ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 303

Credit cards: Responsible lending assessments

July 2018

About this paper

This consultation paper is for Australian credit licensees (licensees) that are credit providers or that provide credit assistance, as well as other interested parties.

It seeks feedback on our proposal for the prescribed period to be used when assessing whether a credit card contract or credit limit increase is unsuitable.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This paper was issued on 4 July 2018 and is based on the National Credit Act as at the date of issue (including amendments yet to commence).

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change because of the comments we receive or as other circumstances change.

Contents

The consultation process

You are invited to comment on the proposal in this paper, which is only an indication of the approach we may take and is not our final policy.

As well as responding to the proposal and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

Your comments will help us refine our proposal.

Making a submission

You may choose to remain anonymous or use an alias when making a submission. However, if you do remain anonymous we will not be able to contact you to discuss your submission should we need to.

Please note we will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any personal or financial information) as confidential.

Please refer to our privacy policy at www.asic.gov.au/privacy for more information about how we handle personal information, your rights to seek access to and correct personal information, and your right to complain about breaches of privacy by ASIC.

Comments should be sent by **Tuesday 31 July 2018** to:

creditcards@asic.gov.au.

What will happen next?

Stage 1	4 July 2018	ASIC consultation paper released
Stage 2	31 July 2018 August 2018	Comments due on the consultation paper Drafting of final instrument
Stage 3	August/September 2018	Final instrument released

A Background to the proposal

Key points

Following recent reforms to the regulation of credit card lending, ASIC has been given the power to set a 'prescribed period' for assessing whether a credit card contract or credit limit increase is unsuitable.

Under the revised responsible lending obligations, a credit card contract or credit limit increase must be assessed as unsuitable if it is likely that the consumer would be unable to repay the credit limit within the prescribed period.

The new requirement will apply to licensees that are credit providers or that provide credit assistance in relation to both new and existing credit card contracts from 1 January 2019.

ASIC's new power under the National Credit Act

1 Under s160F of the *National Consumer Credit Protection Act 2009* (National Credit Act), ASIC has the power to prescribe the period to be used for assessing whether a credit card contract or credit limit increase is unsuitable for responsible lending assessments.

2 Consumers that cannot repay the proposed limit of the credit card contract within the period prescribed by ASIC are taken to only be able to comply with that contract with substantial hardship. In effect, entering into the contract or providing credit assistance in relation to the contract, would be a breach of the responsible lending obligations.

Note: For guidance on the responsible lending obligations generally, see Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209).

3 The revised obligations will apply to licensees that are credit providers or that provide credit assistance in relation to both new and existing credit card contracts from 1 January 2019.

4 Existing civil and criminal penalties that currently apply to breaches of the responsible lending obligations will apply to breaches of the revised obligations. Existing infringement notice powers will also apply.

5 In Section A of this consultation paper, we explain:

(a) the context and background to this reform (see paragraphs 7–14); and

(b) the purpose and scope of the revised obligations (see paragraphs 15–23).

6 In Section B, we outline ASIC's proposal and rationale for the prescribed period and seek your feedback on this proposal.

The need for legislative reform

Senate Inquiry

7 In June 2015 the Senate referred matters relating to credit card interest rates to the Senate Economics References Committee for inquiry and report (Senate Inquiry). On 16 December 2015 the committee released its report, *Interest rates and informed choice in the Australian credit card market*.

8 A primary concern of the Committee was that too many Australians are ‘revolving’ credit card debt for extended periods of time while paying high interest charges.

9 The Senate Inquiry found that a problem arises when a consumer consistently fails to pay their outstanding credit card balance in full at the end of statement periods, using their card as a borrowing facility, rather than to manage cash. In those situations, consumers risk taking on significant levels of ongoing debt with little prospect of repaying it in the short to medium term. The Senate Inquiry found that the high rates of interest often charged on credit card debts make them unsuited as long-term debt facilities.

10 To address this problem, the Senate Inquiry recommended that the responsible lending obligations that apply to credit cards should be amended so that serviceability is assessed based on the consumer’s ability to pay off their debt over a reasonable period. It also recommended that the Government consult with industry, consumer groups and other interested stakeholders to determine what constitutes a ‘reasonable period’.

Government response to Senate Inquiry

11 The Government responded to the Senate Inquiry findings and recommendations through a consultation paper released by Treasury in May 2016, *Credit cards: Improving consumer outcomes and enhancing completion*.

12 In this paper, it confirmed its support of the Senate Inquiry recommendation that the responsible lending obligations should be amended so that serviceability is assessed on the consumer’s ability to pay off their debt over a reasonable period and proposed to tighten these obligations.

