The Senate

Economics
References Committee

Interest rates and informed choice in the Australian credit card market

December 2015

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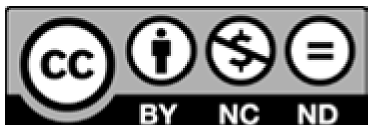

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Chapter 1

Introduction and overview of the Australian credit card market

1.1 On 24 June 2015, the Senate referred matters relating to the economic effects of credit card interest rates to the Senate Economics References Committee for inquiry and report by 24 November 2015. The committee was asked to give particular reference to:

a. the Reserve Bank of Australia's cash rate announcement and associated changes in credit card interest rates;

b. the costs to banks, credit providers, and payments systems, including those related to:

   i. borrowings,

   ii. credit risk and default rates, and credit risk pricing,

   iii. various credit card loyalty programs, and

   iv. consumer protection measures, including reforms introduced following the global financial crisis,

c. transaction costs, including interchange fees, on the payments industry;

d. the costs to consumers, including those related to:

   i. how and when interest is applied,

   ii. minimum monthly payment levels,

   iii. various credit card loyalty programs of other users, and

   iv. card fees, including ATM and POS fees;

e. what impact competition and price signals have on the credit card market;

f. how the enforcement of responsible lending laws and the national consumer credit regime affect consumer costs;

g. how consumer choice of credit card products can be improved, with reference to practices in other jurisdictions; and

h. any other related matters.

1.2 On 23 November 2015, the Senate extended the reporting date to 3 December 2015, and on 30 November 2015 the Senate again extended the reporting date to 16 December 2015.

Conduct of inquiry

1.3 The committee advertised the inquiry on its website and called for written submissions. The committee also wrote directly to a range of government departments

and agencies, companies, industry bodies, consumer groups and academics with an interest in matters relating to credit cards, drawing their attention to the inquiry and inviting them to make written submissions.

1.4 The committee received 37 submissions, which have been published on the committee's website. The committee held five public hearings: two in Sydney (27 August and 16 October 2015), one in Melbourne (3 September 2015), and two in Canberra (22 September and 9 November 2015).

1.5 The committee thanks all those who assisted with the inquiry, especially individuals and organisations that made written submissions and the witnesses who put in the time and effort to appear before the committee.

Background to inquiry

1.6 In part, the committee's interest in regard to credit card interest rates and the credit card market more broadly was stimulated by a discussion about these subjects during Senate Estimates in June 2015. In this discussion, the Secretary to the Treasury, Mr John Fraser, indicated that Treasury had recently considered the gap between the cash rate and credit card interest rates, and believed more work might be required in this space. Mr Fraser told the committee:

> My personal view is that it is an issue well worth further and deeper investigation and consideration. I am driven partly by the fact that it does seem that the people who pay these credit-card interest rates—those who do not fully pay off the amounts—tend to be people, perhaps, less capable of servicing that debt, and that worries me. I think it is something well worth considering, and we will give some further thought to it.[1]

1.7 During the same Senate Estimates hearings, officials from the Reserve Bank of Australia (RBA) were also asked about the 'stickiness' of credit card interest rates ('stickiness' meaning that credit card interest rates had not fallen in line with the fall in the RBA cash rate in recent years). Dr Malcolm Edey, RBA Assistant Governor (Financial Systems), noted that there were several factors that might help explain why credit card interest rates had not responded to a falling cash rate, including higher costs of funding (independent of the cash rate) and a repricing of risk in the post-Global Financial Crisis (GFC) period. However, Dr Edey acknowledged that the 'gap seems high and it is hard to explain why it is as large as it is'.[2]

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1 Mr John Fraser, Secretary, Department of the Treasury, *Official Committee Hansard*, 1 June 2015, p. 42. Subsequent to Senate Estimates, Treasury released a March 2015 ministerial brief and slide presentation on credit card interest rates in response to a Freedom of Information (FOI) request. Treasury, 'Briefing documents on matters relating to credit cards provided to the Treasurer and referred to in June 2015 Budget Estimates', http://www.treasury.gov.au/Access-to-Information/DisclosureLog/2015/1746.

2 Dr Malcolm Edey, Assistant Governor, Financial Systems, Reserve Bank of Australia, *Official Committee Hansard*, 1 June 2015, p. 62.

1.8 Dr Edey quite rightly made the point that Australia does not regulate interest rates, and, as such, there is no interest rate regulator. He told the committee that Australia does have 'an ACCC [Australian Competition and Consumer Commission] that can investigate uncompetitive conduct if they see it, but they clearly have not seen it in this market'.[3] It was put to Dr Edey that the issue was not so much whether there was uncompetitive conduct in the market, but whether regulatory settings were conducive to the promotion of sufficient competition to put downward pressure on credit card interest rates.[4] In part, the committee's inquiry has been directed at understanding whether existing regulatory settings in relation to credit cards are appropriate in this respect. More broadly, the committee has sought to determine what might be done to improve competition in the credit card market or otherwise put downward pressure on credit card interest rates.

Structure of report

1.9 Chapter two of this report provides a contextual overview of the Australian credit card market, with a particular focus on interest rate settings within that market. A brief overview is also provided of the responsible lending obligations as they operate in relation to credit card lending.

1.10 In turn, chapter three explores the reasons for the apparent 'stickiness' of credit card interest rates in the context of a falling RBA cash rate. In doing so, the chapter considers the extent to which apparent consumer inattention to credit card interest rates might be inhibiting downward pressure on those rates. Chapter three also assesses the explanations provided by the banks and other card providers for the continued prevalence of high interest rates despite a falling cash rate.

1.11 Chapter four examines the competitive dynamics of the credit card market and the capacity of consumers to exercise choice in that market. A key focus of the chapter is how consumers might be empowered to better value and compare credit cards and switch to a product that best suits their needs and circumstances. The potential of peer-to-peer lending as an alternative form of consumer credit is also briefly considered.

1.12 Chapter five explains how credit cards often become a 'debt trap', and suggests reforms that might help consumers better manage their credit card debt or, better still, avoid accruing it in the first place. Specific consideration is given to the efficacy of existing responsible lending obligations as they operate in relation to the credit card market, whether there is merit in requiring higher minimum repayments on credit card debt, and the role played by balance transfer offers in shaping consumer decisions about credit card debt. Chapter five also looks at financial literacy programs

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3 Dr Malcolm Edey, Assistant Governor, Financial Systems, Reserve Bank of Australia, *Official Committee Hansard*, 1 June 2015, p. 67.

4 Acting Chair (Senator Dastyari), *Official Committee Hansard*, 1 June 2015, pp. 67–68.

and tools in relation to credit card debt, and evaluates the adequacy of existing support for people experiencing financial hardship due to credit card debt.

1.13 Chapter six considers the related matters of interchange fees, surcharging and the competitive neutrality of the regulation of credit cards.

Chapter 2

Overview of the Australian credit card market

2.1 This chapter provides an overview of the Australian credit card market. It begins with a brief summary of the importance credit cards have in the Australian payments system and sets out key data in relation to the value of credit card transactions and outstanding balances. In turn, this chapter explains the critical distinction between cardholders who pay off their balance in full each month and thereby avoid paying credit card interest ('transactors'), and cardholders who carry part of their balance over at the end of the statement period and therefore incur interest charges ('revolvers').

2.2 This chapter further provides information on the number and type of credit card providers in Australia, along with an explanation of the current situation and trends with respect to credit card interest rates and their relationship to the RBA cash rate. Comparisons are also provided between credit card interest rates in Australia and overseas.

2.3 This chapter also summarises the responsible lending obligations that apply to credit card lending.

Use of credit cards in Australia

2.4 In recent decades, credit cards have grown to become a critical component of the Australian payments system. There are currently around 16 million credit cards on issue in Australia, and approximately 40 per cent of Australian adults have at least one credit card.[1] There are also a large number of credit card providers and products available to Australian consumers: according to CANSTAR data cited by Westpac, as at July 2015, there were at least 83 institutions offering 266 credit card products.[2]

2.5 Credit cards and debit cards account for approximately two-thirds of non-cash transactions in Australia (although only about 3 per cent of the value of total transactions, with high-value non-cash transactions typically using payment methods such as electronic funds transfer). In 2014–15, Australians made 2.2 billion credit card payments, with a total value of $285 billion. According to the RBA, in the June quarter of 2015 new credit card transactions averaged around $24 billion per month. At the end of June 2015, the total quantum of outstanding credit card debt was $51.5 billion. Of this total, $33.1 billion was accruing interest.[3]

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1 Australian Bankers' Association, *Submission 15*, pp. 1, 5.

2 Westpac, *Submission 21*, p. 3; Australian Bankers' Association, *Submission 15*, p. 1.

3 Reserve Bank of Australia, *Submission 20*, p. 5.

2.6 Credit cards comprise a small and (as discussed further below) declining proportion of total household borrowings, at about 2 per cent according to the Australian Bankers' Association (ABA), or a little under 3 per cent according to the RBA.[4] However, according to the ABA, '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'.[5] In this sense, credit cards provide revolving credit facilities which can play an important role in helping households manage cash flows.[6]

2.7 Credit cards also play a significant role for Australian merchants. In its submission, the Australian Retailers Association outlined some of the benefits credit cards provide to merchants:

> [Credit cards] have reduced the risk for merchants having to keep large amounts of money on the premises and made the point of sale experience faster and easier. Before credit cards, many retailers held accounts for customers (where they could take their goods and pay for them at a later date) for several weeks, thus accepting and carrying the risk of not being paid for the duration—and in some cases, not being paid at all. With the use of credit cards, retailers are paid overnight and do not have to worry about credit losses.[7]

2.8 Typically, interest on credit card debt is only applied if a cardholder does not pay their balance in full at the end of the one-month statement period. As cardholders generally have about 14 to 25 days to pay their monthly balance, this means there is usually an interest fee period of up to 44 to 55 days, or thereabouts. If a balance from a statement period is not paid off in full, then interest will be applied to the outstanding balance, and any transactions made since the end of the statement period will also attract interest from the date of transaction.[8]

2.9 While the RBA advised that about 75 to 80 per cent of credit card transactions do not accrue interest, about 65 per cent of the total quantum of credit card debt (or, as noted above, $33.1 billion) is accruing interest. To clarify, interest paying cardholders 'account for about 30–40 per cent of accounts, about 20–25 per cent of transactions, but close to two-thirds of the outstanding stock of debt'.[9]

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4 Australian Bankers' Association, *Submission 15*, p. 4; Reserve Bank of Australia, *Submission 20*, p. 16.

5 Australian Bankers' Association, *Submission 15*, p. 4.

6 Australian Bankers' Association, *Submission 15*, p. 1.

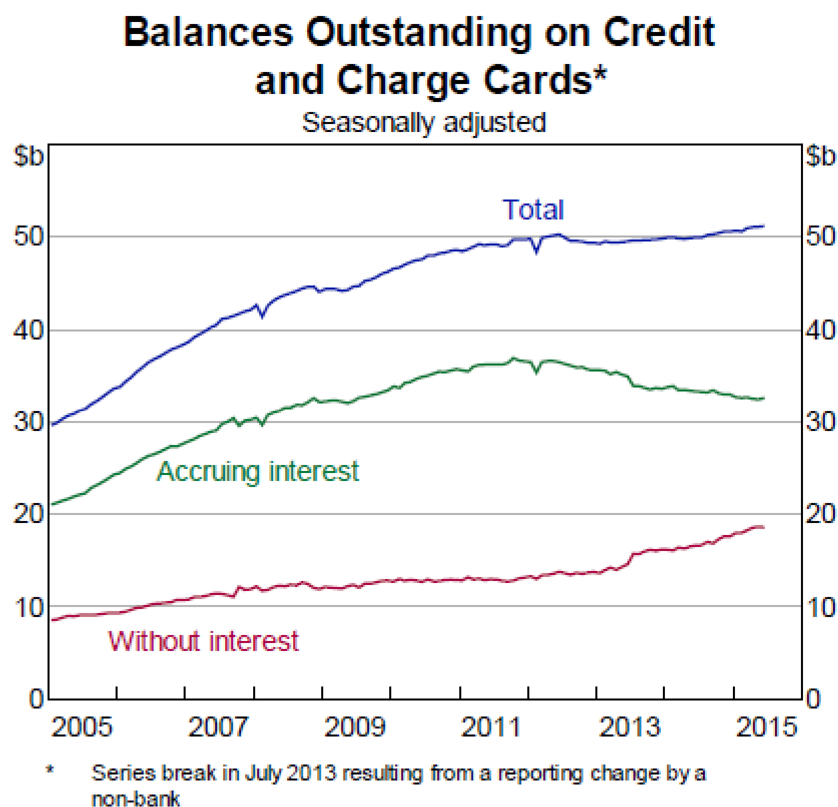
7 See, for example, Australian Retailers Association, *Submission 6*, p. 2; Australian Bankers' Association, *Submission 15*, p. 2.

8 Australian Securities and Investments Commission, *Submission 16*, p. 7.

9 Reserve Bank of Australia*, Submission 20*, p. 15.

2.10 The RBA observed that the proportion of credit card debt balances accruing interest has fallen from around 75 per cent to 65 per cent since 2012. Balances accruing interest have also fallen in absolute terms since peaking in late 2011 (as shown in Figure 1). The RBA suggested the decline 'possibly reflects a range of factors such as changes in consumers' financial behaviour, government reforms that took effect in 2012 relating to repayments and limit increase arrangements, and possibly also the effect of competition for balance-transfer offers'.[10] Similarly, the CBA suggested the trend might be attributed to 'higher customer repayment rates and aggressive zero per cent balance transfer offers'.[11]

Figure 1: Balances outstanding on credit and charge cards



Source: Reserve Bank of Australia, *Submission 20*, p. 15.

