Submission to

Australian Securities and Investments Commission

Consultation Paper 303
Credit Cards: Responsible lending assessments

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25th July 2018

The agency

Care Inc. Financial Counselling Service (Care) has been the main provider of financial counselling and related services for low to moderate income and vulnerable consumers in the ACT since 1983. Care's core service activities include the provision of information, financial counselling and advocacy for consumers experiencing problems with credit and debt.

Care also provides a Community Development and Education program, gambling financial counselling as part of the ACT Gambling Counselling and Support Service (AGCSS) in partnership with lead agency Relationships Australia; makes policy comment on issues of importance to its client group and operates the ACT's first No Interest Loans Scheme which was established in 1997. Care also hosts the Consumer Law Centre (CLC) of the ACT. Across Care's service delivery programs, the agency responds to over 2,000 new requests for assistance every year.

Given the focus of our work, Care is acutely aware of the need for responsible lending assessments for credit facilities as we regularly work with clients affected by levels of debt that they cannot afford to repay. We therefore welcome the opportunity to provide this brief submission to the Australian Securities and Investments Commission Consultation Paper 303, Credit Cards: Responsible lending assessments.

Clients generally approach our service because they are experiencing financial hardship, often this is with credit card facilities. They may have been given a credit limit that is too high at the outset of the credit card and/or they have had a change of circumstances such as unemployment, illness, relationship breakdown or trauma that has affected their ability to maintain payments. Many clients make only the minimum payment each month and pay large amounts of interest as a result, sometimes over long periods of time.

We regard the current practice by financial institutions of using the 'Household Expenditure Measure[1]' to assess expenses as grossly inadequate to identify and cost any level of realistic household expenditure and we believe that this contributes to the likelihood that consumers, particularly those on lower incomes, will experience financial hardship at some point.

Financial counsellors carry out a detailed assessment of the client's financial position, including whether they are able to meet payments on credit cards (and other debts) or not. While taking the history of any debts that clients present with, it will often become apparent that the initial amount of credit granted was higher than should have been when factoring realistic household expenses and income. We also reject the notion that the minimum payment being made is a useful measure of a customer's ability to repay the full amount on a credit card. Using the minimum payment as the measure can appear to show that the credit card is affordable when in reality it is not. In fact when customers regularly pay only the minimum required, this is a more useful gauge of financial stress.

[1] https://melbourneinstitute.unimelb.edu.au/publications/social-indicator-reports

Below we respond to those questions from the consultation paper that are relevant to our client group

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

We agree with the proposal for a prescribed maximum three-year period for assessing suitability for a credit card. Credit cards become debt traps for many consumers, particularly those on low incomes who are only able to make the minimum monthly repayments. This can lead to life-long debt problems for them and mean they pay large amounts of interest, sometimes over decades, draining financial resources that would be better spent on essentials.

Low income and disadvantaged consumers can also struggle to maintain even the minimum monthly repayments causing accrual of further interest and fees. This can then result in a credit card debt being sold to a debt collector, adverse credit file reporting and in some instances legal proceedings and bankruptcy. A consumer needing larger sums of money with longer repayment options should be able to access low or no interest personal loans. Care's No Interest Loan program provides access for people on low incomes to purchase household goods to a value of $1,500 and the Step Up program run by other community agencies with support from NAB lends up to $3,000 with a modest interest rate. There are few other options for low income consumers needing credit. Care regards this as an area where banks in particular could take the lead and develop low interest credit options so low income consumers do not feel the need to obtain a 'payday loan', with the excessive fees and charges attached.

As described in the Senate Economics Reference Committee report on Interest rates and informed choice in the Australian credit card market (December 2015)[2], we often work with clients who are unable to pay their outstanding credit card balance in full at the end of the statement period and because of multiple disadvantages (including insufficient income), use their credit card as a repeat borrowing facility, resulting in a 'debt trap' that is nearly impossible to escape from. In these situations, consumers risk taking on significant levels of ongoing debt with little prospect of repaying it in the short to medium term. Added to this, our clients generally have no savings and the high interest rates make credit cards a constant drain on them.

A particularly destructive product in the credit card market is where clients have transferred from one credit card to another to obtain a 0% (zero per cent) balance transfer. These offers end up being problematic as there is no easy option to close the original credit card once the transfer has been completed. We recommend that banks should enable a 'click and close' option for credit cards as soon as a balance transfer has been completed. This would help to reduce the scenario which financial counsellors regularly see where a client has made several balance transfers and also retained the original credit card. They then accrue a debt on the original one as well as the new card; effectively there can be a doubling (or more) of debt this way. We regard this as a significant failing of the current system. When clients are trying to survive on very low incomes and in need of

[2]https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Credit_Card_Interest/Report/c05

medical treatment, braces for their children, medications, funds to pay utility bills, unexpected costs like car or home repairs and even food in some instances, it is understandable that they might use a credit card that has not been closed.

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

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?

Care agrees that all credit card providers, when assessing whether a credit card is 'not unsuitable' for a consumer, adhere to the same regulations and responsible lending reforms, thus ensuring consistency.

We agree that a consumer's ability to repay a credit limit should be assessed based on the total amount borrowed and on interest charged over a three-year period.

We also agree (in the absence of a 'click and close' option for the original credit card) that when a consumer already has one or more credit cards, and applies for another one, a limit increase or a balance transfer, that the new provider will assume that the consumer is making repayments on the other credit contracts based on the three year period and the full interest charged rather than the minimum monthly repayments on the other contracts. However we stress the need for a 'click and close' option for the older credit card to prevent debts accruing on multiple credit cards.

Case example[3]

A client approached Care for information about bankruptcy several years after escaping domestic violence. The client had a credit card debt of over $80,000 which they had accrued as a result of using credit cards for living expenses (including rent payments) while awaiting a family court settlement and sale of the family home which the client hoped would clear the credit card debts.

When the home sold at a loss, the client was unable to repay the credit cards. Subsequently, high interest rates and the client's inability to repay the balance outstanding each month resulted in the amount increasing. Although the client had been working since they left the violent relationship, the job was not highly paid and there was often not enough money to repay any more than the minimum balance on each credit card. Despite several attempts to obtain appropriate financial hardship with the bank, the client had been unable to do so and this resulted in their contacting Care about bankruptcy.

[3] Please note some aspects of this case example have been altered to protect the privacy of the client.

In closing Care:

- agrees with the proposal for a prescribed three-year period for assessing suitability for a credit card

- rejects the use of the 'Household Expenditure Measure' to assess expenses and recommend a review of this as a mechanism for determining household expenditure, and

- recommends a 'click and close' option for credit cards where a balance transfer is made to a new credit card.

Thank you for the opportunity to provide these comments.