



**Australian Government**

# **Credit cards: improving consumer outcomes and enhancing competition**

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May 2016

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# CONSULTATION PROCESS

## REQUEST FOR FEEDBACK AND COMMENTS

A public consultation process will run from 6 May 2016 to 17 June 2016.

**Closing date for submissions: 17 June 2016**

Email: CreditCards@treasury.gov.au

Mail: Principal Adviser  
Financial System Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Enquiries: Enquiries can be initially directed to the Financial Innovation and Payments Unit

Email: CreditCards@treasury.gov.au

## PROVIDING A CONFIDENTIAL RESPONSE

All information (including name and address details) contained in formal submissions will be made available to the public on the Australian Treasury website, unless it is indicated that you would like all or part of your submission to remain confidential. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain confidential should provide this information marked in a separate document.

A request made under the *Freedom of Information Act 1982* for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

## NEXT STEPS FOLLOWING THE PUBLIC CONSULTATION PROCESS

Stakeholder feedback to the public consultation process will inform the Government's consideration of actions to enhance competition and improve consumer outcomes in the credit card market. Once the public consultation process is concluded, further targeted consultation may be necessary to clarify any issues or questions which arise from the initial consultation period.

Stakeholder feedback will also help to inform the Final Assessment Regulation Impact Statement (RIS) associated with the proposed reforms. The Final Assessment stage RIS will be published on the Office of Best Practice Regulation's website.



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# OVERVIEW

## CONTEXT AND FINDINGS

Credit cards are used by many Australians as a valuable tool for managing their financial affairs. The majority of Australians use their credit cards responsibly. There is, however, a subset of consumers incurring very high credit card interest charges on a persistent basis because of the inappropriate selection and provision of credit cards as well as certain patterns of credit card use. For this subset of consumers, credit cards may impose a substantial burden on financial wellbeing.

The Government finds that these outcomes reflect, among other things, a relative lack of competition on ongoing interest rates in the credit card market (arising partly because of the complexity with which interest is calculated). These outcomes also reflect behavioural biases that encourage card holders to borrow more and repay less than they would otherwise intend leading to higher (than intended) levels of credit card debt.

These views are consistent with the findings of the recent Inquiry into matters relating to credit card interest rates by the Senate Economics References Committee released in December 2015. On 18 December 2015, the Senate Committee released its report entitled *Interest Rates and Informed Choice in the Australian Credit Card Market*. The Government has carefully considered the recommendations made by the Senate Committee. This consultation paper also constitutes the Government's response to that Inquiry. A summary of the Inquiry's recommendations and the Government's response is at Appendix A.

The Government proposes a set of reforms that it considers are proportionate to the magnitude of the identified problems. It has drawn upon lessons and insights from regulatory developments in other jurisdictions as well as available empirical evidence, including relevant insights from behavioural economics. The Government has further drawn on evidence given by stakeholders at the Senate Inquiry hearings and its own consultation with card issuers and consumer representatives.

The proposed measures form part of a wider package of reforms that should improve competition and consumer outcomes in the credit card market. A number of aspects of the Financial System Program announced by the Government in October 2015 – including measures to improve the efficiency of the payments system and support access to and sharing of credit data – should also have a material and positive impact on consumer outcomes in the credit card market. There are already signs that reforms enacted in January 2015 to open up the credit card market to a wider pool of potential card issuers are beginning to have a positive impact on competition in the market.

Relatedly, on 19 April 2016 the Government released the final report of the review of the small amount credit contract (SACC) laws. Consistent with its approach to the credit card market, the Government wants to ensure that the SACC regulatory framework balances protecting vulnerable consumers without imposing an undue regulatory burden on industry. The final report made recommendations to increase financial inclusion and reduce the risk that consumers may be unable to meet their basic needs or may default on other necessary commitments. The Government is undertaking further consultation before making any decisions on the recommendations.

The Government recognises the importance of financial literacy in supporting good consumer outcomes in the financial system and is committed to raising the standard of financial literacy across the community. The Government provides funding to the

Australian Securities and Investments Commission (ASIC) to lead the National Financial Literacy Strategy and undertake a number of initiatives to bolster financial literacy under the ASIC MoneySmart program.

### PROPOSED ACTIONS

Table 1 outlines the Government’s assessment of problems in the credit card market and the actions it is proposing to address them. The package consists of two phases. For Phase 1 (measures 1 to 4), the Government seeks stakeholder feedback with a view to developing and releasing associated exposure draft legislation in the near term. For Phase 2 (measures 5 to 9), the Government plans to shortly commence behavioural testing with consumers to determine efficacy in the Australian market and to ensure they are designed for maximum effect. Testing will be led by the Behavioural Economics Team of the Australian Government. The decision to implement these measures will be subject to the results of consumer testing and the extent to which industry presents solutions of its own accord. The Government intends to commence consumer testing in the near term and will report on the outcomes of that testing and make a final decision on implementation in due course.

**Table 1: Proposed actions and problems addressed**

Proposed actions	Problems addressed
<b>Phase 1</b>	
1. Tighten responsible lending obligations to ensure card issuers assess suitability based on a consumer’s ability to repay the credit limit within a reasonable period	Over-borrowing contributing to financial distress
2. Prohibit issuers from making unsolicited credit limit increase offers including the ability to seek prior consent	
3. Prohibit issuers from backdating interest charges and charging interest on the portion of the balance that has been paid-off	Complex application of interest charges
4. Require issuers to provide consumers with online options to initiate a card cancellation or reduce their credit limit	Over-borrowing through accumulation of multiple cards
<b>Phase 2 (for consumer testing)</b>	
5. Require that issuers provide information on the annual cost of a consumer’s credit card use and to prominently display annual fees	Lack of competition on ongoing interest rates; consumers in unsuitable card products; over-borrowing and under-repayment
6. Require issuers to clearly disclose in advertising and marketing material a card’s interest rate and annual fee	
7. Require issuers to provide information about potential savings from switching to lower-cost products	
8. Require issuers to provide consumers with timely electronic notifications regarding the expiry of introductory offers and credit use	Over-borrowing and under-repayment
9. Require issuers to provide consumers with alternative payment tools, and proactively contact consumers who are persistently making small repayments	Under-repayment; consumers in unsuitable card products



## STRUCTURE OF THIS CONSULTATION PAPER

This consultation paper is structured as follows. Section 2 outlines the plan for stakeholder consultation. Section 3 gives an overview of the Australian credit card market, the Government's assessment of deficiencies in the credit card market and the arguments for Government action. Section 4 details the Government's proposed actions to address those deficiencies. Finally, an assessment of the regulatory impact of those proposed actions is presented in Section 5.

## CONSULTATION PLAN

The Government's goal is to ensure that the reform package best balances the objectives of improving consumer outcomes and enhancing competition, whilst minimising the potential for unintended outcomes and unnecessary compliance costs for industry. The purpose of this consultation paper is to obtain stakeholder feedback on the Government's proposed reforms.

Feedback and views are sought from a range of stakeholders, including: bank and non-bank credit card issuers; industry associations; credit card schemes; consumer advocacy and welfare groups; academics with an interest in consumer law and behavioural economics; other government agencies; and private individuals. Stakeholders will be able to make submissions via the Treasury website. This process may be supplemented by targeted consultations or roundtables.

Input is specifically sought on whether the proposed reforms are commensurate with the magnitude of the problems identified and the potential for any unintended consequences not already identified. Input is also sought on the assessment of regulatory benefits and costs outlined in this paper.

The consultation paper will be open for public comment for 6 weeks, from 6 May to 17 June 2016.

## AN ANALYSIS OF THE CREDIT CARD MARKET

The credit card has two main functions: a transaction function and a credit function. Credit cards are attractive as a method of payment because they are convenient, are widely accepted at retail outlets and can be used to facilitate online payments. New contactless payment technologies have further increased their attractiveness by speeding up point-of-sale payments. Many cards also carry rewards programs – where accrued spending amounts on cards can be redeemed for cash, gift cards, goods and services – and a range of other attached features such as free overseas travel insurance and concierge services. These features typically rate highly in consumers' decisions to acquire a new credit card.<sup>1</sup>

The credit function of a credit card allows consumers the flexibility to smooth their consumption patterns over time. By providing discretion over the amount borrowed and the amount repaid, credit cards allow consumers to cover periods of particularly high

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1 CHOICE (2015).

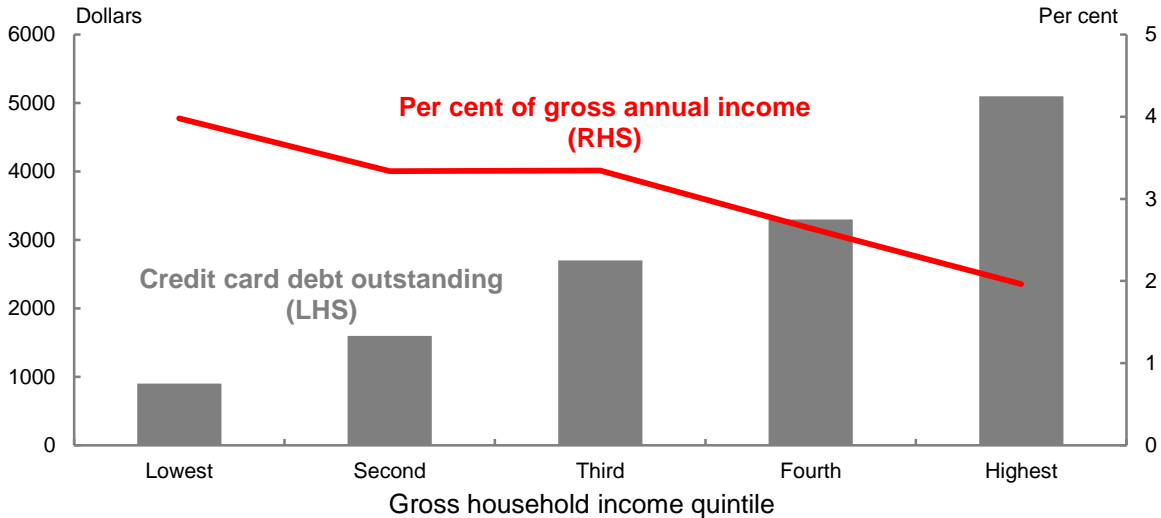
expenditure (such as those associated with major household purchases and unanticipated life events) or of temporary shortfalls in income.

### LEVEL AND IMPACT OF CREDIT CARD DEBT

There are currently around 16 million credit and charge card accounts in Australia (or 1.8 cards per household).<sup>2</sup> Around two-thirds of outstanding credit card debt (by value) is accruing interest.<sup>3</sup> This proportion has fallen over recent years (from above 70 per cent in 2011). The decline likely reflects that credit cards are an expensive form of credit and their relative price has increased in recent years as interest rates on other forms of credit – such as household mortgages and personal loans – have fallen. Increasing use of debit cards, and the growing availability of discounted balance transfer offers, may also have been important, whilst reforms enacted under the National Consumer Credit Protection Act in 2009 and 2011 may have contributed to improved repayment behaviour.