2.11 Credit card debt has also declined as a proportion of overall household debt in the past decade, from about 4.5 per cent in 2001 to a little below 3 per cent now. It is important to note that while the ratio of household debt to income has remained relatively stable over this period, the ratio of credit card debt to household debt has declined. The RBA observed that this trend might reflect the increasing availability

10 Reserve Bank of Australia, *Submission 20*, p. 15.

11 Commonwealth Bank of Australia, *Submission 23*, p. 5.

and use of mortgage offset and redraw facilities (mortgage interest rates being lower than credit card interest rates).[12]

2.12 While the use of credit cards grew strongly through the 1990s and early 2000s, since 2004–05 spending on debit cards has grown more strongly than on credit cards.[13] The RBA suggested that this trend:

> …is likely mostly a reflection of broader macroeconomic trends, as the period to the mid-2000s was one where the ratio of household debt (especially for housing) to income grew significantly and where the household saving rate was falling. By contrast, the period since the mid-2000s has seen a broad stabilisation in the household debt ratio, a recovery in the saving rate and more conservative trends in card use and debt.[14]

2.13 The ABA pointed to similar trends in how Australians were using their credit cards. It noted that while the overall value of credit card transactions is currently growing at around 4 to 5 per cent a year, over the past decade 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.[15]

2.14 Whereas the RBA referred to recent declines in the amount of credit card debt accruing interest and the proportion of credit card debt to overall household debt, a joint submission from the Financial Rights Legal Centre and Consumer Action Law Centre highlighted higher levels of credit card indebtedness in the past decade:

> Australian credit card debt is continuing to grow rapidly, in line with a huge growth in household debt. The majority of Australian households now have a net credit card debt. Statistics released by the Reserve Bank of Australia show that as at May 2015 there were 16 million credit cards with outstanding balances of $51.2 billion. Almost 64% of outstanding balances, or $32.6 billion, was accruing interest. This represents an incredible 47.3% increase in balances accruing interest over the past 10 years. These statistics correspond with the huge increase in household debt. Since March 1977, we have seen the percentage of household debt to disposable income increase from nearly 40% to over 140%.[16]

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12 Reserve Bank of Australia, *Submission 20*, p. 16.

13 Reserve Bank of Australia, *Submission 20*, p. 5.

14 Reserve Bank of Australia, *Submission 20*, pp. 5–6.

15 Australian Bankers' Association, *Submission 15*, p. 3.

16 Consumer Action Law Centre and Financial Rights Legal Centre, *Submission 13*, p. 4.

'Revolvers' and 'transactors'

2.15 Industry and regulatory analysts commonly categorise cardholders as 'revolvers' and 'transactors'. Revolvers typically pay interest on their balances (as they carry forward, or 'revolve', card balances over time), whereas transactors typically pay off their balance in full and thereby avoid paying interest on their balances. According to the RBA, revolvers are more likely to hold lower-rate cards than transactors, and transactors are more likely to hold higher-rate rewards cards.[17]

2.16 The RBA advised that the proportion of revolvers is higher among low-income households and when high-income households do fall into the revolver category, they are more likely to be 'occasional revolvers' as opposed to 'persistent revolvers'.[18]

2.17 Drawing on data from the household, income and labour dynamics survey in Australia (HILDA), Treasury also noted that low-income households have more credit card debt relative to their incomes and pay more in credit card interest relative to their incomes than high-income households (although higher income households pay more interest in absolute terms). HILDA data similarly shows that low net worth households pay higher proportions of interest relative to their income.[19] Summarising the data in its submission, Treasury advised that low income households:

> …would be more likely to be paying the high interest rates charged on credit cards and be more likely to be subject to high additional fees and charges. In particular, they will be more affected by the practice of backdating interest charges when cardholders fail to pay off their full balance at the end of each billing cycle.[20]

2.18 The committee also received evidence suggesting that people on low incomes, including many disadvantaged and vulnerable people, are more likely to use credit cards for cash advances.[21] In addition to generally being subject to specific fees, cash advances are not eligible for any interest free period and typically attract an even higher rate of interest than the ongoing purchase rate on a credit card.

2.19 The RBA's *2013 Consumer Use Survey* showed that 73 per cent of cardholders participating in the survey typically pay off their account in full within the interest free period, implying that 27 per cent typically do not. Industry estimates suggest the proportion of cardholders who typically pay interest is slightly higher, at between 30 and 40 per cent. The RBA ventured that the gap between its survey results

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17 Reserve Bank of Australia, *Submission 20*, p. 5.

18 Reserve Bank of Australia, *Submission 20*, p. 6.

19 Treasury, *Submission 17*, p. 2.

20 Treasury, *Submission 17*, p. 3.

21 For example, see Good Shepherd Australia New Zealand, *Submission 5*, p. 5.

and industry data may reflect hoped-for, rather than actual behaviour on the part of consumers.[22]

2.20 A similar point was made in a joint submission by the Consumer Action Law Centre and Financial Rights Legal Centre. They referred to a recent ANZ financial literacy survey which found that 65 per cent of cardholders claimed they had always paid their main card balance in full over the last 12 months:

> However, the proportion of credit card balances accruing interest indicates this figure is overly optimistic. A significant number of consumers are actually 'revolvers': consumers who pay minimum monthly repayments or a fraction of the outstanding balance and incur high interest rate charges—around two thirds of outstanding balances actually attract interest. This tendency towards identifying oneself as a transactor, when in fact you are a revolver, is a basic behavioural bias. Consumers tend to underestimate or are blind to factors that can impede repayment of their credit card balances. People are overly optimistic and have other biases in assessing risk, meaning they are overconfident when it comes to estimating the amount of debt they will incur.[23]

Providers of credit cards

2.21 As noted above, there are currently over 80 institutions offering more than 250 credit card products in Australia. CANSTAR data provided to the committee by Westpac showed that of the 83 institutions offering credit cards in July 2015, 30 were banks, 45 were credit unions and building societies and 8 were not Authorised Deposit-taking Institutions (ADIs).[24] The number of providers operating in the market obscures the fact that the Australian credit card market is dominated by banks, and in particular the four 'majors' (the CBA, Westpac, ANZ and NAB, and their subsidiaries). The ABA informed the committee that banks provide approximately 88 per cent of credit cards on issue in Australia, and account for approximately 81 per cent of balances outstanding.[25] The four majors alone account for about 68 per cent of balances outstanding.[26]

2.22 As Treasury noted, while the four major banks' share of the credit card market is high, this reflects the 'concentration of the Australian banking system more

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22 Reserve Bank of Australia, *Submission 20*, p. 6.

23 Consumer Action Law Centre and Financial Rights Legal Centre, *Submission 13*, pp. 4–5.

24 Westpac, *Submission 21*, p. 3. These figures do tend to fluctuate from month to month. The ABA cites CANSTAR data from June 2015 showing at least 67 providers (32 banks, and 35 other institutions) offering at least 193 credit card products. Australian Bankers' Association, *Submission 15*, p. 6. The change is perhaps indicative of both the fluidity of the market and the difficulty in precisely measuring the number of providers and products available at any point in time.

25 Australian Bankers' Association, *Submission 15*, p. 4.

26 Westpac, *Submission 21*, p. 1.

generally rather than being a unique feature of the credit card market'.[27] It can also be noted that the majors' 68 per cent share of balances outstanding has fallen slightly over the past decade (from around 74 per cent in 2004, although it has increased from about 66 per cent immediately prior to the GFC) and is lower than the major banks' share of household deposits, which stands at just over 81 per cent.[28]

2.23 It is also important to state that neither Visa nor MasterCard, the two most widely used credit card brands, actually issue any credit cards themselves. Rather, they are both operators of payment networks that are utilised by banks and other providers of credit cards. As such, Visa and MasterCard do not have any role in determining credit card interest rates (or indeed any other aspect of credit card pricing), and do not receive any revenue from interest payments.[29]

Credit card interest rates and spreads: variations and trends

2.24 The persistence of high interest rates in the credit card market, despite a falling RBA cash rate, has been an important focus of this inquiry. While the issue is explored in detail in chapter three, some general contextual information regarding credit card interest rates is offered below.

2.25 Interest charged on credit cards varies widely depending on the type of card and provider. According to an August 2015 search of comparison website Mozo, there is a 15.5 per cent gap between the lowest rate card, a Quay Credit Union Visa Credit Card with an ongoing purchase rate of 7.99 per cent, and the highest rate card, a GE Money MasterCard at 23.5 per cent.[30]

2.26 While there are a range of credit cards available offering a variety of rate features and pricing structures, cards on issue can be broadly categorised as either 'low-rate', 'low-fee' or 'rewards'. With respect to interest rates, the RBA maintains and publishes two data series: one on 'standard' cards, a category that most reward and many low-fee cards fall into, and which commenced in January 1990; and the other on low-rate cards, commencing in November 2003.[31] The RBA explained in its submission that while there is a wide variation in the advertised interest rates for credit

27 Treasury, *Submission 17*, p. 4.

28 Westpac, *Submission 21*, p. 1.

29 MasterCard, *Submisson 2*, p. 1; CANSTAR, webpage, 'Visa or MasterCard: what's the difference?' http://www.canstar.com.au/credit-cards/visa-or-mastercard/, accessed 30 November 2015.

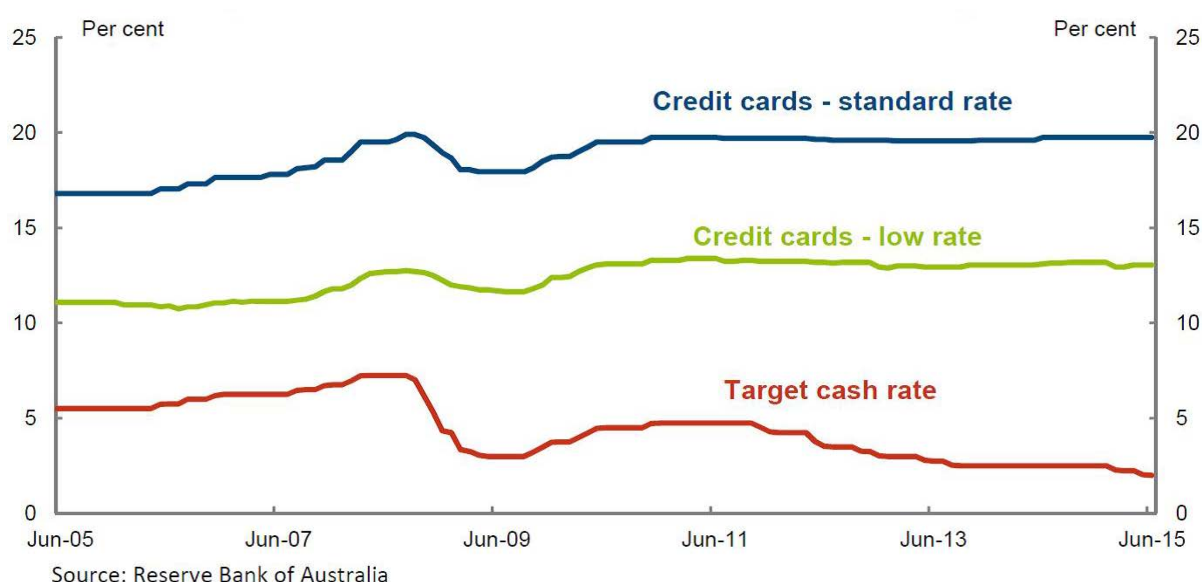
30 Nicole Pedersen-McKinnon, 'Big bank sentence? 18 years card-labour', *Canberra Times*, 22 August 2015, http://www.canberratimes.com.au/money/borrowing/big-bank-sentence-18-years-cardlabour-20150819-gj2xo3.html.

31 Australian Bankers' Association, *Submission 15*, p. 11.

cards, standard cards currently tend to bunch around the 20 per cent mark, while lower-rate cards bunch around 13 per cent.[32]

2.27 As Treasury confirmed in its submission, while the RBA cash rate has declined by 2.75 percentage points since late 2011, credit card interest rates have remained essentially unchanged over the same period (see Figure 2).[33] According to consumer advocacy group CHOICE, if credit card rates had moved at the same rate as the cash rate over that period, Australian credit card holders would have paid $2.07 billion less in interest since mid-2011.[34]

Figure 2: Credit card interest rates and the cash rate target



Source: Treasury, *Submission 17*, p. 3.

2.28 A document tabled by CANSTAR also shows that the gap between credit card interest rates and the RBA cash rate has grown considerably since 2007, although the gap has grown rather more slowly in the post-GFC environment. CANSTAR's document tracked the gap since 2007 between the official cash rate and three other measures of credit card interest rates: the average purchase rate, the minimum purchase rate, and the maximum purchase rate. The gap between the cash rate and each of these three measures has, according to CANSTAR's document, grown since 2007 (see Figure 3). As CANSTAR explained, whereas the gap between the average credit card purchase rate and the cash rate was 8 per cent in 2007, it currently stands at about 15 per cent. This was, CANSTAR suggested, 'an extraordinary blow-out'.[35]

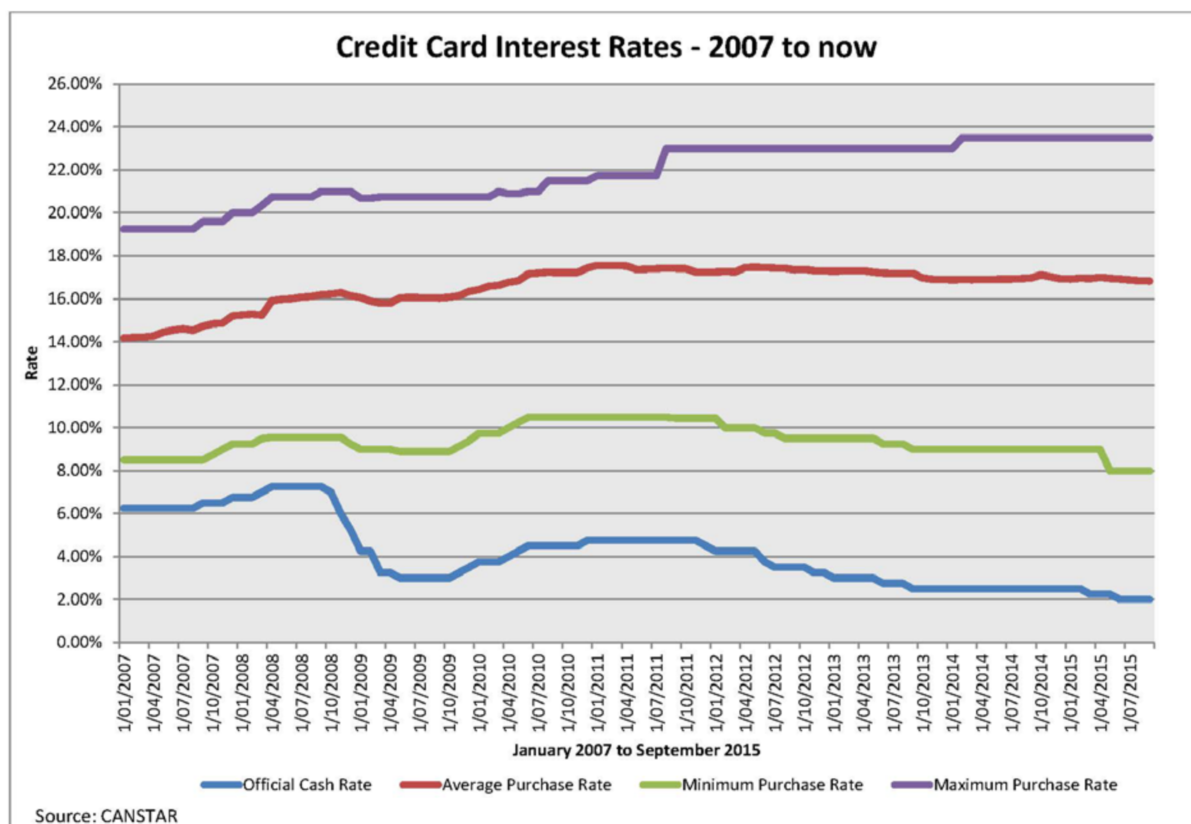
32 Reserve Bank of Australia, *Submission 20*, p. 10.

