AUSTRALIAN BANKERS' ASSOCIATION INC.

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ABA response to the Inquiry into credit card interest rates

Senate Standing Committee on Economics

10 August 2015

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1. Preamble

The Australian Bankers' Association (ABA) welcomes the opportunity to provide a submission to the Senate Standing Committee on Economics inquiry (Inquiry) into credit card interest rates.

With the active participation of 24 member banks in Australia, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

2. Introduction

This submission addresses the key issues for the Inquiry, including the cost of credit cards, competition and consumer choice in the credit card market, and the responsibilities of banks in providing credit card facilities. The submission also looks at some aspects of the services provided through automated teller machines (**ATMs**).

The key findings are:

- Credit cards provide a unique payment service in facilitating customer-initiated borrowings for purchases, payments and access to cash. They offer a strong value proposition for customers, with exceptional convenience. Credit cards do not play a large role as a source of ongoing credit outstanding (including for cash advances), but they are important in household finances as a revolving credit facility and for managing cash flows.
- There are around 16 million credit cards on issue in Australia.
- Banks are the primary issuers of credit cards and most bank credit card accounts are for personal use.
- Around 40 per cent of adults have a credit card. The highest take up of credit cards is among the 50-64 age group where the take up is slightly above 50 per cent.
- The credit card market is very competitive with at least 70 different providers and 200 different products[1].
- Consumers have a wide choice of credit cards with different attributes and can choose a credit card which best suits their financial needs. It is relatively straightforward to obtain information on the available products, for example, through banks' websites, other providers' websites and comparison websites.
- Switching between credit card products and credit card providers is generally straightforward. The one area where switching can be more complex is in arranging the transfer or cancellation of recurring payments[2] entered into with merchants.
- Most credit cards have relatively small balances outstanding. More than half of accounts have balances under $3,000. The amount accruing interest per card has been falling since 2012.

[1] Canstar
[2] A recurring payment is a where a debit or credit card number and other details are provided by a credit card holder to a service provider/merchant to make a regular payment for a good or service, such as subscriptions, memberships, insurances, etc. Recurring payments differ from a direct debit request (**DDR**) which is an automatic or regular payment made from a bank account (using a BSB and account number) and covered by the Code of Banking Practice and the 'switching package'.

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- The headline credit card rates published by the Reserve Bank of Australia **(RBA)** do not fully convey the diversity and choice in the credit card market or to the returns earned by banks on credit card products. The effective interest return of banks is much lower than the headline rate on full service cards.
- The widening in the spread between the RBA cash rate and advertised credit card rates since the global financial crisis **(GFC)** also occurred for other credit products, and on the other side of the balance sheet with a widening in the spread between the cash rate and some deposit rates. This was symptomatic of a repricing of risk in response to increased uncertainty and volatility in financial markets. In addition, the cost of funds has become less important as a component of overall expenses for credit cards. Scheme fees, value-added services and rewards programs, and security and fraud management now comprise a greater proportion of credit card product costs. There have also been additional costs associated with improved technology such as contactless technology and regulatory change.
- Comparisons with the UK and the USA suggest the dynamics for interest rates on credit cards in Australia are not out of line with international developments.
- Banks charge a fee for ‘foreign’ users of ATM**s** because they are providing a service to people who are not customers of the bank. There are costs in providing an ATM facility including installation, maintenance, security, location, cash usage and administration. Fees charged for transactions in Australia are at the lower end of fees charged in comparable countries.
- There are strong protections in place for credit card customers. Banks are legally required to observe responsible lending provisions in granting credit card facilities, including for applications to switch credit card providers. In addition, most members of the ABA have signed on to meet further voluntary obligations under the Code of Banking Practice when dealing with individual and small business customers. Also, the ABA has augmented these protections with a number of initiatives to improve the financial literacy and understanding of customers.

3. The structure of the credit card market in Australia

3.1 Market overview

Credit cards provide a unique payment and credit service with a strong value proposition for customers.

They facilitate customer-initiated small amount borrowings, for purchases, payments and access to cash. They provide exceptional convenience, allowing purchases and cash withdrawals to be made almost anywhere and at any time, both in Australia and most countries overseas. Overseas transactions can be in foreign currencies, obviating the need to carry foreign currency or dedicated pre-loaded travel cards.

Credit cards offer security and fraud protection with zero liability for customers, so that customers are insured against fraudulent transactions and non-delivery of promised goods and services. Many credit card accounts also offer extra facilities, such as rewards programs and value added services, including travel insurance, travel services, entertainment services, etc, augmenting the customer experience. Most credit card accounts also offer interest free periods, typically around 45 to 55 days, for purchases and payments, so that customers can access interest free credit by paying the balance outstanding by the due date.

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In 2014, there were 2 billion credit card purchase transactions with a cumulative value of $277 billion and a further 25 million credit card cash advances with a cumulative value of just under $10 billion. The value of credit card transactions is currently growing by 4 to 5 per cent per year.

Figure 1 - Summary of credit card transaction activity

		Cash advances		Purchases		Total	
	Accounts	Number	Value	Number	Value	Number	Value
	million	million	$bn	million	$bn	million	$bn
2004	11.6	36.3	$11.0	1,128.4	$146.8	1,164.7	$157.8
2005	12.5	37.4	$11.5	1,190.1	$158.1	1,227.4	$169.6
2006	13.2	38.2	$12.6	1,272.9	$173.9	1,311.2	$186.4
2007	13.9	36.7	$12.5	1,352.4	$192.2	1,389.1	$204.8
2008	14.2	34.5	$12.9	1,419.5	$207.3	1,454.0	$220.2
2009	14.4	29.9	$11.4	1,480.8	$214.3	1,510.6	$225.8
2010	14.8	27.9	$11.1	1,573.0	$228.4	1,600.9	$239.5
2011	15.0	26.1	$10.1	1,662.5	$239.5	1,688.6	$249.6
2012	15.2	25.0	$9.7	1,775.6	$250.8	1,800.6	$260.5
2013	15.5	24.5	$9.8	1,912.0	$261.9	1,936.5	$271.7
2014	15.7	24.6	$9.8	2,062.5	$276.6	2,087.1	$286.3

Source: RBA

For the past decade or so, repayments on credit cards, excluding interest, have exceeded new transactions. Over the year ending May 2015, repayments exceeded the value of transactions by $8 billion; the value of transactions on credit cards was $293 billion and repayments were $301 billion.

Figure 2 – Difference between repayments and transactions ($billion, annual)

Source: RBA

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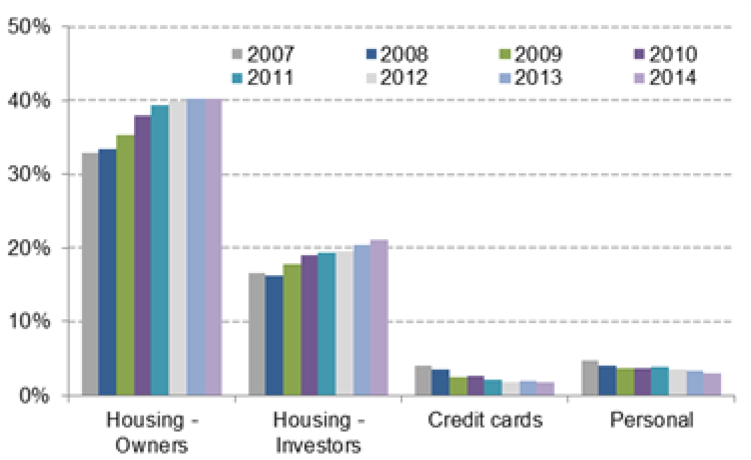
Credit cards have never played a large role as a source of credit for households. Balances outstanding on credit cards currently comprise only around 2 per cent of household borrowings. However, this metric tends to underplay the importance of credit cards in household finances because they are a revolving credit facility with loans generally taken for short periods, partly or totally repaid, and then drawn again.

