



**Submission to: Senate Economics
Committee**

**Subject: Matters relating to
Credit Card interest
rates**

**Submission prepared by: Consumer Credit
Law Centre of South Australia**

A service of Uniting Communities

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Uniting Communities

Uniting Communities works with South Australian citizens across metropolitan, regional and remote South Australia through more than 90 community service programs.

Our vision is : A compassionate, respectful and just community in which all people participate and flourish.

We are made up of a team of more than 1500 staff and volunteers who support and engage with more than 20,000 South Australians each year.

Recognising that people of all ages and backgrounds will come across challenges in their life, we offer professional and non-judgemental support for individuals and families

Consumer Credit Law Centre

The Consumer Credit Law Centre of South Australia (CCLCSA) was established in 2014 to provide free legal advice, as well as legal representation and financial counselling to consumers in South Australia in the areas of credit banking and finance. The Centre also provides legal education and advocacy in the area of credit, banking and financial services. The Consumer Credit Law Centre of South Australia is managed by Uniting Communities who also provide an extensive range of financial counselling and community legal services as well as a range of services to low income and disadvantaged people including mental health, drug and alcohol and disability services. Uniting Communities, through the CCLCSA, is particularly interested in this enquiry due to our extensive involvement in the provision of financial counselling over many years and ongoing advocacy on a raft of measures associated with financial matters, financial stress, and financial hardship for low and modest income households. Our particular focus is providing support to low income and disadvantaged households, and to building families and communities.

Recent reforms

CCLCSA recognises that there has been good progress on a number of fronts related to consumer credit issues over the last five or so years. These improvements including:

- Establishment of the ACL (Australian Consumer Law) with protections across a wide range of consumer products and purchases.
- The introduction of the National Consumer Credit Protection Act, the National Credit Code and responsible lending obligations.
- The changes in legislation and regulation preventing the offering of unsolicited credit card offers to consumers as part of other financial arrangements and as a result of heavy marketing by banks and other financial institutions in the past. We are very pleased that the provision of unsolicited credit has been removed.
- There has also been some reigning in of the worst aspects of payday lending, although we continue to be concerned about aspects of payday lender behaviour and will advocate elsewhere for increased measures to better protect consumers, particularly unwitting consumers from exploitation.

Changing nature of financial services

Before moving into the detail of this submission, we make the observation that credit cards, whilst ubiquitous in modern Australian society, are really quite a new financial instrument with a significant number of people in our community having not grown up with credit cards and still being unsure of some aspects of the way they work. We also note that provision of credit card services has been an

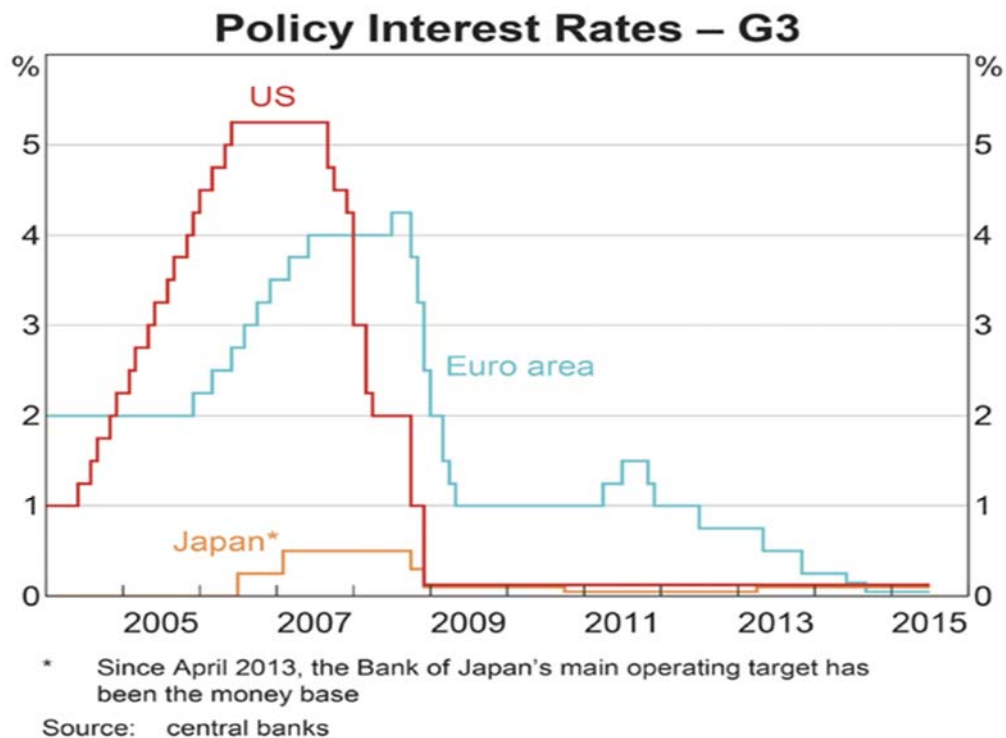
area of significant and rapid change over recent years as have other aspects of financial markets. The enquiry is also taking place at a time of relatively low consumer trust in banks, in financial institutions-no doubt heightened by some very poor performance by financial advisers employed by financial institutions. The declining trust of many societal institutions is part of an important context for this enquiry. We also recognise that as the financial service industry changes so do consumer protections need to change quickly to adjust to these changes.

