Your Choice, Your Voice

Australian Securities and Investment Commission
ASIC

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Credit Card Responsible Lending Assessments Submission

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The FBAA welcomes the opportunity to provide a submission to Consultation Paper 303 - Credit Cards: Responsible Lending assessments.

This paper first provides some general comments for context and then provides specific responses to the questions posed in CP303.

## FBAA Preliminary Comments

1. We recognise the need for some further supervision, and perhaps regulation of, the issuance and management of credit cards, although we have some reservations about the approach proposed in CP303 and some of the findings cited in support for further reform.
2. We broadly support measures that encourage credit providers to monitor consumer use of credit cards and to engage with consumers who appear to be encountering difficulty, however this must be balanced with consumer accountability and freedom to conduct their own affairs as they choose.
3. We are concerned this round of reform proposals are really aimed at attempting to change consumer behaviour through imposing obligations on credit card issuers.
4. Aside from a subset of people who should not hold credit cards, or cards with high limits where they are unable to repay the balance within a reasonable time, most consumers are capable of understanding how to use a credit card. Further regulation is more likely to frustrate genuine users and those predisposed to make poor financial choices will find an alternative way to access credit and will continue to make poor choices.
5. We are most concerned about the impact on consumers who utilise interest free periods and move debt between card providers to leverage the interest free periods and consumers who like the security of carrying a high-balance card for emergencies. Granted a number of consumers mis-use the balance transfer opportunity however

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there are many who use it extremely effectively. No study has been conducted to try to identify this group and to determine whether they would be adversely impacted by the proposed reforms.

6. A consumer on average income would lose the interest-free balance transfer opportunity if credit card providers are required to assess their capacity to repay the full balance within three years.

   a) Example: Simon has a $10,000 limit credit card. Simon purchases tickets for an overseas family holiday for $8,000 using the card. Simon then applies for a new card with a $10,000 balance and 6 months' interest free on the transferred balance.

      Simon keeps his first card as his primary transaction card because purchases on the second card would immediately attract interest and he is not able to only pay off new purchases made off the card. Any payments towards the card would also pay off the interest free balance of the card which would negate the benefit of the strategy.

      The second issuer would need to assess Simon's ability to repay $10,000 at 22% per annum over three years – payments of approximately $382 per month[1] whilst also recognising his existing commitments.

      At the end of the second interest free period, Simon proposes to roll the balance of his card to a third issuer to take advantage of another interest free period. The third issuer would need to assess Simon's capacity to repay three cards of $382 per month. With an average monthly income of around $6,000 and other financial commitments plus living expenses, Simon is unlikely to qualify for another card even though he intends to cancel the second card once the balance has been transferred.

## Previous reforms have not been as effective as anticipated

7. ASIC Report 580 comments on the effectiveness of previous reforms including the requirement to provide a Key Fact Sheet, the way payments are allocated and the minimum repayment warning. Report 580 notes the limited effectiveness of these previous reforms. Prior reforms which were advanced as suitable solutions to address concerns around credit issuance and use by consumers at a particular point in time have had limited effect. It is equally plausible the mooted reforms in CP303 will follow the same path yet they impose significant obligations on issuers and potentially

[1] Calculated as repayments on a $10,000 personal loan at 22% APR.

significant restrictions on consumers' access to credit in an attempt to change consumer behaviour.

8. Report 580 notes that consumers do not always make choices that best serve their own interests[2]. Regardless of further measures being implemented, consumers will continue to behave in ways that do not always produce the optimal outcome for their personal circumstances. At some stage we must accept that his will endure regardless of the degree of protections and regulatory obligations that are imposed on participants. Consumers make less than perfect choices in every aspect of their every-day lives and Government should not seek to eliminate this through over-regulation. It will not achieve the outcome but will overburden the regulated population to the point where goods and services are too complex or costly to provide.
9. We support enforcing the requirements to allocate payments to credit card contracts in the way that produces the best outcomes for consumers. This is a measure that assists consumers and there is no reason for issuers not to do this. It is also a measure that cannot be undermined by consumer behaviour (i.e. consumer behaviour can do little to erode the effectiveness of this measure). Conversely, disclosure-based solutions such as Key Fact Sheets and minimum repayment warnings have no impact on consumers who choose not to engage with the information – and we would suggest that this is a high proportion.
10. The range of credit products available to consumers is quite narrow which further amplifies the perception that one of the prevailing forms of credit requires further reform.
11. There is little evidence of predatory behaviour by credit card issuers. Consumers strive for higher standards of living and require access to credit to achieve it. Absent unfair / unconscionable behaviour by issuers, we strongly support the position that consumers must be encouraged to take accountability for their choices; and that most consumers do.
12. ASIC states in Report 580 that it expects improvements in credit providers' practices in a number of areas. We note that some of these are again disclosure based actions[3]. ASIC must accept the realities about consumers' levels of engagement with much of this information. That is, regardless of how much consumers are told and in how many different ways, many will not change. We do not believe the answer is to excessively regulate credit providers in order to try to engineer consumer outcomes that consumers themselves can currently attain yet remain ambivalent about.