33 Treasury, *Submission 17*, p. 3.

34 CHOICE, *Submission 10*, p. 12.

35 Mr Stephen Henry Mickenbecker, Group Executive, Ratings and Financial Services, CANSTAR Pty Ltd, *Proof Committee Hansard*, 22 September 2015, pp. 32–33.

Figure 3: CANSTAR data on credit card interest rates



Source: Documents tabled by CANSTAR at a public hearing held in Canberra on 22 September 2015.

2.29 The growth in the gap between the cash rate and headline credit card interest rates appears even more pronounced when annual fees are added to the interest rate. Mr Ross Greenwood, the Nine Network's Business and Finance Editor, tabled a document that annualised average fees into average credit card rates from a range of providers to a card with a $5000 balance. Using this approach, Mr Greenwood assessed the gap between the adjusted interest rate (the interest rate with the annual fee annualised into it) and the RBA cash rate. Mr Greenwood found that for cards provided by the major banks the gap had in effect blown out to between around 17 and 20 per cent (and higher still for Amex and Citibank). This compared, according to Mr Greenwood's analysis, to a gap for the same banks' card offerings that, using the same measure, was consistently around the 12 per cent mark in 1998.[36]

2.30 It should be noted that average advertised interest rates do not fully reflect trends in interest actually paid by cardholders, at least in aggregate terms. Advertised

36 Document tabled by Mr Ross Greenwood, Channel 9, at a public hearing held in Sydney on 27 August 2015. For Mr Greenwood's explanation of his analysis, see Mr Ross Greenwood, Business and Finance Editor, Nine Network, *Proof Committee Hansard*, 27 August 2015, pp. 33–34.

rates do not, for instance, capture the effect of interest free periods or low or zero-interest balance transfer offers. According to the RBA, the effective interest rate received by the major banks on their entire credit card portfolios—actual interest earned as a proportion of balances outstanding—has fallen about 2 per cent since mid-2011, and is currently 11.6 per cent.[37] As noted above, since the current easing cycle began in late 2011, the cash rate has fallen from 4.75 per cent to 2 per cent, suggesting that it has fallen a little more than effective interest rates on credit cards over the same period, but not dramatically so.

2.31 In seeking to understand interest rate spreads,[38] it is also useful to look at the gap between effective interest rates and the weighted average of the interest rates paid on banks' sources of funds, as opposed to the gap between effective interest rates and the RBA cash rate. While funding costs have moved roughly in line with the RBA cash rate since the current easing cycle began, Treasury pointed out that funding costs 'have risen relative to the target cash rate since the financial crisis as banks switched to a greater proportion of (more expensive) deposit funding'.[39] Treasury presented a comparison of funding costs and effective credit card interest rates since 2007 for the major banks (see Figure 4).

2.32 The abovementioned average effective interest rate of 11.6 per cent takes account of the banks' entire book of credit card loans, including debt that does not yield interest. The effective rate for cardholders who *do* pay interest ('revolvers') is around 17 per cent, which is down about 1 per cent since 2011 (see Figure 4). The RBA concluded:

> Taken together, the recent changes in these two series [for the effective rate for credit card balances accruing interest, and the average rate on entire card portfolios] are consistent with the observed decline in the proportion of the stock of debt that is accruing interest (either reflecting more consumers paying down debt ahead of being charged interest, or reflecting an increase in the take up of zero and lower-rate balance transfers) and also some switching by consumers from high- to lower-rate cards.[40]

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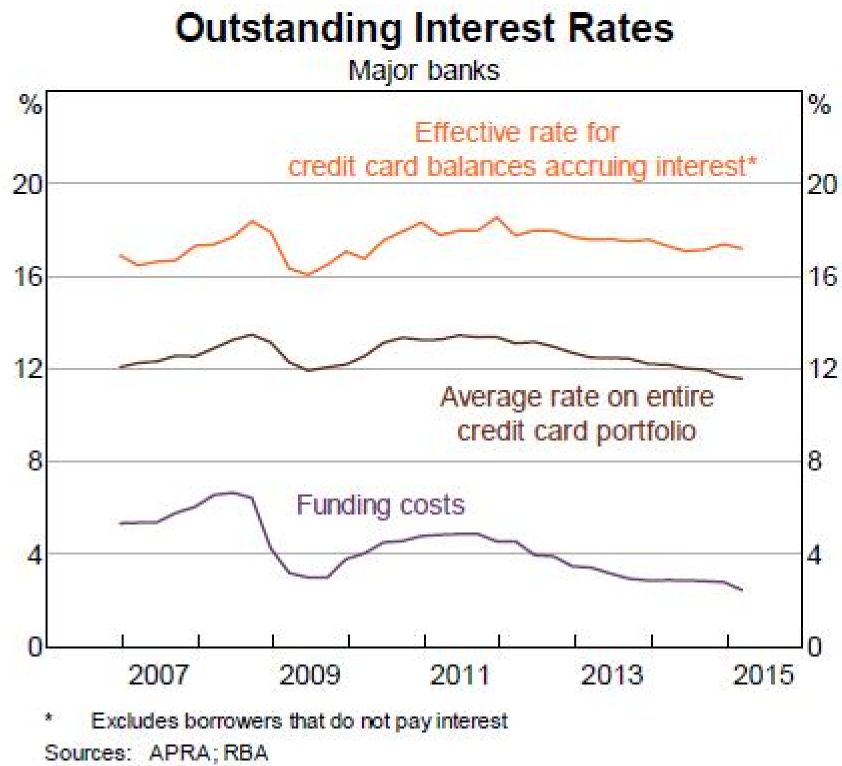
37 Reserve Bank of Australia, *Submission 20*, pp. 17–18.

38 The World Bank defines 'interest rate spread' as the 'interest rate charge by banks on loans to private sector customers minus the interest rate paid by commercial or similar banks for demand, time, or savings deposits'. http://data.worldbank.org/indicator/FR.INR.LNDP, accessed 30 November 2015.

39 Treasury, *Submission 17*, p. 7.

40 Reserve Bank of Australia, *Submission 20*, p. 18.

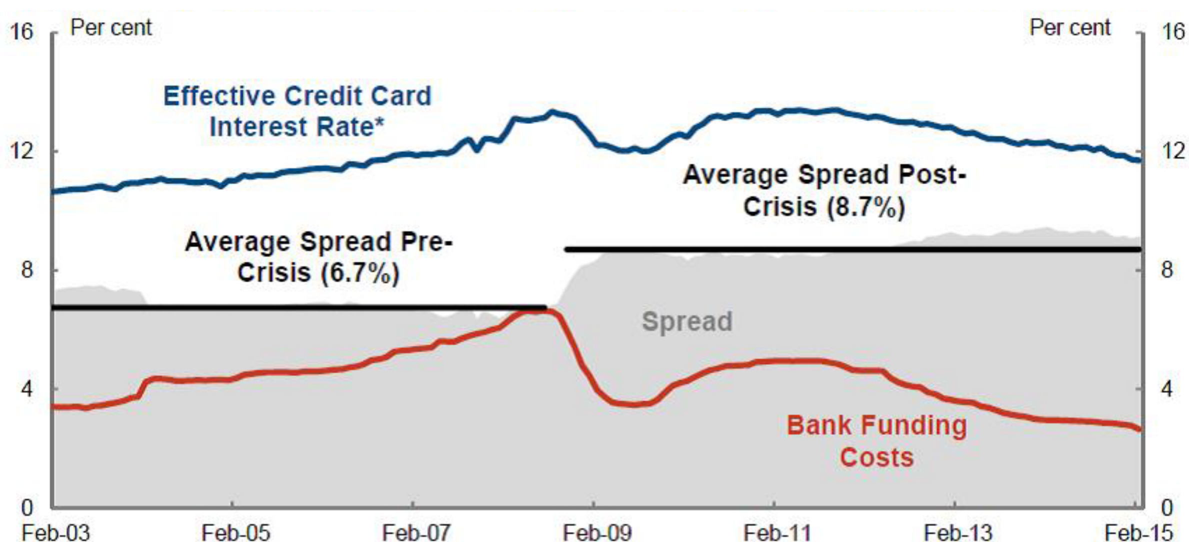
Figure 4: Interest rates on outstanding credit card balances



Source: Reserve Bank of Australia, *Submission 20*, p. 18.

2.33 Even if effective interest rates have trended down over the current easing cycle, it is apparent that the spread between bank funding costs and effective interest rates has grown significantly since the GFC. In the years prior to the GFC, the spread was on average 6.7 per cent, and did not vary much from this mark; since the GFC, the spread has been on average 8.7 per cent, and again that spread has not varied greatly in the post-GFC period (see Figure 5).

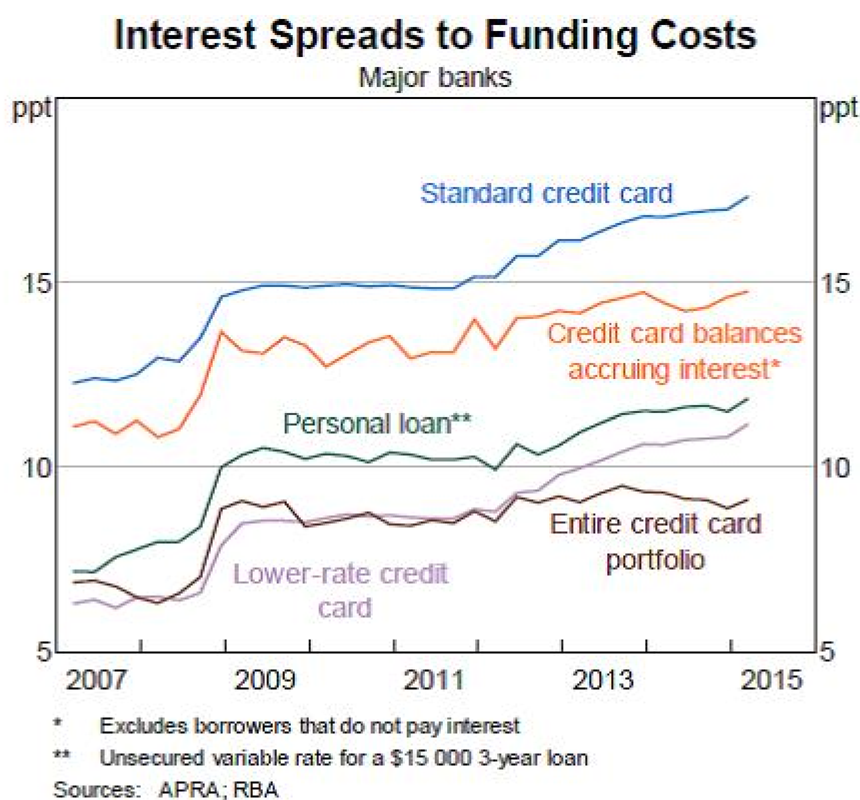
Figure 5: Spread between credit card 'effective' interest rates and bank funding costs



Source: Treasury, *Submission 17*, p. 3.

2.34 In its submission, the RBA provided an even more differentiated and detailed picture of trends in interest spreads to funding costs. It showed that while the spread between funding costs and effective credit card interest rates on balances outstanding is currently about 9 per cent, the spread for cardholders paying interest is about 14.75 per cent (see Figure 6).

Figure 6: Various interest spreads to funding costs



Source: Reserve Bank of Australia, *Submission 20*, p. 19.

2.35 The reasons for the apparent decline in the effective interest rate on credit card portfolios, and trends in the spread between the cash rate and credit card interest rates (both headline and effective), are explored in chapter three.

2.36 It is important to emphasise at this point that funding costs are only one component of credit card costs. Indeed, as discussed in the next chapter, the major banks advised the committee that funding costs constituted less than 25 per cent of the cost base of providing credit cards. Other costs, they noted, include but are not limited to credit management and costs associated with fraud and fraud protection, rewards and product benefits, insurances and concierge services, technology and systems costs, and innovation and product development. Card providers also stressed that credit card lending has a higher risk profile than secured forms of lending, and this higher risk is priced into credit cards. The relative importance of these various costs in informing credit card interest rates is considered in chapter three.

Australian credit card interest rates: international comparisons

2.37 Several witnesses told the committee that trends in interest rate settings on Australian credit cards were not dissimilar to trends in comparable markets overseas. For example, the ABA argued that comparisons with the United States and United

Kingdom 'suggest the dynamics for interest rates on credit cards in Australia are not out of line with international developments'.[41] Similarly, the RBA noted that high-rate cards are not uncommon overseas, and that it was likely 'some of the same forces are at work' in those markets as in the Australian market.[42]

2.38 The CBA also told the committee that the spread between the cash rate and credit card interest rates was not unusual by international standards. It further suggested that card providers internationally, like the CBA, also accounted for economic risk in pricing their products:

> If you look at international experience, in the UK you will find credit card rates ranging from about seven to 30 per cent and in the US probably in the range of 11 to 30 per cent, despite their cash rates being effectively at zero. That supports the fact that credit card providers, not just domestically but internationally, are very cognisant of pricing for risk. Those markets have demonstrated that losses can be substantial in any given year, and our role is to price competitively and appropriately through the cycle.[43]

2.39 However, Professor Abbas Valadkhani claimed that the gap between the cash rate and credit card rates was substantially wider in Australia than in the United States and United Kingdom. He asserted that if credit card spreads in Australia were like those in the United States, Australians would be somewhere in the order of $840 million better off; and if spreads were the same as those in the UK market, Australians would be $2.2 billion better off.[44]

Responsible lending obligations for credit card providers

2.40 The *National Consumer Credit Protection Act 2009* (National Credit Act) sets out responsible lending obligations which apply to all forms of regulated credit, including credit cards. ASIC has responsibility under the Act for administering the obligations.[45]

2.41 The responsible lending obligations require credit licensees to do certain things before providing a credit card to a consumer or increasing a cardholder's credit limit. As ASIC explained, these processes include making reasonable inquiries about a consumer's requirements and financial situation, taking reasonable steps to verify the

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41 Australian Bankers' Association, *Submission 15*, p. 2.

42 Dr Malcolm Edey, Assistant Governor, Financial System, Reserve Bank of Australia, *Proof Committee Hansard*, 27 August 2015, p. 15.