Available data indicate that the debt-servicing burden associated with outstanding credit card balances falls more heavily on households with relatively low levels of income and wealth. Households in the lowest income quintile hold, on average, credit card debt equal to 4 per cent of their annual disposable income, while those in the highest income quintile hold debt equal to around 2 per cent of disposable income (Figure 1). Low income households are also more likely to persistently revolve credit card balances (and, therefore, pay interest) than high income households.<sup>4</sup>

**Figure 1: Credit card debt by household income quintile, 2013-14**



Source: ABS Catalogue Number 6523.0

The ABS’ Household Income and Expenditure surveys show that households in the lowest income quintiles also pay more in interest charges relative to their incomes than higher

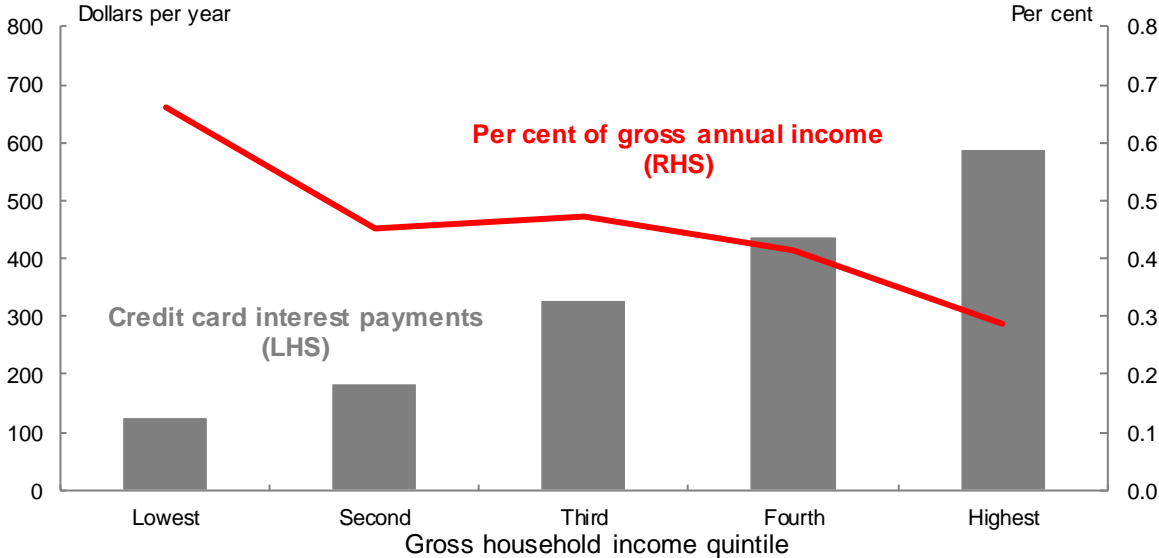
2 Number of credit and charge cards and number of transactions from RBA Statistical Table C1; number of Australian households from ABS Catalogue Number 3236.0.

3 The Australian Bankers’ Association reports that around 55 per cent of customers pay off their balance in full each month (Australian Bankers’ Association, 2016). The Reserve Bank of Australia quotes industry estimates that between 30 and 40 per cent of cardholders (i.e. by number) pay interest (Reserve Bank of Australia, 2015)

4 Over 15 per cent of credit card users in the lowest income quartile were likely to persistently revolve credit card balances (and, therefore, pay interest), compared to less than 5 per cent of users in the highest income quartile (Reserve Bank of Australia, 2015).

income households, although overall differences between quintiles are small (Figure 2). Households in the bottom two quintiles by net worth also pay the most in credit card interest relative to their income.

**Figure 2: Credit card interest payments by household income quintile, 2009-10**



Source: ABS Catalogue Numbers 6523.0 and 6530.0

Although reliable data on the number of consumers that are in credit card distress are not publically available, a range of evidence supports the conclusion that carrying large credit card debt is a significant cause of financial vulnerability and distress for a small but sizeable subset of consumers.

Default rates on credit cards give a sense of the proportion of credit card balances that are in severe distress. Recent estimates from the RBA suggest that total (annualised) losses on the major banks’ credit card loan portfolios are around 2½ per cent.<sup>5</sup> Other data suggest that many consumers struggle to make the required repayments on credit cards without necessarily defaulting. A 2010 survey by Citi Australia found that 9 per cent of respondents reported that they had struggled to make minimum repayments on credit cards within the past 12 months, with low-income earners being more likely to report this than high-income earners.<sup>6</sup>

Compared to other types of loans, the number of consumers struggling to or failing to make the required repayment is likely to understate the financial distress associated with credit cards. Card issuers set minimum repayment amounts as a very small proportion of the outstanding balance, so that households making the minimum repayment will only pay off their balance over a very long period and incur very large interest costs.<sup>7</sup> Making the higher repayments required to pay off their outstanding balance may be sufficient to cause financial distress for many consumers.

5 Reserve Bank of Australia (2015).

6 Citibank (2010).

7 Typically 2-3 per cent of the outstanding balance, except for very low balances. Unlike a fixed repayment, the absolute amount of the minimum payment on a credit card typically declines as the balance is paid down. In contrast, the repayment on a \$300,000, 25-year mortgage with an interest rate of 5 per cent is fixed at around \$1,800 a month, or 6 per cent of the initial principal; the repayment as a percentage of the outstanding balance increases as the loan is paid down.

In giving evidence to the Senate’s inquiry into the issue, the Consumer Action Law Centre (Consumer Action) and the Financial Rights Legal Centre (Financial Rights) stated that credit card debt is the most commonly cited problem by callers to Financial Rights’ financial counselling telephone service. Consistent with this, Consumer Action’s telephone service is reported to receive at least 15 calls per day related to credit card debt, with over 50 per cent of callers having credit card debt exceeding \$10,000 and 28 per cent with a debt of over \$28,000.<sup>8</sup>

Credit cards are also the most common cause of consumer credit disputes received by the Financial Ombudsman Service – of the more than 11,000 consumer credit disputes received in 2014-15, almost half were about credit cards.<sup>9</sup> In contrast to the number of home loan disputes, which fell by 5 per cent over 2014-15, the number of credit card disputes rose by almost 4 per cent.

Apart from its direct financial impact, high and unmanageable credit card debt can have a significant impact on other indicators of wellbeing. An examination of financial stress amongst New South Wales households by Wesley Mission detailed the impact that financial stress can have on the household and individual, including impacts on physical and mental health, family wellbeing, interfamily relationships, social engagement and community participation. More than one quarter of respondents that identified themselves as having been in financial stress indicated that the experience had resulted in sickness or physical illness (31 per cent), relationship issues (28 per cent) or a diagnosed mental illness (28 per cent). While there are many causes of financial stress, Wesley Mission found that financially stressed households owed, on average, 70 per cent more in credit card debt than households that weren’t financially stressed.<sup>10</sup>

**Observation: a subset of consumers are carrying high and unmanageable credit card debt**

While the majority of Australian consumers manage their credit card debt prudently, there remains a significant minority of consumers for whom credit card debt imposes a large burden on their financial and general wellbeing.

## COMPETITION IN THE AUSTRALIAN CREDIT CARD MARKET

Consumers are required to pay interest on credit card debt if the debt is not repaid within the interest free period. An interest free period is a period of time where no interest will be charged on new purchases, provided the total amount owing on the current statement is paid by the due date. There are currently around 15 million credit cards that offer an interest free period as one of the features. This means the majority of credit cards in Australia offer an interest free period.

In competitive markets, the interest rates on loan products should reflect the lender’s cost of extending credit. In Australia, the lender’s cost is partly determined by the cost of funds in the market, which is linked to the Reserve Bank of Australia’s (RBA) official cash rate.

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8 See Consumer Action Law Centre’s appearance at the Senate Inquiry into matters relating to credit card interest rates public hearing on 3 September 2015.

9 Financial Ombudsman Service Australia (2015).

10 Wesley Mission (2015).

The inflexibility of credit card interest rates to successive reductions in the official cash rate has prompted concern over the level of competition in the credit card market. Since late 2011, the average interest rate on 'standard' credit cards monitored by the RBA has remained around 20 per cent, at a time when the official cash rate has been reduced by a cumulative 2.75 percentage points. The average rate on 'low rate' cards (around 13 per cent) has been similarly unresponsive to reductions in the cash rate over the period.

Analysis conducted by the Treasury in 2015 showed that effective spreads earned by credit card providers have increased over the past decade. In particular, spreads increased substantially during the financial crisis and have remained high in the years since then.<sup>11</sup> The increase during the financial crisis is consistent with a repricing of unsecured credit risk observed in other credit markets and economies. However, the fact that spreads have since remained very high (and have even increased a little further more recently) suggests limitations in the degree of competition in the credit card market and unsecured lending markets more generally.

In submissions to the Senate inquiry into the issue, major credit card providers argued that other components of the cost of providing credit cards had risen over recent years and that these have become a more important determinant of the credit card pricing decision. The Australian Bankers' Association presented evidence that the cost of providing rewards programs, scheme fees and fraud and security costs have increased over recent years. Results from the RBA's latest (2013) survey of payment costs indicate that some elements of the cost to issuers of providing credit cards had increased, particularly scheme fees (Stewart et al 2015, p51).

The evidence that card issuers have recouped those higher costs mostly by keeping interest rates high while the cost of funds has fallen suggests that there is relatively less competition on ongoing interest rates. Determining whether that relative lack of competition is driven by a fundamental imbalance in market power, or in an inadequacy of demand-based pricing pressure, is an important consideration for any potential policy interventions.

## **Supply-side considerations and observed competition**

The credit card market is characterised by a large number of competing products and brands. However, a number of the brands are backed by larger financial institutions, making the number of issuing institutions considerably smaller. Cards issued by the four major banks accounted for around three-quarters of credit card transactions in 2014-15.<sup>12</sup> In part, this reflects the concentration of the Australian financial system more broadly, with many consumers choosing to hold a credit card from the institution with which they hold their major banking relationship.

The Government's assessment is that while market power is relatively concentrated in the major banks, there are no obvious 'supply side' barriers to a competitive market. Reforms enacted in January 2015 to open up access to the Mastercard and Visa credit card systems have significantly reduced barriers to entry for new credit card providers and there are no

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11 Treasury (2015).

12 Reserve Bank of Australia (2015).

formal impediments to consumers switching between different card providers.<sup>13</sup> Lower-rate products are available, offering choices to those consumers who place more value in a lower interest rate than other product features.

Competition appears most intense on the generosity of balance transfer offers, interest free periods on purchases and rewards programs. For instance, as at January 2015, around 70 of the 95 credit cards monitored by the Reserve Bank of Australia had some form of active balance transfer offer, with terms as long as 24 months. Offers of interest free purchase periods of up to 12 months are currently available in the market. To attract new business, many card providers also offer to waive annual fees for the first year or give sign-on bonuses in the form of frequent flyer points.