13 The Government noted that credit providers typically assess the affordability of a credit limit based on a consumer’s ability to meet only the minimum repayments on the proposed credit limit, sometimes with a small buffer (rather than taking into account the length of the repayment period and cumulative interest charges if the consumer only makes the minimum repayments).

14 The Government was concerned that this industry practice could result in a subset of consumers incurring credit card debts with very large cumulative interest charges that cannot be paid down in a timely manner without substantial financial hardship.

Revised obligations for credit card lending

Prescribed period for assessments

15 In 2018, the Government implemented the first phase of the reforms outlined in its response to the Senate Inquiry: see Pt 1 of Sch 5 to the *Treasury Laws Amendment (Banking Measures No. 1) Act 2018* (Banking Measures Act).

16 This reform builds upon the existing responsible lending obligations, which generally provide that:

(a) credit licensees must not enter into a credit contract with a consumer, or suggest or assist a consumer to apply for such a contract, if it is unsuitable for the consumer; and

(b) a credit contract is unsuitable for a consumer if it does not meet the consumer's requirements and objectives, or the consumer could only comply with their obligations under the contract with substantial hardship.

17 A consumer's ability to repay will be taken to only be able to comply with their obligations with substantial hardship where they cannot repay the proposed credit limit within the period prescribed by ASIC under s160F. Section 160F allows ASIC to prescribe different periods for different classes of contract.

18 The Explanatory Memorandum to the Banking Measures Act sets out that when prescribing the period, it is expected that ASIC will seek to achieve a balance between preventing consumers from being in unsuitable credit card contracts and ensuring that consumers continue to have reasonable access to credit through credit card contracts.

UK approach to a reasonable period

19 In its response to the Senate Inquiry, the Government outlined that legislative reform would bring Australia into line with other jurisdictions, such as the United Kingdom.

20 The UK's Financial Conduct Authority (FCA) regulates credit card providers' conduct under its Consumer Credit Sourcebook (CONC). The CONC states that when assessing a consumer's ability to repay, credit card providers:

(a) should consider the consumer's ability to repay the credit limit within a reasonable period;

(b) in considering what is a reasonable period, may have regard to the typical time required for repayment of an unsecured personal loan for that amount; and

(c) should not use the assumption of the amount required to make only the minimum monthly repayment.

21 It also includes rules for how providers should treat consumers in existing credit card contracts who have persistent debt. ‘Persistent debt’ is defined as the consumer paying more in interest, fees and charges than they have repaid of the principal.

22 If a consumer has remained in persistent debt for 36 months, the CONC states that credit card providers need to help the consumer by proposing ways of repaying more quickly within a reasonable period.

23 For this purpose, the FCA expects a reasonable period to be between three and four years. Only in exceptional circumstances should the repayment period extend beyond four years. Even then, the extension should not be significant and there should be no additional cost to the consumer.

B Prescribed period for assessments

Key points

We seek feedback on our proposal that:

- responsible lending assessments for credit card contracts or credit limit increases would be based on whether the consumer can repay the credit limit within three years; and
- the three-year period would apply to all classes of credit card contracts.

ASIC Credit (Unsuitability—Credit Cards) Instrument 2018/XX

Proposal

B1 We propose to use our power under s160F of the National Credit Act to prescribe a period of three years for responsible lending assessments for new credit card contracts or credit limit increases. Under our proposal:

(a) assessments would be based on the consumer's ability to repay the credit limit within three years; and

(b) this period would apply to all classes of credit card contracts.

Note: See ASIC Credit (Unsuitability—Credit Cards) Instrument 2018/XX (draft legislative instrument) in the attachment to this consultation paper.

Your feedback

B1Q1 Do you agree with our proposal to prescribe a three-year period? If not, why not?

B1Q2 Should we prescribe a period of two years for consistency with other requirements, such as the minimum repayment warning under reg 79B of the National Consumer Credit Protection Regulations 2010 (National Credit Regulations)?

B1Q3 Do you agree with our proposal that the prescribed period apply to all classes of credit card contracts? If not, why not?

B1Q4 What changes would need to be made to systems and processes to ensure compliance with the prescribed period by 1 January 2019?

B1Q5 Do you agree with our expectations about the assumptions that should be made when assessing whether a consumer can repay the credit limit within three years (see paragraphs 48–51)? If not, why not? Should any other assumptions be made?

Rationale

24 We think that a three-year period strikes an appropriate balance between:

(a) preventing consumers from being in unsuitable credit card contracts; and

(b) ensuring that consumers continue to have reasonable access to credit through credit card contracts.

