Item 8 of the Bill (s160F) lists a number of factors that ASIC must have regard to when determining a period for repayment for the purposes of affordability assessments. Item 8 would introduce new legal concepts of 'unsuitable credit card contracts' and 'suitable credit card contracts'. Currently, responsible lending laws under the Credit Act refer to a general 'not unsuitable' standard.[6] We recommend ASIC issue guidance on the meaning of 'unsuitable' and 'suitable' credit card contracts, and how this relates to the current 'not unsuitable' general standard.

We also recommend that ASIC have regard to preventing 'persistent credit card debt' when determining an appropriate period for repayment (that is, a period shorter than three years).[7]

Recommendation 3: Specify a maximum repayment period of three years for the purposes of the affordability assessment, and empower ASIC to set a lower period if appropriate.

Recommendation 4: ASIC issue further guidance on the meaning of 'unsuitable' and 'suitable' credit card contracts under Schedule 1 Item 8 (s160F), and how this relates to the current 'not unsuitable' standard.

Recommendation 5: ASIC have regard to preventing persistent credit card debt when determining an appropriate period for unsuitability assessments under Schedule 1 Item 8 (s160F).

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[5] Centre for Responsible Credit and New Economics Foundation, *Tackling persistent credit card debt: Response to the FCA Consultation CP17/10,* 2017, p. 6.
[6] *National Consumer Credit Protection Act 2009* (Cth) ss128-133.
[7] Financial Conduct Authority, *FCA proposes new credit card rules to help millions of customers get out of persistent debt,* 3 April 2017, available at: https://www.fca.org.uk/news/press-releases/fca-proposes-new-rules-help-customers-persistent-debt-credit-cards.

Reform 2: Prohibit unsolicited credit limit offers in relation to credit card contracts

We strongly support the proposed prohibition of unsolicited credit limit increase offers in relation to new and existing credit card contracts. 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. 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.

We believe this reform would have a significant and positive impact, and would help keep people stay in control of their finances and avoid ending up with unmanageable credit card debt. In conjunction with the proposed strengthening of responsible ending obligations, this measure could see a shift in consumer behaviour to using credit cards as transactors, rather than revolvers holding an outstanding balance.

We have been concerned for many years that unsolicited credit limit increase offers result in people taking 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.

In terms of consequential amendments, we anticipate that *National Consumer Credit Protection Regulations 2010* (Cth) regs 28LH and 28LI would also need to be repealed. These regulations were made for sections 133BE and 133BF of the Credit Act, which permit unsolicited credit limit increase offers with consent.

Recommendation 6: Consider whether consequential amendments to the *National Consumer Credit Protection Regulations 2010* (Cth) regs 28LH and 28LI are needed to implement the prohibition of unsolicited credit limit increase offers.

Reform 3: Simplify the calculation of interest charges under credit card contracts

We strongly support the proposal to simplify the calculation of interest charges to prohibit retrospectively charging interest on credit card balances, which we believe is a fair and sensible reform. The reform has a clear precedent in the United States 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.

We also strongly support this reform applying to new and existing credit card contracts.

Reform 4: Reducing credit limits and terminating credit card contracts, including by online means

We support the proposal to require credit card contracts to allow people to reduce credit card limits and terminate credit card contracts. We also support the proposal to require credit card providers to allow consumers make these requests online. Implementing this reform would give people more control over their credit card spending and help them to move towards a financially healthy transactor approach to credit card use—rather than revolving an ongoing balance, incurring high interest charges.

The dangers of repeated increases to credit limits are demonstrated by Jenny's case study below:

Joanne's story

We were recently contacted by Joanne (name changed). Joanne is a nurse and single mother of 2 children. Joanne's credit card debt has spiralled out of control. How did this happen? Joanne had a credit card with an $8,500 limit. Over a few years, Westpac slowly increased her limit to $15,500. Joanne was struggling to control her debt, and when it reached $12,500, Westpac offered to transfer it to a personal loan. When the balance was transferred, Westpac gave Joanne her card back with the full $15,500 credit limit available again, and had recently issued her another card with a limit of $15,000. We are instructed that there was no suitability assessment undertaken when Joanne was given back her card with the full credit limit available again. Then the debt just piled up. Joanne has now declared bankruptcy.