There is less evidence of competition on ongoing interest rates, with these rates often receiving little prominence in the marketing material for many cards (particularly cards with rewards programs attached).<sup>14</sup> This is of some concern, given that approximately two-thirds of outstanding credit card balances are attracting interest and, for those balances, the interest rate has a large bearing on the cost of holding a credit card.

## Behavioural factors shaping competition

Limited competition on ongoing interest rates is consistent with the relative inattention of many consumers – including those who end up paying interest – to this aspect of a credit card. Academic research suggests this is due to the interaction between the structure of a credit card and inherent biases and limitations in consumers’ decision-making process. These cognitive and behavioural factors are not unique to Australian consumers, and have been well-documented in numerous other contexts, including in overseas credit card markets.<sup>15</sup>

Many consumers optimistically (and often mistakenly) believe at the time that they apply for a card that they will always pay off the balance by the end of each statement period and, hence, that the rate of interest charged on a card is not a relevant consideration.<sup>16</sup> This ‘optimism bias’ is pervasive in many decision-making contexts, but manifests strongly in credit cards because of the prevalence of conditional and time-limited interest-free periods.

Present bias (also known as ‘hyperbolic discounting’ or ‘time-inconsistent preferences’) can result in consumers’ giving disproportionately little consideration to the implications of a credit card’s ongoing interest rate whilst placing more emphasis on the immediate benefits

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13 On 1 January 2015, new rules and regulations commenced to open up access to the MasterCard and Visa credit card systems to entities that are not authorised deposit taking institutions. The *Banking Amendment (Credit Card) Regulation Act 2014* removed the determination that credit card issuing or acquiring was banking business (and, thus, subject to Australian Prudential Regulation Authority supervision). The Reserve Bank of Australia (RBA) also varied its Access Regimes for the MasterCard and Visa systems, giving those system providers more flexibility to set eligibility criteria for potential card issuers. The RBA has noted that, while those reforms have only been in operation since January 2015, the indications are that the reforms are working, with a number of new participants admitted or progressing applications to the major card schemes.

14 The *National Consumer Credit Protection Act 2009* requires credit card issuers to include a ‘Key Facts Sheet’ with the purchase rate, among other features, whenever a credit card application form is made available. However, the Key Facts Sheet is often provided separately to the primary marketing material, either through a hyperlink or on a separate document that is less prominent than the main material.

15 See, for instance, Ausubel (1991).

16 More than 60 per cent of respondents to a survey conducted by Choice in July 2015 said that they do not know the interest rate that applies to the credit card they use most often (Choice 2015).

associated with the card, such as rewards points and zero-interest introductory offers. Present bias can also have important effects on the use of credit cards, as explained in section 2.

The complexity of the credit card product universe – with its array of interest free purchase periods, discounted balance transfer offers, interest rates on purchases and cash advances, and rewards programs – can result in consumers discounting or ignoring the implications of key product features, such as the interest rate, when choosing a credit card. So-called ‘choice overload’ can occur when consumers have to compare too many products and features, and can lead to consumers taking sub-optimal decisions or even choosing products at random.<sup>17</sup>

For those consumers that end up paying interest on a recurring basis, inertia effects – or the ‘status quo bias’ – mean they tend to stay with their current credit card product even in the presence of alternative products with lower interest rates.<sup>18</sup> This is partly explained by ‘loss aversion’, which makes people more sensitive to a loss (for example, losing the ability to earn rewards points) than to a gain of the same dollar amount (Kahneman et al., 1991).

These inertia effects appear to be compounded by the time and effort required to cancel an existing card account. Consumers wishing to cancel an existing card are generally required to do so by visiting a bank branch or by calling a consumer service representative. During this process they may be encouraged to keep their card open, sometimes through attractive offers. The time and effort involved in transferring recurring payments from a consumer’s existing card to a new card can also make some consumers reluctant to switch.<sup>19</sup> A potential outcome is that consumers seeking to switch may keep their old card active when obtaining a new card, resulting in an increase in their total available credit limit (which may induce higher spending than otherwise).

## The complexity of interest calculations on credit cards

The calculation of interest charges on credit cards is complex and varies across card issuers. The most common contractual arrangement is that when the statement balance is not paid in full, interest is charged (in the next statement) on every purchase in that month from the date that the purchase was recorded to the date when repayments are made. Two aspects of this arrangement are likely to be poorly understood by consumers or perceived as unfair:

- in the first statement where interest charges appear (that is, the statement following the one where the balance was not repaid in full), interest is charged not only for that statement period, but also the previous one (‘backdating’ or ‘two-cycle billing’); and
- for the balance from the previous statement period, interest is charged on the total balance –rather than just the unpaid balance – up to the date that the repayment for that

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17 For an examination of these issues in the mobile phone market see Xavier (2011).

18 A consumer survey commissioned by Choice in July 2015 found that more than 70 per cent of respondents had not considered switching credit cards in the past two years, 17 per cent had considered switching but not taken action, leaving 11 per cent of consumers who have switched credit card products in the last two year (CHOICE, 2015).

19 Recurring payments are set up with a merchant or retailer when the card user provides their card details to authorise a series of payments. Because these payments are set up with the merchant, and regulated by card scheme rules, card issuers have reported that they have limited ability to redirect these payments on behalf of consumers. Instead, merchants and consumers must communicate directly to update the card details associated with each recurring payment.

statement period was made; in other words, interest-free days are lost for all purchases in that period, and not just those that were unpaid by the due date.

On the one hand, credit card issuers that follow this practice explain the consequences of not repaying in full on their websites or in their product terms and conditions. However, the complex nature of the calculation is likely to mean that this industry practice does not align with many consumers' understanding of the operation of interest-free days and expectation of how much interest is being incurred. In particular, the loss of interest-free days on amounts that have been paid can appear unfair and disproportionate: interest charged for a consumer who repaid 90 per cent of their balance will be identical to that incurred by a consumer who only made the minimum required repayment.

A few credit card issuers deviate from this practice. For example, on Bendigo Bank credit cards, interest on purchases only begins accruing on the statement date, and interest is only charged on the part of the balance that was not repaid by the due date. These differences between card issuers can mean that the same interest rate on otherwise identical cards can result in a wide range of interest charges. It is unlikely that many consumers are aware of this variation between card issuers.

#### **Problem 1: inadequate competition on ongoing interest rates**

The interplay of various behavioural biases and the complexity of credit card products makes consumers relatively inattentive to the impact of a card's ongoing interest rate. As a result, there is relatively little interest rate competition between card issuers.

This limitation in competition is compounded by what can be an onerous process to cancel a card when switching to a new card. This is partly due to the lack of online options to initiate the cancellation of a card as well as the manual process involved in transferring recurring payments from one card to another.

## **SELECTION AND PROVISION OF CREDIT CARDS**

As discussed above, credit cards can vary on a number of dimensions. The selection of credit cards and credit limits, as well as the decision to use a credit card rather than an alternative product, reflects the interaction of consumers' preferences and decision-making, issuers' incentives and regulatory constraints. This section considers the extent to which these forces result in consumers making choices that lead to high ongoing interest charges and the risk of future financial distress.

### **Selection and allocation of credit cards across consumers**

Data from the RBA's 2013 Survey of Consumers' Use of Payment Methods show that the majority of low income households with credit cards hold a 'standard rate', rather than low rate, credit card (although they are somewhat more likely to hold a low-rate card than other income groups). The average interest rate on standard rate cards is currently around 20 per cent. While banks' testimonies to the Senate Inquiry noted that the take-up of low-rate cards has increased, of all those cardholders that pay interest on a recurring basis (across all income groups), three-quarters use a standard, gold, platinum or super premium card that have a high interest rate rather than a low interest rate card.

For interest-paying consumers on high-rate cards, the potential interest savings from switching to a low-rate card can be significant. This is particularly the case for consumers who persistently make the minimum repayment: for a \$5,000 credit card debt, the difference



between a 19 per cent interest rate and a 12 per cent interest rate would be over \$10,000 of interest over the period it takes to pay the card off.<sup>20</sup>

Behavioural studies of decision-making show how the behavioural biases discussed above may lead consumers to choose and stick with a high-cost credit card, when a lower cost credit card or personal loan would better suit their needs. Optimism bias may cause some consumers to underweight or pay little attention to the ongoing interest rate when selecting a credit card. It may also cause consumers to overestimate the benefits they will receive through rewards programs or underestimate their spending. One study demonstrated that consumers select an introductory credit card offer that ends up costing more than an alternative offer because they underestimate the amount of debt they will hold at the end of the introductory offer period (Shui and Ausubel, 2005).

Present bias could result in some consumers having a different repayment and spending appetite – and hence different credit card preferences – when decisions are made about the long-term compared to the short-term. Another consideration is the likelihood that consumers will switch credit cards when their circumstances change or when more competitive or better-suited product offerings become available. One study showed that some consumers persisted with a particular credit card even when switching to an alternative card with the same issuer would have resulted in significant savings (Agarwal et al., 2007). The factors that limit complete switching (opening a new card and closing an old one) were discussed in Section 3.

In some cases, a consumer may be better off taking out a personal loan instead of a credit card. If the purpose of a credit card is to finance a specific, one-off purchase over a number of years, a personal loan would offer multiple advantages. Secured personal loans are available at interest rates that are lower than many low-rate cards, and unsecured personal loans offer rates lower than most high-rate cards.<sup>21</sup> A personal loan also offers certainty and commitment when it comes to the amount borrowed, the schedule of repayments, total interest costs, and the life of the loan.

## **Responsible lending obligations and provision of credit cards and limits**

Credit card issuers, like other credit providers, must comply with the responsible lending obligations of the *National Consumer Credit Protection Act 2009* (National Credit Act). Prior to providing a credit card, or when increasing an existing card's credit limit, a credit card issuer must:

- make reasonable enquiries about the consumer's requirements and objectives in relation to the credit contract;
- make reasonable enquiries about the consumer's financial situation; and
- take reasonable steps to verify the consumer's financial situation.

Based on these enquiries, credit providers must make an assessment about whether the credit card is 'not unsuitable' for the consumer. In general, a credit product is considered unsuitable if the consumer will be unable to comply with their financial obligations under the contract, or could only comply with substantial hardship, or if the product does not meet

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<sup>20</sup> Assuming the minimum payment is the greater of 2 per cent of the outstanding balance or \$20.

<sup>21</sup> See InfoChoice.com.au and other comparison websites.

the consumer’s requirements and objectives. These obligations do not require card issuers to determine the most suitable card for the consumer.

The existing legislation is ambiguous about how the general obligation placed on credit providers to make reasonable enquiries about the consumer’s requirements and objectives applies with respect to credit cards. The Explanatory Memorandum to the *National Consumer Credit Protection Act 2009* states that, in the case of credit cards, there is only ‘a limited requirement to understand the consumer’s requirements and objectives’ because consumers may use credit cards for a range of purposes.

While credit providers are still required to ensure the consumer is able to meet their financial obligations without substantial hardship, many card issuers test affordability of a credit limit based on a consumer’s ability to meet only the minimum repayment amount, sometimes with a small buffer. This then sets an upper bound on the credit limit that the issuer is able to offer the consumer. The length of the repayment period and cumulative interest charges associated with only making the minimum repayments may not be considered when assessing whether a card is ‘not unsuitable’.

