



30 July 2018

Australian Securities & Investment Commission (ASIC)

By email only: creditcards@asic.gov.au

Submission: Credit cards – Responsible lending assessments

1. Introduction

- 1.1 Thank you for the opportunity to provide feedback on ASIC's proposal to set a prescribed period that must be used when assessing whether a credit card contract or a credit card limit increase is unsuitable set out in Consultation Paper 303 Credit cards: Responsible lending assessments (**CP 303**).
- 1.2 We will firstly set out our unique position to provide a useful and insightful submission in this area as a specialist community legal centre. Secondly, we will draw on our experience with consumers caught in revolving credit card debt and explain why we think prescribing a period is an important step to helping consumers. Thirdly, we propose our considered alternative approach of a 2 year prescribed period. Finally, we will address the specific questions raised in CP 303.

2. About Consumer Credit Legal Service (WA) Inc.

- 2.1. Consumer Credit Legal Service (WA) Inc. (**CCLSWA**) is a not-for-profit specialist community legal centre based in metropolitan Perth that:
 - 2.2.1 provides legal advice, assistance to, and advocacy on behalf of consumers, with issues arising out of their credit and debt related problems or out of their Australian Consumer Law disputes;
 - 2.2.2 operates a telephone advice line which consumers can call and receive free legal advice and information;
 - 2.2.3 provides resources for financial counsellors and other consumer advocates working with low-income people to resolve their credit and debt related problems, or Australian Consumer Law related disputes;
 - 2.2.4 provides community legal education programmes relating to credit and debt issues, and the Australian Consumer Law;

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- 2.2.5 provides financial literacy programs to high school students and select groups within the community;
 - 2.2.6 provides contributions to relevant policy and law reform initiatives; and
 - 2.2.7 provides a training and supervision program for law student and graduate volunteer paralegals.
- 2.2. In providing these services, CCLSWA aims to support the community by educating people about, and advocating for, their consumer and financial rights.
- 2.3. We seek to empower people to resolve their own disputes with banks, financial institutions, and commercial enterprises. We also aim to educate people about banking, finance and consumer law, and improve the commercial marketplace for the benefit of the community through participating in community legal education and policy and law reform.
- 2.4. As such, believe that CCLSWA is well placed to provide ASIC with insight into, and information on, how Western Australian consumers use credit cards and manage their credit card debt.

3. Our experience

- 3.1. The following case study demonstrates our experience of helping a client with credit card debt.

Case study: Linda's story

Linda first applied for a credit card with the Big Bank in 2007. The initial credit card limit was \$3,000 which was reasonably assessed as not unsuitable.

Linda often used Big Bank's online banking system to manage her credit card. Through this system, Big Bank often offered Linda credit card limit increases which she would accept.

Linda's credit card limit gradually increased as follows:

<u>Credit card limit increase no.</u>	<u>Assessment date</u>	<u>Credit card limit increase</u>
1	n/a	\$3,900
2	6 April 2011	\$7,400
3	16 November 2012	\$11,400
4	16 July 2013	\$14,900
5	18 November 2014	\$18,000
6	24 December 2015	\$22,600

Linda regularly incurred over limit fees and late charges indicating that she was struggling to manage her debt. Despite the consistently late payments, Big Bank continued to offer Linda credit card limit increases.

Linda regularly relied on small amount credit contracts (SACC's) to meet her debt obligations and using this means she managed to make repayments regularly up until June 2016. She subsequently defaulted 9 times before seeking assistance from a financial counsellor who assisted her to negotiate a hardship variation.

When Linda first sought assistance from CCLSWA her credit balance was approximately \$24,000 consisting mostly of interest.

CCLSWA assessed Linda's financial situation at the relevant dates and determined that credit card limit increases no.3 to no.6 were unsuitable.

Big Bank failed to reply in full to CCLSWA's request for documents, but the documents they did provide stated the purpose for seeking each credit card limit increase as "general purpose". RG209.35 provides that such general descriptions of the purpose of a loan would not be sufficient. This very general description is indicative that Big Bank likely did not make inquiries into the timeframe that Linda sought the increases for nor the specific purpose nor benefit she was seeking from the increases.

CCLSWA lodged a dispute with Big Bank's external dispute resolution scheme (EDR). The EDR determined that Big Bank breached its responsible lending obligations when it approved Linda's credit card limit increases because Linda could not afford to repay the credit card limit increases. The EDR determination required Big Bank to reverse/refund all interest, fees and charges incurred by Linda that she would not have incurred had Big Bank complied with its responsible lending obligations. EDR calculated the total value of purchases and repayments made by Linda during the relevant period and determined an adjusted balance credit card of \$14,978.00

- 3.2 The above case study shows that not only did Big Bank fail to comply with responsible lending laws but it did not take any steps to address Linda's problematic credit card debt, let alone the proactive steps that ASIC expects credit providers to take to address this type of debt.
- 3.3 CCLSWA assists and advises many consumers who find themselves in situations such as Linda. We believe that this occurs, in part, due to the inadequacy of current responsible lending obligations that apply to credit card limit increases.