43 Mr Matthew Comyn, Group Executive, Retail Banking Services, Commonwealth Bank of Australia, *Proof Committee Hansard*, 16 October 2015, p. 14.

44 Professor Abbas Valadkhani, Department of Accounting, Economics and Law, Swinburne University of Technology, *Proof Committee Hansard*, 3 September 2015, p. 28.

45 Australian Securities and Investments Commission, *Submission 16*, p. 2. Prior to the introduction of the responsible lending obligations on 1 July 2010, consumer credit was primarily regulated by the states and territories.

consumer's financial situation, and making an assessment as to whether a credit contract is 'not unsuitable' for a consumer based on inquiries made.[46]

2.42 As ASIC noted, its primary guidance on responsible lending, including in relation to credit cards, is set out in Regulatory Guide 209, *Credit licensing: Responsible lending conduct* (RG 209). RG 209 also provides guidance to credit licensees on ASIC's interpretation of the responsible lending obligations.[47]

2.43 ASIC also administers obligations that are specific to credit cards and were introduced by the *National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Act 2011* and associated regulations. These obligations are as follows:

- a requirement for card providers to send a 'key facts sheet' to new card applicants, setting out how minimum repayments are calculated, interest rates that apply, and interest-free periods and fees;
- a prohibition on unsolicited offers to increase card limits;
- restrictions on the ability of providers to charge fees or higher interest rates when a cardholder exceeds their credit limit;
- a requirement that repayments on credit cards must first be allocated towards those portions of a balance to which the highest interest rate applies (this applies to cards issued after 1 July 2012); and
- the inclusion of a minimum repayment warning on monthly credit card statements, highlighting the length of time it would take a cardholder to repay their balance if they only made the minimum payment.[48]

Understanding the impact of high credit card interest rates

2.44 The foregoing discussion about statistical trends in credit card interest rates should not obscure the very real and troubling effects that high credit card interest rates can have on individuals, families and communities. The committee received a large amount of evidence on these effects which has played an important role in informing the committee's thinking about credit card interest rates and the credit card market more generally.

2.45 The Consumer Action Law Centre and Financial Rights Legal Centre observed that credit card debt can have 'serious and profound impacts':

> For those with the most acute problems with credit card debt, the debt seriously harms their lives. It can cause, amongst other things, family breakdown, violence, crime and deterioration in health (including mental

46 Australian Securities and Investments Commission, *Submission 16*, p. 3.

47 Australian Securities and Investments Commission, *Submission 16*, p. 5.

48 Australian Securities and Investments Commission, *Submission 16*, pp. 4–5.

> health). Significant credit card indebtedness can also have a long-term impact on the capacity to provide for housing, health, education and retirement.[49]

2.46 The St Vincent de Paul Society advised the committee that it worked with people every day who in their struggles to manage out-of-control credit card debts had resorted to:

> …borrowing money, selling items of value, taking out short-term pay day loans, and seeking the assistance of welfare services in addition to increasing the limit or taking out new credit cards when the offer is made available.[50]

2.47 A number of organisations relayed personal stories of hardship resulting from high-interest credit card debt. Good Shepherd Australia New Zealand told how one of their clients had not only been a victim of domestic violence but also financial abuse, and had incurred a large credit card debt as a result.[51] The WA Consumer Credit Legal Service referred to a number of cases it had dealt with where, as a result of mental illness, family breakdown or other crises, a vulnerable individual had amassed a credit card debt that they had no prospect of ever repaying.[52] Financial Counselling Australia (FCA) provided a number of examples which showed that people of all ages and from all walks of life could become trapped by credit card debt. For example, FCA told how a woman in her 30s had accrued a long-term credit card debt and now felt 'trapped, and unable to move forward with any financial plans until she had repaid this debt'. The FCA also explained how a 75 year old pensioner had used his credit card to supplement his income and avoid homelessness, but in the process had built a credit card debt so large that he struggled simply to pay the interest.[53]

2.48 Chapter five provides a detailed analysis of the problem of long-term credit card debt, and sets out some options for helping people avoid the credit card debt trap and, when that fails, better assisting people experiencing financial hardship. In addition, reference is made throughout this report to how the credit card market is currently failing vulnerable and disadvantaged Australians. In part, this story is told in statistics and headline figures, including those set out earlier in this chapter. However, it needs to be emphasised that the committee's concern in this regard has been largely informed by the compelling and troubling evidence it received of individuals and families struggling under the weight of high-interest credit card debt.

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49 Consumer Action Law Centre and Financial Rights Legal Centre, *Submission 13*, p. 6.

50 St Vincent De Paul Society, *Submission 4*, p. 2.

51 Good Shepherd Australia New Zealand, *Submission 5*, p. 6.

52 Consumer Credit Legal Service (WA) Inc., *Submission 12*, pp. 3–5.

53 Financial Counselling Australia, *Submission 25*, pp. 8–9.

Chapter 3

Explaining the 'stickiness' of credit card interest rates

3.1 As explained in the previous chapter, different measures of credit card interest rates offer different insights into whether those rates are fair and appropriate, or whether, as Mr David Koch put it, average Australians are getting 'fleeced at every step on the credit card journey'.[1] During the inquiry, critics of card providers pointed to the 'stickiness' of headline (advertised) interest rates, arguing that for revolvers, this was the most meaningful measure of interest costs. Card providers, however, pointed to declines in the aggregate interest paid on their entire credit card portfolios (the 'effective' interest rate). This chapter outlines and assesses the relative merits of these different perspectives.

3.2 To the extent that credit card rates have not declined in line with the RBA cash rate—and this has certainly been the case with regard to headline interest rates, and to a lesser extent the average rate paid by credit card 'revolvers'—this chapter explores the reasons for this 'stickiness'. Again, the committee received conflicting explanations for this phenomenon. Card providers argued that funding was only part of the cost base of credit cards, and referred to a range of other significant costs influencing credit card pricing. Others, however, argued that the growing gap between the cash rate and credit card interest rates could only be explained by the fact providers were taking advantage of consumer inattention to credit card interest rates. This chapter outlines and assesses these arguments, and considers the need for reforms designed to better focus consumer attention on credit card interest rates.

3.3 Finally, this chapter briefly assesses the profitability of the credit card market in Australia.

'Up like a rocket, down like a feather': Credit cards and the RBA cash rate

3.4 Two related measures of credit card interest rates (that often attract the most public scrutiny), are headline rates and the gap between average headline rates and the RBA cash rate. As noted in chapter two, headline interest rates on standard cards currently bunch around 20 per cent, while low-rate cards tend to be set at 13 per cent or thereabouts. The average headline rate—the effective rate for cardholders who are paying interest on their balances—is around 17 per cent. There is therefore a 15 per cent gap between the average headline rate on credit cards and the current RBA cash rate of 2 per cent. In 2007, the same gap was around 8 per cent.[2]

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1 Mr David Koch, Finance Editor, Seven Network, *Proof Committee Hansard*, 27 August 2015, p. 34.

2 These figures were set out in greater detail in chapter two.

3.5 A number of witnesses during the inquiry questioned whether current headline rates and the gap between headline rates and the RBA cash rate (or, alternatively, between headline rates and the costs of funds) could be adequately explained simply as a function of the costs of providing the facility. Dr Edey from the RBA, for instance, suggested that while there was a great deal of variation in interest rates across the credit card market, rates at the higher end of the spectrum could not be easily explained:

> Interest rates in the order of 20 per cent on credit cards are not uncommon. The average rate for borrowers who incur interest on credit cards is currently about 17 per cent. Once you deduct from that banks' cost of funds and the cost of credit losses, that would equate to an interest margin of more than 10 percentage points.[3]

3.6 Professor Valadkhani provided the committee with research he had undertaken indicating that credit card providers appear to behave asymmetrically in response to changes in the RBA cash rate. According to Professor Valadkhani, between 1990 and 2012 the banks had immediately passed on 112 per cent of RBA cash rate increases (the full value of increases, plus 12 per cent), but only 53.7 per cent of rate cuts: but cuts were delayed by an average of two-and-a-half months. Professor Valadkhani has suggested this asymmetry is an example of the 'rockets-and-feathers' effect: credit card interest rates 'shoot up like a rocket' in response to RBA cash rate increases, but 'float down like feather' when the cash rate is decreased.[4] This means that over time the gap between the RBA cash rate and credit card interest rates has grown, and consumers have been left paying higher rates of interest overall.

3.7 Professor Valadkhani took issue with the banks tendency to downplay the relevance of the cash rate to credit card interest rates:

> We do not have enough information about what their funding sources are. The argument they always make is: 'We cannot pass rate cuts on because our sources of funding are different—it is not just the cash rate; it is our external sources.' My argument to banks is: if that is the case, how come, when the cash rate goes up, you immediately lift your rates? You may have other external sources that are not related to the cash rate, but you increase your rates anyway. When the cash rate goes down, though, you resort to the argument of external sources.[5]

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3 Dr Malcolm Edey, Assistant Governor, Financial System, Reserve Bank of Australia, *Proof Committee Hansard*, 27 August 2015, p. 10.

4 Abbas Valadkhani, Sajid Anwar and Amir Arjomandi, 'Downward stickiness of interest rates in the Australian credit card market', *Journal of the Asia Pacific Economy* 19(1) (2013), pp. 52–53; Professor Abbas Valadkhani, Department of Accounting, Economics and Law, Swinburne University of Technology, *Proof Committee Hansard*, 3 September 2015, p. 27.

5 Professor Abbas Valadkhani, Department of Accounting, Economics and Law, Swinburne University of Technology, *Proof Committee Hansard*, 3 September 2015, p. 30.

3.8 CHOICE noted that despite a falling cash rate, average credit card interest rates had gone up for both standard-rate and low-rate cards in recent years. This was of particular concern to CHOICE, because:

> …if you must have a credit card and you are on a low income that means you cannot pay off your balance every month, a low-rate card is the best option. So to see banks taking advantage of drops in interest rates to dip their hands deeper into the pockets of low-income consumers is of deep concern.[6]

The role of behavioural biases in informing credit card interest rates

3.9 An important finding of this inquiry is that consumers do not appear as focused on the interest rates on credit cards as they are for other lending products (such as personal or home loans). In fact, CHOICE told the committee that its consumer survey suggested that 64 per cent of people do not even know their credit card interest rate, up from 48 per cent in 2013, suggesting a 'growing problem'.[7]

3.10 The committee received evidence suggesting consumers' apparent inattention to credit card interest rates was likely a factor in the prevalence of high-interest credit cards, reducing pressure on card providers to compete on interest rates. Treasury suggested that the 'large and widening spread between funding costs and headline credit card interest rates' could be explained in part by consumer inattention:

> The spread appears not to just reflect pricing of credit risk or non-performing loans and funding costs. Rather, the spread seems to incorporate as well a premium reflecting consumer inattention to headline rates.[8]

3.11 Bank Australia made a similar point, telling the committee that the spread likely reflected the fact that people are 'not terribly rate sensitive' when they choose a card, because they expect to pay off the card balance in full each month. In this sense, the spread was as large as it could be without affecting the market's ability to sell credit card products.[9] Likewise, Mr Greenwood remarked that consumer inertia reduced the need for card providers to lower their average rates:

> There is clearly room for the banks to move these credit card interest rates down. They have chosen not to do so and they have justified it in all sorts of ways—in terms of the services they provide and the rewards they provide. And they will give you an idea of the bad debts that are there as

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6 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Proof Committee Hansard*, 27 August 2015, p. 51.

7 Ms Erin Turner, Campaigns Manager, CHOICE, *Proof Committee Hansard*, 27 August 2015, p. 53.

8 Mr Michael Willcock, Acting Deputy Secretary, Markets Group, Department of the Treasury, *Proof Committee Hansard*, 22 September 2015, p. 55.

9 Mr John Yardley, Chief Operating Officer, Bank Australia, *Proof Committee Hansard*, 3 September 2015, p. 20.

> well. But the bottom line is that, clearly, the consumer is not acting to try and find a better deal.[10]

3.12 Drawing on insights provided by behavioural economics, ASIC suggested that people may give insufficient attention to a card's interest rate at the point of application because they are naively optimistic about their ability to pay their balance off in full each month.[11]

3.13 Credit cards are multifaceted products, with features that have a significant bearing, real or perceived, on the value proposition for a particular consumer. For some consumers, the tendency to prioritise card features such as rewards points may be entirely rational. As CANSTAR explained, for big spenders who consistently pay off their full credit card balance each month, the interest rate is irrelevant. For these customers, features such as rewards programs are likely to be given a higher priority than interest rates. However, CANSTAR emphasised that customers who do not consistently pay off the entire card balance each month 'should not even consider rewards. The interest rate will blow the rewards away'.[12]

3.14 Despite evidence that interest rates are often the most salient feature of a credit card, Treasury stated that competition is generally more intense on other aspects of the value proposition, including balance transfer offers, interest-free periods on purchases, rewards programs, and other benefits such as insurance and concierge services.[13] CHOICE made a similar point, telling the committee that the banks were not competing on interest rates, but instead on other generally less important card features such as rewards points and balance transfers. To focus more competition on interest rates, and thereby put downward pressure on them, CHOICE suggested it was necessary 'to force the banks to give people the information they need when they need it'.[14]

3.15 The Customer Owned Banking Association (COBA) also argued that consumers were more focused on credit card 'bells and whistles', and 'are not looking at that interest rate as a key factor in deciding what product to take up'. This also meant that card providers 'are not really competing on price in that space'. The problem with this situation, COBA told the committee, was that while consumers

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10 Mr Ross Greenwood, Business and Finance Editor, Nine Network, *Proof Committee Hansard*, 27 August 2015, p. 42.

11 Australian Securities and Investments Commission, *Submission 16*, p. 10.

12 Mr Stephen Henry Mickenbecker, Group Executive, Ratings and Financial Services, CANSTAR Pty Ltd, *Proof Committee Hansard*, 22 September 2015, p. 35. Mozo made the same point to the committee. Mr Rohan Gamble, Managing Director, Mozo, *Proof Committee Hansard*, 22 September 2015, p. 35.

13 Treasury, *Submission 17*, p. 4.

14 Ms Erin Turner, Campaigns Manager, CHOICE, *Proof Committee Hansard*, 27 August 2015, p. 54.

might generally expect that they will not be paying interest on credit card debt, in fact a relatively high percentage of people (about 30 per cent) end up paying interest.[15]

Committee view

3.16 The committee believes there is strong and compelling evidence to suggest that part of the reason credit card interest rates are so high is that card providers know consumers often pay little attention to their significance. Disclosure requirements in credit card advertising and other marketing could be enhanced, and the committee considers that card providers should be required to disclose the ongoing headline interest rate on a credit card in any advertising or marketing material clearly and prominently. This requirement would be established as part of additional disclosure requirements set out in recommendation 1 in chapter four. These additional disclosure requirements are intended to focus consumer attention on headline interest rates, and more broadly enhance the ability of consumers to value and compare credit card products in what is a very complex market.