In an environment of regulated interchange fees and strong competition on upfront benefits and costs, interest charges comprise credit card issuers’ largest source of revenue. Consumers with high credit limits who cannot afford to pay much more than the minimum repayment are the most profitable to card issuers. These incentives could be resulting in many consumers being offered credit limits in excess of their requirements.

Although not necessarily the case, a higher credit limit can induce the accrual of debt that would not otherwise have been incurred, particularly for higher-risk consumers.<sup>22</sup> While data suggest that only a third of a credit limit is utilised by the average consumer, a recent US study found that for otherwise identical consumers with the lowest credit scores, a \$100 higher credit limit was associated with \$59 more in credit card debt after 12 months.<sup>23</sup>

The example below shows how the granting of credit limits based on ability to meet minimum repayments can lead to debt being held for long periods and the incurrence of large interest charges.

**Example: Credit card debt when credit limits are granted based on minimum repayment**

Step	Amount
<b>1a</b> Issuer determines repayment that consumer can afford without substantial hardship	<b>\$200 a month</b>
<b>1b</b> Interest rate on credit card	<b>17% p.a.</b>
<b>1c</b> Minimum repayment (monthly financial obligation under contract)	<b>2.0% of balance outstanding</b>
<b>2</b> Using information in (1), card issuer offers credit limit (approx.)	<b>\$9,800</b>
<b>3</b> Cardholder decides to spend within \$1,000 of limit	<b>\$8,800 debt</b>
<b>4b</b> If cardholder stops spending and pays minimum repayment (1c)	
Repayment period (approx.)	<b>37 years</b>
Total interest charges (approx.)	<b>\$19,240</b>

22 See, for example, Agarwal et al (2015) and Gross and Souleles (2002).

23 See, for example, Prelec and Simester (2001) and Raghurir and Srivastava (2008).

## **Problem 2: consumers in unsuitable card products**

Some consumers select and stay with high interest credit cards on which they subsequently incur interest charges. These consumers could save significant amounts of interest and pay down debt more quickly – reducing the chance of future financial distress – by switching to a low-rate card or personal loan.

The regulatory framework does not provide credit card issuers with enough incentive to provide credit limits that are consistent with consumers' requirements and financial situation. As a result, some consumers are provided excessive credit limits and accrue unsustainable debt.

## **OVER-BORROWING AND UNDER-REPAYING ON CREDIT CARDS**

The particular features of credit cards and various behavioural biases can lead to over-borrowing or under-repaying. These behaviours contribute to the build-up of excessive credit card debt, which, as discussed above, can have significant impacts on the wellbeing of some consumers. On the other hand, some features of credit cards – such as the flexibility afforded by interest-free purchase periods – provide benefits to consumers who are able to restrain their spending and repay their balances in full.

### **Over-borrowing**

Over-borrowing can be driven by a number of factors, including the granting of excessive credit limits and the behavioural factors examined previously. A consumer may intend to use their credit card purely as a payments device but, unlike a debit card, the money spent on a credit card is not immediately withdrawn from their account. This has been shown to influence consumer behaviour.

Present bias, combined with the flexible and convenient nature of borrowing on a credit card, can result in borrowing more on their credit card than they planned to.<sup>24</sup> Relatedly, optimism bias can lead consumers to believe they can afford to repay a greater amount in the future than they will actually be able to.

While it is impossible to estimate the precise extent and degree of over-borrowing across credit card users, data from various sources suggests that a significant minority of Australian consumers maintain large balances on their credit cards. According to the Australian Bankers' Association, around 20 per cent of credit card accounts in 2014 – over 3 million accounts – had outstanding balances of over \$7,500.<sup>25</sup> Around 6 per cent of accounts had balances of over \$15,000.<sup>26</sup> Not all of these balances will be incurring interest. However, the Reserve Bank of Australia estimates that 30 to 40 per cent of credit card accounts incur

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24 See Benton et al. (2007) for a discussion of how behavioural factors can lead to over-borrowing, particularly on credit cards and more generally on unsecured, revolving lines of credit.

25 See Australian Bankers' Association (2015).

26 With many credit card users holding more than one card, credit card balances per user will be higher than those per account.

interest and that credit card users who incur interest charges have larger balances than users who do not pay interest.<sup>27</sup>

## Under-repaying and minimum required repayments

Under-repayment can be driven by the same factors as over-borrowing. Present bias, combined with the ability to push repayment further into the future, may cause some consumers to repay less than they planned to at the time they made the purchase. Similarly, optimism bias causes some consumers to overestimate the likelihood that they will be able to afford to repay the debt in the future, reducing the need to repay debt in the present.

Some cases of under-repayment reflect a behavioural phenomenon known as ‘anchoring’. This refers to the influence of irrelevant but salient reference points on decisions. In the credit card context, the minimum repayment serves as an important reference point. A growing body of experimental research and field studies have shown that some consumers make a smaller repayment than they otherwise would have simply due to the presence of the minimum repayment.<sup>28</sup>

Under the existing regulatory framework, the minimum repayment amount is not explicitly regulated. The minimum repayment is typically specified by the card issuer as the greater of a small fixed repayment (for example, \$20) or a percentage of the balance carried forward (typically around 2 per cent of the sum of principal, interest and some fees that are not immediately payable in full).

Banks have stated that the fraction of consumers persistently making only the minimum repayment is very small.<sup>29</sup> However, this likely understates the proportion of consumers who under-repay due to the influence of minimum repayments. Partly this reflects narrow measurement of what constitutes a minimum repayment: consumers often exhibit ‘rounding’ behaviour when deciding how much to repay and so may pay slightly more than the exact minimum (for example, \$40 instead of \$38). A 2014 study in the United States found that credit card repayments follow a strongly bimodal distribution and that close to a quarter of credit card users paid the minimum or an amount close to the minimum more than half the time.<sup>30</sup> Similar findings have been reported by the UK Financial Conduct Authority: over 5 per cent of consumers made nine or more minimum repayments in 2014 while incurring interest, while a further 6.6 per cent of consumers maintained ‘persistent debt’, with some

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27 As at February 2016, there were around \$52 billion of balances across 16 million credit card accounts. Of these balances, \$33 billion are incurring interest. Given that around 35 per cent of accounts are typically not paid in full, this suggests that the average balance on an account incurring interest is \$5,800, while the average balance on an account not incurring interest is \$1,800.

28 See for example Stewart (2009), Navarro-Martinez et al (2011) and Keys and Wang (2014).

29 Westpac Group’s submission to the Senate Inquiry suggested that 4 per cent of their credit card consumers persistently make the minimum repayment continuously over a 12-month period (Westpac, 2015). At an Inquiry hearing on 16 October 2015, National Australia Bank said that just over 2 per cent of consumers paid the minimum balance or less in any given month over the past year, while ANZ suggested 0.3 per cent of consumers persistently paid the minimum balance over the past six months.

30 Keys and Wang (2014).

of these consumers also systematically making minimum repayments on at least one card.<sup>31</sup>

Even on a low rate credit card, under-repayment can have a significant impact on a consumer's financial situation. For example, on a \$5,000 balance incurring 13 per cent interest, the difference between making the minimum repayment and paying \$100 each month is around \$3,000 of interest and 15 additional years of repayment.<sup>32</sup> On a card with a 20 per cent interest rate, the difference is even more dramatic: \$14,500 of interest and 40 years of repayment.

## Discounted balance transfer offers

Zero- or low-interest introductory balance transfer offers, which have increased in popularity, may compound the problem of over-borrowing and under-repaying. By pushing the possibility of incurring interest into the future, some consumers may use such offers to extend their indebtedness or avoid repaying debt. Consumers are likely to pay less attention to interest costs that may occur a year or more in the future.

Consumer groups and some major card issuers have expressed concern that zero-interest balance transfer offers can lead to detrimental outcomes for consumers.<sup>33</sup> Major Australian banks have reported that 30 to 60 per cent of consumers do not repay their balances in full before the end of the zero-interest balance transfer period.<sup>34</sup> On the other hand, these offers provide consumers with the opportunity to consolidate debt. The Government considers that balance transfer offers are not on their own problematic, but can induce problematic credit card use by some consumers.

### **Problem 3: credit cards encourage some consumers to over-borrow and under-repay**

Behavioural biases and the anchoring effect of low minimum repayment amounts can drive consumers to over-borrow and under-repay credit card debt. Balance transfer offers have the potential to compound this behaviour although, like credit cards more generally, they provide benefits to many consumers.

Consumers could avoid significant sums of interest and reduce the chance of future financial distress if they used the flexibility offered by credit cards to repay debt more quickly.

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31 The Financial Conduct Authority found that 5.2 per cent of consumers made systematic minimum repayments, but this was only after excluding the 13.4 per cent of consumers who were identified as being in 'severe' or 'serious' arrears or in 'persistent debt' (Financial Conduct Authority 2015). It is likely that some consumers in these latter groups also made systematic minimum repayments.

32 Assuming the minimum repayment is the greater of 2 per cent of the outstanding balance or \$20.

33 See Financial Counselling Australia (2015), Consumer Action Law Centre and Financial Rights Legal Centre (2015), and the testimonies of Commonwealth Bank of Australia and Westpac Group to the Senate Inquiry (16 October 2015).

34 See testimonies of National Australia Bank, Westpac Group to the Senate Inquiry into matters related to credit card interest rates (16 October 2015). In contrast, ANZ stated that 70 per cent of consumers pay off balances within the zero-interest period. According to the UK Financial Conduct Authority (2015), around half of accounts had the transferred balance repaid in full by the end of the introductory period.

## POLICY OPTIONS

The preceding sections have outlined how specific behavioural biases have played a major role in shaping the credit card market and how, in some cases, those biases can result in significant consumer detriment. While Australians have generally been using their credit cards more prudently over recent years, there remains a subset of consumers for whom credit card debt is a significant contributor to financial vulnerability and distress. A larger subset of consumers incur significant ongoing interest charges because of over-borrowing, under-repayment, the use of credit cards that don't suit their needs, and limited competition on ongoing interest rates.

The Government acknowledges that significant reforms to the regulatory framework for credit cards were introduced as part of the *National Consumer Credit Protection Act 2009* (including amendments to the Act made in 2011). These reforms put in place a range of new protections for credit card consumers, including the banning of unsolicited (written) higher credit limit offers and obligations on card providers to allocate repayments to higher interest debits first.

However, the Government's assessment is that there remain specific deficiencies in the current regulatory framework. Government action is required to improve consumer protection, to empower consumers to make decisions consistent with their goals and intentions, and to exert more competitive pressure on credit card issuers.

In proposing these actions, the Government has carefully considered how comprehensively the possible options address the problems identified and whether they are proportionate to the magnitude of these problems. To be successful, interventions must be effective in achieving their stated aim, whilst minimising the potential for unintended outcomes and unnecessary compliance costs for industry. The Government has also sought to identify options that encourage more effective use of credit cards without restricting consumers' freedom to select a credit card and use it in accordance with their requirements.