Preventing consumers from being in unsuitable credit card contracts

25 Our proposal addresses the Government's concern that current industry practices can result in a subset of consumers incurring credit card debts that cannot be paid down in a timely manner without substantial financial hardship.

26 As highlighted in the Senate Inquiry report, minimum repayments levels lead to very long amortisation periods. We think that the proposed three-year period addresses this problem by ensuring that consumers are assessed on their ability to repay the credit limit on materially higher amounts than the minimum repayments that are typically required under credit card contracts, without unreasonably restricting access to that form of credit.

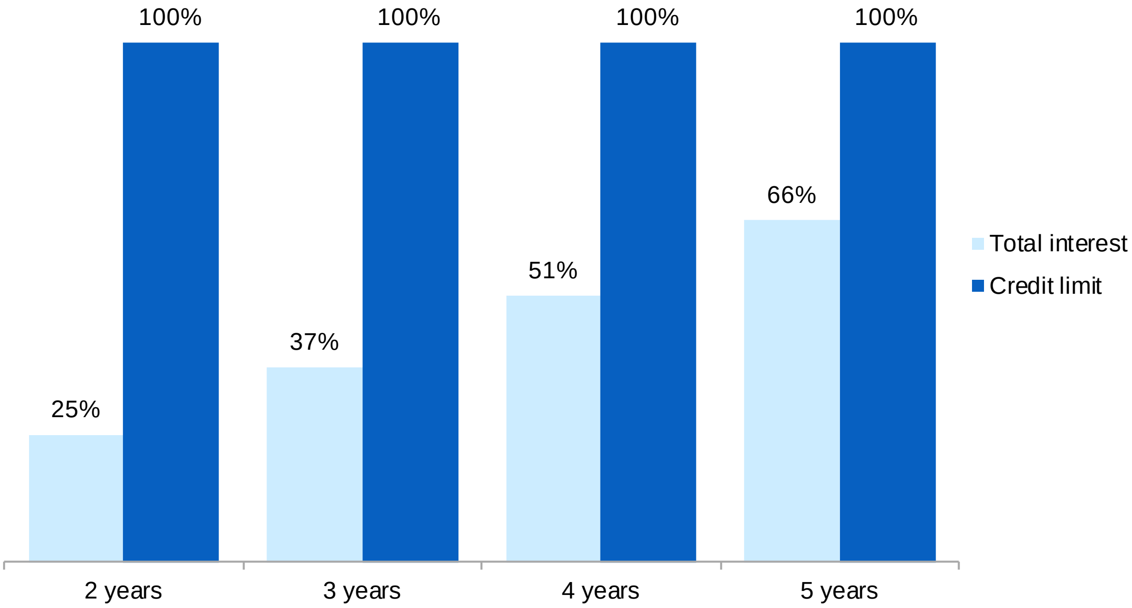
27 Another option we considered is a two-year period. This would align with the minimum repayment warning that must be included on monthly statements. The warning advises consumers of how much they would need to repay to pay off their balance within two years, and how much interest they would save by doing this compared to making minimum repayments. However, prescribing a two-year period would have a greater effect on access to credit card contracts.

28 In our view, extending the period beyond three years would result in consumers potentially incurring substantially higher costs for credit.

29 Figure 1 compares the proposed credit limit of a card to the amount of interest paid if the consumer repaid the limit over three, four or five years. The figure assumes that the consumer is making equal repayments and the interest rate that applies is 22%, which reflects the highest interest rates that may apply under many credit card contracts.

Note: For our views on assumptions in responsible lending assessments for credit cards, including about interest rates, see paragraphs 48–51.

Figure 1: Interest charges as a proportion of credit limit during assessments



Note: See paragraph 30 for a description of this figure.

30 Figure 1 shows that if a consumer repays the credit limit within three years, they will pay interest charges equal to 37% of the credit limit (compared to 25% for repayments over two years). This amount increases to 51% if a consumer repays the credit limit within four years or 66% over five years.

Current practices

31 We have received feedback from several credit providers indicating a preference for a five-year period. We have considered this feedback along with data obtained through our credit card review on typical credit limits and the types of assumptions currently made by providers during their responsible lending assessments.

Note: For details of the findings of our review, see Report 580 *Credit card lending in Australia* (REP 580).

32 For the purposes of those assessments, almost all credit providers currently assess whether the consumer could afford to repay a fixed proportion of the proposed credit limit every month. The proportion varies between providers but is between 2.5% and 5% of the credit limit in all cases; the most common proportion used is 3%.