Should credit card interest rates be regulated?

3.17 A number of submissions argued for limiting or otherwise regulating credit card interest rates. The WA Consumer Credit Legal Service (CCLSWA), argued that in order to protect low income, vulnerable, and disadvantaged consumers, legal reform was required to 'limit the gap between cash rates and credit cards rates'.[16] It argued that absent such action:

> …it is likely that when cash rates rise, credit card interest rates will rise considerably also. This will increase the already unfair and disproportionate costs placed on low income, disadvantaged and vulnerable consumers and will ultimately result in further long-term and severe damage to these consumers' financial and emotional well-being. Further, with more consumers experiencing serious financial hardship, there would be an increase in demand on government and community services.[17]

3.18 Similarly, the St Vincent de Paul Society recommended a legislative requirement that 'credit card interest rates align with changes in RBA cash rates'.[18] Good Shepard Australia New Zealand argued that a failure to pass on the full benefit of RBA cash rate cuts to credit card customers 'should be seen as an exception, with credit providers being made accountable to the regulator and consumers to apply for an exception to this rule'.[19]

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15 Mr Luke Lawler, Head of Public Affairs, Customer Owned Banking Association, *Proof Committee Hansard*, 3 September 2015, p. 20.

16 Consumer Credit Legal Service WA, *Submission 12*, pp. 2, 8.

17 Consumer Credit Legal Service WA, *Submission 12*, p. 2.

18 St Vincent De Paul Society, *Submission 4*, p. 6.

19 Good Shepherd Australia New Zealand, *Submission 5*, p. 3. Good Shephard did not specify which regulator it was referring to.

3.19 While Australia does not regulate interest rates, ASIC explained that the United States had adopted an approach characterised by 'a strong commitment to the direct regulation of fees and interest rates'. For example, increases on interest rates, fees and other charges are banned in the first year of an account being opened. Moreover, the United States has banned 'interest rate increases on outstanding amounts except at the end of an introductory rate period, if the rate is pegged to another rate that is not controlled by the provider or if the borrower is more than 60 days delinquent'.[20]

3.20 Asked about the possibility of regulating prices in the credit card market, CHOICE sounded a note of caution:

> As an organisation we are inherently cautious about anything that involves price controls or price-fixing. Ideally, the best way to protect consumers is to have effective markets that are supported by effective competition. We would much rather think about how you protect consumers from the negative effects of a market that is not working properly than price interventions, because they tend to ultimately produce other distortions in the system that have unintended consequences.[21]

Committee view

3.21 The committee acknowledges and shares the legitimate concerns raised by some witnesses regarding the apparent unresponsiveness of credit card interest rates to declines in the RBA cash rate. However, the committee does not agree that credit card interest rates should be regulated. Rather, the committee considers that the best way to put downward pressure on credit card interest rates is through regulatory and policy interventions designed to improve the competitive dynamics of the market and enhance the ability of consumers to measure and compare the value of products within that market accurately and easily.

Card providers: headline rates are steady, but effective rates have fallen

3.22 While much of the evidence received by the committee focused on headline interest rates, credit card providers argued that the average effective rate is a better measure of credit card interest rates. As explained in the previous chapter, this is calculated as the percentage of gross interest paid on balances outstanding. According to the RBA, this figure currently stands at 11.6 per cent, which is not only significantly lower than the average headline rate of about 17 per cent, but also 2 per cent lower than the average effective rate in 2011 when the current easing cycle for the RBA cash rate began.[22] These figures were supported during the inquiry by

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20 Ms Fiona Maguire, Senior Specialist, Australian Securities and Investments Commission, *Proof Committee Hansard*, 27 August 2015, p. 32.

21 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Proof Committee Hansard*, 27 August 2015, p. 56.

22 The 11.6 per cent figure is from the March 2015 quarter. For more detail, see chapter two.

evidence provided by the banks. For example, Westpac told the committee that the current effective interest rate for its entire card portfolio was 11.27 per cent, which was down from over 13 per cent in 2010.[23] Westpac also advised that its current return on capital (the primary measure of profitability) for its credit card portfolio had remained flat over the past five years, despite the declining cost of funds.[24]

3.23 In large part, the difference between headline rates and effective interest rates was influenced by three industry-wide factors which had offset the benefit of a reduction in the cash rate. As Westpac explained:

> First, more customers are spending more and paying off their cards in full [each] month. This means that banks are funding higher balances that are in the interest-free period. In the last three years, interest-free balances have grown by around 45 per cent. In industry speak, the revolve rate has declined. Second, a higher percentage of balances are being held in lower rate cards. This means that the effective average interest rate has declined relative to the headline rate on these products. Finally, low or zero rate balance transfers are becoming a much larger component of the market, with zero for 18 months becoming the industry standard. Balances in this category earning no interest have grown considerably.[25]

3.24 Similarly, NAB explained that the effective interest rate on its credit card portfolio had been falling, in part due to the increasing numbers of cardholders moving to low-rate cards and taking advantage of zero per cent balance transfer offers (which are discussed further in chapter five).[26] ANZ also noted that trends in consumer behaviour in recent years have had 'the combined effect of reducing the total amount of interest bearing debt in the Australian credit card market and lowering the net effective interest rate that credit card providers receive on the lending they provide'.[27]

3.25 The ABA referred to data from July 2015 showing that while the number of cards and value of transactions had continued to grow in recent years, the gross amount of outstanding credit card balances accruing interest was actually at the lowest level in six years. Repayments over the year to July 2015 had exceeded transactions

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23 Mr David Robert Lindberg, Chief Executive, Commercial and Business Bank, Westpac Group, *Proof Committee Hansard*, 16 October 2015, p. 25. ANZ provided similar figures to the committee. Mr Graham Hodges, Deputy Chief Executive Officer, ANZ, *Proof Committee Hansard*, 16 October 2015, p. 60.

24 Mr David Robert Lindberg, Chief Executive, Commercial and Business Bank, Westpac Group, *Proof Committee Hansard*, 16 October 2015, p. 15.

25 Mr David Robert Lindberg, Chief Executive, Commercial and Business Bank, Westpac Group, *Proof Committee Hansard*, 16 October 2015, p. 15.

26 Mr Antony James Cahill, Group Executive, Product and Markets, National Australia Bank, *Proof Committee Hansard*, 16 October 2015, p. 32.

27 ANZ, *Submission 27*, p. 2.

by $8.6 billion, and 'the excess of repayments over transactions is now at a record high level and continues 10 years of strong repayment activity'.[28]

3.26 While effective credit card interest rates have fallen in absolute terms in recent years, the spread between credit card effective interest rates and bank funding costs has increased from a relatively stable average of 6.7 per cent in the years prior to the GFC to an also stable average of 8.7 per cent in the years since (see Figure 5 in chapter two). Several witnesses said that this shift could be explained by the global repricing of risk following the GFC. This repricing, the ABA remarked, was by no means unique to the credit card market, but was in fact reflected in a widening in the spread between cash rates and a range of lending and deposit products, both in Australia and internationally.[29]

3.27 Treasury indicated that the general repricing of credit across advanced economies in the aftermath of the GFC:

> …may be attributable to a general under-appreciation of credit risk prior to the crisis, particularly on unsecured lending, but may also reflect a failure to properly price default correlations across asset classes and their propensity to increase following a shock to the financial system.[30]

3.28 While measuring credit card interest rates using the effective interest rate might appear a logical approach, it must be emphasised that this measure is of little relevance to cardholders who are actually paying interest on their balances. The average rate paid by revolvers (17 per cent) has only fallen about 1 per cent since 2011, against declines in the average effective rate of 2 per cent and in the cash rate of 2.75 per cent, which would suggest an increase in the extent to which 'revolvers' are subsidising 'transactors'. This cross-subsidisation in the credit card market was raised by Dr Edey from the RBA, who noted that 'different kinds of customers incur different fees and different levels of interest expense'. [31] Mr Greenwood was more direct in his criticism of this cross-subsidisation, declaring that 'we have a system where some of the poorest and most vulnerable in our community subsidise the wealthiest in our community'. [32]

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28 Mr Anthony Pearson, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association, *Proof Committee Hansard*, 22 September 2015, p. 10.

29 Mr Anthony Pearson, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association, *Proof Committee Hansard*, 22 September 2015, pp. 9, 11.

30 Treasury, *Submission 17*, p. 8.

31 Dr Malcolm Edey, Assistant Governor, Financial System, Reserve Bank of Australia, *Proof Committee Hansard*, 27 August 2015, p. 15.

32 Mr Ross Greenwood, Business and Finance Editor, Nine Network, *Proof Committee Hansard*, 27 August 2015, p. 37.

Card providers: funding costs only one component of credit card costs

3.29 Beyond emphasising the importance of focusing on effective interest rates instead of headline rates, card providers asserted that the RBA cash rate was one of many components of the cost base of credit cards. CBA and NAB advised the committee that the cost of funds only accounted for approximately 22 per cent of the costs of providing a credit card; similarly, ANZ reported that it was less than 25 per cent.[33] The industry average of the costs of fund as a proportion of the overall cost base, as reported by the ABA, was slightly higher, at about one third. As a relative proportion of the cost base of providing credit cards, the ABA added, this figure had 'fallen substantially over the past six years'.[34]

3.30 Westpac also maintained that the 'link between Credit Card headline (advertised) rates and the official cash rate is low'. Westpac added:

> The RBA's discussion paper, 'The Evolution of Payment Costs in Australia', confirms that funding costs are a low component of overall Credit Card issuing costs and consequently the official cash rate has a negligible impact on card economics. Rather, the highest Credit Card costs are associated with high operation costs, payments functionality (such as real-time systems) and the rich bundle of benefits associated with Credit Card products.[35]

3.31 While public commentary often focuses on the low correlation between the cash rate and credit card interest rates relative to the correlation between the cash rate and mortgage lending rates, the banks asserted that the comparison was misleading. ANZ stated that whereas funding costs only accounted for less than 25 per cent of credit card costs, they made up about 85 per cent of the cost base for mortgages. Given this difference, ANZ continued, it was not surprising that the relationship between product interest rates and the cash rate is less direct for credit cards.[36] The ABA made a similar point, aruging it was misleading to compare credit card pricing with interest on straight loan products. Credit cards, the ABA submitted, are a more complex product that other loan products:

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33 Mr Matthew Comyn, Group Executive, Retail Banking Services, Commonwealth Bank of Australia, *Proof Committee Hansard*, 16 October 2015, p. 9; Mr Antony James Cahill, Group Executive, Product and Markets, National Australia Bank, *Proof Committee Hansard*, 16 October 2015, p. 32; Mr Graham Hodges, Deputy Chief Executive Officer, ANZ, *Proof Committee Hansard*, 16 October 2015, p. 60.

34 Mr Anthony Pearson, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association, *Proof Committee Hansard*, 22 September 2015, p. 9.

35 Westpac, *Submission 21*, pp. 12–13.

36 Mr Graham Hodges, Deputy Chief Executive Officer, ANZ, *Proof Committee Hansard*, 16 October 2015, p. 60.

> …because of their payment convenience, the fact that they have 24/7 access to what is a rolling credit facility and the fact that they involve third parties, such as the providers of the credit card infrastructure.[37]

3.32 NAB advised that banks have had to 'change their funding mix over time and move to more stable funding mixes', observing that deposit rates have increased in relation to spreads and wholesale funding costs have also increased.[38] For non-bank card providers, the correlation between the RBA cash rate and credit card interest rates is weaker still. For example, GE Capital explained that its interest rates are not directly influenced by the RBA cash rate, and depended on the state of wholesale funding markets, rather than the deposit funded market. [39]

Credit risk and loss rates

3.33 Card providers also emphasised that because credit card lending is unsecured, it is subject to higher risk profiles than many other forms of lending, arguing that the pricing of credit cards (including interest rates) is in part a reflection of this higher risk, and the fact that credit card lending attracts higher risk weights than secured forms of lending. As ANZ advised:

> This risk dynamic is well recognised by both the banks and regulators as evidence by the risk weights applied to credit card limits (APRA defined). While recent increases in mortgage lending requirements increased risk weights to 25 per cent to account for the potential risk borne by banks, the risk weights applied to credit card balances is significantly higher at 40 per cent.[40]

3.34 CBA explained that this higher risk, and the fact that credit is available on an ongoing basis rather than for a fixed period, meant that the pricing of credit cards was 'sensitive to market pressures and the economic environment, particularly the unemployment rate'.[41] According to CBA, this need to price risk through the economic cycle was a 'much more significant contributor' to credit card pricing than funding costs,[42] and while credit card portfolios might look profitable over the short-term, profitability needed to be considered over the entire economic cycle:

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37 Mr Anthony Pearson, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association, *Proof Committee Hansard*, 22 September 2015, p. 19.

38 Mr Antony James Cahill, Group Executive, Product and Markets, National Australia Bank, *Proof Committee Hansard*, 16 October 2015, p. 32.

39 Mr Duncan Berry, Chief Executive Officer, GE Capital Australia & New Zealand, *Proof Committee Hansard*, 16 October 2015, p. 58.

40 ANZ, *Submission 27*, p. 9.

41 Commonwealth Bank of Australia, *Submission 23*, pp. 2, 7.

42 Mr Matthew Comyn, Group Executive, Retail Banking Services, Commonwealth Bank of Australia, *Proof Committee Hansard*, 16 October 2015, p. 1.

> Whilst we have been fortunate to have periods of economic growth in Australia, many markets have demonstrated that losses increase quite dramatically in times of stress. So our default rates, for example, tend to be in the range of two to three per cent; if you look at the US experience over the last five years, they peaked at more than 10 per cent. So in any given year the credit card business can look very profitable. Over the long term, there is likely to be a year where it is distinctly less profitable—possibly unprofitable—and our role of running a credit card business is trying to ensure that we run it profitably over the long term.[43]

3.35 Westpac made a similar point, submitting that credit card pricing adjustments 'reflect broad changes over the economic cycle rather than as a frequent, point-in-time response to individual movements such as changes in the official cash rate'.[44] ANZ also noted that interest rate movements on unsecured credit products like credit cards 'must take account of through-the-cycle loss rates and the underlying economic factors driving reductions in cash rates (e.g. unemployment)'.[45]

3.36 Higher default risk on credit cards was also identified by some as a factor in determining interest rate settings. For example, Bank Australia stated:

> Pricing still has to take into consideration that credit card default risk and fraud risk is higher than with secured debt. Unsecured debt forms the bulk of the bank's write-offs.[46]

3.37 As the RBA outlined in its submission, the Australian Prudential Regulation Authority's (APRA) non-performing loan (NPL) rate on banks' credit card debt (that is, where repayment is more than 90 days past due or otherwise doubtful) was 1.5 per cent in early 2015:

> However, the overall loss rate for credit card issuers is probably higher than suggested by the NPL rate. Unlike some other types of household loans such as residential mortgages, credit card loans are unsecured, with little prospect, in some cases, of recovering a significant portion of the debt if the borrower defaults. As a consequence, some credit card debt may be written-off directly to an issuing institution's profit and loss account, without first being recorded as a non-performing loan.[47]

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43 Mr Matthew Comyn, Group Executive, Retail Banking Services, Commonwealth Bank of Australia, *Proof Committee Hansard*, 16 October 2015, p. 6.