Necessity of prescribed period

- 3.4 We acknowledge the scalability of the level of reasonable inquiries to be made and verification obligations of credit providers (Regulatory Guide 209 (RG 209) at [209.19]).
- 3.5 The factors relevant to the scalability of the reasonable inquiries and verification obligations are set out in Table 3 of RG 209. The main factor that we believe is at play in situations such as Linda's is that the credit provider can make less extensive inquiries about the consumer, and take less extensive steps to verify information, where the consumer is an existing customer.
- 3.6 This could be seen as reasonable because credit card limit increases are essentially a continuing credit contract of an existing customer, and a credit card limit increase may be considered to be a small change relative to the size of the initial credit card

limit. As such, the potential impact of an unsuitable credit card limit increase on a consumer may be construed as minimal; and, as a result, the credit provider 'scales down' their responsible lending inquiries.

- 3.7 However, as Report 580 demonstrates, this would be a misconception. The propensity of people to have persistent debt and make repeated low repayments is high. As found in Report 580, over 890,000 consumers who were in problematic debt in 2013 also met those indicators in 2017 (at [19]). This means that these consumers were in the same position of being unable to manage their credit card debts nearly 5 years later. Therefore, it is important that credit card contracts *and* credit card limit increases are properly and fully assessed as both can significantly affect consumers and place them at risk of harm.
- 3.8 Further, applying a sliding scale of responsible lending inquiries and requiring minimal responsible lending inquiries for credit limit increases does not take full account of how the consumer's financial circumstances may have changed since the credit card contract was initially provided to the consumer. This is particularly the case when that information is not known to the credit provider solely from the information it has before it (eg information about accounts held by the consumer with that particular credit provider). Changes could relate to the customer's debts such as other credit cards, SACC's, car loans and personal loans the consumer may have, and the amount owing on any home loans, as well as changes to income.
- 3.9 The minimal responsible lending inquiries also do not take full account of how the consumer's personal circumstances may have changed since the credit card contract was initially provided to the consumer. This can include life events such as a divorce, a marriage or starting a family.
- 3.10 These circumstances are important because not only can they mean that the consumer cannot afford the credit card or credit card limit increase, but it can mean that a credit card is not an appropriate credit facility to achieve the consumer's desired objectives.
- 3.11 CCLSWA strongly supports the introduction of a responsible lending assessment for credit cards based on a consumer's ability to repay the entire debt within a prescribed period of 3 years (or, in the alternative, 2 years (see section 4 below)).
- 3.12 We believe a prescribed period would place an increased onus on credit providers by 'scaling up' the level of inquiries required to be made in relation to credit card contracts and/or credit card limit increases and would improve the arguably minimal inquiries that in our experience credit providers currently apply in reliance on a sliding scale of responsibility.
- 3.13 We also consider that introducing a prescribed period is necessary as credit providers do not have an incentive to proactively manage at risk consumers themselves.
- 3.14 As acknowledged in Report 580, consumers who are in persistent debt, or repeatedly make low repayments, are profitable for credit providers (at [27]; [166]). This becomes obvious when one looks at Report 580's finding that roughly 67% of credit

providers do not proactively contact consumers that make payments around the minimum amount for an extended period to prompt them to repay more, and do not proactively look for signs of potential consumer harm (at [25] to [26]). Additionally, 50% of credit providers that offer promotional rates on balance transfers do not take proactive steps to remind consumers who have not repaid the transferred amount that the promotional period is about to end (at [40]).

- 3.15 Report 580 found that generally credit providers' proactive measures were more common where there were direct incentives to act, and that some providers do not look for consumer harm until the consumer's issue crystallises into either delinquency or consumer-initiated contact (at [188]). Therefore, it is clear that credit providers do not have a financial interest in prioritising consumers' interests and that other measures need to be taken to protect consumers.
- 3.16 For the reasons above, we are confident that a prescribed period is necessary to reduce consumer harm.