## PROPOSED REFORMS

### **Prescribe a credit limit to be unsuitable if a consumer cannot afford to repay the limit within a reasonable period**

As discussed in section 3, the responsible lending obligations in the *National Consumer Credit Protection Act* require card issuers, when extending a credit contract or increasing a credit limit, to assess whether the contract will be 'not unsuitable' for the consumer.

In extending a credit card contract, card issuers typically make an assessment of the consumer's ability to meet minimum required repayments on the prescribed credit limit amount. The typical minimum repayment amount set by card issuers is around 2 per cent of the outstanding balance.

The Government is concerned that the current industry practice can result in a subset of consumers incurring credit card debts that cannot be paid down in a timely manner without substantial financial hardship and which are associated with very large cumulative interest charges. Consistent with the recommendation of the Senate Inquiry, the Government proposes to amend the responsible lending obligations to prescribe that a credit card contract, or credit limit increase, be assessed as unsuitable if it is likely that the consumer would be unable to repay the credit limit within a reasonable period. The reform would

bring Australian legislation into line with that in other jurisdictions, such as the UK, which defines a reasonable period with reference to the typical time required for repayment under a fixed-sum unsecured personal loan (see Box 1).

### **Box 1: Credit assessments based on ability to repay in a reasonable period — the UK approach**

The UK's Financial Conduct Authority regulates credit card issuers' conduct in accordance with its Consumer Credit Sourcebook (CONC). The CONC requires credit providers, in extending a credit contract, to consider:

- the potential for the commitments to adversely impact the consumer's financial situation; and
- the consumer's ability to make repayments as they fall due or within a reasonable period.

Accompanying guidance in the CONC makes clear that, in the case of a credit card, the credit provider:

- should consider the consumer's ability to repay the maximum amount of credit available (i.e. the credit limit) within a reasonable period;
- may, in considering what is a reasonable period, have regard to the typical time required for repayment under a fixed-sum unsecured personal loan for that amount; and
- should not use the assumption of the amount necessary to make only the minimum repayment each month.

In practical terms, and supposing the credit limit is £5,000 and the typical duration of a £5,000 personal loan is 3 years, the credit provider can assess affordability on the assumption that the consumer draws down the entire credit limit on day one, and repays by equal instalments over three years, with no further drawdowns.

In addition, the credit provider must consider whether repaying on this basis would adversely impact the consumer's financial position, taking into account the information of which the credit provider is aware at the time the agreement is made (or at the time a credit limit increase is proposed), and whether it is otherwise reasonable to grant the credit. Specifically, it is not sufficient to assess merely whether the consumer can afford minimum repayments.

The Government believes that this change appropriately balances preserving consumers' access to a credit card with the need to protect some consumers from incurring excessive debts. It is important to note that this change is unlikely to affect the majority of credit card consumers, which have sufficient financial means to pay off the typical limit on a credit card within a reasonable period. The Government proposes to make this requirement apply to new card and credit limit increase applications only, or if an existing consumer opts in to have their credit limit assessed against the new criteria.

### **Question**

- How should a 'reasonable period' be defined in the regulatory framework?

### **Prohibit unsolicited credit limit increase offers**

Amendments to the National Consumer Credit Protection Act made in 2011 prohibited credit card issuers from making unsolicited offers to increase a consumer's credit limit in

written form, unless the issuer had sought and been granted the consumer's prior consent to make unsolicited offers.

The Government is aware that some card issuers circumvent the spirit of the legislation by making unsolicited offers by other means, such as over the phone or via online banking portals. Consumers are also often unaware that they have granted their prior consent to receiving unsolicited offers, because of the way in which consent is sought at the time of applying for a credit card.

The Government proposes to broaden the prohibition on unsolicited credit limit increase offers to all forms of communication, and to remove card issuers' ability to seek consumers' prior consent to receiving unsolicited offers. All consumers would, of course, retain the power to request an increase in their limit at any time. As discussed above, the majority of Australian consumers use their credit cards responsibly and this proposal would not constrain consumers' ability to apply for a higher credit limit if they so desired.

The Government is conscious that, under current credit sharing arrangements, repeated applications for higher credit limits can adversely affect a consumer's credit score, even when those applications are accepted. It notes, however, that this will be mitigated as industry moves towards increased sharing of positive credit history under the comprehensive credit reporting regime.

### **Standardise the application of interest to the unpaid balance and to the current statement period when an interest-free period is lost**

As discussed in Section 3, for the majority of credit cards the interest charges that apply when a consumer loses their interest-free period are likely to be poorly understood by consumers. As a result, many consumers incur unexpected and disproportionate interest charges when their balance is not paid in full. The complex way in which interest is charged also contributes to the lack of competition on ongoing interest rates.

The Government proposes to standardise and simplify the application of interest when an interest free period is lost due to a partial payment. Currently, if the interest-free period is forfeited, interest will be charged from the date of the purchases on the full purchase cost, even though there was a partial payment by the end of the statement period. Under the proposed change, interest will be charged from the end of the statement period on the amount outstanding at the end of the statement period.

This requirement has been mandated in other jurisdictions: in the US, for example, the Truth in Lending Act (Regulation Z) prohibits finance charges from being imposed on balances for days in previous billing cycles and on any portion of the balance that was repaid during the interest-free period.

This change will not directly affect consumers who repay their balances in full every month. It will also have no impact on the interest charges for consumers who have already lost their interest-free period by making a partial repayment in the previous period. However, it will benefit consumers who, by making a partial repayment following full repayments in previous months, lose their interest-free period. For these consumers, the interest that they incur will be calculated consistently across card providers, be proportionate to their unpaid balance, and align better with their expectations at the time the debt was incurred.



## **Consumers are provided with simple, electronic options to initiate the cancellation of a credit card and reduction of credit limit**

Most card providers require consumers wishing to cancel a credit card, or to reduce their credit limit, to do so by visiting a bank branch or by calling a customer service representative. Consumer feedback indicates that the process can be unnecessarily onerous, and can represent a material constraint on some consumers' willingness to initiate a card cancellation or credit limit decrease request. The difficulty in closing a card or reducing a credit limit can result in some consumers continuing to hold credit cards that don't suit their needs, or the accumulation of unsustainable debts across multiple cards.

The Government understands there are processes which need to be followed in order for a card to be cancelled or for a credit limit decrease to take effect. However, this alone does not justify the disparity between the ease of applying for a new credit card or requesting a higher credit limit (which in many cases can be done entirely online) and the process for closing an account or reducing a credit limit.<sup>35</sup> This view is consistent with the findings of the Senate Inquiry.

Consistent with the recommendation of the Senate Inquiry, the Government proposes to require card issuers to provide consumers with the option to cancel their credit card, or reduce their credit limit, via simple electronic means. An electronic request should bypass the need to write, call or visit a branch and reduce the opportunity for consumers to be dissuaded from cancelling their credit card account or reducing their credit limit.

### **Question**

- How would this option be implemented to be consistent with the Government's commitment to ensure regulation is technology neutral?

## **FURTHER REFORMS FOR TESTING**

In addition to the above reforms, the Government has identified further reforms that it intends to pursue, subject to stakeholder feedback, the results of consumer testing and the extent to which industry presents solutions of its own accord. Testing may involve the use of behavioural laboratory experiments as well as in-field experiments with participating credit card issuers. The Government notes that a small number of card-issuing institutions are showing leadership in this area and are moving to provide some of these solutions to their consumers. If more card-issuing institutions were to follow their lead, the need for Government action may become less compelling.

## **Issuers to provide consumers with information about the annual costs of their credit card use and to clearly display annual fees**

Consistent with the 'informed choice' approach recommended by the Senate Inquiry, this proposal would require credit card issuers to provide regular summary information to consumers about the annual costs of their credit card use – such as, their year-to-date interest charges, ongoing annual fees, average balance and repayment behaviour. If presented effectively, this information may increase consumers' attention to how they have

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<sup>35</sup> It is also worth noting that some credit card issuers in other markets already provide the functionality to close a credit card online if the balance outstanding has been repaid.

used their credit card on an ongoing basis. While monthly credit card statements already contain information on the interest and other fees incurred over the statement period, under this proposal consumers would receive regular information about the longer-term costs of their particular pattern of card use.

Presenting this information in a simple and standardised format could also encourage card issuers and card comparison websites to develop tools for potential consumers to receive quotes on the cost of a particular card based on their historical usage. A consumer could take the information provided by their current card provider, enter it into such a tool, and receive estimates of cost savings relative to their current card.

The medium through which this information is delivered will be crucial to ensuring its effectiveness. Discussions with banks and consumer groups suggests that a significant proportion of credit card consumers do not view their monthly statement, as all relevant information is typically available in online account management tools. Accordingly, this option would require the relevant information to be displayed in the major electronic tools offered by the issuer, either as a substitute or as well as in an information sheet included with the monthly statement. The information should be easy to access and presented to maximise consumer exposure.

In line with the recommendation of the Senate Inquiry, this proposal would also require card issuers to clearly display on monthly statements and electronic tools a credit card's annual fee. The Senate Inquiry also proposed that card issuers be required to clearly display a credit card's ongoing interest rate. However, as the existing legislation already requires that such information be provided on monthly statements, the Government does not propose to pursue this.

The Government notes that it has also tasked the Productivity Commission with an inquiry to investigate ways to improve the availability and use of public and private sector data. The terms of reference for the inquiry include assessing individuals' ability to access their own financial data and ways to improve this access. The Government will consider the outcomes of this inquiry following the Productivity Commission's final report.

## Questions

- Apart from those detailed above, are there other types of information that could be presented to increase consumers' attention to the costs of their credit card usage?
- What aspects of the presentation and distribution of the information would be important in ensuring that it is seen and has the intended effect?

## Issuers to prominently disclose in advertising and marketing material a card's interest rate and annual fee

As discussed in Section 3, the ongoing interest rate and annual fee often receive little prominence in the advertising and marketing material for credit cards (particularly cards with rewards programs attached). This is of some concern, given that approximately two-thirds of outstanding credit card balances (by value) are attracting interest and, for those balances, the interest rate has a large bearing on the cost of holding a credit card.

Consistent with the recommendation of the Senate Inquiry, this proposal would require card issuers to display a credit card's ongoing interest rate and annual fee in advertising and marketing material. To be effective, this information should be displayed prominently.<sup>36</sup> If presented effectively, this should result in fewer instances of consumers choosing cards that don't suit their needs and of consumers discounting the implications of the interest rate and annual fee when choosing a card. Easier price comparison between cards may also increase competitive pressures on card providers, resulting in better value for consumers.

### Question

- How prominently should the required information be presented to ensure its effectiveness?

### Issuers to provide consumers with personalised information on potential savings from alternative credit card products

Most credit card issuers offer a number of different cards to suit different consumer profiles. Under this proposal, credit card issuers would be required to provide existing consumers with information about alternative card products that would result in the lowest cost given the customer's historic card usage. The information would also detail how much money would be saved by switching products, and contain information on how to switch to the alternative product. This information would only be required if a lower cost product was available within the issuer's suite of products.