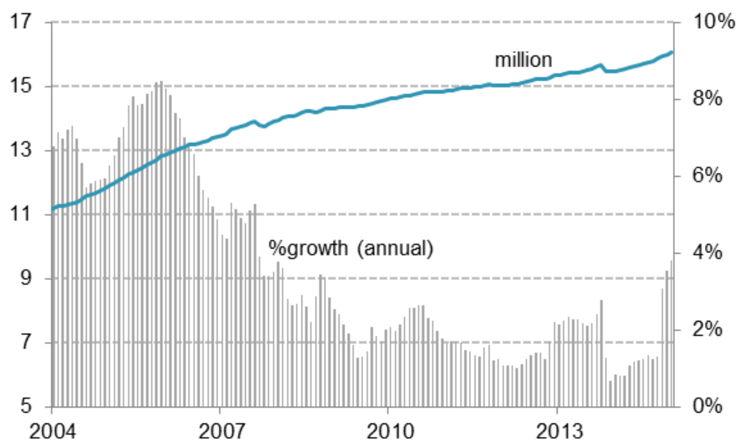
Figure 3 – Household borrowings by type



Source: RBA

There were 16 million credit cards on issue in Australia as at May 2015. Growth in credit card accounts has slowed appreciably in recent years.

Figure 4 – Number of credit card accounts



Source: RBA

Banks are the primary issuers of credit cards with around 88 per cent of cards on issue[3] and around 81 per cent of balances outstanding[4]. Most credit cards are for personal use - 87 per cent of bank credit cards are used only for personal purposes, 3 per cent for business purposes and 10 per cent for both personal and business purposes.

3 Roy Morgan Research, May 2015
4 APRA/RBA

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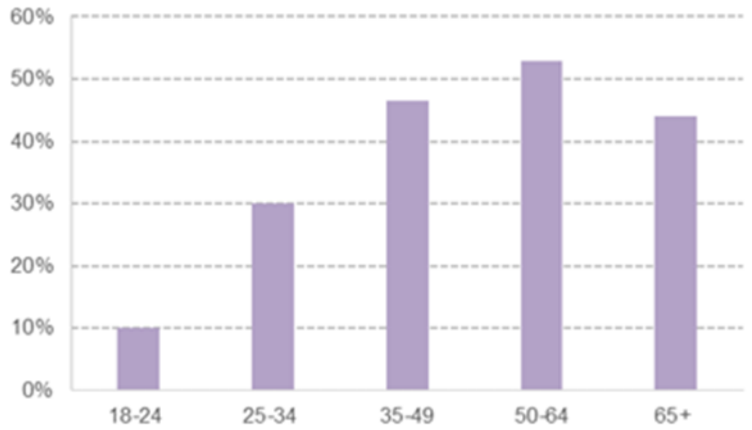
Figure 5 – Credit card issuance and use (May 2015)

Credit cards	Bank	Other ADI	Non-ADI
Provider	87.9%	2.3%	8.7%
For personal use only	86.9%	92.5%	83.8%
For business use only	3.3%	2.4%	6.2%
Both	9.8%	5.1%	10.0%

Source: Roy Morgan Research

Around 40 per cent of persons aged 18 and over have a credit card. This varies considerably by age group with the highest take up among the 50-64 age group with over half having a credit card account[5]. The lowest take up is among the youngest age group, 18-24, where only 10 per cent have a credit card.

Figure 6 – Credit card take up by age group



Source: Roy Morgan Research

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3.2 Australia's competitive credit card market

Australia's credit card market is very competitive and offers consumers a wide choice of credit cards.

There are a number of comparison websites which provide an overview of the number of credit card products and providers in the market.

Canstar shows that at the end of June 2015 there were at least 193 credit card products on offer in the Australian market[6] and at least 67 providers, including banks, credit unions, building societies and specialist credit providers, highlighting the significant competition in the market.

Figure 7 - Credit cards by institution type

	Institutions	Card products	Min	Max
Bank	32	127	5.30%	20.99%
Other	35	66	7.99%	23.50%
Total	67	**193**	**5.30%**	**23.50%**

Source: Canstar

Most banks provide a range of credit card products, from full service cards with added features, such as payment management tools and rewards programs, to 'no frills' cards which offer just a credit facility. Credit cards without rewards programs have significantly lower interest rates.

Figure 8 - Credit card interest rates with and without rewards programs

	No rewards	Rewards	Total
Bank			
Affinity		20.99%	20.99%
Gold	15.20%	19.55%	17.74%
Platinum	15.27%	19.70%	18.65%
Standard	14.34%	18.76%	15.91%
Other			
Gold		20.74%	20.74%
Platinum	20.99%	20.35%	20.39%
Standard	13.10%	18.53%	14.18%
Total	**14.10%**	**19.50%**	**16.83%**

Source: Canstar

Just under one quarter of credit card accounts with banks are low rate cards, with the balance broadly divided between rewards cards, low fees cards and other cards. The take up of low rate cards is rising, and they now comprise just under 40 per cent of newly activated accounts.

6 Canstar

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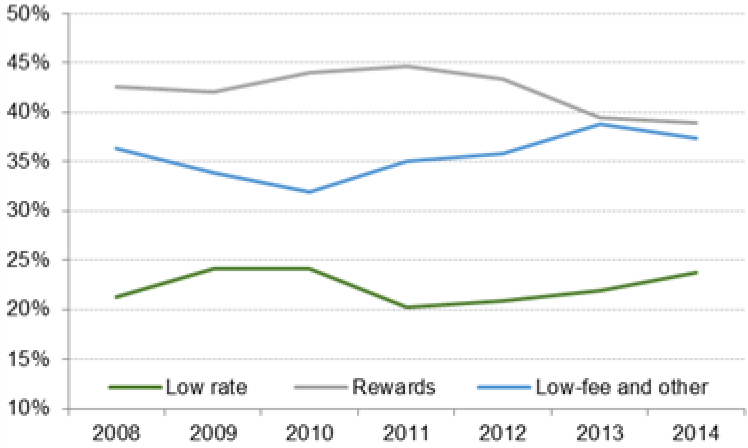
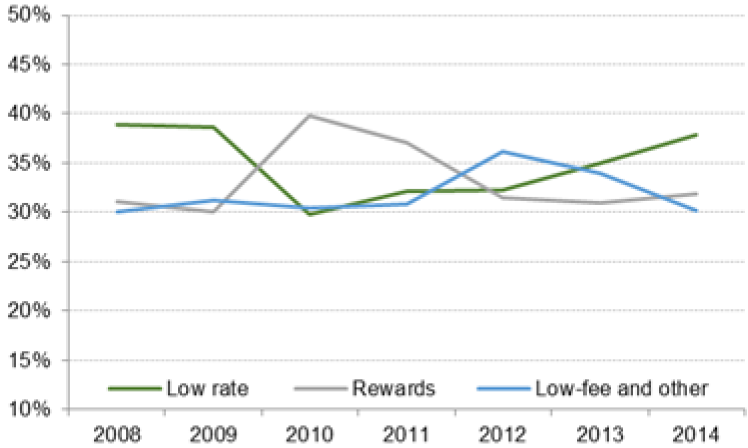
Figure 9 – Stock of credit cards by type



Source: Argus

Figure 10 – Newly opened credit card accounts by type



Source: Argus

3.3 Switching credit cards

Switching between credit card products and between credit card providers is generally straightforward. Banks are required to initiate their standard credit assessment checks for customers who apply to switch to ensure compliance with responsible lending obligations.

The one area where switching can be laborious for customers is in arranging the transfer or cancellation of recurring payments entered into with merchants.