We now turn to responses to a couple of aspects of the terms of reference for this enquiry.

The Reserve Bank of Australia's cash rate announcement and associated changes in credit card interest rates.

To quote the obvious, the headline interest rate, as determined by the Reserve Bank of Australia is currently 2.0%, yet many credit card interest rates are of the order of 18-20%, while the default rate for many of the credit card offers associated with retailers are at 30%. Note that we will discuss this topic in fuller detail in later parts of this submission.

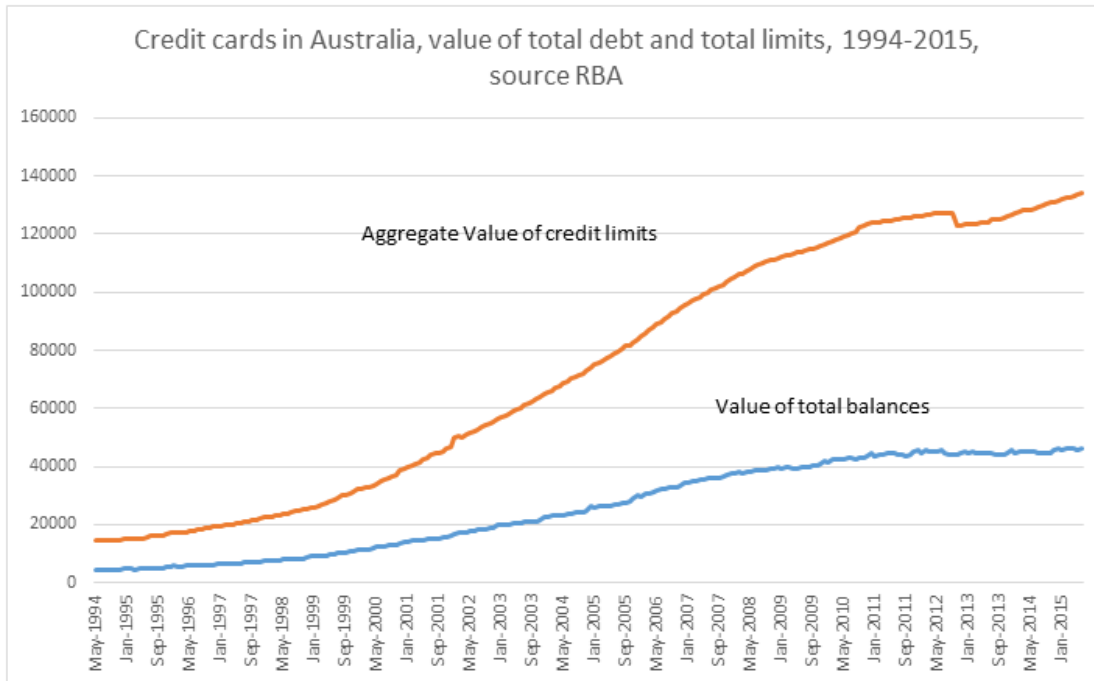
Please see figure 1.0 which show our current interest rates from major international regions and this graph shows that interest rates are very low across the world at the moment and so capital raising costs are low, consequently the very high interest rates charged for credit cards, including default interest rates, are excessive.