For example, for a consumer who is regularly paying interest on a high-rate credit card, the card issuer would be required to alert the consumer about the availability of a low rate card (if one was offered by the same institution). In contrast, for a consumer who pays off balances in full on a high-rate credit card with no annual fee, no extra information would be required as switching to a low-rate card would not reduce costs for this consumer.

### Questions

- To what extent would the information provided under this proposal induce consumers to switch to lower cost cards?
- What aspects of the presentation and distribution of the information would be important in ensuring that it is seen and has the intended effect?

### Issuers provide consumers with timely electronic notifications regarding the expiry of introductory offers and credit utilisation

Electronic notifications, such as those required to be provided by mobile phone service providers, can be useful in providing consumers with the information they need to make better decisions. These notifications can be short, be triggered by specific circumstances, delivered quickly and at a relevant time for consumer decision making.

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<sup>36</sup> As the Senate Inquiry noted in its final report, requiring the provision of a standardised 'comparison rate' – as applies for residential mortgage lending – is complicated by the multifaceted and diverse nature of the credit card product.

## **Periodic notifications regarding the expiry of introductory reduced-interest offers**

Discounted balance transfer periods and other introductory offers provide significant benefits to consumers when used effectively. However, upon expiry of the introductory period, credit card debt often reverts to a high interest rate that a consumer may struggle to service.

The length of an introductory offer may lead some consumers to forget that the offer is about to expire. The shock of having interest suddenly applied to a large credit card balance can be sufficient to push some consumers into credit card debt distress. While the term of the introductory offer period is disclosed to consumers at the time of application, it is not typically in card issuers' interests to provide consumers with advance or periodic notice of the impending expiry of a balance transfer period.

Consumer outcomes would be improved if consumers were provided with simple electronic notifications at specific points in the introductory period. These notifications would highlight the date the introductory period expires and the interest rate that will be applicable to any remaining balance upon expiry. Advance warning would encourage the repayment of outstanding balances within the introductory period, without prescribing or forcing a particular pattern of repayment. This proposal has also been made by the UK Financial Conduct Authority in their 2015 credit card market study interim report.

It is important to note that this option does not limit the availability or length of introductory offers, or seek to set controls on how a consumer should repay their balance during the introductory period. Instead, it maintains existing flexibility and choice but provides consumers with timely reminders which may help them make better repayment decisions.

## **Consumers are provided with notifications of how much credit they have used**

The flexibility and convenience through which credit card debt can be extended is likely to mean that consumers are not always aware of their existing credit card balance when making new purchases. Timely reminders of this balance would result in more informed decisions about borrowing on a credit card. The Government notes that some credit card issuers already provide this as an option to their consumers, but that the practice is not widespread.

This option would require card issuers to provide electronic notifications alerting consumers to the dollar value of their credit card balance and the percentage utilisation of their credit limit. These notifications, by default, could be triggered by transactions which cause the outstanding balance to cross specified thresholds or percentage amounts of the credit limit. Consumers would be given the option to opt-out or change the frequency of notifications.

As an example, card issuers would be required to provide notifications to a consumer once their balance exceeded 70 per cent of their credit limit, and weekly reminders for as long as the balance remained above 70 per cent of their limit.

### **Questions**

- What are the most appropriate triggers to provide these notifications, or should these notifications be periodic rather than tied to specific events?
- What is the most appropriate method for card issuers to provide these notifications?

## Issuers to proactively provide consumers the option to commit to higher repayments and contact consumers persistently making small repayments

One of the key features of a credit card is the flexibility offered around repayment timing and amount. Depending on a consumer's preferences, repayment decisions may be made on a monthly basis (when a statement is received), at multiple times within a month (for example after each significant transaction), or when consumers set up automatic repayments.

### Repayment tools for consumers

For some consumers, the ability to delay repayment and make very small minimum repayments can mean that debt persists for an extended period. For these consumers, present bias and the anchoring effect of the minimum repayment amount may be leading to under-repayment. These consumers could benefit from simple tools and options that allow them to commit to making higher repayments.<sup>37,38</sup> Moves towards providing such tools have already been made by a number of credit card issuers around the world, including at least one issuer in Australia (see Box 2).

#### **Box 2: Repayment tools and instalment options offered by credit card issuers**

In the US, Chase (a subsidiary of JPMorgan Chase & Co.) has offered a set of free credit card debt management tools – branded *Blueprint* – on a number of their credit cards since 2009. Some of these tools allow the credit card consumer to set plans for paying off a balance, a specific purchase or type of purchase within a selected period of time. Once these plans have been set through Blueprint, an alternative repayment amount is shown on the consumer's statement that is consistent with achieving the consumer's plan. However, the consumer is free to ignore this suggested repayment and the issuer-set minimum repayment remains visible on the statement.

Chase reported in 2015 that more than 3 million Blueprint plans have been activated since the feature was offered and almost two-thirds of consumers who set up a plan remain committed to the plan (Santucci, 2015). Moreover, consumers with a Blueprint plan are reported to have paid down existing balances at a significantly faster rate than comparable consumers without a plan. However, anecdotal evidence suggests that some consumers have been dissatisfied with the Blueprint tool to the extent that it discourages or restricts immediate repayment of outstanding balances.

In India, RBL Bank offers *Split n Pay*, an option to transfer individual credit card purchases to a repayment plan of 3, 6 or 12 months. The monthly repayment required to pay off the purchase within the specified time is then incorporated into the credit card's minimum repayment amount until the purchase is paid off. Underpayment relative to this higher minimum repayment attracts a late fee. However, the consumer can cancel the Split n Pay facility at any time by contacting the bank. If this occurs, the remaining principal is transferred back to the credit card's standard balance, off which the minimum

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37 Commitment devices have been shown to be effective in a number of contexts, especially when consumers are aware of the gap between their intentions and behaviour. See, for example, Rogers et al (2014).

38 A similar recommendation was made by the Financial Conduct Authority (2015) in their interim report on the UK credit card market.

## **Box 2: Repayment tools and instalment options offered by credit card issuers (continued)**

repayment is calculated as usual. Unlike Chase's Blueprint, RBL Bank charges a processing fee to move transactions on and off the Split n Pay facility.

In Australia, Citibank Australia offers the free *Fixed Payment Option* to existing credit card consumers. Like the *Split n Pay* facility, this tool allows consumers to transfer purchases of over \$1,000 to a fixed-repayment instalment plan over a term of 1, 2 or 3 years. Alternatively, a portion of the consumer's credit card limit can be transferred as funds to a bank account and be repaid over the specified term. The consumer is offered an incentive to maintain these repayments as the plans are offered at interest rates that are lower than the ongoing interest rate on the credit card. If a consumer fails to make the monthly instalment, the instalment amount will begin to incur interest at the credit card rate. If the consumer pays more than the monthly instalment, the monthly repayment is reduced, but the term of the loan is not shortened unless a request is made by phone.

Non-traditional financial institutions, such as marketplace lenders, also provide an alternate option for refinancing credit card debts in Australia. A marketplace lender involves a financial service provider (the lending platform) that acts as an intermediary between investors and borrowers. This market is relatively new in Australia, but growing. Products offered include personal loans to refinance credit card debts to creditworthy consumers. Consumers can choose to repay debt over two, three or five years and amounts typically range between \$5,000 and \$35,000.

The Government proposes to require card issuers to make available to consumers who repay less than their full balance tools and options by which they can commit to higher repayments. To achieve this targeting, the option should be presented to these consumers in a salient, accessible manner. For consumers who repay their balance in full, the option would not need to be presented.

Issuers could implement this requirement a number of ways. For example, the simplest form may be to provide an option to transfer some or all of a credit card balance to a personal-loan-like product, where the debt is repaid with fixed repayments over a specified period of time. Alternatively, issuers may prefer to offer consumers the option to increase their minimum repayment to a level that ensures the outstanding balance is paid within a specified period of time.

### **Pro-active assistance for consumers who persistently make small repayments**

Even with the availability of repayment tools and options, a small proportion of consumers are likely to continue persistently making repayments that are at or close to the minimum repayment. Persistently making small repayments is likely to reflect one of two broad experiences: the consumer is experiencing financial hardship and cannot afford to pay more than the minimum, or is unaware of the consequences of under-repayment and the options available to pay off debt more quickly.

In these cases, one option is for card providers to identify these consumers and contact them to offer 'solutions'. The Government is aware that a number of card issuers already have similar policies in place but is concerned that this practice is not widespread and may be

triggered too late in the life of the debt. Under this proposal, card issuers would be required to contact consumers well before they reach the point of imminent default.

Consumers would be identified by their balances and repayment behaviour over a minimum period of time – for example, 6 months. Once a consumer is identified, the relevant solution offered would depend on the consumer’s financial situation. Solutions might include forbearance or, for consumers who can afford to make larger repayments, the offering of one of the repayment options discussed above.

In the case of consumers who do not take up either of these solutions, the requirement for the issuer to contact these consumers – if they continue to make small repayments – would be waived until a further period of time had elapsed (for example, 6 months).

## Questions

- What factors would maximise the take-up of repayment tools by consumers who are subject to under-repaying?
- What is the most effective and efficient way to engage consumers who are persistently making small repayments to suggest an alternative course of action?

## OTHER REGULATORY OPTIONS CONSIDERED

The following policy options have been considered thoroughly in the decision-making process but are not preferred at this time. As further analysed in Section 5, the Government’s current assessment is that these options are unlikely to be sufficiently effective to address the problems identified, or would disproportionately impose costs on, or limit the choices of, consumers, industry and taxpayers.

### Require issuers, acquirers and card networks to facilitate the transfer of recurring payments across cards

The Senate Inquiry recommended a review of innovations that could lower the cost of switching, including account portability. The Government acknowledges that the time and effort involved in transferring recurring payments from a consumer’s existing provider to a new provider might discourage some consumers from switching between cards (and closing existing cards) but believes that the more significant barriers to switching are a lack of consumer awareness and the difficulties consumers face in comparing credit card products. This view is consistent with the findings of the Senate Inquiry.

In support of this view, data provided in the Financial System Inquiry Interim Report indicate the take up of a switching service in relation to bank (transaction) accounts has been low. Similarly, ANZ reported low take up of its service to assist consumers to switch automated payments on credit cards. While this may reflect a lack of awareness, a previous Government inquiry into Switching Arrangements undertaken by Bernie Fraser in 2011 found that ‘consumers who are sufficiently motivated to switch find it reasonably easy to do so, and that the problems encountered by others may have more to do with motivation and perceptions, rather than real barriers’.<sup>39</sup> Similarly, the Senate Inquiry report cites the results of a survey of 40,000 members of One Big Switch as supporting this finding.

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<sup>39</sup> Australian Government (2011).