A recurring payment is established by a customer directly with a merchant to make a regular purchase of, or payment for, a good or service. The customer provides the credit card number, the expiry date and the security code. These recurring payments are ongoing contractual obligations entered into by a customer with the merchant.

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A recurring payment is processed by the card schemes, such as Visa, MasterCard or Amex, and is regulated under card scheme rules. Card schemes set the conditions requiring customers to cancel regular payment arrangements directly with the merchant. These rules are global rules which apply across jurisdictions.

The practical difficulty is that not all merchants set up and classify the payments in the same way. This means that the customer cannot request a 'global' redirection or cancellation of recurring payments. To switch these payments to a new credit card account, or to cancel them, the customer must identify which payments are recurring and contact each merchant individually. To redirect a recurring payment to a new card account the customer must provide details of the new credit card number, expiry date and security code.

The ABA has prepared a consumer fact sheet with information about cancelling and redirecting recurring payments to provide greater clarity for customers.

3.4 Cardholder characteristics

Over 2014, on average, there were 133 transactions per credit card with a cumulative value of $18,212 per card. This comprised just under 2 cash advances per card with a cumulative value of $621 and 131 purchases per card with a cumulative value of $17,590.

Figure 11 - Credit card transaction activity per card per year

	Cash advances		Purchases		Total	
	Number	Value	Number	Value	Number	Value
2004	3.1	$950	97.6	$12,696	100.7	$13,645
2005	3.0	$924	95.4	$12,673	98.4	$13,597
2006	2.9	$950	96.3	$13,152	99.2	$14,101
2007	2.6	$902	97.2	$13,815	99.8	$14,717
2008	2.4	$908	99.8	$14,572	102.2	$15,480
2009	2.1	$793	102.6	$14,855	104.7	$15,648
2010	1.9	$751	106.2	$15,422	108.1	$16,173
2011	1.7	$675	110.8	$15,970	112.6	$16,645
2012	1.6	$639	116.8	$16,491	118.4	$17,129
2013	1.6	$632	123.1	$16,856	124.6	$17,488
2014	1.6	$621	131.2	$17,590	132.7	$18,212

Source: RBA

Over 2014, the *average* value of a credit card transaction was $137. The average value for cash advances was $397, and purchases was $134. The average value of transactions has been broadly falling since 2008.

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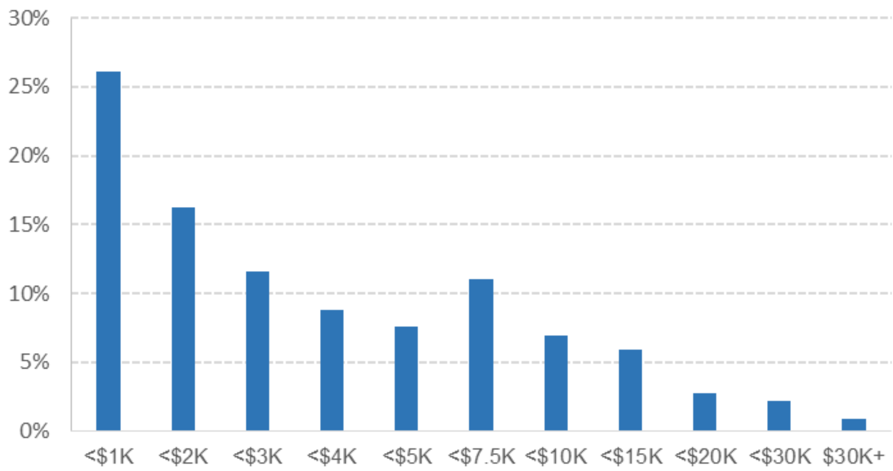
Figure 12 - Average value of credit card transactions

	Cash advance	Purchase	Total
2004	$303	$130	$135
2005	$308	$133	$138
2006	$328	$137	$142
2007	$342	$142	$147
2008	$375	$146	$151
2009	$383	$145	$149
2010	$398	$145	$150
2011	$388	$144	$148
2012	$388	$141	$145
2013	$401	$137	$140
2014	$397	$134	$137

Source: RBA

Most credit card accounts have relatively small balances outstanding. Over a quarter of all cards have a balance outstanding of less than $1,000. More than half of accounts have balances under $3,000. Less than one per cent of accounts have a balance exceeding $30,000.

Figure 13 – Distribution of credit card accounts by balance outstanding



Source: ABA (September 2014)

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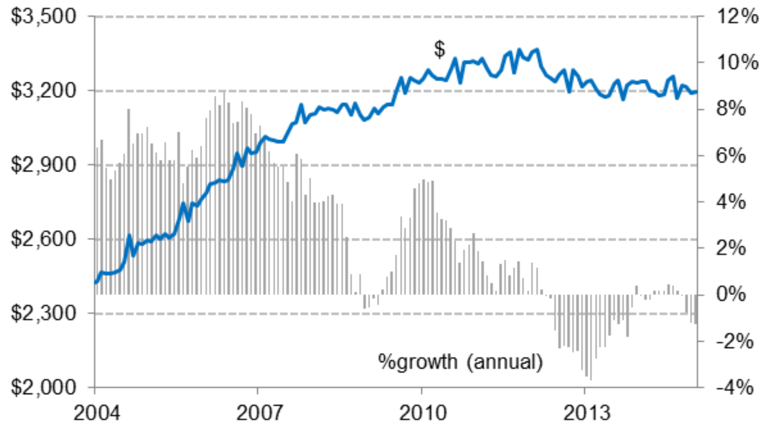
The average balance outstanding per credit card is now $3,195. The average balance per card has been falling since mid-2012 and is now around 5 per cent below the mid-2012 peak.

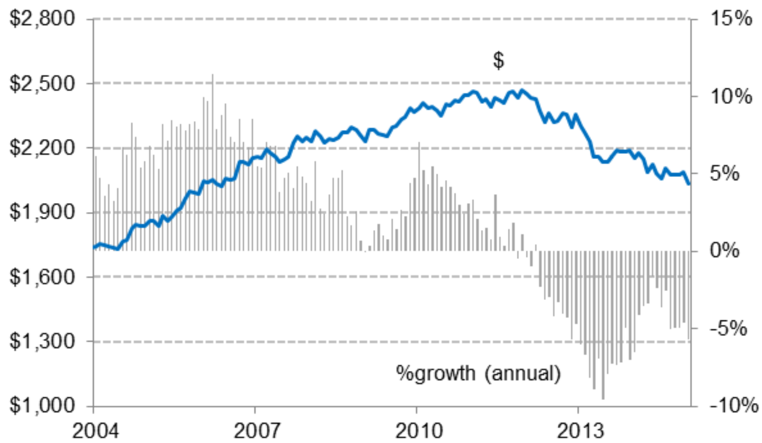
Figure 14 – Average balance outstanding per credit card



Source: RBA (May 2015)

The amount accruing interest per card has also been falling since early 2012. At the end of May 2015, the average amount accruing interest was $2,033 - the lowest level in over eight years.

Figure 15 – Amount accruing interest per credit card



Source: RBA

This fall in the proportion of the balance outstanding which accrues interest is the result either of an increased propensity to pay balances outstanding by the due date to take advantage of the interest free period, and/or an increase in balances which are transferred between credit card providers and subject to an interest free 'honeymoon' period.

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Figure 16 – Amount accruing interest as % of balance outstanding

Source: RBA

The average credit limit per card has not changed much over the past four years. The average limit per card at the end of May 2015 was $9,038, slightly lower than mid-2012[7].

4. Interest rates

4.1 Key features

Much of the discussion on credit card interest rates is focused on the two data series published by the RBA.

These series show the headline interest rates on two types of product:

- 'Standard' cards, which are standard Visa and MasterCard with an interest free period; and
- 'Low rate' cards which are Visa and MasterCard with an interest free period, but with fewer features than standard cards.