Graph 1, Source RBA

Graph 2 shows credit cards in Australia over time showing both the aggregate value of credit limits and the value of total balances on credit cards. What we see from this graph is the significant divergence of the two series over the last decade or so, so that aggregate value of credit limits is a significant multiple of the value of the total balances. This suggests that credit card providers are

ramping up credit limits in order to encourage customers to use more credit than may be in their best interests.



Graph 2, Source RBA

The series dealing with value of total balances shows that the trend has been relatively flat since the Global Financial Crisis reflecting, we suggest, a positive change in consumer use of credit cards and increase in aggregate savings by consumers which has many positive aspects. So the banking and finance industry should be actively discouraged e.g. through statements from financial regulators, the Reserve Bank etc., from excessive promotion of credit cards.

Term of reference B4

The costs to banks, credit providers and payments systems, including those related to – consumer protection measures, including reforms introduced following the global financial crisis.

Point of Sale Credit Provision

We’ve noted that there have been significant consumer protection improvements for financial service customers over recent years. We’ve also recognised areas where changes are still needed. The main concern of our financial counsellors and Community Legal Service at the moment is the extent of point of sale credit card provision by retailers. In short, a customer goes into a retailer, often to buy a ‘consumer durable’ i.e. largish purchase, and is encouraged by the retailer to pay for that good through a credit card with the credit card supplied by a third party. The limit applied to the credit is significantly above the cost of the good purchased, and invariably provides capacity for cash withdrawal. Further, there is often the promotion of these as ‘interest free’ when in reality there can be a large number of triggers that put the customer into a default arrangement, with a 29.99% interest rate. This means that consumers can unwittingly be paying very high interest rates on what

they believe to be an interest free credit card. One CCCLSA financial counsellor says that “this practice is just as pernicious as pay day lending”, a view that is widely supported by the organisation.

The problem with point of sale credit card provision, as seen by CCLCSA and financial counsellors include:

- Consumers are given a credit card at the retail purchase with little or no understanding of the conditions or requirements of the credit card product that they are encouraged to use;
- Retail staff are given incentives to actively promote the acceptance third party credit cards for use as payment irrespective of the appropriateness of that product for their customer;
- The default rate is high e.g. GE credit card arrangements have default rates of 29.99% on the whole amount that is on the card which includes the value of the product purchased as well as cash withdrawals and any other purchases that have been made with the card;
- There is minimal assessment of the customer’s capacity to pay by the retail provider, or it would appear, the credit provider;
- There is no retailer responsibility for any discernment of the capacity of the customer to pay for the purchase using the credit card, or their suitability for being encouraged to take a credit card which would almost certainly be additional to other credit cards that they already have. In short, there is no retailer responsibility to the customer for actively encouraging taking up the credit card to make a purchase;
- Interest free periods can be for four years when, in fact, the functionality of the product purchased is likely to have diminished dramatically in that time, and in the case of computers, home entertainment etc., the product is likely to be out of date by the time payment is due. This simply creates a future problem for many consumers from current purchase.

This is a case taken directly from a CCLC Financial Counsellor

“The client was a single female in her late thirties. She was referred by a community legal service. Her background was mild intellectual disability, income was Disability Support Pension, plus some part time employment.

She wished to purchase a computer. She noticed one advertised by a large retailer on interest free terms and no payment for three years. The cost of the computer was \$1,000. She approached the retailer seeking to purchase just the computer. What she got was a credit card with a limit of \$5,000, no payment on purchases for three years, a default interest of 29.99%, default trigger was failure to make any monthly payment on time.

She was then urged to make further purchases, items such a printer and other add-ons she did not need. All this left a credit balance on the card of \$2,000.

Someone then told her she could withdraw cash, using the card. She then withdrew cash of \$2,000 (up to the overall limit). What she failed to realise was that cash withdrawals were subject to an immediate interest rate of 29.99%. This then triggered an immediate monthly payment which she failed to make. This failure triggered a default on the entire balance of \$5,000, at the default rate of 29.99%.

The outcome was, I went to FOS, the balance was reduced by \$2,000, and she paid the remainder over time, interest free. This was on the basis of maladministration in lending, but good outcomes may not always be available.”