While we are supportive of this reform, we believe a number of technical amendments are required to the Bill in order to ensure credit card providers are not able to circumvent the intent of these proposals.

Information required

Under Schedule 1 Item 18 (s133BFA(2)) and Item 23 (s133BU(2)), the credit card provider's website must tell the consumer 'what information the consumer will need to enter' and provide instructions on how to make a request to terminate the credit card contract or reduce the credit card limit. We are concerned that broad wording of these provisions provides an opportunity for credit card providers to put barriers in place, for example, by requiring an unreasonable amount of information from the consumer or requiring the consumer to undertake a number of unnecessary steps to make a request. We suggest the Bill or Regulations specify a form or set of words, in addition to the general principles in sections 133BFA(2) and 133BU(2), to avoid credit card providers hiding this online function in the depths of their websites, or making the process too difficult for consumers. At a minimum, there should be some requirement of prominence in sections 133BFA(2) and 133BU(2).

Requesting an 'amount'

Under Schedule 1 Item 18 (s133BFB), a credit provider must not suggest the consumer not reduce their credit limit. However, this prohibition only applies if consumer has 'requested to exercise the entitlement by reducing the consumer's credit limit under the contract by an amount' (s133BFB(1)(b)). We believe this provision is drafted too narrowly. For example, people who want to reduce their limit may not necessarily nominate 'an amount'. Instead, we suggest that the prohibition apply when a person simply expresses a desire to reduce their credit limit. We note that Schedule 1 Item 23 (s133BV) relating to requests for termination does not seem to be limited in this way.

Application to existing credit card contracts

Schedule 1 Item 18 (s133BF) and Item 23 (s133BT) limit the requirement to provide a 'credit limit reduction entitlement' and 'credit limit termination entitlement' to new credit card contracts. Under the proposed reforms, credit card providers would only be required to give effect to a request to reduce a credit limit or terminate a credit card contract for an existing credit card if the contract 'contemplates a consumer reducing their credit limit or terminating their credit card'.[8] In our view, all credit card contracts 'contemplate' a consumer reducing their credit limit or terminating their card—this is an inevitable inference from the product design itself. In our view, the requirement to give effect to requests to terminate or reduce credit limits should apply to both new and existing credit card contracts.

Minimum credit limits

Under Schedule 1 Item 23 (s133BF(3)(b)), a consumer would only be able to entitled to reduce the credit limit to any amount that equals, or exceeds, the minimum credit limit. We are concerned that this exemption would provide an incentive for credit card providers to artificially and unnecessarily increase minimum credit limits in order to circumvent the requirement to give effect to requests for credit limit reductions. We recommend that, if a person requests a credit limit reduction below the minimum credit limit, the credit card provider be required to suggest a more suitable credit card product with a lower credit limit.

'Reasonable steps': Outstanding balances and direct debit authorisations

We are also concerned by the examples in the Exposure Draft Explanatory Materials (**the Explanatory Materials**) of 'reasonable steps' by credit card providers to give effect to a request for a credit limit reduction or termination.[9] In the Explanatory Materials, a suggested 'reasonable step' is communicating any 'further actions that must be undertaken by the consumer for the credit provider to complete the request.' This includes communicating to the consumer that they are

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[8] Exposure Draft Explanatory Materials, Treasury Laws Amendment (2017 Measures No. 8) Bill 2017: Credit card reforms; National Consumer Credit Protection Amendment (Credit Cards) Regulations, paragraph 1.98.

[9] Treasury Laws Amendment (2017 Measures No. 8) Bill 2017: Credit card reforms, Schedule 1 Item 18 (s133BFC) and Item 23 (s133BW).

required to repay any outstanding balance or that 'they are required to cancel any credit card authorisations (for example direct debits)' before the contract can be terminated.[10]

It is highly likely that a person struggling with credit card debt will have an outstanding balance when they request to cancel their credit card. The fact that a consumer has an outstanding balance should not be used by credit card providers as an excuse to enter into a customer retention pitch. Instead, if a consumer requests to cancel a credit card where an outstanding balance remains, credit card providers should be required to prevent any additional charges being incurred on the relevant card until the balance is paid off and the card is cancelled, in accordance with the consumer's request.