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[2] *ASIC Report 580: Credit card lending in Australia*, paras 348 and 349.

[3] See for example Issue 6: Credit providers should develop tools to help consumers choose credit cards that reflect their actual needs and use.

13. Increasing levels of financial literacy and consumer engagement could already see a majority of consumers selecting products that best suit their needs and utilising their credit cards in a manner that produces optimal financial outcomes (for example by paying off the balance each month). That not all consumers choose this is not a failing of regulation or misconduct by credit providers.
14. There are multiple reasons why consumers do not use cheaper forms of finance to reduce credit card debt, and not all of them have any relationship with credit provider conduct.
    b) **Segregating expenditure**
    Many consumers seek to separate home loan debt and personal expenditure debt. Despite home loan debt being considerably cheaper, many consumers wish to see their mortgage balance progressively reducing and are reluctant to redraw from their mortgage for personal expenditure. ASIC has previously recognised the dangers of offset and redraw facilities and indeed criticised mortgage brokers for advising consumers to borrow additional funds and keep a buffer in their mortgages for unforeseen situations.
    c) **Flexibility**
    Consumers prefer credit card debt to personal loans and other more rigid finance contracts for their flexibility[4]. Personal loans bind consumers into rigid repayment obligations which increases the likelihood of default. Flexibility comes at a cost that many consumers are willing to pay. The more than 14 million cards in circulation in Australia is testament to this.
    d) **Convenience**
    Credit cards are more convenient to obtain than other forms of finance. Leaving aside arguments about assessments of unsuitability, consumers can apply for credit cards online (not branch visit required) and at a time that suits them. Credit cards are the preferred form of finance for financially astute consumers. We recognise that affordability assessments of the nature mooted in this Consultation Paper would not impact very high net wealth individuals however they do have potential to impact a very high percentage of the population who would otherwise wish to emulate the successful financial habits of wealthy individuals.
15. When the factors above are combined, it is difficult to point to any other form of credit/financial product that can serve consumers' needs as efficiently as credit cards.
16. Perhaps one of the most revealing statements in the consultation paper is found at paragraph 25 of the CP wherein it states the "proposal addresses the Government's

[4] ASIC Report 580: Credit card lending in Australia, paragraph 2.

concern that current industry practices can result in *a subset of consumers* [emphasis added] incurring credit card debts that cannot be paid down in a timely manner without financial hardship". Owing to the vagaries of data analysis, it is not possible to differentiate between consumers who choose to misuse credit or are otherwise disengaged with the consequences of its inefficient use, and those who genuinely cannot meet their commitments without hardship. The *Pacoccio* case was assistive in demonstrating this (the Court found that Mr Pacoccio could have paid the balance off his card each month yet instead chose to pay a lesser amount knowing he would incur fees for doing so). We are concerned to ensure there is a balance between the objectives of the proposed further regulation and unfairly impacting everyone else. Worse, the proposed regulations could unfairly impact all other users and have little influence on the behaviour of the subset that may merely find alternate ways to obtain credit .

17. We very strongly encourage industry when considering reforms mooted in CP303 to consider whether, in a further 5 years' time, there will be another ASIC report such as Report 580 stating the reforms of 2018 have not produced the outcomes that were hoped for. Where consumer behaviour is a key factor in its success and is something that cannot be corralled, such an outcome may be more likely than not.

**Data -linking**

18. We were encouraged to see that ASIC attempted data-linking to identify situations where consumers held more than one card. It would have no doubt been a very difficult exercise and the results likely to be irresolute.

19. The FBAA conducted its own straw polls at recent PD days as to the number of cards most consumers held who were applying for finance through our broker network. The results were neither formal nor quantified, however very few attendees indicated that a typical consumer had only one credit card. It was most common for consumers to have 3 or more cards.

### The risk of multiple smaller cards

20. CP 303 does not specifically seek submissions to identify potential risks of the proposed approach. We agree the existence of multiple cards is a critical consideration for the reform proposal because lower lending limits per card are likely to push consumers to apply for more cards. This is a potentially inferior outcome since consumers will be juggling more commitments to more providers. Holding multiple, smaller-limit cards increases a consumer's risk of default because:

   a) they are more likely to overlook a payment on a particular contract; and

b) they are more likely to max out the limit of multiple smaller amount cards.

21. Consumers falling into financial difficulty may find themselves seeking hardship relief from a larger number of providers on smaller individual debts. Clearly this would be a concerning outcome.