These data series are long standing with the data collection for standard cards commencing in January 1990 and low rate cards in November 2003. There has been considerable diversification of the credit card market since the data series commenced, in terms of the number of credit card providers, the interest rates, and the features and value-add services offered.

The RBA data, while accurate in terms of what they purport to measure, are no longer representative of the totality of the offers available in the market. A bank may offer many different credit cards with a variety of features and interest rates, however, only one or two of these cards may be included in the data series.

The headline interest rates for both card types have been very stable over the past five years. For standard cards, the rate has moved in a tight band of 40 basis points from 19.50 per cent to 19.90 per cent, while for low-rate cards the range has been 50 basis points from 12.90 per cent to 13.40 per cent.

[7] RBA

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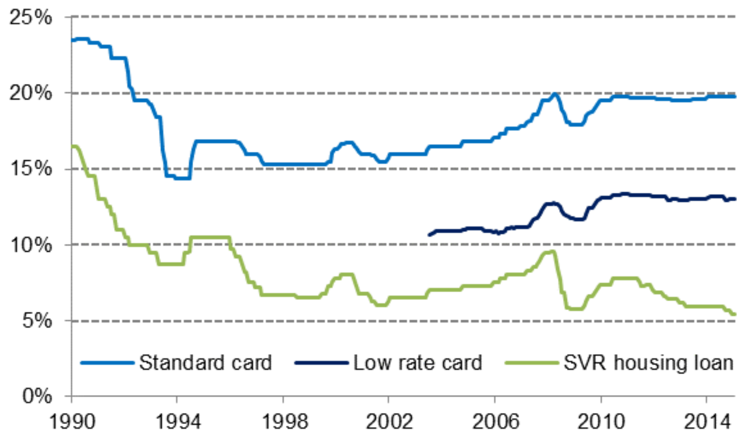
4.2 Unsecured lending

The headline interest rates on the standard credit cards are higher than on variable rate mortgages.

One reason for this is that credit cards provide unsecured finance. Unlike a home loan, there are no assets securing the outstanding debt on a credit card. This means the credit card is a higher risk to the lender. Delinquency rates are highest for low fee and other credit cards and lowest for credit cards with rewards schemes and value-added services. Across the spectrum of all credit cards, about 0.7 per cent of credit card balances are between 90 and 119 days past the due payment date[8].

Also, unlike a home loan where interest is charged from day one, on a credit card with an interest free period, interest is only charged if the balance is not paid by the due date.

Figure 17 – Interest rates on credit cards and standard variable home loans



Source: RBA

The features of credit cards as unsecured personal lending products are more akin to those of personal loans, not mortgages. The interest rates on full service credit cards are higher than on personal loans, but the interest rates on 'no frills' credit cards are lower.

Over the three years ending June 2015, the low-rate credit cards have been priced, on average, at about 110 basis points below the fixed personal loan rate and 126 basis points below the variable personal loan rate.

8 Argus, ACE benchmark studies

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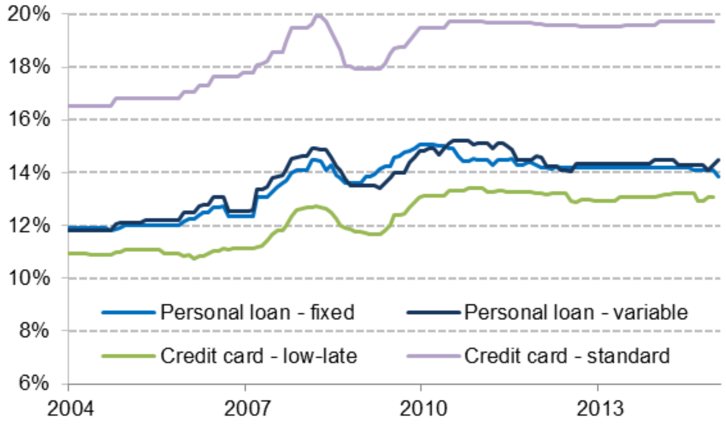
Figure 18 – Interest rates on personal loans and credit cards



Source: RBA

The headline interest rates on Visa and MasterCard products monitored by the RBA are not a reliable guide to the interest returns reaped by credit card providers.

There are a number of factors in this.

First, there is great diversity in the headline interest rates on different credit card products. For example, today one in four cards on offer by all providers have an interest rate of less than 13 per cent and one in 20 cards have an interest rate of less than 10 per cent.

Figure 19 - Credit cards by interest rate

	Banks		Other		All cards	
Interest rate	**Number**	**%distbn**	**Number**	**%distbn**	**Number**	**%distbn**
5.00-9.99	5	4%	4	6%	9	5%
10.00-12.99	22	17%	22	33%	44	23%
13.00-14.99	14	11%	5	8%	19	10%
15.00-16.99	6	5%	5	8%	11	6%
17.00-18.99	13	10%	4	6%	17	9%
19.00-19.99	37	29%	1	2%	38	20%
20+	29	23%	23	35%	52	27%
na	1	1%		0%	3	2%
Total	127	100%	66	100%	193	100%

Source: Canstar

Second, around 98 per cent of credit cards offer an interest-free period. This enables customers to control their interest expenses. Customers can pay no interest by repaying the outstanding balance in full by the due date. ABA data shows that over 50 per cent of customers repay their credit card in full each month.

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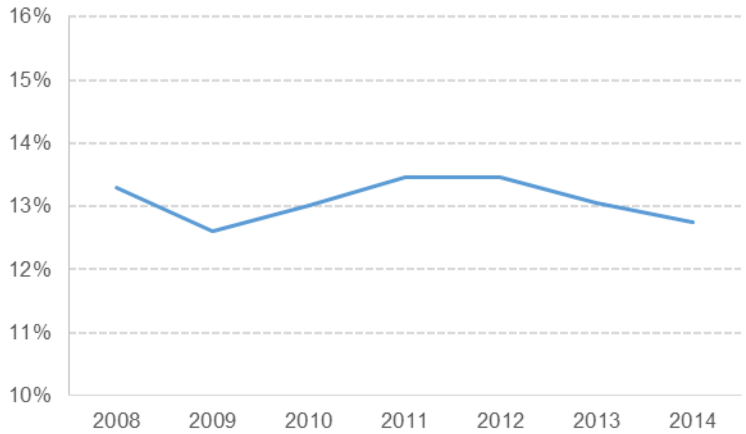
Third, there are low promotional interest rates - often zero - on balance transfers, i.e. on existing accounts transferred from other providers. These concessional rate balances now comprise around 7.5 per cent of total balances outstanding with about three quarters of these balance transfers not accruing interest[9].

The overall interest return on credit cards can be measured as the interest income relative to total balances outstanding. The average interest return is much lower than the advertised rate on full service cards.

Figure 20 – Interest earned as a percentage of balances outstanding



Source: Argus

5. Credit cards – key costs

Credit cards are a fully supported payment product, with many costs for features and services contributing to the way they are priced.

Some costs are ongoing operational expenses while others are more in the nature of one-off expenses associated with regulatory change and technological innovations.

5.1 Operational costs

Operational expenses include the overall cost of funds borrowed by the provider to on lend to the customer; losses on the non-repayment of the credit; the costs of special services such as rewards programs and travel insurance; and other costs including scheme fees, security and protection and fraud. In addition there is the cost of capital which providers are required to hold against the credit provided.

The significance of these components in the total costs of providing credit cards has changed over time. The cost of borrowed funds has become less important as a driver of overall operational expenses. Industry data indicates that in 2008, funding costs comprised a bit over half of overall operational expenses, but by 2014 this had fallen to slightly over one third. As a consequence, the degree to which the overall operational expenses are impacted by changes in the cost of funds, including those funds raised at the cash rate, has been reduced. In contrast, other components such as scheme fees, valued-added services and rewards programs have become a greater proportion of operational expenses.