In relation to cancelling credit card authorisations, most consumers use regular direct debit arrangements, but very few would be aware that there is a difference in regulation based on whether the payment is coming from their transaction account or their credit (or scheme debit) card. Consumers are rightly baffled when they find that 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. There is no reason why the two types of payment should behave differently. This is an issue that must be fixed by industry, and should not be used as an excuse by credit card providers to avoid terminating a credit card contract upon request.

Recommendation 7: The Bill or Regulations specify a form or set of words, in addition to the general principles in Schedule 1 Item 18 (s133BFA(2)) and Item 23 (s133BU(2)), to ensure the information and steps required to make a request are not overly onerous. At a minimum, there should be some requirement of prominence in ss133BFA(2) and 133BU(2).

Recommendation 8: Apply the prohibition under Schedule 1 Item 18 (s133BFB) when a person simply expresses a desire to reduce their credit limit, rather than requiring the consumer to request a reduction of a certain amount.

Recommendation 9: Require credit card providers to give effect to a request to reduce a credit limit or terminate a credit card contract for both new and existing credit card contracts under Schedule 1 Item 18 (s133BF) and Item 23 (s133BT).

Recommendation 10: If a person requests a credit limit reduction below the minimum credit limit, then the credit card provider be required to suggest a more suitable credit card product with a lower credit limit.

Recommendation 11: If a consumer requests to cancel a credit card where an outstanding balance remains, credit card providers be required to prevent any additional charges being

[10] Exposure Draft Explanatory Materials, Treasury Laws Amendment (2017 Measures No. 8) Bill 2017: Credit card reforms; National Consumer Credit Protection Amendment (Credit Cards) Regulations, paragraph 1.86.

incurred on the relevant card until the balance is paid off and the card is cancelled in accordance with the consumer's request.

Recommendation 12: Reconsider the examples provided in the Explanatory Materials of further actions that a credit card provider might require a consumer to undertake before giving effect to a request for a credit limit reduction or termination under Schedule 1 Item 18 (s133BFC) and Item 23 (s133BW).

Further reform: Increasing minimum repayments

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. 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. This is generally described as the 'anchoring effect'.

A recent study in the United States by the National Bureau of Economic Research estimated that at least 10% of all consumer credit card accounts anchor to the minimum payment. The study found that this anchoring response is immediate, and occurs for both increases and decreases in the minimum payment. The study also found that:

> *The minimum payment may be an especially powerful anchor because it signifies staying in good standing with the issuer and avoiding late fees. This feature may create the perception that the minimum is a suggested payment amount, as the most prominent amount besides the full balance featured on credit card statements and payment interfaces.*[11]

We believe increasing minimum repayment amounts would provide a powerful tool to lower credit card indebtedness and reduce credit card related financial hardship. We note that some credit card providers have already increased their minimum repayment amounts. For example, the minimum repayment for ING Direct's Orange One credit card is now 10% of the closing balance.[12]

We contest the assertion that implementing this measure would result in a wave of consumer defaults—particularly when hardship variations, and the other proposed reforms are taken into account. 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. There could also be a lead up phase where consumers are warned for a 6-month 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

[11] Benjamin Keys and Jailan Wang, *Minimum payments and debt paydown in consumer credit cards,* October 2016, p. 35, available at: http://www.nber.org/papers/w22742.
[12] ING Direct, *Orange One Terms and Conditions,* 21 April 2017, p. 6, available at: https://www.ing.com.au/pdf/orangeone/Orange%20One%20Terms%20and%20Conditions.pdf.

outstanding balance in anticipation of these changes. Even if higher minimum repayments were considered too onerous for existing customers, they could still be implemented for prospective credit card customers.

Recommendation 13: Reconsider increasing minimum credit card repayments to lower credit card indebtedness and reduce credit card-related financial hardship.

Please contact Katherine Temple on 03 9670 5088 or at katherine@consumeraction.org.au if you have any questions about this submission.

Yours sincerely

CONSUMER ACTION LAW CENTRE

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