44 Westpac, *Submission 21*, p 15.

45 ANZ, *Submission 27*, p. 2.

46 Mr John Yardley, Chief Operating Officer, Bank Australia, *Proof Committee Hansard*, 3 September 2015, p. 19.

47 Reserve Bank of Australia, *Submission 20*, p. 16.

3.38 The RBA advised that the current 'loss rate' on credit cards was about 2.5 per cent.[48] This corresponds with Westpac's advice to the committee that the annual level of credit losses for credit cards is around 2.52 per cent of outstanding balances, compared to around 0.02 per cent for secured loans.[49] Other banks also advised that proportional defaults and losses were significantly higher for credit card lending than for secured forms of lending.[50]

Additional cost drivers

3.39 Card providers and the ABA referred to a range of factors contributing to credit card costs that were unrelated to funding costs. According to the ABA:

> …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.[51]

3.40 ANZ presented the following breakdown of industry-wide credit card operating costs, drawing on data provided by Argus Information and Advisory Services:

- Funding costs are about 35 per cent of total credit card operating costs. While RBA rates influence funding costs, funding must also take into account credit risk, and liquidity characteristics of credit card financing.
- Credit management and fraud comprise around 30 per cent of costs. These costs include credit related losses, consumer protection and protection against fraud.
- Rewards and product benefits are around 27 per cent. These include scheme administration, points reward, discounts and travel insurance.
- Scheme fees are around nine per cent. Banks pay for services such as infrastructure, processing, settlement, foreign exchange services and customer service and support.[52]

3.41 ANZ commented that these operating costs do not include material additional costs of providing credit card services, including: the capital investments associated

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48 The RBA explained that the 'loss rate' was a more useful measure than the non-performing loan rate, as non-performing loans can become performing again and even if a non-performing loan is written off there may be some recovery. Dr Anthony Richards, Head, Payments Policy Department, Reserve Bank of Australia, *Proof Committee Hansard*, 27 August 2015, p. 13.

49 Westpac, *Submission 21*, p. 13.

50 For example, Mr Antony James Cahill, Group Executive, Product and Markets, National Australia Bank, *Proof Committee Hansard*, 16 October 2015, p. 35.

51 Australian Bankers' Association, *Submission 15*, p. 2.

52 ANZ, *Submission 27*, pp. 13–14.

with technology and regulatory requirements; contact services for customers; research and intellectual property costs; marketing costs; innovation and product development costs, and so on. Once these other costs were taken into account, ANZ wrote, funding costs fell to 'well below 25 per cent of total costs'.[53]

Profitability of credit card portfolios

3.42 In determining whether current interest rate settings on credit cards are justifiable, the committee sought to ascertain the profitability of the credit card market.

3.43 The RBA explained in its submission that credit card issuers earn revenue on their credit card portfolios from three major sources:

- Fees: which the RBA estimated accounted for about $1.4 billion in revenue in 2014, or $90 per account;
- Interchange revenues: or issuer fees, in the case of American Express 'companion' card transactions, which based on incomplete data the RBA estimated at approximately $1.5 to $1.75 billion in 2014; and
- Interest payments: which APRA reported were around $5.4 billion in 2014.[54]

3.44 Beyond the fact that this data is imperfect, revenues are of course distinct from profits but it is apparent that interest payments, as the largest source of revenue for card providers, are a major driver of credit card profits.

3.45 Three of the four major banks advised the committee that they were unable to publicly disclose the profits earned on their credit card portfolios, as they roll credit card outcomes into broader divisional outcomes before those divisional outcomes are disclosed to the market.[55] In contrast, ANZ was willing to share its net profit after tax on its credit card portfolio. ANZ Deputy Chief Executive Officer, Mr Graham Hodges, told the committee the bank's credit card business accounted for approximately $400 million, or 5 per cent, of group profit. He added that this profit also:

> …accounts for five per cent of risk weighted assets, which is the balance sheet adjusting for the risk profile. So the consistency there is good. A credit risk weighted asset is that you get your product and then you risk

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53 ANZ, *Submission 27*, pp. 13–14. Westpac also suggested that innovation costs were a significant cost driver. Westpac, *Submission 21*, p. 14.

54 Reserve Bank of Australia, *Submission 20*, p. 3.

55 Mr Matthew Comyn, Group Executive, Retail Banking Services, Commonwealth Bank of Australia, *Proof Committee Hansard*, 16 October 2015, pp. 4–5; Mr David Robert Lindberg, Chief Executive, Commercial and Business Bank, Westpac Group, *Proof Committee Hansard*, 16 October 2015, pp. 19–20; Mr Antony James Cahill, Group Executive, Product and Markets, National Australia Bank, *Proof Committee Hansard*, 16 October 2015, p. 29.

> adjust it according to the risk characteristics of the product. So you have to look at it in risk adjusted terms.[56]

3.46 As noted earlier, Westpac, while not disclosing its actual profits on its credit card portfolio, advised the committee that its return on capital for its credit card portfolio had remained stable over the past five years:

> The Westpac Group's current net margin for Credit Cards is in line with 2010, with small movements up and down over the period. Therefore, while funding costs have declined the overall profitability of the product has not improved as funding cost reductions have been offset by declining revolve rates, higher promotional rates and changes in product mix.[57]

Committee view

3.47 The committee does not dispute the banks' contention that the effective interest rate on the total sum of outstanding credit card debt has fallen slightly since 2011. However, the committee also suggests that the effective rate provides little insight into how credit card 'revolvers' are affected by credit card interest rates. Ultimately, the committee is less concerned with the aggregate interest being paid by Australians on their credit cards, than the fact that many Australians appear to be paying interest that is well above what might be expected in a properly competitive market. This is particularly concerning as it appears those cardholders paying interest are often those who can least afford it.

3.48 The committee accepts that funding costs are only one component of the cost base of credit cards, and acknowledges that it is neither realistic nor reasonable to expect a direct correlation between the RBA cash rate and credit card interest rates (however those rates might be measured). The committee does not accept that high interest rates can be explained by cost alone. Rather, it appears credit card providers are taking advantage of the relative inattention of consumers to credit card interest rates, and earning significant profits in the process.

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56 Mr Graham Hodges, Deputy Chief Executive Officer, ANZ, *Proof Committee Hansard*, 16 October 2015, p. 60. ANZ explained that while it typically did not disclose unit profits, 'in a sense it is not a material profit for the group', which is why they could disclose it without having to do a market disclosure. Mr Graham Hodges, Deputy Chief Executive Officer, ANZ, *Proof Committee Hansard*, 16 October 2015, p. 62.

57 Westpac, *Submission 21*, p. 14.

Chapter 4

Competition and consumer choice in the credit card market

4.1 This chapter assesses the competitiveness of the Australian credit card market, and the extent to which consumers exercise choice.

4.2 As noted in chapter two, there are at least 80 credit card providers in Australia providing more than 250 products. An important paradox in the Australian credit card market, and one which was thrown into sharp relief over the course of this inquiry, is that despite the large number of credit card providers offering a wide range of products, consumers do not appear to be taking advantage of the options available. This chapter attempts to explain this paradox, and identify regulatory and policy interventions that might help improve the competitive dynamics of the market and enhance the capacity of consumers to make informed choices within that market. In doing so, this chapter builds on the discussion in the previous chapter regarding the need to better focus consumer attention on credit card interest rates.

4.3 This chapter also assesses the ability of consumers to switch from one card to another, and identifies and suggests ways to overcome barriers that might be preventing consumers from switching to a card that is more appropriate to their circumstances and needs.

4.4 Finally, this chapter considers whether innovations such as peer-to-peer lending might provide consumers with superior alternatives to credit card borrowing.

Competition and consumer choice in the credit card market

4.5 The banks were united in the view that the credit card market is, as CBA put it, 'very competitive and innovative'.[1] ANZ, for example, argued that the 'credit card segment is one of the most contested markets in the Australian finance industry', and this competition provided consumers with 'more choice than ever before of both provider and product'.[2]

4.6 Westpac submitted that there were various indicators of the competitiveness of the Australian credit card market, including 'the levels of innovation, the number of credit card providers and wide range of product offerings which suit the needs and behaviours of different customers, low barriers to entry and consumer switching'.[3]

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1 Mr Matthew Comyn, Group Executive, Retail Banking Services, Commonwealth Bank of Australia, *Proof Committee Hansard*, 16 October 2015, p. 1.

2 ANZ, *Submission 27*, pp. 4–5.

3 Westpac, *Submission 21*, pp. 16–17.

CBA also argued that the attractive incentives for customers to accept a new card or switch cards was indicative of the 'vigorous competition in the market'.[4]

4.7 The banks told the committee that customers can and were taking advantage of the range of credit cards available to choose products appropriate to their needs.[5] Westpac, for example, noted that 30 per cent of credit card balances across the Westpac Group are now held in low-rate accounts, up from 23 per cent in 2010. Westpac further advised the committee that in the last two years low rate cards had accounted for over 50 per cent of new sales.[6] Other banks also reported that low rate cards accounted for a growing proportion of new card applications, and Westpac's figures were broadly consistent with industry-wide trends reported by the ABA.[7]

4.8 The RBA acknowledged that despite the prevalence of high-rate cards and the concentration of the market around the four major banks, there appeared to be 'some significant competition' in the credit card market, at least in terms of product offerings:

> There are a lot of card products out there that offer lower rates and special deals for balance transfers. In many cases, cardholders should be able to lower their interest rates by taking advantage of those offers if they are willing to shop around.[8]

4.9 While some submitters were concerned about the dominance of the four major banks in the credit card market, the committee received little evidence to suggest that there are significant barriers to new entrants in the market. Treasury advised the committee that the Australian credit card market appeared 'no less competitive than other Australian lending markets'. It further suggested that changes to credit card access regimes that were introduced by the *Banking Amendment (Credit Card)*

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4 Commonwealth Bank of Australia, *Submission 23*, p. 6.

5 Mr Anthony Pearson, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association, *Proof Committee Hansard*, 22 September 2015, p. 20.

6 Westpac, *Submission 21*, p. 9.

7 Commonwealth Bank of Australia, *Submission 23*, p. 5; Australian Bankers' Association, *Submission 15*, p. 7.

8 Dr Malcolm Edey, Assistant Governor, Financial System, Reserve Bank of Australia, *Proof Committee Hansard*, 27 August 2015, p. 10; Reserve Bank of Australia, *Submission 20*, p. 3.

Regulation 2014, which became effective in January 2015, would further reduce barriers to entry into the market for non-bank credit card providers.[9]

4.10 Westpac argued that these barriers were 'relatively low and have not inhibited new entrants', and also suggested barriers had been lowered further still by the January 2015 legislative changes. As evidence of the low barriers to market entry, Westpac pointed to 'an increase in the number of providers and products in the market. Recent new entrants included Woolworths, Coles, ME Bank, Myer and re-entry by Virgin'.[10]

4.11 While evidence about barriers to market entry from the four major banks might be received with scepticism by some, representatives of the community and cooperative banking sector also pointed to strong competitive dynamics on the supply side of the market. Of particular note, COBA advised the committee that the market was generally delivering competitive products and choice to consumers. The challenge, COBA argued, was to ensure 'consumers are informed and empowered to act in their own interests'. To this end, COBA recommended that ASIC devote resources to raising consumer awareness of diversity of product offerings in the credit card market, and the risks of high-rate cards.[11]

4.12 Representatives of comparison websites also suggested that the issue was not so much a lack of credit card options, but apparent consumer inertia. CANSTAR told the committee that despite the wide range of cards available, many consumers had the wrong card and were paying too much interest.[12] Mozo also observed that there were good value products available, but consumers were not moving, probably due to a lack of awareness or because they found switching too difficult.[13]

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9 Treasury, *Submission 17*, p. 4. In relation to these changes, the RBA explained that 'the Access Regimes applying to the MasterCard and Visa systems were varied effective January 2015, along with corresponding changes to the Banking Regulations. The changes are deregulatory in nature, giving the card systems greater flexibility to expand membership beyond existing participants. Following changes to Access Regimes, MasterCard and Visa have published assessment criteria on their websites for potential applicants seeking access to their respective systems, as required under the varied regimes. They are also required to report annually to the Bank on applications to participate, new participants accepted and the reasons for any rejections. Although the revised Access Regimes have only been operating for just over half a year, the indications are that the expanded scope for new participants in the schemes appears to be working, with a number of new participants admitted or progressing applications.' Reserve Bank of Australia, *Submission 20*, pp. 1–2.

10 Westpac, *Submission 21*, p. 3.

11 Mr Luke Lawler, Head of Public Affairs, Customer Owned Banking Association, *Proof Committee Hansard*, 3 September 2015, p. 18.

12 Mr Stephen Henry Mickenbecker, Group Executive, Ratings and Financial Services, CANSTAR Pty Ltd, *Proof Committee Hansard*, 22 September 2015, p. 33.

13 Mr Rohan Gamble, Managing Director, Mozo, *Proof Committee Hansard*, 22 September 2015, p. 33.

4.13 Mr Alan Kirkland, Chief Executive Officer of CHOICE, remarked that while there appeared to be lots of options in the credit card market, it was not clear that consumers were enjoying the benefits of competition:

> Competition, I would say, is not a one-sided force. Competition is about the interactions that occur within a market. Whenever you see a market where there are lots of offers and lots of things available to consumers but consumers are still being ripped off, that is a sign that there is not effective competition in the market and there is a problem that needs to be fixed, and it requires demand-side interventions.[14]

4.14 St Vincent de Paul challenged what it suggested was a neoliberal assumption that people on low incomes possessed the financial literacy necessary to 'interpret the implications of their choices upon their long-term financial situation in an economically rationalist manner'.[15]

4.15 As Treasury explained, even consumers with relatively high levels of financial literacy can struggle to understand and properly compare credit card products, given the multifaceted and complex nature of product offerings:

> …the credit card market is characterised by a large number of products, with these products showing a wide spread of characteristics, including different interest rate and fee structures, balance transfer offers, and rewards. In a way, this suggests that there is competition in the market and there are opportunities for consumers to choose cards suitable for them. However, the complexity of offerings can make it very difficult for consumers to compare products, especially where consumers suffer from behavioural bias such as near-term bias and overconfidence in their ability to constrain future spending.[16]

4.16 ASIC made a similar point, arguing that the actual exercise of consumer choice in the credit card market was made more difficult because of the inherent complexity of the products on offer:

> Credit cards are at least two products in one—a non-cash payment facility and a credit facility, plus a means of withdrawing cash. They are also often bundled and marketed with other financial products (such as insurance) and loyalty points, which make it more difficult for consumers to separate the price and value to them of each feature. This is particularly the case when some of the costs and benefits are immediate and others are realised in the future.[17]

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14 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Proof Committee Hansard*, 27 August 2015, p. 51.