9 Argus, ACE benchmark studies

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Rewards programs entail two key costs.

First, banks pay a management fee to a provider of a rewards program for which the provider administers the rewards program and buys-in and negotiates the provision of the goods and services from the suppliers and participants in the program. The provider presents options from which banks can choose - banks can also suggest goods and services they would like to offer to customers.

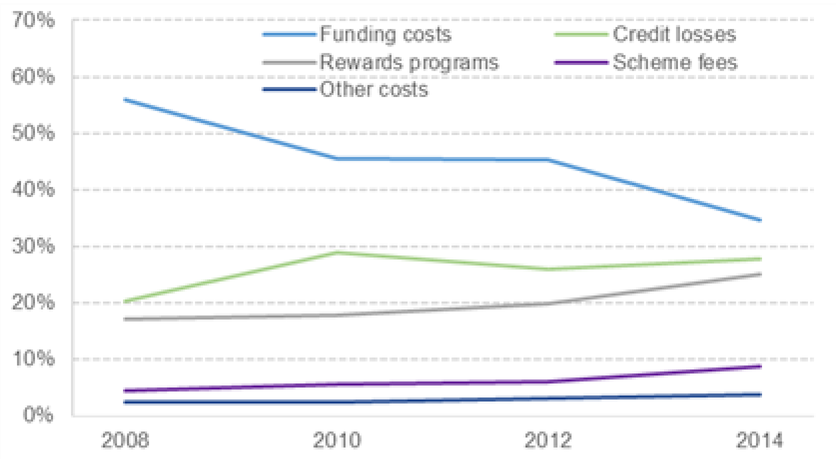
The second cost is the expense associated with the rewards points. Banks will hold a provision against the number of points accumulated by the customer against the day when the points are redeemed. There can be an option for rewards points to be redeemed as cash.

Scheme fees encompass the fees paid to use the services provided by the card scheme (e.g. MasterCard and Visa) which include infrastructure, processing and settlement services and currency transfers, which are necessary to facilitate customers' access 24 hours a day seven days a week, around the world. The key costs in relation to scheme fees can include the licencing fee, transaction volume fee, and the currency hedging fee, given that the billing process is in US dollars.

Credit losses also remain a significant expense, illustrating the unsecured and higher risk nature of credit card lending.

Managing fraud and security entails ongoing, as well as one-off costs, for financial institutions which provide credit cards. The cost of fraud has been increasing over recent years.

Figure 21 – Selected credit card operational expenses



Source: Argus

5.2 Additional costs

There have been a number of significant non-recurring costs for providers of credit cards which include the costs of changes to regulation, technological innovations and product initiatives.

Changes to consumer credit regulations which have incurred large costs for banks include the National Consumer Credit Protection Act **(NCCP)** and the RG209 Regulatory Guide[10]. These have entailed changes to processes and technology, and the ongoing cost of compliance. Estimates of regulatory costs compiled by the ABA show that NCCP cost banks around $150 million to implement with ongoing operational expenses of up to $50 million per year[11].

[10] *Australian Securities and Investment Commission,* Regulatory Guide 209 Credit Licensing: Responsible lending conduct
[11] ABA research, Cost of Regulation for Selected Banks

Technological innovations and product initiatives have included the introduction of mobile functionality, tap and go, chip technology and ongoing investment in fraud protection. These benefits and protections for customers have involved heavy development, establishment and recurring costs.

Improved technologies and card functionality have been implemented at considerable cost to mitigate fraud and to provide customers with better transactional capability.

5.3 The relationship with the cash rate

Funds borrowed at the cash rate are only one component of the pool of funds which underpin credit card balances outstanding, which in turn are only one of the expenses incurred by banks in providing credit card facilities.

There has only ever been a weak relationship between monthly movements in the cash rate and movements in standard credit card interest rates. Over the past 25 years, the official cash rate has changed on 69 occasions. On only 11 of these occasions has the interest rate on the standard credit card changed by the same amount as the cash rate. On 33 occasions both the rate on a standard credit card and the official rate have changed, but by different amounts. On 25 occasions the cash rate has changed with no change to the interest rate on a standard credit card.

Figure 22 – Changes to the cash rate and the standard credit card rate

	Both changed				Total cash rate changes	Total card changes
Year	Same amount	Different amount	Cash rate only	Card only		
1990		3	2		5	3
1991			4	3	4	3
1992		1	2	3	3	4
1993	1		1	4	2	5
1994		1	2	2	3	3
1995				2	0	2
1996		2	1	1	3	3
1997		1	1	3	2	4
1998			1		1	0
1999			1		1	0
2000		4		2	4	6
2001		6		2	6	8
2002	2			1	2	3
2003	2				2	2
2004					0	0
2005		1			1	1
2006	2	1			3	3
2007		2		3	2	5
2008		5	1	2	6	7
2009		5		1	5	6
2010	4			1	4	5
2011			2	1	2	1
2012		1	3	1	4	2
2013			2	2	2	2
2014				2	0	2
2015			2			
Total	11	33	25	36	69	80

Sources: RBA/ABA

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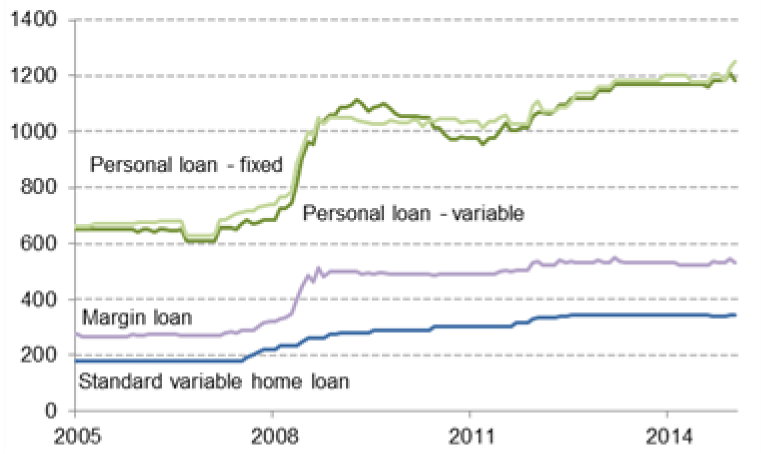
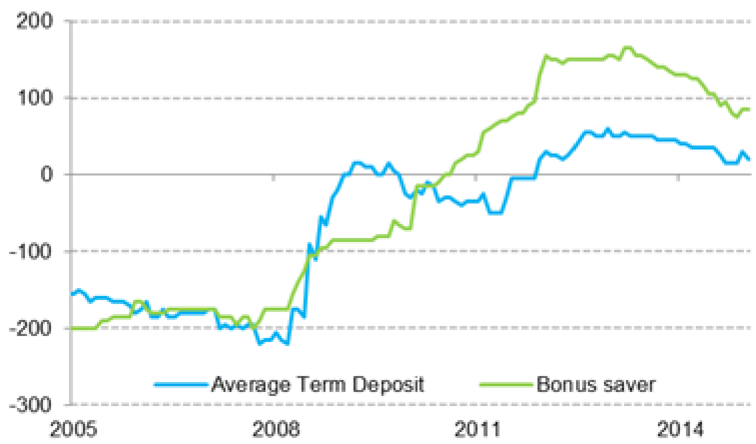
Focussing on the more recent past shows that the spread between the advertised credit card rates and the cash rate has widened since the GFC. This widening occurred for most household lending products, including mortgages, personal loans and margin loans. This widening in the spread also occurred on the other side of the balance sheet, with the interest rates on some bank deposit products, such as term deposits and bonus saver accounts, widening by 250 basis points and 350 basis points respectively. This widening of the spread for both lending and deposit products was symptomatic of a repricing of risk in response to increased uncertainty and heightened volatility in financial markets.