4. Alternative approach

- 4.1 While CCLSWA supports a 3 year prescribed period, we propose that ASIC goes further and prescribes a 2 year period for the assessment of a consumer's ability to repay the credit card limit.
- 4.2 We have considered Figure 1 and Figure 2 of CP 303 and believe that the amount of interest payments that may be avoided by a consumer if they repay within 2 years (25%) rather than 3 years (37%) represents a substantial saving, particularly when it is considered relative to the amount of the payments that a consumer would need to make to repay the limit within 2 years (5.2%) rather than 3 years (3.8%).
- 4.3 We note ASIC's comments and acknowledge that prescribing a 2 year period would have a greater effect on access to credit card contracts. We argue that this is entirely the purpose of the reform.
- 4.4 To have a significant impact on the revolving debt trap, the proposal must necessarily markedly affect access to credit card contracts/credit card limit increases in order to reduce the number of unsuitable credit card contracts/credit card limit increases.
- 4.5 It is counter to propose to prescribe a 3 year period (as opposed to 2 years) precisely in order to give greater access to the class of consumer that sits on the cusp of suitability, ie, precisely the class of consumers that the proposal seeks to save from the 'debt trap'.
- 4.6 Noting that current industry practice is to assess a consumer's ability to repay between 2.5% and 5% of their credit card limit every month; the most common proportion used being 3%, we do not believe the proposed 3 year repayment period goes far enough to effect change (noting that Figure 2 reflects that a 3 year repayment period equates to a monthly repayment of 3.8%).

- 4.7 We assert that in order to have the desired impact of relieving the revolving credit card debt trap, the prescribed period must cause the assessment of a consumer's ability to repay to deviate further from current industry practice.
- 4.8 A monthly repayment of 3.8% sits too comfortably within current industry parameters to effect any meaningful change. It will allow consumers to carry high balances for a significant period at relatively high interest rates, which is the status quo that ASIC has set out to change for the better.
- 4.9 We contend that an appropriate balance between preventing consumers from being in unsuitable credit card contracts and ensuring their reasonable access to credit card contracts can be struck at the outer parameters of current industry practice.
- 4.10 Noting the outer parameters of current industry practice is to assess on a consumer's ability to repay 5% of their credit card limit every month; and that a 2 year prescribed period would require only a monthly repayment of 5.2%, this would require little compromise from the industry but to greater effect.
- 4.11 Further restricting access to credit card contracts does not restrict access to credit per se, but may simply translate to a consumer seeking access to an alternative, more suitable form of credit (for example, a lower interest, fixed term personal loan).
- 4.12 This may cause credit providers to consider the objectives and requirements of the consumer more carefully and modify their credit suggestions to suit the consumer's needs and affordability.
- 4.13 We also note the UK approach which, when considering what a reasonable period is, draws parallels with the time required for repayment of an unsecured personal loan for that amount.
- 4.14 CCLSWA sees merit in drawing parallels between credit cards and personal loans in this regard as this may assist consumers to more directly compare the costs of alternative credit. It may also serve to highlight alternatives where continuing credit is not actually required. This is a positive outcome given that carrying large balances for a significant period at relatively high interest rates is expensive compared to other debt options (Report 580 at [107]).
- 4.15 Drawing parallels may also force consumers and credit providers to focus their inquiries regarding the objectives and requirements for the credit (particularly the length of time for which the credit is required) which in our experience is often overlooked on the sliding scale of responsibility in relation to credit card contracts.
- 4.16 Setting a prescribed period of 2 years may also assist consumers in obtaining credit cards that suit their actual needs or behaviours, if it is found that a credit card is the most appropriate credit option. Report 580 found that most credit providers do not vary their assessments based on the features of the products (eg interest rates, annual fees, rewards programs) when those features can be highly relevant to whether the proposed card is well-suited to the customer's actual behaviour (at

[203]). A lower prescribed period may help ensure that credit providers more actively engage with consumers when it comes to selecting credit cards.