Clauses of a more general nature and appropriate for consumers with intellectual impairments/capacity issues are needed that would amend section 76 of the National Credit Code to explicitly provide that actual or constructive knowledge of a consumer's capacity to decide what is in their best interests is a factor but is not a requirement for an unjust transaction to be reopened under section 76 of the National Credit Code. This would assist in negotiating for some of our clients who have obtained credit cards to acquire whitegoods interest free and who were not aware withdrawing cash from an ATM from their credit card would attract 29% interest, for example, and where the credit provider refutes having any knowledge the consumer suffered any issues with capacity— perhaps not necessarily something for this submission necessarily but one to consider later.

Unconscionable Behaviour

We have seen clients facing a Warrant of Sale or Charging Order over their residential homes where the judgment debt relates to a credit card debt sold onto a credit collection agency. Typically, the credit collection agency will not commence legal action until before the six year limitation period is due to expire. This means that the credit collection agency is entitled to keep accruing the applicable credit card interest to the outstanding balance over the entire six years from the time of default, despite the bank assigning and selling the debt off their books at a much lower sum. The CCLCSA have seen clients who face the imminent threat of losing their principal place of residence through enforcement action of a judgment debt relating to a credit card contract assigned to credit collection agencies.

We are also well aware of legislation, including Australian Consumer Law and Consumer Credit Protection and Australian Securities and Investment Commission Acts that use the term 'unconscionable behaviour'. We are aware of examples where mental illness, for example, is not regarded as unjust for transaction principles. We are firmly of the view that an active dialogue is needed between consumer groups and regulators and the industry about the meaning of 'unconscionable behaviour'. We certainly believe that there has been behaviour of credit card providers and of interest rate levels which is 'unconscionable', but which are currently regarded as acceptable by regulators and the industry. Greater dialogue is needed on clarifying the meaning of this term and this needs to occur as a matter of some urgency.

We have indicated that regulation of credit card rates may be counter-productive and we might not want to necessarily suggest that parliament should appoint regulators for credit card interest rates. However, from a legal perspective there is no way the present law can interfere with credit card interest rates not falling with RBA cash rates. The recent case of **Paciocco v Australia and New Zealand Banking Group Limited** [\[2015\] FCAFC 50](#) although not related to credit cards and related to late payment and direct debit dishonour fees demonstrates that even if the amount charged by credit card providers was considered to be excessive by consumers because credit card interest rates have not fallen with RBA cash rates, our present legislative framework does not allow consumers to take action for fees and charges which are simply high.

Allsop CJ said at paragraph 347 in his judgment said *'To [find the fees unconscionable] would require the court to be a price regulator in banking business in connection with otherwise honestly carried on business in which high fees were extracted from customers'*.

Although this case is likely to be appealed to the High Court, it demonstrates that if Parliament is concerned about the effect of credit card debt on Australians, it must build further protections into existing framework such as making it easier for consumers to terminate credit cards, making costs such as new purchases more transparent, ensuring consumers only get credit limits of what is

required in the first place, removing any 'trickery' in marketing low or 'no interest' rates. Essentially, an argument 'the credit card interest rates have not fallen with RBA cash rates and therefore unconscionable' would in our view be very unlikely to succeed if it were litigated in court. This further supports the need for other protections including such recommendations made by Consumer Law Action and Financial Rights Legal Centre to protect consumers and consideration of what else ought to be regulated, possibly credit card surcharges?)

Consumer Education

There is a clear role for consumer education around the meaning of terms like 'interest free' and of the real credit card interest rates that apply and the triggers for default credit card rates applying. Whilst it is unreasonable to expect the consumer to be totally aware of all the traps of obtaining financial products, there is a role for industry and regulators to be working with community based organisations to ensure a better understanding from the consumers of the growing complexity of credit card arrangements, particularly triggers and default rates.

In appendix 1 we have provided some comments from a recent article: Paul Ali, Ian Ramsay and Cate Read, Behavioural Law and Economics: Regulatory Reform of Consumer Credit and Consumer Financial Services, *Common Law World Review* 43 (2014) 298-343. This article provides some additional perspectives on consumer education / 'nudging', with reference to recent developments in the United States, with some comparison with Australia.