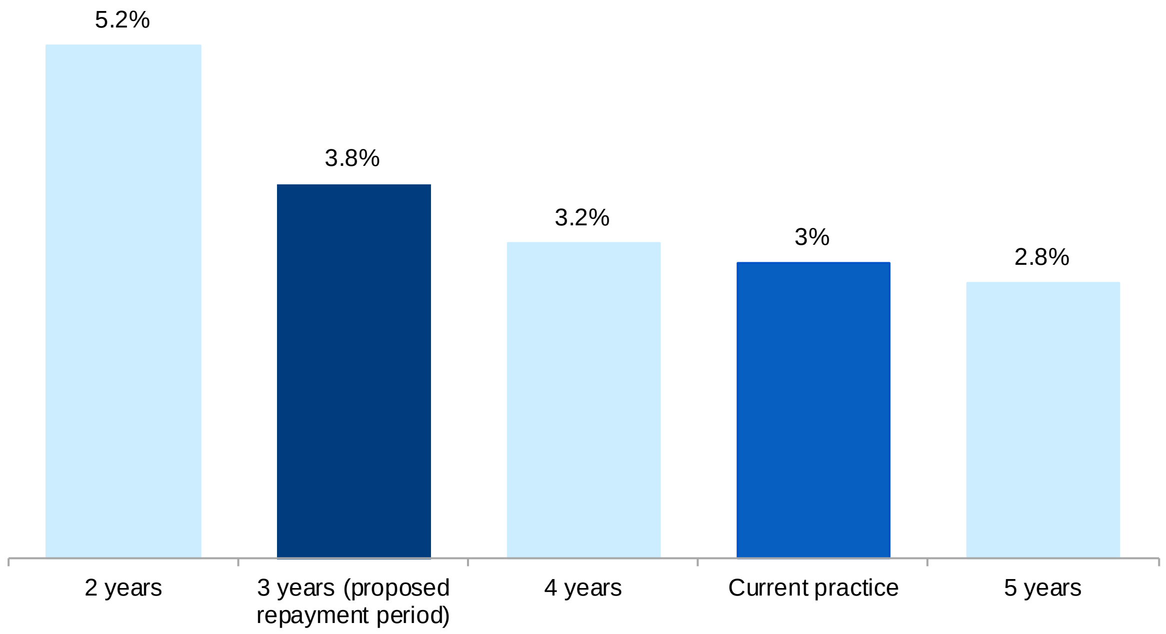
33 Most providers do not currently assess how long the consumer would take to repay the credit limit if making those repayments. This timeframe depends upon other assumptions, especially the interest rate that applies.

Note: For our view on these assumptions, see paragraphs 48–51.

34 Based on reasonable assumptions, the data from our review indicates that current industry practices already closely align with a five-year repayment period, or in some cases, produce a repayment period of less than five years.

35 Figure 2 compares current industry practices (e.g. assuming a consumer can repay 3% of the proposed credit limit each month) against the payments that would need to be made each month to repay the proposed limit within different periods. For the purposes of this analysis, we have assumed that the interest rate that applies is 22%, which reflects the highest interest rates that may apply under many credit card contracts (as for Figure 1).

Figure 2: Potential prescribed periods and the level of consumer monthly repayments



Note: See paragraph 36 for a description of this figure.

36 Figure 2 shows that when these assumptions are made, the proportion of the credit limit that needs to be repaid each month to pay off the limit within five years is 2.8%; this is lower than the most common current practice of 3%. By comparison, repaying the limit within three years requires consumers to repay 3.8% of the credit limit each month.

37 We have also conducted a similar analysis, which assumes that a lower interest rate applies. When an interest rate of approximately 12.5% applies to the balance, the repayments needed to repay the limit within four years are less than 3% of the limit.

38 We therefore consider that prescribing a five-year period would:

(a) not have a material effect on current practice; and

(b) as a result, be inconsistent with the policy intent of the reform.

Ensuring reasonable access to credit

39 We think that this proposal is unlikely to affect most consumers who have sufficient financial means to pay off a typical credit card limit within the prescribed period.

40 A representative sample of the data on credit limits that credit providers gave us as part of our review suggests that in June 2017 approximately:

(a) 15% of credit cards had a credit limit of $2,500 or less;

(b) 47% had a limit of $6,000 or less; and

(c) 25% had a limit of $12,000 or more.

41 The most common credit limit in June 2017 was $5,000.

42 The data from our review suggests that many consumers have credit limits of $5,000 or below. The analysis highlighted in Figure 2 indicates that there is only a relatively small increase in the amount needed to repay a $5,000 credit limit within three years compared to most current practices.