A further consideration is the cost of creating such infrastructure. ANZ reported to the Senate Inquiry that the costs of creating infrastructure to facilitate automated payment switching would be high. In regard to portability of account numbers, the structure of the credit card market makes it unlikely that this could be achieved without significant and unreasonable cost:

Credit card schemes operate technology on a global scale ensuring infrastructure investment is spread across a large number of consumers and transactions. As a relatively small market, implementing 'card number portability' in Australia would result in significant industry costs.<sup>40</sup>

The Government believes that its proposed reforms – to require card issuers to provide consumers with better information on the costs of their credit card use, standardise the application of interest charges and provide online options to close credit cards – should have a material and positive impact on switching activity and address many of the concerns prompting the Senate Inquiry recommendation. A further review of switching is not currently warranted. Nonetheless, the Government would support industry initiatives to facilitate greater switching, including the development of this service by third-party providers.

### **Substantially raise the level of minimum required repayment**

In Australia today, card issuers typically set the minimum payment at a low level of around 2 per cent of the balance carried forward. A direct way to address under-repayment of credit card debt is to mandate higher levels of minimum repayments, which the Senate Inquiry recommended for the Government's consideration. A higher floor (that is, a larger percentage of the balance carried forward or principal) would mean that consumers making the minimum repayment would pay off their balances faster and incur less interest. Setting higher minimum repayments may also help to dissuade excessive use of credit.

An alternative approach taken in the UK is to prevent 'negative amortisation', that is, when a cardholder incurs more debt because the minimum payment was not enough to cover the interest and other fees due that month. However, this principle does not necessarily imply that the original debt is paid down over a reasonable period. To achieve this goal, the minimum payment would need to be set at a meaningful percentage of the balance outstanding. Such a requirement would imply a large increase in the minimum payment for some consumers. A higher floor would also imply a reduction in the flexibility afforded by credit cards to consumers that make prudent decisions and occasionally choose to make the minimum payment for a short period.

A significant increase in the minimum payment may have other unintended consequences. The higher the floor, the more likely it is that existing credit card consumers who cannot afford to pay much more than the minimum repayment will be forced to default. The Australian Bankers' Association and a number of credit card providers have raised this concern, sometimes informed by their previous experience in raising minimum payment amounts.

As discussed in Section 4, the Government proposes to give greater effect to the application of the responsible lending obligations to credit cards by requiring that issuers assess ability to pay off a credit limit within a reasonable period. It also proposes to require issuers to offer a means to reduce debt by committing to a higher repayment voluntarily. These measures

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<sup>40</sup> ANZ (2015).



should result in a material reduction in the incidence of consumers servicing credit card debts over very long periods. Nevertheless, the Government considers that setting higher minimum repayment amounts is worthy of further consideration and seeks stakeholder feedback on this option.

### **Question**

- Taking into account the potential benefits and costs discussed above, is there merit in further investigation of this policy option?

## IMPACT ANALYSIS

This section outlines the benefits and costs of the options outlined above, and the Government’s assessment of the likely net social benefit. Estimates of total regulatory costs are presented in Table 2.

Benefits and costs are estimated under the Government’s Regulatory Burden Measurement Framework. The annual change in regulatory costs is measured against ‘business as usual’ costs and incorporates estimates of one-off implementation costs and ongoing compliance costs, averaged over a 10-year period. The estimates exclude the value of opportunities that cannot be realised because of the regulatory intervention.

The Government seeks stakeholder feedback on these estimates, with specific reference to the following questions:

### Questions

- In addition to those detailed below, are there other potential benefits or costs associated with the proposed reforms?
- Are the estimates detailed below a reasonable reflection of the likely costs faced by industry to implement the proposed reforms?

### No policy change

Benefits	Costs
<ul style="list-style-type: none"> <li>• No additional compliance and regulatory uncertainty costs for card issuers that could be passed on to consumers.</li> <li>• Consumers who select suitable credit cards and use them appropriately will continue to benefit from the existing competitive dynamic, which may improve over time with new market entrants.</li> <li>• Some card issuers will continue proactively offering hardship assistance or personal loans to consumers that are otherwise likely to default.</li> </ul>	<ul style="list-style-type: none"> <li>• Inappropriate selection and use of cards and insufficient competition on ongoing interest rates results in a significant subset of consumers continuing to pay large interest costs on an ongoing basis.</li> <li>• The incidence of over-borrowing and under-repaying likely to remain significant.</li> <li>• A smaller subset of vulnerable consumers will continue to fall into financial distress, with attendant impacts on their economic and broader wellbeing.</li> </ul>
<p><b>Assessment of net impact:</b> Nil</p>	

## PROPOSED REFORMS

**Table 2: Regulatory burden estimate table**

Average annual regulatory costs (from business as usual)				
Change in costs (\$mn)	Business	Community organisations	Individuals	Total change in costs
Phase 1 (reforms 1 to 4)	20.8	NA	4.3	<b>25.0</b>
Phases 1 & 2 (reforms 1 to 9)	105.6	NA	21.1	<b>126.7</b>

NA — Not available

### Prescribe a credit limit to be unsuitable if a consumer cannot afford to repay the limit within a reasonable period

Benefits	Costs
<ul style="list-style-type: none"> <li>Significant reduction in incidence of consumers being granted cards with excessive credit limits.</li> <li>Associated reduction in incidence of consumers incurring unsustainable debts, and in lifetime interest charges and debt servicing periods.</li> <li>Makes the responsible lending obligations in the National Consumer Credit Protection Act more binding with respect to credit cards.</li> </ul> <p><b>Total benefit estimate: large but unquantifiable</b></p>	<p><b>Industry</b></p> <ul style="list-style-type: none"> <li>Requires up-front changes to card issuers' calculations and processes for assessing new card applications and limit increases, including associated staff training costs.</li> <li>Ongoing costs for monitoring and reviewing compliance, especially if 'reasonable period' is not fixed.</li> </ul> <p><b>Total cost estimate: \$7.1 million per year</b></p> <p><b>Consumers</b></p> <ul style="list-style-type: none"> <li>Will reduce the maximum credit limit available for some consumers who may derive benefit from having a high credit limit as a form of financial insurance.</li> </ul> <p><b>Total cost estimate: small but unquantifiable</b></p>
<p><b>Assessment of net impact:</b></p> <p>Large net benefit</p>	

## Prohibit unsolicited credit limit increase offers

Benefits	Costs
<ul style="list-style-type: none"> <li>Eliminates the risk of consumers accepting offers for higher credit limits that may lead to the incurrence of large and unsustainable debt.</li> <li>Reduce over-borrowing, particularly by those consumers least able to control their spending and to service large debts.</li> <li>Eliminates scope for consumers to unwittingly consent to receive unsolicited offers.</li> <li>Eliminates scope for consumers to be annoyed with unsolicited offers.</li> <li>Would not restrict ability to seek a credit limit increase, if a consumer so desired.</li> </ul> <p><b>Total benefit estimate: significant but unquantifiable</b></p>	<p><b>Industry</b></p> <ul style="list-style-type: none"> <li>Requires one-off change in procedures and forms.</li> <li>May be ongoing labour costs associated with a higher rate of credit limit increase requests, but this may be offset by the reduction in staff providing credit limit increase offers.</li> </ul> <p><b>Total cost estimate: \$5.7 million per year</b></p> <p><b>Consumers</b></p> <ul style="list-style-type: none"> <li>Repeated applications for higher credit limit may reduce a consumer's credit score (but mitigated by move to positive credit reporting regime).</li> <li>Consumers seeking to increase their limit will have to proactively request a higher limit.</li> </ul> <p><b>Total cost estimate: \$1.8 million per year</b></p>
<p><b>Assessment of net impact:</b> Significant net benefit</p>	

## Standardise the application of interest to the unpaid balance and to the current statement period when an interest-free period is lost

Benefits	Costs
<ul style="list-style-type: none"> <li>Most consumers who lose their interest-free period will pay less interest and be less likely to enter a state of persistently revolving balances.</li> <li>The standardisation of interest charges will help consumers compare cards by interest rate. This should increase the competitive tension on interest rates.</li> <li>Consumers' borrowing and repayment decisions will better reflect their understanding of the consequences of partial repayment.</li> </ul> <p><b>Total benefit estimate: large but unquantifiable</b></p>	<p><b>Industry</b></p> <ul style="list-style-type: none"> <li>Card issuers will experience one-off costs associated with changing their application of interest calculations.</li> <li>One-off costs in updating advertising and education material, terms and conditions and in notifying existing consumers of the change.</li> </ul> <p><b>Total cost estimate: \$4.6 million per year</b></p> <p><b>Consumers</b></p> <ul style="list-style-type: none"> <li>One-off cost involved in understanding the new application of interest rules.</li> </ul> <p><b>Cost estimate: \$2.5 million per year</b></p>
<p><b>Assessment of net impact:</b> Significant net benefit</p>	

**Consumers are provided with simple, electronic options to initiate the cancellation of a credit card or reduction of credit limit**

Benefits	Costs
<ul style="list-style-type: none"> <li>• Consumers will be more likely to cancel a credit card or reduce their credit limit, reducing the incidence of consumers accumulating large debts across multiple cards, rates of financial distress and lifetime interest costs.</li> <li>• Consumers may experience non-financial benefits by having a total credit limit that is more consistent with their preferences.</li> <li>• An increase in the threat of losing business will drive greater competitive pressure between credit card providers.</li> <li>• Reduced labour costs for card providers if fewer people cancel cards or lower credit limits via assisted channels.</li> </ul> <p><b>Total benefit estimate: significant but unquantifiable</b></p>	<p><b>Industry</b></p> <ul style="list-style-type: none"> <li>• Upfront costs to develop and upgrade IT systems infrastructure to provide online options.</li> <li>• Ongoing compliance costs likely to be relatively low. Involves a change to the means by which a cancellation is initiated, not the process itself.</li> </ul> <p><b>Total cost estimate: \$3.4 million per year</b></p> <p><b>Consumers</b></p> <ul style="list-style-type: none"> <li>• No material compliance costs.</li> </ul>
<p><b>Assessment of net impact:</b> Significant net benefit</p>	

**Issuers provide existing consumers with better information about the annual costs of their credit card use and to clearly display annual fees**

Benefits	Costs
<ul style="list-style-type: none"> <li>• Information on long-term usage and costs should result in spending and repayment decisions that are more consistent with intentions.</li> <li>• Issuers and comparison sites may be better placed to offer personalised quotes based on card usage and repayment patterns — this should lead to more switching and selection of more suitable cards.</li> <li>• Easier comparisons may increase competitive pressures on card issuers, resulting in better value for consumers.</li> </ul> <p><b>Total benefit estimate: unquantifiable</b></p>	<p><b>Industry</b></p> <ul style="list-style-type: none"> <li>• Transitional compliance costs for card issuers, such as system changes to calculate the required information, redesigning statements and online account management tools.</li> </ul> <p><b>Cost estimate: \$21.3 million per year</b></p> <p><b>Consumers</b></p> <ul style="list-style-type: none"> <li>• Additional time taken to read and understand the new information.</li> </ul> <p><b>Cost estimate: \$8.4 million per year</b></p>
<p><b>Assessment of net benefit:</b> Possible net benefit</p>	