Consumer Engagement

We also note that the financial institution and credit card in particular, represents an industry of many billions of dollars with a very sophisticated industry promoting, what at times are, very complex products. There is a massive asymmetry with consumer voice and capacity for consumer education and awareness with regard to these products. We believe that there is a very strong argument for government providing some resourcing e.g. through a credit industry levy for provision of community based people with expertise in credit issues who are able to both assist with consumer education and persist with consumer advocacy regarding a range of issues of consumer concern relating to credit card fees and credit card interest rates.

Marketing practices continue to be a key focus of credit card providers with the practice of 'bundling' problematic. With this practice, complex pricing structures and product information is bundled together which makes the overall costs difficult for the average consumer to understand.

Credit card disclosure needs to focus on how consumers actually use disclosure and how they make decisions rather than compliance and risk avoidance. For example, merely displaying the interest rate in the credit card offer is not enough. To be effective disclosure must target consumers behavioural biases. The 'product use model' is recommended, that discloses actual costs of a credit card based on consumers transaction history. Consumers need to know actual costs have access to a cooling off period and access to independent advice, which may be advice that the consumer consult a financial counsellor before deciding to accept a credit card offer.

Recommendations for action

With specific regard to the retailer credit card provision that we have discussed above, we believe a number of recommendations need to be made by this Senate committee. These include:

1. Requiring a cooling off period for all point of sale credit card arrangements for both business and consumer. For the business the cooling off period allows time to undertake appropriate credit checks e.g. by checking the customer's credit file. It also allows the consumer time to rethink their purchase and to have the opportunity to get advice about the likely impacts for them of the purchase that they have made using credit product.
2. Much greater disclosure is needed to customers from the retailer, as well as the credit provider, about the terms and details of the credit provision.
3. Explicit, informed consent should be required of customers so that they understand the likely traps to them, including the trigger mechanisms for default interest rates and the value of the default interest rate, and any future changes that may be made to interest rates, default interest rates, triggers or any other aspect of the contract.
4. There needs to be assessment of credit worthiness for customers being encouraged to take out a credit card that is based on banking lending criteria. We observe that a customer going into a financial institution to ask for a credit card is much more likely to be informed about the product they are seeking to obtain and how they will use it than is a customer who is making a retail purchase and is provided with, or encouraged to accept a credit card in order to make that purchase.
5. All providers, both retailers and credit providers, should be required to have credit provision licences in order to ensure that appropriate duty of care is taken in explaining credit card implications to customers, and to ensure appropriate offering of credit card arrangements.
6. The active promotion of interest free terms, up to four or even five years, needs to be thought through more carefully by consumer groups, industry and regulators to understand how these offers play out in the longer term when consumers are confronted with high repayments with a product that is either not functioning or badly out of date at the time by which payment is required.
7. Regulation should require that, where a credit card is provided as part of a retail purchase arrangement, the credit limit on the credit card should be to the value of the purchase, not a significantly inflated value.
8. The meaning of the term "unconscionable" needs to be better understood and applied to practice that is clearly contrary to the best interests of end consumers.

We are also supportive of the recommendations made by Consumer Action in their submission to this inquiry.

Contact for further information

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Appendix 1

Article review: from *Common Law World Review* 2014

This is a very recent article on policy perspectives and approaches to regulatory reforms in US and Australia in relation to consumer protections for credit card debt. We include this summary of the paper because we consider the paper to be of considerable merit.

Paul Ali, Ian Ramsay and Cate Read, Behavioural Law and Economics: Regulatory Reform of Consumer Credit and Consumer Financial Services, *Common Law World Review* 43 (2014) 298-343.

Key message: The policy tool of ‘nudging’ as positive tool for reducing harms associated with credit card debt on its own is not enough.

Abstract Information:

The paper explores behavioural research on economic policy making in relation to regulation of consumer credit and consumer financial services using the example of credit cards in the United States and Australia.

It examines the impacts of ‘nudging’ in relation to regulatory reforms.

In particular the degree to which policies based on this approach substantially change consumer conduct in relation to credit cards without the support of other mandatory or other forms of strategies.

It concludes ‘nudging’ should be viewed as a **regulatory supplement** or one of a range of tools used to protect consumers from negative consequences of suboptimal outcomes from credit card use.

Note: it is suggested by the authors that interest in the use of behavioural economics has spiked since 2008 global financial crisis because it provides governments with a low cost tool to regulate financial services.