- 4.17 Prescribing a 2 year period will also ensure consistency with other regulatory requirements, such as the minimum repayment warning on credit card statements.
- 4.18 We also assert that a lower prescribed period of 2 years is necessary to improve the lack of focus by credit providers on measures to help consumers with persistent debt or who make repeated low repayments, as found by Report 580 (at [138]). Otherwise, it may eventuate that the proportion of consumers that remain in persistent debt over time and the proportion of consumers that continue to make repeated low repayment will not change (as was found between 2013 and 2017 at [136] to [137] of Report 580). As explained above, credit providers have little incentive to address these issues themselves, so a lower prescribed period will be a more effective way of tackling revolving and spiralling consumer debt.
- 4.19 In summary, we believe that a 2 year prescribed period should be preferred to a 3 year prescribed period because:
 - 4.19.1 the amount of interest payments that may be avoided by a consumer if they repay within 2 years rather than 3 years (12%) is a substantial saving, particularly when considered relative to the extra amount of payments that a consumer would need to make to repay the credit card limit within the 2 year period (extra repayments of 1.4%);
 - 4.19.2 it would further reduce access to unsuitable credit cards and credit card limit increases, consistent with the purpose of the reform of reducing the revolving debt trap;
 - 4.19.3 credit providers are most commonly assessing the minimum repayment as 3% in any event (with the 3 year repayment period equating to a 3.8% monthly repayment), meaning that a 3 year repayment period is unlikely to produce a significant improvement in consumer outcomes;
 - 4.19.4 it will assist consumers to more directly compare the costs of alternative credit, and for credit providers to focus their inquiries on the objectives and requirements for the credit and whether a credit card is the most appropriate option;
 - 4.19.5 credit providers are more likely to actively engage with consumers when it comes to selecting an appropriate credit card, if a credit card is considered to be the most appropriate option;
 - 4.19.6 it is consistent with other regulatory requirements, such as the minimum repayment warning on credit card statements; and
 - 4.19.7 credit providers have little incentive to assist consumers with persistent debt or who make repeated low repayments, so a lower period needs to be prescribed as it will be a stronger and more effective way of reducing revolving and spiralling consumer debt.

5. Feedback

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

5.1.1 CCLSWA agrees with the proposal of prescribing a 3 year period (at most). For the reasons set out at 3.4 – 3.16 above, we believe that the proposal will cause credit providers to ‘scale up’ the level of inquiries for responsible lending assessments for new credit cards and credit card limit increases from its currently ‘scaled down’ position.

5.1.2 However, we consider that a 2 year period is a more effective approach for a number of reasons, which we have set out in section 4 above.

5.2 *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?*

5.2.1 Yes. Consistency with other requirements is another valid reason for prescribing a 2 year period which serves to strengthen our argument for a 2 year assessment period set out in section 4 above.

5.2.2 Alternatively, for the sake of consistency, consideration should be given to changing the other requirements (such as reg 79B) to a 3 year period.

5.2.3 Regulatory consistency may also serve to reduce confusion arising from a consumer’s interpretation of their credit card contracts and statements. It would be more informative for consumers if the warning under reg 79B reflected the actual responsible lending assessment period. As it would be more obvious on the face of a consumer’s credit card statement what the minimum payment would be to repay within the prescribed time, it may also serve to highlight any breaches of responsible lending obligations.

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

5.3.1 CCLSWA agrees with the proposal that the prescribed period should apply to all classes of credit card contracts.

5.3.2 Again, we support this proposition on the basis of consistency. Consistency will increase credit provider compliance, and reduce consumer confusion.

5.3.3 CP 303 suggests that the proposal will apply to both new and existing credit card contracts from 1 January 2019. It is unclear, but we presume that it may only apply to existing credit card contracts in the context of any application for a credit card limit increase. CCLSWA does not support any reform operating retrospectively to reduce a consumer’s existing credit card limit. A

retrospective application of the reform to credit card limits may disadvantage consumers who may be on the brink of suitability but strategically manage their credit card debt to maintain access to credit.

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

5.4.1 CCLSWA suggests that a strong deterrent for non-compliance will help to ensure compliance with the prescribed period by 1 January 2019.

5.4.2 Existing responsible lending requirements would suffice if they were properly adhered to, which in our experience they often have not been. The prescribed period will make it more difficult for credit providers to evade the responsible lending obligations but only if its implementation is followed with force.

5.4.3 CCLSWA proposes that a criminal penalty be added to provisions which only contain a civil penalty. A criminal penalty can further deter breaches of responsible lending obligations.

5.4.4 CCLSWA further proposes that in addition to the current civil and criminal penalties, credit providers should be penalised by being required to write-off, partially or in full, the principal debt owed to them when they have been found to have breached their responsible lending obligations.

5.4.5 In our experience, upon a finding that credit providers had breached their responsible lending obligations by external dispute resolution providers, they were only required to refund the interests and fees charged. This means that credit providers are never out of pocket. The deterrent effect of writing off the principal debt will be higher than merely refunding interest and charges.

5.5 *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? If not, why not? Should any other assumptions be made?*

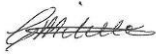
5.5.1 CCLSWA agrees with the assumptions made.

6 Conclusion

6.1 CCLSWA is grateful for the opportunity to provide input to the proposed prescribed period for responsible lending assessments for new credit card contracts and credit card limit increases.

6.2 If you have any questions or would like to discuss this matter further, please contact Gemma Mitchell at (08) 6336 7020.

Yours faithfully
Consumer Credit Legal Service (WA) Inc.

A handwritten signature in black ink, appearing to read 'Gemma Mitchell', written in a cursive style.

Gemma Mitchell
Managing Solicitor