Figure 23 – Spreads between selected household lending products and the cash rate



Source: RBA

Figure 24 – Spreads between selected bank deposits and the cash rate



Sources: RBA/ABA

5.4 International comparisons

There is an issue of whether the relationship between credit card rates and the cash rate in Australia is unusual on a global perspective and whether credit card rates in Australia are atypically high.

To address this issue requires comparison with a retail banking industry which is broadly similar to that in Australia. The UK and USA are useful comparators.

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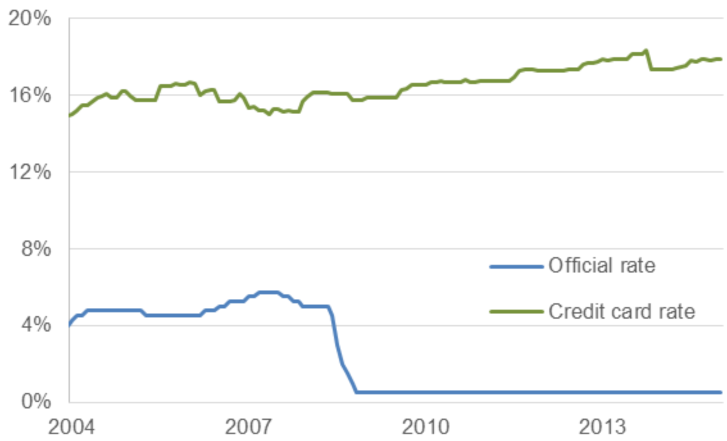
In the UK, interest rates on credit cards[12] have failed to track the official rate over the past decade or so, and in particular have failed to follow the large reductions in the official rate from 2008.

Figure 25 – UK official rate and credit card rate



Source: Bank of England

It also appears the headline credit card rate published by the Bank of England does not fully convey the diversity of products and the wide choice available to consumers. A UK comparison website 'compare and save' shows features on a range of credit cards. Interest rates range from a low of 6.45 per cent for one basic low rate card, from 18.9 per cent to 29.8 per cent for platinum cards with various features, through to a 59.9 per cent high interest rate for a full service premium card with no annual or monthly fees for those with bad credit ratings. These rates compare to the UK official rate of 0.5 per cent.

In the USA a comparison website[13] shows a range of interest rates, with low interest rate cards averaging 11.27 per cent and cash back cards averaging 16.49 per cent. The maximum USA Federal Reserve target rate has been barely above zero at 0.13 per cent since December 2008.

Overall these brief snapshots suggest the dynamics for interest rates on credit cards in Australia are not out of line with international developments.

6. Credit card fees

Credit card customers may be charged various fees by their issuing bank or credit card provider. These include annual fees, cash advance fees, foreign currency fees, reward program fees, and exception fees, including late payment fees and over-the-limit fees.

Annual fees on credit cards have shown little or no change over the five years to 2014.

Cash advance fees and foreign currency fees are levied as a percentage of transaction values. There has been a slight increase in recent years.

Late payment fees are incurred by customers when they do not make their minimum monthly payment by the due date. Usually, customers are given a minimum of 14 days to make their minimum repayment - which is in the order of 2.0 per cent to 2.5 per cent of the outstanding balance. Many banks send reminders to their customers about making repayments, often by SMS alert. There has been a substantial decline in late payment fees since 2009.

[12] Weighted average quoted interest rates for banks and building societies weighted by monthly gross credit card advances
[13] Bankrate.com, 22 July 2015

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There have been changes to the levying of over-the-limit fees in recent years. Prior to 2012, fees were incurred when a customer exceeded their credit limit although an over-the-limit fee could only be incurred once per monthly statement cycle. Under the National Consumer Credit Amendment Regulation 2012[14], customers who opened their credit card account after 1 July 2012 must express consent if they wish to pay a fee when they exceed their credit limit.

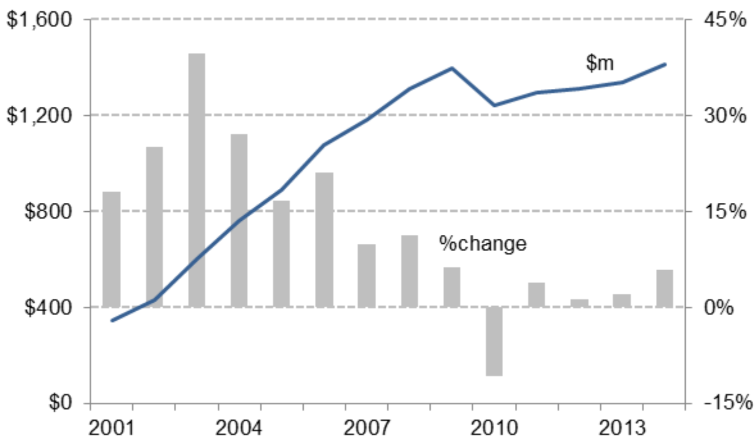
Figure 26 – Credit cards: unit fees

	2009	2010	2011	2012	2013	2014
Annual fees						
Low-rate	$52	$53	$54	$55	$55	$54
Standard cards	$29	$29	$29	$29	$29	$29
Standard rewards	$80	$80	$80	$80	$80	$80
Gold rewards	$140	$151	$137	$128		
Platinum	$231	$283	$283	$246	$236	$236
Cash advance fees						
% of transaction value						
Own bank ATM	1.6%	1.8%	1.8%	1.8%	1.9%	1.9%
Other bank ATM	1.6%	1.8%	1.8%	1.8%	1.9%	1.9%
Overseas ATM	1.7%	1.7%	1.8%	1.8%	1.9%	1.9%
Foreign currency fee	2.6%	2.6%	2.9%	2.9%	2.9%	3.0%
Late payment fee	$31	$15	$14	$14	$14	$14
Over-limit fee	$30	$14	$10	$10	$8	$5

Sources: RBA/ABA

Aggregate bank service fees from credit cards were $1.4 billion in 2014. The flat lining of aggregate fees from 2010 reflects the reduction in late payment fees and the changed arrangements for over-the-limit fees.

Figure 27 – Bank service fees from credit cards



Source: RBA

[14] National Consumer Credit Protection Amendment Regulation 2012.

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Credit card fees as a proportion of the total balances outstanding have been between 3 and 4 per cent over the past 10 years.

Figure 28 – Credit card fees as % of balances outstanding

Source: RBA

7. ATM transactions

7.1 Key features

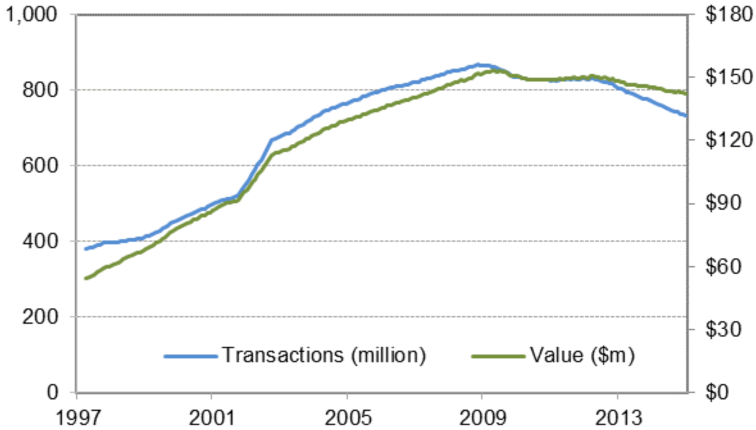
ATMs are a common channel through which consumers withdraw cash from banks and other financial institutions.

As at 30 June 2014, there were 30,544 ATMs of which 13,154 were bank owned[15].