Credit Card Use and Reform in the United States and Australia

- It is noted that credit cards represent the main form of consumer credit [p 308]. To cater for the heterogeneity of demand, the range and complexity of credit card products has increased exponentially. [p 308 f/n 55].
- The process of choosing credit cards presents consumers with a complex web of upfront and hidden fees and interest rates, which challenge even the most literate person and mean that making an informed choice becomes a difficult task. [p 308].
- When complicated financial products are combined with ‘financially illiterate’ consumers the result is often an increase in sub optimal outcomes including financial distress and related social problems. [p 308]
- The US experience: it is argued, reforms such as the CARD Act and the Dodd-Frank Act (Obama) can help to minimize the adverse effects of these outcomes. [p309].
- It is noted however that the lending industry is critical of these types of reform, they prefer mandatory disclosure (blanket not targeted) and not regulation of products because they argue the consumer has ‘rational capacity’. [p 309]
- It is noted that the focus of past reforms in relation to credit cards has been primarily on disclosure, but not necessarily targeted disclosure in plain English that assists consumers with low literacy to unbundle complex pricing structures [p 312 f/n 77]
- Disclosure information strategies (such annual expenditure or late fees) provided on monthly statements) is seen as an attempt to overcome behavioural biases exhibited by

consumers (noted above) that may emerge when consumers are faced with complex information.

- It is noted, this approach also involves minimal expense for governments.
- However disclosure strategies have also been criticised as ‘soft’ Budd & Pildes [p 313 reference on notes – not using primary source]. For example Budd & Pildes argue disclosure will not decrease underlying complexity of products and lenders will inevitably circumvent new mandatory regulations. Nonetheless, they concede it may assist ‘bounded rationality’ consumers but not the person with imperfect self control or will power. [p 313].
- Further, Budd & Pildes contend, behaviour economics ‘truncates its policy analysis by excluding policy tools that might be optimal from a social-welfare perspective that could not be sold as ‘preserving choice’’. A better approach would be to more comprehensively explore alternative regulatory tools perhaps better designed to account for consumer behavioural irrationalities, such as product regulation or ways to lower business’s incentives to exploit consumer mistakes. [p 313]
- **US reforms:** consumer protection that was introduced 2009/2010 was not because of concern about the profitability of credit card but rather the methods used to generate those profits and because it was accepted that the harm to customers was significant and the harm to competition was also substantial. [p 314].
- The purpose: encourage fairness and transparency to credit card consumers. It was designed to make consumers aware of costs they might incur and the ramifications of paying monthly minimum payments only and also to encourage them to more carefully consider their ability to meet credit card repayments.
- Requirements: written minimum payment warning in clear and concise language displayed conspicuously and prominently on monthly statements with financial counsellor contact details provided = this requirements are included in legislation as mandatory disclosure. [p 316]
- Australia: 2010 credit card debt = 47 billion, 2011 Introduction of National Consumer Credit Protection Code, 2014 credit card debt 34 billion. [p 318- 319]
- Ali et. al. note credit card provisions in the NCCP Act are clearly informed by behavioural economic insights [p 319 f/n 62]
- The Act was explicitly developed in part to address two behavioural biases common to credit cards optimism about making repayments and imperfect self-control.
- However it is further noted, the target demographic for the consumer protection provisions provided by the new regulations is low financial literacy, vulnerable consumers.
- These approach was set out in the 2008 Regulatory Impact Statement on Responsible Lending Practices in Relation to Consumer Credit Cards, drafted by the Ministerial Council on Consumer Affairs (MCCA).
- The MMCA described the target demographic for the proposed changes as those who have low financial literacy and do not appreciate the implications of first, spending to the credit limit and second, paying only the minimum repayment. It also notes others may have unrealistic appreciation of their capacity to repay. This group of consumers generally consists of low income, less well educated consumers, and may include the demographic found to have the lowest financial literacy – young and the elderly. [p 320 f/n 134]
- In developing policy recommendations, it is stated, the MCCA was conscious that its proposals would assist vulnerable consumers in making financial decisions. [p 320].
- In this respect, Ali et. al argue, behavioural economics or ‘nudging’ was a natural fit for this process, as nudge-related policies use behavioural insights to alter consumer choice environments, to enable better decision making without eradicating freedom of choice.
- The influence of behavioural economics is clearly articulated in the 2008 regulatory impact statement for example, .. behavioural economics clearly explain why consumers make choices contrary to their interests... etc. [p320]