15 St Vincent de Paul Society, *Submission 4*, p. 5.

16 Mr Michael Willcock, Acting Deputy Secretary, Markets Group, Department of the Treasury, *Proof Committee Hansard*, 22 September 2015, p. 55.

17 Australian Securities and Investments Commission, *Submission 16*, pp. 8–9.

4.17 CHOICE also asserted that the ability of consumers to understand and compare the value of credit cards, and thereby exercise real choice in the marketplace, is inhibited by the sheer complexity of product offerings:

> Credit card costs are hidden in difficult to interpret percentages, behind worthless rewards points and in bamboozling balance transfer traps. It is far too difficult to answer the most important question: how much does this credit card cost?[18]

4.18 As the above evidence suggests, helping consumers accurately and easily value and compare credit cards is an important factor in improving the ability and incidence of consumers pursuing better value credit card options. Empowering consumers in this manner is also likely to help create a stronger competitive focus on the pricing of credit cards. Possible reforms in this regard are considered in the next section of this chapter.

Breaking the 'confusopoly': empowering consumers to compare the market

4.19 The banks told the committee that they provide customers and potential customers with tools and information to help them choose an appropriate product.[19] ANZ, in referring to its own tools and calculators to assist customers in choosing a card, also noted that Australian credit card customers:

> …benefit from a strong regulatory environment designed to ensure customers are able to compare products and pricing and make well informed decisions about credit cards.[20]

4.20 In contrast, CHOICE argued that card providers actually rely on confusion to distract consumer attention from high interest rates:

> Some of the international competition thinkers call this 'confusopoly'—a deliberate strategy of product providers across a whole range of markets to make the comparison more difficult by adding lots of different features that are virtually impossible to compare.[21]

4.21 In order to help consumers cut through this confusion, CHOICE recommended that credit card advertising be required to include the monthly cost for a consumer, expressed in dollar terms, of an average card balance based on the interest rate and annual fee. Ms Erin Turner, CHOICE Campaigns Manager, told the committee that such a requirement would:

> …allow people to actually compare costs, not just interest rates, which are somewhat abstract and do not say anything about 'What'll this mean to me?

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18 CHOICE, *Submission 10*, p. 4.

19 Commonwealth Bank of Australia, *Submission 23*, p. 4; Westpac, *Submission 21*, p. 11.

20 ANZ, *Submission 27*, p. 3.

21 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Proof Committee Hansard*, 27 August 2015, p. 53. Also see CHOICE, *Submission 10*, p. 4.

> How much does this card cost?' I can look at card advertising at the moment and I cannot tell you how much that card will cost me or how much that card will cost an average consumer. We think there needs to be some sort of average cost on all sorts of advertising and marketing—something that tells you this is higher interest, this is high fee, this is what most people are paying.[22]

4.22 CHOICE also argued that card providers should be required to do more to inform their customers about the range of product offerings available in the market. It recommended that card providers should be required to include information in credit card monthly statements 'about the credit card market generally, including the lowest rate in the market as identified by the RBA'.[23]

4.23 The Consumer Action Law Centre and Financial Rights Legal Centre also argued that consumers would be well served if card providers were required to disclose the average annual cost of their cards across their customer base. They also suggested that the ability of consumers to understand and compare credit cards would be enhanced by requiring card providers to 'include a comparison of the cost of a consumer's current credit card versus the cost of the provider's lowest rate card in a monthly statement'.[24] CHOICE made a similar recommendation in its submission, and also recommended that monthly statements include information about the credit market generally, including the lowest interest rate currently on offer.[25]

4.24 Underpinning these recommendations was the understanding that for disclosure to be effective, it must be, as CHOICE put it, 'timely, relevant and tailored to the consumer'.[26] CHOICE further explained:

> In order for consumers to enjoy the benefits of competition they have got to be able to understand the offers that are on the market and they have got to be able to compare them and match them to their own circumstances. Unless you have those three factors present, consumers cannot actually take advantage of the offers that are there…[27]

4.25 Similarly, the Consumer Credit Law Centre of South Australia argued that credit card disclosure:

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22 Ms Erin Turner, Campaigns Manager, CHOICE, *Proof Committee Hansard*, 27 August 2015, p. 53.

23 CHOICE, *Submission 10*, pp. 24–25

24 Consumer Action Law Centre and Financial Rights Legal Centre, *Submission 13*, pp. 14–15.

25 CHOICE, *Submission 10*, p. 25.

26 On the importance of high-quality disclosure, also see Ms Tanya Louise Corrie, Development Lead, Financial Security Specialist, Good Shepherd Australia New Zealand, *Proof Committee Hansard*, 3 September 2015, p. 36; and Ms Katherine Lane, Principal Solicitor, Financial Rights Legal Centre, *Proof Committee Hansard*, 27 August 2015, p. 8.

27 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Proof Committee Hansard*, 27 August 2015, p. 52.

> …needs to focus on how consumers actually use disclosure and how they make decisions rather than compliance and risk avoidance. For example, merely displaying the interest rate in the credit card offer is not enough. To be effective disclosure must target consumers' behavioural biases. The 'product use model' is recommended, that discloses actual costs of a credit card based on consumers transaction history.[28]

4.26 During the inquiry, the committee considered and sought input from witnesses on the possibility of introducing a comparison rate for credit cards, similar to the comparison rate that is used in the mortgage market. Asked if there would be merit in such an approach, ANZ responded:

> The challenge around that is it is much more complicated because of the whole range of benefits—so rewards and what you are opting for. There is a multitude of structures in there, and I think it makes it really difficult to just have a comparison rate like on other products.[29]

4.27 Similarly, COBA and Bank Australia both explained that while there might be merit in the idea, the complexity of credit card products meant a comparison rate would be very difficult to design and implement.[30] Mr Joel Gibson, Campaign Director at One Big Switch, also remarked that while a comparison rate would be of some benefit to consumers, the multifaceted and diverse nature of credit cards made designing a comparison rate 'very difficult':

> At the moment in the credit card space there are probably half-a-dozen different elements that can be part of a credit card offer or are commonly part of a credit card offer. It might be a balance transfer. It might be an interest-free period at the start of the card. It might be an introductory rate. And there are others as well, of course. When you have all the different permutations and combinations of those half-a-dozen different elements, it can be confusing for people. It can be hard to compare. It can be a case of comparing apples with oranges. That can also be a disincentive to switching.[31]

4.28 A more sophisticated approach to product comparison suggested during the inquiry was providing consumers with access to data about their own credit card behaviours, which could then be used to compare and understand the value of different credit cards. In this connection, several witnesses referred to the United

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28 Consumer Credit Law Centre of South Australia (Uniting Communities), *Submission 29*, p. 7.

29 Mr Graham Hodges, Deputy Chief Executive Officer, ANZ, *Proof Committee Hansard*, 16 October 2015, p. 64.

30 Mr Luke Lawler, Head of Public Affairs, Customer Owned Banking Association, *Proof Committee Hansard*, 3 September 2015, p. 22; Mr John Yardley, Chief Operating Officer, Bank Australia, *Proof Committee Hansard*, 3 September 2015, p. 22.

31 Mr Joel Gibson, Campaign Director, One Big Switch, *Proof Committee Hansard*, 16 October 2015, pp. 52–53.

Kingdom's 'midata' program, which was launched in 2011. CHOICE explained that midata is a voluntary scheme:

> …based on the key principle that consumers' data should be released back to them in a uniform, secure, machine readable format. This information will then be able to be used in secure comparison engines to generate personal recommendations. The scheme aims to help consumers make meaningful comparisons about the different products in key markets, with a particular focus on energy and banking.[32]

4.29 Currently, midata is used for comparing current accounts, but it may be extended to other products in the future, including credit cards. A November 2015 report by the United Kingdom's Financial Conduct Authority on the credit card market suggested extending the midata initiative to include credit cards may enable consumers to make more informed product comparisons.[33]

4.30 CHOICE strongly argued the case for a similar 'informed choice' system in Australia, and noted that both the Competition Policy Review and the Financial System Inquiry had recommended exploring the benefits of an open data policy for consumers. Appearing before the committee, Mr Kirkland further explained how CHOICE's thinking on this matter had been 'heavily informed' by the UK experience:

> At the core of it is a recognition that, in really complex markets, in order for consumers to make informed choices those choices need to be linked to their own data about how they consume products and services. I will give you an analogy. In the energy market it is hard to make a decision about what the right plan for you is unless it is linked to your individual consumption data. Applying that to credit cards, it is hard to make a decision about what is right for you unless you have a detailed understanding of your monthly patterns in terms of the amount you repay and the residual balance after any payment. To make that easier, the most effective intervention would be to allow consumers to extract their data rather than just reading reams of statements. They should be able to extract it in an electronic form that then allows third parties to build applications that allow consumers to match that data to the offers available, to the credit cards that are available on the market. That is the essence of the reforms in the UK.
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> The way in which it has been done is through a facilitative process where government got together with the key industries—the banking industry and the energy industry—and said, 'Hey, we think we've got a social problem, and you've got a responsibility to work with us to fix it.' They built a collaborative scheme where, in some of those industries, the key providers agree to collaborate and release data. Control of the data is still in consumers hands. It is not that anyone can get access to your credit card

32 CHOICE, *Submission 10*, p. 22.

33 Financial Conduct Authority, *Credit card market study: interim report* (November 2015), p. 94.

data but it means that you are in a much better position to make decisions about what is right for you.[34]

4.31 CHOICE added that under such a system:

…rather than going to a comparisons site and just seeing a whole bunch of credit card rates you could be going to an online service that says, 'Based on your consumption data this card will cost you X dollars over the next year, whereas this other one will cost you Y dollars.' It is a much more individualised source of information on what is right for you.[35]

4.32 CHOICE suggested that such a system would need to be heavily controlled by consumer consent, but that it was important that the consumer had access to their own data.[36] To this end, it suggested the government should 'start a process that would open up access for consumers to their own data so it is easier to compare offers in the market, similar to some of the reforms that have happened in the UK'.[37]

4.33 Treasury indicated that midata appeared to be working well in relation to current accounts in the United Kingdom. It explained that the initiative:

…relies on the cooperation of the industry that holds the customer data. There was quite an exercise to get to the place where that data could be released by all the different competing providers in a standardised format so that a third party intermediary could then use it and bring it up and do the comparison. It also required there to be a third party intermediary. Ultimately, an intermediation industry that helps consumers make better decisions should emerge out of this. We have some very basic comparative websites that do that job but…on the basis that all these products are so various and different that it is very [difficult] to line them up and say, 'I am making an apples-to-apples-to-apples comparison, and I know the first one is the best one.'[38]

4.34 Making a broader point about the value of empowering consumers with their own data, SocietyOne told the committee that 'real disruption' in the consumer credit market would occur when there was a fundamental change in the ability of consumers to access and utilise data about their behaviour through time. Currently, financial institutions have a clear informational advantage:

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34 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Proof Committee Hansard*, 27 August 2015, pp. 54–55.

35 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Proof Committee Hansard*, 27 August 2015, p. 55.

36 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Proof Committee Hansard*, 27 August 2015, p. 55.

37 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Proof Committee Hansard*, 27 August 2015, p. 51.

38 Mr Michael Willcock, Acting Deputy Secretary, Markets Group, Department of the Treasury, *Proof Committee Hansard*, 22 September 2015, p. 59.

> They have all the transaction records. They have all the history. They build dynamic behaviour scores. They constantly have a view about who to provide limit increases to and who not to, based on profitability metrics and risks scores et cetera. None of that information typically makes its way into the hands of the borrower in such a way that they can make informed decisions. When will disruption happen? It will happen when borrowers are armed with choices that allow them to determine: 'Which credit product is right for me at this point in time?'[39]

Committee view

4.35 The committee considers that in order to make informed choices in the credit card market, consumers need to be provided with the appropriate tools and information to compare and understand accurately and easily the value proposition of different credit cards. As explained below, consumers would be greatly assisted in this regard if they were provided with access to a summary account of their own historical credit card activity, which could then be used to provide personalised credit card comparisons.

4.36 While the concept of a credit card comparison rate has some basic appeal, the committee is not convinced that a credit card's costs and benefits can be separated from the financial circumstances and behaviour of the cardholder. The sheer complexity and multifaceted nature of credit card products makes it impractical to develop a credit card comparison rate similar to the mortgage comparison rate.

4.37 Given the complexities of designing a credit card comparison rate, the committee believes credit card advertising and marketing material should be required to include a prominent statement of a card's ongoing headline interest rate and annual fee.[40] In addition to helping consumers compare credit cards, this requirement would serve to better focus consumer attention on credit card interest rates. As described in chapter three, if consumers are more focused on credit card interest rates then this would encourage card providers to make their products more competitive in this regard.

4.38 In order to make meaningful comparisons of credit card products, consumers need to understand the value proposition of cards in relation to their own circumstances and financial behaviour. For this reason, the committee strongly supports the development of an 'informed choice' system, similar to the midata system in the United Kingdom, which would ultimately enable consumers to easily compare

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39 Mr Matt Symons, Chief Executive Officer and Co-founder, SocietyOne Australia Pty Ltd, *Proof Committee Hansard*, 22 September 2015, pp. 25–26.

40 Under the National Credit Code, an advertisement for a credit product does not need to include an interest rate, but must do so if the advertisement states the amount of any repayment. Australian Securities and Investments Commission, *Regulatory Guide 234: Advertising financial products and services (including credit): Good practice guidance* (November 2012), p. 21.

credit cards using their own data. While a midata-style system applied to the consumer credit sector has considerable merit, the committee recognises that the implementation of such a powerful tool would take considerable time and effort in Australia. However, the committee also suggests that even basic personalised data, such as aggregated spending and repayment data presented in a standardised and machine-readable format in credit card statements and the like, could be used by a consumer to compare the value of various credit cards using tools designed for this purpose. The committee would expect that over time the data available to consumers would became more comprehensive, thus allowing for even more powerful and focused product comparisons.