**Require issuers to clearly disclose in advertising and marketing material a card’s interest rate and annual fee**

Benefits	Costs
<ul style="list-style-type: none"> <li>• May result in fewer instances of consumers choosing cards that don’t suit their needs and of consumers discounting the implications of the interest rate and annual fee when choosing a card.</li> <li>• Easier price comparison between cards may increase competitive pressure on card providers, resulting in better value for consumers.</li> </ul> <p><b>Total benefit estimate: unquantifiable</b></p>	<p><b>Industry</b></p> <ul style="list-style-type: none"> <li>• Transitional compliance costs for card issuers associated with updating existing advertising and marketing material (both physical and online media).</li> <li>• Small ongoing costs for monitoring compliance with the new requirements.</li> </ul> <p><b>Total cost estimate: \$1.8 million per year</b></p>
<p><b>Assessment of net benefit:</b> Possible net benefit</p>	

**Issuers to provide consumers with personalised information on potential savings from alternative credit card products**

Benefits	Costs
<ul style="list-style-type: none"> <li>• Higher levels of switching to lower-cost cards by consumers incurring interest at high rates, leading to interest savings and debt being paid down more quickly.</li> </ul> <p><b>Total benefit estimate: unquantifiable</b></p>	<p><b>Industry</b></p> <ul style="list-style-type: none"> <li>• Transitional compliance costs for card issuers, such as system changes to calculate the required information, redesigning statements and online account management tools.</li> </ul> <p><b>Cost estimate: \$21.3 million per year</b></p> <p><b>Consumers</b></p> <ul style="list-style-type: none"> <li>• Some credit card holders may lose rewards and other benefits by switching to a lower cost card. However, the lost benefits may in many cases be valued less than the reduction in costs.</li> </ul> <p><b>Cost estimate: \$8.4 million per year</b></p>
<p><b>Assessment of net benefit:</b> Possible net benefit</p>	

**Issuers provide consumers with timely electronic notifications regarding the expiry of introductory offers and credit utilisation**

Benefits	Costs
<ul style="list-style-type: none"> <li>• Notifications should prompt consumers to make better spending and repayment decisions. These consumers will save interest and be less likely to experience financial distress in the future.</li> <li>• Reduces the risk of some consumers being surprised by the end of an introductory offer and incurring large interest charges that may lead to financial distress.</li> <li>• No reduction in consumer choice regarding repayment amount or timing.</li> </ul> <p><b>Total benefit estimate: unquantifiable</b></p>	<p><b>Industry</b></p> <ul style="list-style-type: none"> <li>• Compliance costs for card issuers in setting up the front- and back-end systems to provide notifications and the option to opt-out or change notifications.</li> <li>• Ongoing cost with meeting these requirements, including the cost of sending a higher volume of electronic notifications to consumers.</li> </ul> <p><b>Total cost estimate: \$18.3 million per year</b></p> <p><b>Consumers</b></p> <ul style="list-style-type: none"> <li>• For some consumers, receiving automatic notifications may come as an unwelcome intrusion.</li> </ul> <p><b>Cost estimate: insignificant</b></p>
<p><b>Assessment of net impact:</b> Possible net benefit</p>	

**Issuers to provide consumers the option to commit to higher repayments and pro-actively contact consumers persistently making small repayments**

Benefits	Costs
<ul style="list-style-type: none"> <li>• For consumers who commit to a higher repayment, credit card debt will be held for a shorter period of time, resulting in significant interest savings and reduced risk of financial distress.</li> <li>• When card issuers proactively offer the option to at-risk consumers, these consumers could be offered lower-rate products, which will further reduce interest costs for these consumers and the probability that they will experience financial distress.</li> <li>• Little reduction in consumer choice regarding repayment amount.</li> </ul> <p><b>Total benefit estimate: unquantifiable</b></p>	<p><b>Industry</b></p> <ul style="list-style-type: none"> <li>• Upfront and ongoing compliance costs for card issuers in setting up the front- and back-end systems to support higher repayment options.</li> <li>• Setting up processes to identify consumers making small repayments and providing training to consumer service staff to contact these consumers.</li> <li>• Upfront costs for card issuers to clearly communicate (on websites and printed disclosures) the opt-in and opt-out processes to consumers.</li> <li>• Ongoing compliance costs for card issuers in identifying and proactively offering higher repayment options to a larger group of consumers than they currently do.</li> </ul> <p><b>Total cost estimate: \$22.2 million per year</b></p> <p><b>Consumers</b></p> <ul style="list-style-type: none"> <li>• For some consumers, being contacted proactively may come as an unwelcome intrusion.</li> </ul> <p><b>Cost estimate: insignificant</b></p>
<p><b>Assessment of net impact:</b> Possible net benefit</p>	

## OTHER REGULATORY OPTIONS CONSIDERED BUT NOT PREFERRED

### Require issuers, acquirers and card networks to facilitate the transfer of recurring payments across cards

Benefits	Costs
<ul style="list-style-type: none"> <li>Increase in switching activity, which may result in more consumers holding cards that better suit their needs, and enhance the level of competition between card providers.</li> <li>Significant reduction in the time and effort required by consumers when switching to a new card.</li> </ul> <p><b>Total benefit estimate: unquantifiable</b></p>	<p><b>Industry</b></p> <ul style="list-style-type: none"> <li>Labour costs involved in transferring consumers' recurring payments to a new issuer.</li> </ul> <p><b>Cost estimate: unquantifiable</b></p> <p><b>Consumers</b></p> <ul style="list-style-type: none"> <li>No material costs.</li> </ul>
<p><b>Assessment of net impact:</b> Uncertain net impact</p>	

### Substantially raise minimum repayment amounts

Benefits	Costs
<ul style="list-style-type: none"> <li>Consumers making minimum repayments will make large repayments, meaning credit card debt will be paid down more quickly.</li> </ul> <p><b>Total benefit estimate: unquantifiable</b></p>	<p><b>Industry</b></p> <ul style="list-style-type: none"> <li>Upfront systems costs associated with changing minimum repayment amount calculations.</li> </ul> <p><b>Total cost estimate: \$3.1 million per year</b></p> <p><b>Consumers</b></p> <ul style="list-style-type: none"> <li>Additional time taken to understand the new (higher) minimum repayment amount.</li> </ul> <p><b>Cost estimate: \$1.1 million per year</b></p> <ul style="list-style-type: none"> <li>All consumers will lose some flexibility in repayment as the range of permissible repayments will be reduced.</li> <li>A small subset of existing consumers will not be able to afford a higher minimum repayment, pushing them into default.</li> <li>Small risk that some existing consumers who were paying more than the new minimum repayment will shift down towards the minimum repayment due to anchoring effects.</li> </ul> <p><b>Total cost estimate: unquantifiable</b></p>
<p><b>Assessment of net impact:</b> Uncertain net impact</p>	



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# APPENDIX A — SENATE INQUIRY RECOMMENDATIONS AND GOVERNMENT’S RESPONSE

Senate Inquiry recommendations	Government’s response
<p>1. Advertising and marketing material should disclose clearly the cost of credit, including a card’s interest rate and ongoing annual fee.</p>	<p>The Government <b>supports</b> this recommendation and proposes to require that advertising and marketing material prominently display a card’s interest rate and annual fee.</p>
<p>1. Monthly statements should include prominent reminders about a card’s headline interest rate and ongoing annual fee.</p>	<p>The Government <b>supports</b> this recommendation and proposes to require card issuers to clearly display annual fees in monthly statements and via electronic tools.</p>
<p>2. Government should work with stakeholders to develop a system that informs consumers about their own credit card usage and associated costs. Initially, historic usage and cost data could be provided in monthly statements. Over time, it would be desirable to provide consumer-specific, online, machine readable records that would allow credit card users to compare cards using online comparison engines.</p>	<p>The Government <b>supports</b> this recommendation and proposes to require card issuers to provide consumers with information on the annual costs of their card use.</p> <p>The Government has also requested the Productivity Commission to conduct an inquiry into data access and use. The Government will consider the outcomes of this inquiry following the release in early 2017 of the Commission’s final report.</p>
<p>3. Government should undertake a review into innovations that might help facilitate switching, including the feasibility of account number portability.</p>	<p>The Government <b>notes</b> this recommendation, but proposes alternative measures that should have a material and positive impact on switching activity.</p>
<p>4. Card providers should provide consumers the ability to close a credit card online.</p>	<p>The Government <b>supports</b> this recommendation and proposes to require issuers to provide consumers with online options to initiate the cancellation of a card or a reduction of credit limit.</p>
<p>5. Responsible lending obligations for credit cards should be amended so that serviceability is assessed on the borrower’s ability to pay off their debt over a reasonable period. The Government should consult on what constitutes a ‘reasonable period’.</p>	<p>The Government <b>supports</b> this recommendation and proposes to tighten responsible lending obligations to ensure issuers assess a consumer’s ability to repay the credit limit within a reasonable time.</p>
<p>6. Government should consider introducing credit card minimum repayment requirements and alternative means of reducing the use of credit cards as long-term debt facilities.</p>	<p>The Government <b>notes</b> that this recommendation is worthy of further work, but that measures to ensure credit limits can be repaid in a reasonable time and a requirement to provide alternative payment methods may achieve this goal.</p>
<p>7. Credit card providers should be required to make reasonable attempts to contact a cardholder when a balance transfer period is about to expire and the outstanding balance has not been repaid. In doing so, the provider should be required to initiate a discussion about the suitability of the consumer’s current credit card and, where appropriate, provide advice on alternative products.</p>	<p>The Government <b>supports</b> this recommendation and proposes to require that card issuers provide customers with timely electronic notifications regarding the expiry of introductory offers (and credit utilisation) and with information on potential savings from alternative products.</p>

Senate Inquiry recommendations	Government's response
8. Government should consider expanding financial literacy programs such as ASIC's MoneySmart Schools Program.	The Government <b>notes</b> this recommendation. Measures relating to funding for financial literacy are considered in line with other spending measures as part of the Budget process.
9. Credit card providers should be required to make reasonable attempts to contact a cardholder in cases where a cardholder has only made the minimum payment for 12 consecutive months, and thereby initiate a discussion about product suitability and alternative products.	The Government <b>supports</b> this recommendation and proposes to require that card issuers provide customers the option to commit to higher repayments and proactively contact customers persistently making small repayments.
10. Government should consider a PC inquiry into the value and competitive neutrality of payments regulation, with a particular focus on interchange fees.	The Government <b>notes</b> this recommendation.  The Financial System Inquiry undertook an extensive examination of the payments system and made several recommendations, which the Government has agreed to implement. Implementation of recommendations relating to interchange fees is being considered by the Payments System Board. In December 2015, the Government also took action to ban excessive card payment surcharging and gave the Australian Competition and Consumer Commission new powers to enforce the ban.
<p><b>Senator Xenophon additional recommendation</b></p> <p>Government should consider providing appropriate warnings on credit card statements and advertisements, similar to those for gambling venues and cigarette packaging</p>	The Government notes this recommendation but considers that the measures proposed are sufficient to address the problems identified.