The frequency of ATM withdrawals has been falling since the GFC. Over the year ending May 2015, there were 726 million ATM withdrawals, around 20 per cent down on the 2009 peak. This fall largely reflected the introduction of ATM direct charging (more on this below).

The value of ATM withdrawals over the year ending May 2015 was $142 billion. This peaked at about $151 billion over the year ending September 2009 – 8 per cent higher than now.

Figure 29 - Number and value of ATM withdrawals



Source: RBA

[15] APRA

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7.2 ATM fees

There are two broad types of ATM transactions – a transaction where the customer uses an ATM owned by their bank (own ATM transaction), and a transaction where the customer uses an ATM owned by another institution or company (which is known as a foreign ATM transaction).

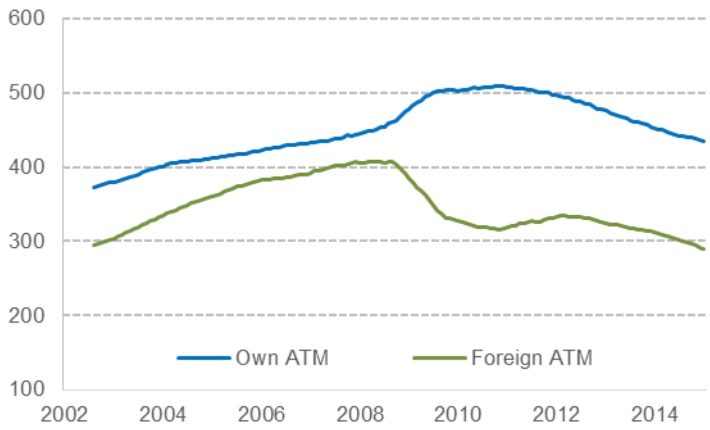
Customers are usually not charged for transactions at ATMs owned by their financial institution.

In March 2009, the RBA introduced major reforms to Australia's ATM system for foreign ATM transactions. These reforms involved the elimination of interchange fees paid between ATM providers and the introduction of the right for ATM providers to charge fees directly on consumers for foreign ATM transactions. Under these reforms, the ATM must display the amount of the fee prior to the transaction being executed to allow customers to decide whether or not to proceed.

A number of smaller institutions have in place arrangements that allow customers to make fee-free withdrawals from ATMs that they do not own.

There has been a marked change in the relative use of own institution and foreign ATMs since these reforms were introduced with customers showing an increased preference to use own institution fee-free ATMs. The number of own institution ATM transactions is now about 50 per cent higher than foreign ATM transactions, with customers choosing to conduct about 60 per cent of withdrawals at their own institution's ATMs.

Figure 30 – Number of ATM withdrawals by own institution or foreign ATM (million)



Sources: RBA/ABA

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Figure 31 – Proportion of ATM withdrawals at ATM owned by own institution

Source: RBA

It would appear that customers are responding to the more transparent price signals and are actively finding alternatives to avoid paying fees. This includes using mobile and internet banking facilities to do their banking and EFTPOS to make cash withdrawals.

Banks charge an ATM fee for foreign users because they are providing a service to people who are not customers of the bank.

The ATM network in Australia is a 'universal' system which provides a very extensive and convenient facility for accessing cash. Providing an ATM facility is not costless. There are costs for installation, maintenance and servicing, security, location and site rental, cash usage and administration.

Some observations about ATM fees:

- ATM fees can vary depending on the type of transaction.
- ATM fees charged by banks can be up to $2.50 for a withdrawal and balance inquiry.
- ATM fees levied by independent providers can be significantly higher.
- ATM fees charged for foreign use of ATMs in Australia are at the lower end of comparable fees charged in Canada, Germany, UK and the USA[16].

[16] http://banking.treasury.gov.au/content/reports/atm_transparency/html/atm_transparency-03.asp

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Figure 32 – International comparison of ATM fees

	Direct Charge	Foreign Fee	Interchange fee levied?	Total
Australia				
Financial institutions	Nil to $2.50 (b)	Nil (d)	No	Nil to $2.50
Independents	Nil to $5.00 (c)	Nil	No	Nil to $5.00
Canada				
Financial institutions	$0.97 to $1.93	Nil to $3.47	Yes	$0.97 to $5.40
Independents	$1.45 to $4.82	Nil to $3.47	Yes	$1.45 to $8.29
Germany	$2.56 to $13.57	Nil	No	$2.56 to $13.57
United Kingdom (c)				
Financial Institutions	Nil	Nil	Yes	Nil
Independents	Nil to $7.71	Nil	Yes	Nil to $7.71
United States (f)				
Banks	$2.19	$1.32	Yes	$3.51
Credit Unions	$1.97	$1.20	Yes	$3.17

(a) Exchange rates as at 14 June 2011; data as at June 2011 for Australia, June 2010 for Canada, March 2011 for Germany, March 2005 for the United Kingdom, and October 2010 for banks and February 2011 for Credit Unions in the United States.

(b) Some financial institutions have fee-free arrangements with other ATM networks.

(c) While almost all independent ATMs levy a direct charge, a few machines do not because of their machine type or location (e.g. machines dispensing foreign exchange may instead levy a currency conversion commission, and machines at some special locations - such as some military bases - are fee-free).

(d) Some financial institutions levy a fee on their own customers if the latter's ATM transactions exceed a certain number in a given month.

(e) UK ATM owners can either levy a direct charge or receive an interchange fee, but not both, on the same transaction; interchange fees paid by a cardholder's financial institution may nonetheless be passed on to the cardholder through other means.

(f) Average per ATM for direct charge; average levied per own-customer account for the foreign fee.

Sources: Bankrate; biallo.de; Financial Consumer Agency of Canada; House of Commons Treasury Committee; RBA; ATM owners

7.3 ATMs in remote Indigenous communities

The banking industry, through the 'ATM Fee Proposal', has made a commitment[17] to contribute to helping alleviate the challenges with social and financial inclusion in remote Indigenous communities.

Banks[18] with customers in certain very remote Indigenous communities have entered an agreement with two ATM deployers to provide free ATM transactions for their customers.

[17] ABA Indigenous Statement of Commitment

[18] Participating banks include: ANZ, Bank of Queensland, BankSA, Bank of Melbourne, Bankwest, Bendigo & Adelaide Bank, Citibank, CBA, HSBC, ING Direct, ME Bank, NAB, St George, Suncorp and Westpac.

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This was in response to the report of the ATM Taskforce appointed by the Federal Government in 2010 for the purpose of reviewing high ATM fees being incurred in remote Indigenous communities.

The ATM Taskforce found that while fees in Indigenous communities are generally on parity with those of metropolitan and regional areas, this was not the case in a subset of very remote Indigenous communities. This is due, in part, to the fact that people in very remote Indigenous communities tend to use ATMs with greater frequency than other groups, partly due to socio economic reasons, and often due to a lack of access to alternative banking channels.

To be eligible for this concessional treatment, ATMs must meet the following criteria set by the Federal Government:

- The ATM must be located in very remote Indigenous communities based on indicators of remoteness provided by the Australian Bureau of Statistics;
- The ATM must be located in a community store (and not in a venue that provides alcohol or gambling services); and
- The residents of these very remote Indigenous communities must lack access to an alternative retail banking service, such as a bank branch, bank ATM, post office (Bank@Post) or Traditional Credit Union branch.

There are currently 84 identified ATMs which meet these criteria.[19]

The initiative is operated under a commercial contract signed by the parties to the agreement. To implement the agreement the banking industry required regulatory approvals from the Australian Competition and Consumer Commission and the RBA. The initiative was given regulatory approval to operate for a maximum of five years from commencement in December 2012.

8. Framework for responsible lending

8.1 Regulatory protections

The interests of consumers who borrow money are protected under law through the *National Consumer Credit Protection Act 2009* (**the Act**) which includes the National Credit Code (**Code**). This Code sets out the obligations of credit providers when they provide credit to individuals who use that credit (wholly or predominantly) for personal, domestic or householder purposes, or for purchasing, renovating or improving residential property for investment purposes. The Act is administered by ASIC.