## FCA Experience

22. CP303 draws information from the UK experience in support of proposed reforms. CP303 identifies that the UK's FCA influences credit card provider conduct under its Consumer Credit Sourcebook (CONC). Several provisions appear to resonate in the ASIC recommendations under CP303 namely:

   a) That credit card providers consider a consumer's ability to repay a credit limit
   b) Requiring credit providers to monitor consumer conduct and to engage consumers in persistent debt

23. Without the full context of the regulatory regime of the FCA it may be misleading to isolate specific measures from the FCA approach and to insert them into the Australian regime. With the amount of time available to formulate a response to the paper, FBAA has not had the opportunity to fully explore this with its international counterparts but we ask that any consideration given to adopting measures from foreign jurisdictions take into account the other protections and economic data necessary to balance out priorities.

24. There is a very broad range of data necessary to understand the FCA regulatory approach in context. For example, we do not have data on the average number of cards held by consumers, the average limits or balances of such cards, the levels of household debt and credit card debt, debt to income ratios or the other criteria credit providers are required to take into account when assessing a consumer application for a credit card.

25. The UK's policy statement PS18/4 helpfully acknowledges that that not all debt concerns are caused by credit provider conduct[5]:

> 1.6 We recognised that some bad debt is a feature of all credit activity. Borrowing is never risk free as the ability to repay can be affected by major life events which cannot beknown in advance when deciding to borrow or lend.
>
> 1.7 We also recognised that the flexible nature of credit cards is one of their most

[5] References taken from FCA's PS 18/4 dated February 2018.

Positive features valued by millions of consumers. They can benefit consumers by helping to defer payment and spreading its costs over a number of months. They are also an effective way to smooth payments and outgoings in response to temporary shocks to income or unexpected expenses and avoid transaction costs associated with multiple transactions.

1.8 But the downside of this flexibility is that consumers can accumulate and sustain debt over a long period without making significant contributions to repaying the outstanding balance. Such customers are profitable for lenders, meaning firms have an incentive to allow this to continue. This harms customers because it can be an expensive way to carry longer-term borrowing and can hide deeper financial difficulties.

26. Other measures appear to be in place in Australia that are not present in the UK such as a ban on auto credit card limit increases. A complete and comprehensive assessment of both regimes is required to weigh the need for adopting measures used in other jurisdictions because the Australian jurisdiction may already have more stringent measures in other areas that offset the need for further regulation.

## ASIC 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?**

27. We do not agree with a three year period. We are concerned the interference with the majority of consumers' legitimate choice and access to credit outweighs the protective nature of the reforms aimed at addressing the concerns around the misuse of credit by a *subset* of consumers.

**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)?**

28. We strongly oppose any further shortening of the proposed period.

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

29. The FBAA has an alternative consideration to advance which is proposed under our response to B1Q5 below.

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

30. We provide no response to this question.

**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?**

31. Whilst we are not broadly supportive of the tightening of responsible lending assessments and the assumptions underpinning these proposals for reasons we have identified earlier in the submission, we propose an alternative model we believe would more effectively deliver on the objective of limiting the harm of consumers misusing credit cards as a source of finance where the cost of such is higher than alternative forms.

### Different repayment periods for cards depending on the interest rate

32. IF further regulation of the assessment of serviceability under a credit card is unavoidable, the FBAA proposes a model whereby the repayment periods for cards is aligned with the interest rate.

33. Low rate cards should carry a longer repayment period and higher rate cards a shorter repayment period. Such a model would:

a) Encourage credit card issuers to offer more cards at lower rates;
b) See a narrowing of the margin between the cash rate and credit card interest rates;
c) Drive consumers wishing to obtain a higher credit balance towards low interest rate cards (and then if they subsequently rely on this card for day to day credit by making lower monthly repayments, the level of consumer

detriment is lower);

d) Still make available premium cards with rewards programs which generally carry higher interest rates available to consumers with higher disposable incomes and who can demonstrate serviceability.

34. If there is any interest in such a model, the FBAA would propose the threshold be set around 10% with cards with interest rates of 10% or lower being assessed on repayments over 5 years and cards over 10% being assessed on repayments over 3 years.

35. Alternately the interest rate could be a function of the RBA cash rate plus a margin.

## Additional Matters

36. The proposed reforms do not address existing credit cards. It would take many years for restrictions around serviceability assessments on new cards to permeate through the marketplace. We recognise however that credit providers could improve monitoring and intervention which might have the largest impact on potentially problematic cards which are already in circulation.

37. The emergence of alternative, unregulated options such as After-Pay will quickly fill any void left by tightening of credit card issuance. The proposals against credit card issuance unfairly target credit card issuers and leave other operators already subject of little to no regulation to gain market share.

38. Credit card affordability reforms are likely to have a sizeable impact on the retail industry. Has ASIC undertaken any study to model the potential impact and is ASIC satisfied the reforms are necessary when balanced against adverse impact on the retail industry?

END

Yours faithfully

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