Ability of low income consumers to access credit cards

43 While this proposal might reduce the credit limits available to low-income consumers who might otherwise have accessed higher limits they could repay over a very long timeframe, we think that credit cards will still be accessible to these consumers.

44 Credit cards are currently on the market with credit limits as low as $1,000. Where an interest rate of 22% applies, this credit limit can be repaid over three years with a repayment of less than $40 a month. Cards with lower interest rates will require smaller repayments to repay the limit within three years. This indicates that low-income consumers would still have access to credit card products under our proposal.

45 We note that the Senate Inquiry concluded that credit cards are unsuited as long-term debt facilities, as more affordable products are often available. A period of three years (assuming a credit card limit of $10,000) might appropriately segment the market so that those consumers needing larger loans with longer repayment options could move into lower cost products, such as some types of personal loans.

Note: Regulation 97 of the National Credit Regulations assumes (for the purposes of comparison rate calculation) that a loan of $10,000 will have a repayment term of three years.

A single prescribed period

46 Based on data and feedback from credit providers, we do not think there is a need at this stage to set different periods for different classes of credit card contracts, credit limit amounts or rates of interest to tailor the requirements to different circumstances.

47 We think that prescribing one period for all classes of credit card contracts, credit limit amounts and rates of interest will help to minimise the costs of changes to credit card providers' systems and processes while being consistent with the intent of the reform.

Assumptions about assessments

48 We note that credit providers' current practices for assessing credit card serviceability vary. As highlighted by the Government in its response to the Senate Inquiry, providers may not be considering the length of the repayment period and cumulative interest charges when assessing whether a credit card is 'not unsuitable' under the National Credit Act.

49 We think that the clear intention of the reform is to ensure that consumers can repay their credit limit within the prescribed period, including interest charges.

50 For this reason, a consumer's ability to repay the credit limit should be assessed based on interest charged over the three-year period. We think it would be good practice for the assessment to assume interest is accruing at the highest rate that applies under the credit card contract. We understand that this is consistent with some current practices, including how some providers calculate their mandatory warnings about the effect of repeatedly making the minimum allowable repayment.

51 We also expect that when assessing whether a credit card is 'not unsuitable' for a consumer with other credit card contracts, providers will assume that the consumer is making repayments on the other contracts based on these assumptions, rather than the minimum repayment amount required under those contracts.

C Regulatory and financial impact

52 In developing the draft legislative instrument, we have carefully considered its regulatory and financial impact. On the information currently available to us, we think it will strike an appropriate balance between:

(a) preventing consumers from being in unsuitable credit card contracts; and

(b) ensuring that consumers continue to have reasonable access to credit through these contracts.

53 The Office of Best Practice Regulation has confirmed that the implementation of the credit card responsible lending reform through the proposed instrument complies with the Australian Government's regulatory impact analysis requirements.

54 The Explanatory Memorandum to the Banking Measures Act sets out the costs that would be incurred by credit providers in tightening these obligations, including costs for:

(a) developing new procedures and policies for staff;

(b) developing IT systems; and

(c) monitoring compliance with the new requirements.

Key terms

Term	Meaning in this document
ASIC	Australian Securities and Investments Commission
Banking Measures Act	*Treasury Laws Amendment (Banking Measures No. 1) Act 2018*
consumer	A natural person or strata corporation Note: See s5 of the National Credit Act
credit	Credit to which the National Credit Code applies Note: See s3 and 5–6 of the National Credit Code
credit assistance	Has the meaning given in s8 of the National Credit Act
credit assistance provider	A person who provides credit assistance to a consumer in relation to a credit card contract and who is not the credit provider
credit card	Has the meaning given in s133BA(2) of the National Credit Act
credit card contract	Has the meaning given in s133BA(1) of the National Credit Act
credit limit	Has the meaning given in s5 of the National Credit Act
credit licensee (or licensee)	A person who holds an Australian credit licence under s35 of the National Credit Act
credit provider	Has the meaning given in s5 of the National Credit Act
National Credit Act	*National Consumer Credit Protection Act 2009*
National Credit Code	National Credit Code at Sch 1 to the National Credit Act
reg 79B (for example)	A regulation of the National Credit Regulations (in this example numbered 79B)
responsible lending assessment	An assessment of the consumer's ability to repay the credit limit of a credit card contract within a period prescribed by ASIC
responsible lending obligations	The obligations under Ch 3 of the National Credit Act
s160F (for example)	A section of the National Credit Act (in this example numbered 160F)
Senate Inquiry	The inquiry by the Senate Economics References Committee in 2015 into matters relating to credit card interest rates