Like all financial institutions which provide credit to consumers, banks are legally required to comply with the responsible lending obligations under the Act.

The key responsible lending obligation is that banks and other financial institutions must not suggest, assist with or provide a credit product that is unsuitable for a consumer. A credit contract will be unsuitable if it does not meet the consumer's objectives and requirements, and/or the consumer would be unable to meet the repayments, either at all or only with substantial hardship.

In compliance with responsible lending obligations,[20] banks are required to take the following three steps:

- Make reasonable enquiries about the consumer's financial situation, and their requirements and objectives;
- Take reasonable steps to verify the consumer's financial situation; and
- Make a preliminary assessment or final assessment about whether the credit contract is 'not suitable' for the consumer (based on the enquiries and information obtained in the first two steps).

[19] http://banking.treasury.gov.au/content/atms.asp
[20] Australian Securities and Investment Commission, *Regulatory Guide 209 Credit Licensing: Responsible lending conduct*.

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The Act was amended in 2011[21] to further strengthen the protections for consumers. Key reforms were:

- Division 3 imposes requirements aimed at ensuring a consumer obtains a Key Fact Sheet before entering into a credit card contract. The Key Fact Sheet must contain information relating to the contract that is required by the regulations and must comply with any other requirements prescribed by the regulations. This is designed to encourage shopping around for a credit card.
- Division 4 imposes restrictions on a licensee making offers etc. to increase the credit limit of a credit card contract. This prohibits a credit provider from making a limit increase offer to its customer either by offering to increase the credit limit, inviting the customer to apply for an increased limit or encouraging the customer to consider requesting an increased limit. A customer can, in advance, provide express consent to receiving offers for an increased credit limit after understanding their options, including withdrawing consent and discretion whether or not to apply for an increased limit.
- Division 5 provides for consumers to be notified if a credit card is used in excess of its credit limit, and restricts the charging of fees etc. for use of a credit card in excess of its credit limit. Further, the credit provider under the contract must not, because the credit limit was exceeded, impose any liability to pay fees or charges, or a higher rate of interest on the consumer unless the provider has obtained express consent from the consumer covering the imposition of the fees or charges, or the higher rate of interest.
- Division 6 imposes requirements relating to the order of application of payments made under credit card contracts. Generally, a payment must be applied against higher interest rate debts first. The customer can specify a debt to which a repayment must first be applied but otherwise it must be applied to the higher interest rate debt applicable.
- Amendments to the regulations - account statement disclosures. These amendments provide that the monthly credit card statement must disclose on the front page of the statement how long it would take to pay off the closing balance if only the minimum monthly amount was paid, as well as how much the customer should pay if they wanted to pay off that amount in two years.

There was another round of reforms in 2014[22] to open up the credit card market to non-authorised deposit-taking institutions. These allow non-authorised deposit-taking institutions to become credit card issuers and acquirers in the Visa and MasterCard schemes, and make the credit card market even more competitive.

8.2 Additional banking industry standards

In addition to the legal obligations under the Act, most members of the ABA have signed on to meet further obligations to assist customers under the Code of Banking Practice.[23] The Code of Banking Practice is a voluntary code of conduct that sets out standards of good banking practice for banks when dealing with individual and small business customers.[24]

Clause 27 (provision of credit) requires banks, when offering, providing or increasing an existing credit facility, to exercise the care and skill of a diligent and prudent banker in selecting and applying credit assessment methods and in forming an opinion about a customer's ability to repay the credit facility.[25]

21 *National Consumer Credit Protection Amendment (Home Loan and Credit Cards) Act 2011*
22 Banking Amendment (Credit Card) Regulation 2014
23 http://www.bankers.asn.au/Industry-Standards/ABAs-Code-of-Banking-Practice/Banks-that-have-adopted-versions-of-the-Code-of-Banking-Practice
24 http://www.bankers.asn.au/industry-standards/ABAs-code-of-banking-practice
25 Code of Banking Practice clause 27

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Clause 28 (customer financial difficulty) requires banks to try and help customers who are experiencing financial difficulties with their credit facilities. This may involve developing a repayment plan, dealing with an authorised financial counsellor, and discussing options to assist the customer in meeting their obligations.[26]

8.3 Additional banking industry protections and financial literacy initiatives

Financial hardship

The banking industry has developed a financial hardship package to assist bank customers experiencing financial difficulties. This package demonstrates the industry commitment to work with customers experiencing financial difficulties and to promote best practice across the banking industry.

The ABA's financial hardship package[27] consists of:

- Industry guideline on financial hardship. This guideline provides practical guidance on how banks can support customers in ways that meet and, in some areas, exceed their existing legal and Code of Banking Practice obligations. More importantly, the guideline outlines a framework for banks which balances standardised access to financial hardship assistance with the need for flexibility when responding to customers' individual circumstances.
- Consumer fact sheet on financial hardship. This fact sheet provides consumers with information about what to do if they find themselves in financial hardship, including the options available and the steps involved in seeking hardship assistance.
- Doing It Tough consumer website (www.doingittough.info). Through this dedicated website consumers can find information about how banks can help with temporary financial difficulties and can access a list of phone numbers for the financial hardship teams at each bank.
- Website disclosure. Under an industry commitment to improve access to information about financial hardship, banks have a new button on their websites' homepages – "Are you experiencing financial difficulty?"
- Staff training. There is an industry commitment to ensure bank staff across the industry are aware of their responsibilities and banks' hardship programs.

Financial literacy

The ABA and the banking industry have also put in place a number of initiatives to improve the financial literacy and understanding of consumers.

Financial literacy is not just about numeracy; it is about people gaining a practical understanding of financial matters and the consequences of their own behaviours that will affect their financial wellbeing.

Even though many Australians have a good foundation of basic skills, it is very clear that challenges remain. These challenges include helping to increase understanding in the areas of managing money, spending, investing and managing credit.

In response, the ABA and member banks have delivered a number of financial literacy tools and resources to bank customers and the broader community to improve awareness and understanding of retail banking.

[26] Code of Banking Practice clause 28
[27] http://www.bankers.asn.au/Consumers/Are-you-experiencing-financial-difficulty-

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The ABA's "Broadening Financial Understanding" program was introduced in 2004 and includes the following relevant booklets for the purposes of this inquiry into credit cards:

- *Smarter Banking - Know your banking rights and responsibilities*[28]. This booklet helps consumers understand their relevant rights and responsibilities when dealing with their bank. It looks at the rights and responsibilities that are set out in law and in codes of practice.
- *Smarter Banking - Make credit work for you*[29]. This booklet provides essential information about credit, including the benefits and pitfalls of different types of credit, the cost of credit, helpful tips on keeping credit under control and what to do if credit becomes a problem.
- *Smarter Banking - Make the most of your money*[30]. This booklet contains useful information about choosing and using bank products and services, including bank accounts, credit cards and ATMs.

The ABA has also developed a number of consumer fact sheets providing information on conducting banking transactions and managing finances, including ATM direct charging and tips on how to minimise ATM fees.

Financial literacy is one of the banking industry's long term priorities and the ABA is committed to continuing to invest in these financial literacy programs and activities to help all Australians take control of their money and finances.

[28] http://www.bankers.asn.au/Consumers/Financial-Literacy-Program/Booklets/Smarter-Banking---Know-your-banking-rights-and-responsibilites

[29] http://www.bankers.asn.au/Consumers/Financial-Literacy-Program/Booklets/Smarter-Banking---Make-credit-work-for-you

[30] http://www.bankers.asn.au/Consumers/Financial-Literacy-Program/Booklets/Smarter-Banking