Prior to implementation of the National Consumer Credit Protection Amendment Act 2011 the Ministerial Council on Consumer Affairs (“MCCA”) provided the following views and recommendations;

1. In relation to pre-contractual information.

- ⇒ It was noted costs associated with credit cards are difficult to locate until after the application was processed. As a result, vulnerable clients are less likely to select suitable products and are therefore exposed to a greater risk of selecting beyond their means.
- ⇒ Therefore MCCA recommended the lender gives the consumers a summary of essential information titled **Key Facts Sheet** prior to processing the application.
- ⇒ The aim is to address consumers to have an overly optimistic bias about meeting repayments.
- ⇒ This has been implemented in the NCCPA Act. An exemplar of the KFS is set out in schedule 6 and the lender is required to comply with how the information must be presented; in accessible language and must unbundle costs. [p321 also see NCCPA Act ss 133BB 133BD]

2. In relation to credit limits.

- ⇒ The MCCA statement noted credit limits approved for low income people often exceeded their ability to afford repayments.
- ⇒ It noted, the Act correctly contained provisions that prohibit unsolicited invitations, which involved lenders offering credit card increases, this is now prohibited unless the consumer provides express consent to this and the lender must also take reasonable steps to notify the consumer where they have exceeded the credit limit. [p 322 s 133BE & 133BF]
- ⇒ The intention, it is suggested, is to provide information to consumers to encourage them to act on this information to avoid the risk of further financial hardship.
- ⇒ *In our opinion, the prohibition on unsolicited invitations is particularly appropriate.*

3. In relation to assessment of application.

- ⇒ The MCCA noted its concern that credit providers were not taking adequate steps to ensure that vulnerable consumers had capacity to repay debt.
- ⇒ Particular emphasis to this issue in our discussions and noted it is a big concern for CCLCSA.
- ⇒ MCCA noted inadequate assessment was often due to the credit scoring methods used by lenders instead of assessing the **actual financial commitments** of applicants.
- ⇒ MCCA proposed provisions prohibiting lenders from being able to provide more credit than the consumer can repay from income without ‘substantial hardship’. This should be achieved for example, by assessing whether the current financial situation of the lender provided capacity to repay debt within a particular period of time (should the credit limit be reached).
- ⇒ It was further suggested a debt incurred above a ‘reasonable’ credit limit would/should be unenforceable. [p 322]
- ⇒ **However the government did not implement these recommendations.**

4. In relation to minimum monthly repayments.

- ⇒ The MCCA highlighted the extent minimum monthly repayments contribute to significant long term debt. [p 323]
- ⇒ This was also a focus of our discussion Ian, Belinda and David talked about this.
- ⇒ The MCCA proposed the lenders be required to provide 'health warnings' on monthly statements of how long it would take to pay off on minimum payments and it also proposed that the amount required for minimum monthly repayments should be raised.
- ⇒ The government implemented the 'health warnings' recommendation but not the increased minimum monthly repayments requirement. [p 323 also see ss 79B & 79B(2) NCCPR, 2010]
- ⇒ Ali et. al. explain this is a good example of targeted disclosure as opposed to blanket disclosure and suggests shift in the mindset of Australian policy makers to target disclosure strategies. [pp 324-325]
- ⇒ However they also note commentary from the credit lenders industry about fears these strategies are associated with implementation costs that may need to be passed onto consumers. [p 325]

Notes on Final Conclusion

- Ali et. al. conclude that regulating the credit card market involves finding a balance between effective consumer protection and enabling lenders to compete within a regulatory environment that does not stifle competition.
- However, they suggest there is evidence this balance has often favoured lenders with consequent detriment to consumers. [p326]
- Recent reforms in the US and Australia reflect the influence of behavioural economics theorists and specifically the concept of 'nudging' as a regulatory tool for reforming consumer behaviour.
- However they argue, the question remains whether 'nudging' is sufficient to empower consumers, while – at the same time- curbing the aggressive behaviour of some industry groups. [p 326].

Uniting Communities recognises the usefulness of 'behavioural economics' in some public policy settings, but also sees a need for more direct regulation to adequately protect all consumers, particularly people who are most vulnerable to exploitation.