Recommendation 1

4.39 The committee recommends that credit card advertising and marketing material should disclose clearly the cost of a credit card for a consumer, including the card's headline interest rate and ongoing annual fee.

Recommendation 2

4.40 The committee recommends that credit card monthly statements should include prominent reminders about a credit card's headline interest rate and ongoing annual fee.

Recommendation 3

4.41 The committee recommends that the government work with key 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 customer-specific, online, machine readable records that would allow credit card users to compare credit cards using online comparison engines.

Switching and closing credit cards

4.42 The ability to switch credit cards—which generally means that not only is a new card account opened but an existing card account is closed—is an important component of a competitive marketplace. If cardholders consider it is difficult to switch cards, this would suggest a failure in this competitive dynamic to deliver real choice to consumers. This section of the report considers whether there are any impediments to switching and, if so, what might be done to reduce or remove those impediments.

4.43 Treasury advised the committee that there 'are minimal barriers to consumers obtaining a new credit card or switching to a different provider, apart from credit assessments and upfront fees'.[41] The major banks claimed that switching cards was a straightforward process, and this was reflected in the incidence of switching in the

41 Treasury, *Submission 17*, p. 4.

market. For example, CBA told the committee that the ease of switching was demonstrated by the fact that more than $1 billion of CBA credit card balances had been switched to low-rate cards since 2011.[42]

4.44 Similarly, ANZ argued that competition in the market made switching a simple process, and estimated that close to one million customers change or add a new credit card each year (approximately 8 per cent of all credit card customers). According to ANZ, this made credit cards the most switched product in Australian banking.[43] Westpac put forward a similar argument, and referred to the Argus 2014 Benchmarking Study, which estimated that:

> …approximately 1.4 million to 1.5 million new Credit Card accounts are opened each year in Australia. This represents around 9% of the 15.7 million accounts currently in the market. Given net account growth is approximately 2% this demonstrates a churn rate of 7% per annum. This data provides strong evidence that consumers are willing to shop around and that switching Credit Card type and providers is relatively easy.[44]

4.45 A recent survey undertaken by Dr Juliana Silva-Goncalves from the Queensland University of Technology casts some doubt on the banks characterisation of the incidence of switching in the credit card market, particularly relative to switching on other banking products and in other consumer markets. According to the survey, while 32 per cent of respondents indicated that they had seriously considered switching credit cards in the past five years, only 17 per cent have actually switched. This figure was lower than the number of respondents who indicated they had switched their home loan (18 per cent), home and contents insurance (28 per cent), energy supplier (29 per cent), main groceries supplier (22 per cent), and mobile phone and internet providers (both 24 per cent).[45]

4.46 A number of witnesses also challenged the bank's characterisation of switching as an easy, straightforward process, particularly when a cardholder wanted to not only apply for a new card but also cancel an existing card. For example, CHOICE told the committee that it was 'incredibly hard to cancel or switch a credit card'. In order to cancel an existing card, CHOICE told the committee, the major banks required customers:

> …either to go into a branch, where they can then hit you with the sales tactics, or to get on the phone. Some of them require you to write to them or

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42 Mr Matthew Comyn, Group Executive, Retail Banking Services, Commonwealth Bank of Australia, *Proof Committee Hansard*, 16 October 2015, p. 10; Commonwealth Bank of Australia, *Submission 23*, p. 5.

43 ANZ, *Submission 27*, pp. 6–7. NAB made similar points. Mr Antony James Cahill, Group Executive, Product and Markets, National Australia Bank, *Proof Committee Hansard*, 16 October 2015, p. 31.

44 Westpac, *Submission 21*, p. 5.

45 Dr Juliana Silva-Gonclaves, report prepared on behalf of Heritage Bank, *Australians' switching behaviour in banking, insurance services and main utilities* (September 2015).

> send that card. The ANZ say you have to cut your card in half diagonally and send it back to them as a condition before they will even cancel your card—I do not know what happens if you cut it in half in a different direction. This is crazy. This is a time when banks have used closures and fees to force people online for so many other transactions, yet they put so many barriers in the way if you want to do anything to change your credit card.[46]

4.47 In its submission, CHOICE noted that a consumer survey it had commissioned revealed that 27 per cent of consumers who had switched cards had experienced difficulties cancelling their old card. The process of cancelling a card, it wrote, appeared 'stuck in the pre-internet age':

> There is no reason why the process of cancelling a card should not include an online option. Card providers have little incentive to offer this to consumers, instead requiring most customers to have a sales discussion.[47]

4.48 The Consumer Action Law Centre and the Financial Rights Legal Centre also suggested it can be 'incredibly difficult' to cancel an existing credit card, and as a result customers 'may eventually find they have a number of credit cards, and are gradually increasing their overall credit card limit'. They therefore expressed support for an online option for cancelling a credit card.[48]

4.49 Appearing before the committee, banks confirmed that it was not currently possible for a cardholder to complete the process of cancelling a card through an entirely online process. Rather, a cardholder would ultimately need to speak to a representative of the bank, either in a branch or over the phone. This is despite the fact that in some circumstances a person can actually apply for and receive a credit card through an entirely online process, without ever having to speak to a representative of the bank.[49]

4.50 Several witnesses also argued that consumers were discouraged from switching cards because the process requires them to contact merchants and manually cancel any direct debits linked to the card. For example, Coles told the committee:

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46 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Proof Committee Hansard*, 27 August 2015, p. 51.

47 CHOICE, *Submission 10*, p. 26.

48 Consumer Action Law Centre and Financial Rights Legal Centre, *Submission 13*, p. 10.

49 Mr David Robert Lindberg, Chief Executive, Commercial and Business Bank, Westpac Group, *Proof Committee Hansard*, 16 October 2015, p. 18; and Mr Antony James Cahill, Group Executive, Product and Markets, National Australia Bank, *Proof Committee Hansard*, 16 October 2015, p. 28; Mr Matthew Comyn, Group Executive, Retail Banking Services, Commonwealth Bank of Australia, *Proof Committee Hansard*, 16 October 2015, pp. 6–7. Several banks also allow customers to cancel a card by writing a physical letter. For details, see CHOICE, *Submission 10*, p. 26.

> [W]hen customers switch their credit card they have to move the direct debits that are linked to that card. That is, we believe, a complex and time consuming process, and the effort involved in that means that some customers just do not take advantage of better offers.[50]

4.51 The Consumer Action Law Centre and the Financial Rights Legal Centre contrasted the need for consumers to cancel credit card direct debits by contacting merchants with the ability of transaction account holders to instruct their bank to cancel direct debits. They submitted that:

> …there should be no difference in treatment between credit card accounts and other accounts under the Banking Code. In our view, a consumer should be able to instruct their bank to cancel a credit recurring payment authority, as they can with a transaction account direct debit authority. Further, upon cancellation or closure of a credit card account, a bank should take steps to cancel all regular transactions and other standing authorities.[51]

4.52 The RBA, while suggesting there were few formal impediments to switching, also observed that cardholders sometimes experience difficulties in cancelling or modifying some types of periodic or recurring payments that are debited from their accounts:

> These difficulties can arise when a merchant does not act on a cardholder's instruction to cancel a recurring payment, or when the cardholder closes their account but does not take steps to cancel such payments.[52]

4.53 Even the ABA acknowledged that the 'one area where switching can be more complex is in arranging the transfer or cancellation of recurring payments entered into with merchants'.[53]

4.54 Mr Christopher Zinn, a consumer advocate, suggested that enhancing the portability of credit cards, and saving consumers the need to cancel direct debits and the like, would likely make a positive difference.[54]

4.55 In its submission, CHOICE noted that its aforementioned survey revealed that 10 per cent of consumers had not switched because they believed it was too difficult to cancel or update direct debits. CHOICE argued that card providers should make it simple for a customer to arrange the transfer of all direct debits, and provide an automated option for customers to do so. CHOICE recommended:

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50 Mr Richard Wormald, General Manager, Coles Financial Services, Coles, *Proof Committee Hansard*, 16 October 2015, p. 44.

51 Consumer Action Law Centre and Financial Rights Legal Centre, *Submission 13*, p. 9.

52 Reserve Bank of Australia, *Submission 20*, p. 3.

53 Australian Bankers' Association, *Submission 15*, p. 1.

54 Mr Christopher Zinn, private capacity, *Proof Committee Hansard*, 27 August 2015, p. 50.

> The government should introduce legislation to establish a 'tick and flick' switching process to allow customers to easily transfer direct debits to a new credit card. The process should be offered online and in-branch. It should be promoted in credit card statements and other key communications to card holders.[55]

4.56 CHOICE further recommended that to overcome impediments to switching, the industry should work towards account number portability. It noted that while account number portability had been ruled out in a 2011 government-commissioned report on technical grounds, innovations to the payments system since then suggested the matter should be reconsidered.[56] To this end, CHOICE recommended that the government 'commission an independent report to outline practical next steps to facilitate switching, including portable account numbers, in the credit card market'.[57] The Consumer Action Law Centre and the Financial Rights Legal Centre also argued that account number portability for credit cards should be considered.[58]

4.57 ANZ informed the committee that it was already able to assist customers switching from an ANZ card to transfer recurring payments. It acknowledged that further cooperation between providers might be possible, but cautioned that the required infrastructure would likely impose significant costs on the industry.[59] On the possibility of implementing account number portability in Australia, ANZ wrote:

> Credit card schemes operate technology on a global scale ensuring infrastructure investment is spread across a large number of customers and transactions. As a relatively small market, implementing 'card number portability' in Australia would result in significant industry costs.[60]

4.58 While much of the discussion above concerns what some consider technical or logistical barriers to switching, other witnesses suggested that the barriers to switching had more to do with consumer knowledge (or, more precisely, a lack of it) and behaviours. Asked if there was a need to make it easier for people to bring direct debits with them when they changed card, and the extent to which this was an issue for portability in the current market, CANSTAR responded:

> It is interesting, because the consumer is probably more empowered down that path than ever before—they can go into their online banking in some

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55 CHOICE, *Submission 10*, p. 27.

56 The report in question, which was requested by the then Treasurer, the Hon Wayne Swan MP, was prepared by Mr Bernie Fraser. Australian Government, *Banking Services: cost-effective switching arrangements* (July 2011), http://banking.treasury.gov.au/content/reports/switching/downloads/switchingarrangements_aug2011.pdf.

57 CHOICE, *Submission 10*, p. 27.

58 Consumer Action Law Centre and Financial Rights Legal Centre, *Submission 13*, pp. 10–11.

59 ANZ, *Submission 27*, p. 6.

60 ANZ, *Submission 27*, p. 7.

> institutions and change all of that without too much drama. They do have to go to billers—to the gym, to PayPal et cetera and make those changes also, but there are also online processes. I would imagine that we—and when I say 'we' I mean the industry—could put in certain tools that would make that a little easier. I am not sure that that is actually the barrier, though. It has never been easier to find yourself a second credit card, or a third or a fifth. It is simplicity itself. I am not sure that there is a genuine barrier because, in many, many cases, it is not a case of surrendering or cutting up the old credit card; one has a reasonable period of time to observe those transactions and to then make the changes. So I do not think that those barriers are genuine barriers to switching.[61]

4.59 Mozo agreed with CANSTAR on this point, and added:

> Inertia is a lot beyond the technical and the physical. Particularly, as we have seen in recent tough financial times, there has been a real flight back to the bigger institutions—the big banks and other big institutions. That is part of the inertia as well. People feel more comfortable with a big bank. They are making a choice—a very deliberate choice—to stay with a Big Four bank because they are uncertain about going to a small credit union.[62]

4.60 The results of a credit card survey of 40,000 of One Big Switch members, while by no means disproving the role of technical and logistical barriers to switching, suggest the barriers to switching are largely attributable to a lack of consumer knowledge about the market and certain consumer preferences. According to One Big Switch, the survey revealed 'massive consumer inertia' in the credit card market. In part, it appeared this inertia was underpinned by a lack of engagement and knowledge on the part of consumers regarding credit card interest rates (discussed in chapter three), and a lack of consumer confidence in comparing the market. One Big Switch added that consumers evidently placed a premium on the convenience of having all of their banking accounts in the one place, and indeed 39 per cent of survey respondents reported that this was their reason for choosing their main card. This perceived convenience, One Big Switch suggested, was a factor in people not changing to a product better suited to their needs, and the fact that the banks often bundled credit card products with home loan packages indicated the banks were alert to this dynamic.[63]

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61 Mr Stephen Henry Mickenbecker, Group Executive, Ratings and Financial Services, CANSTAR Pty Ltd, *Proof Committee Hansard*, 22 September 2015, p. 34.

62 Mr Rohan Gamble, Managing Director, Mozo, *Proof Committee Hansard*, 22 September 2015, p. 34.

63 Mr Joel Gibson, Campaign Director, One Big Switch, *Proof Committee Hansard*, 16 October 2015, p. 50–51. One Big Switch's survey results are supported by CHOICE's survey results, which suggest that the biggest reason consumers do not switch cards (apart from being satisfied with their existing card) is that they want to keep all of their accounts together in the one place. CHOICE, *Submission 10*, p. 17.

Committee view

4.61 The committee believes that many of the most significant barriers to switching in the credit card market can be attributed to a lack of consumer awareness, and the difficulties consumers face in comparing the value proposition of different credit cards accurately and easily. This reinforces the need for reforms to enhance the ability of consumers to compare products and properly exercise choice within the market. The committee considers the 'informed choice' system set out above in recommendation 3 would make a substantial contribution in encouraging consumers to switch credit cards when it is in their interests to do so.

4.62 The committee suggests that further consideration should also be given to reforms that would help consumers overcome any technical or logistical barriers to switching. While the issue of switching banking products more generally was considered in a government-commissioned report in 2011, the committee considers there would be value in a government review into technical and systems innovations that might ease the process of switching in the credit card market specifically. As part of this review, the committee recommends that the government consider the feasibility of account number portability in the Australian credit card market.

4.63 Finally, the committee notes that there appears to be no good reason why credit card customers are currently unable to close a credit card account through an online process. As such, the committee recommends that credit card providers should be required to provide an online 'click-and-close' facility to cardholders.

Recommendation 4

4.64 The government should undertake a review into technical and systems innovations that might help facilitate switching in the credit card market, and as part of this review consider the feasibility of account number portability for credit card accounts.

Recommendation 5

4.65 The committee recommends that card providers should be required to provide consumers with the ability to close a credit card through an online process ('click-and-close').

Peer-to-peer lending and differentiated interest rates

4.66 During the inquiry, the committee considered whether peer-to-peer lending might provide consumers with access to an alternative form of credit that, for some cardholders at least, is more affordable than using a credit card. SocietyOne, a leading Australian peer-to-peer lender, informed the committee that it provided consumers with access to personal loans where the interest rate was set according to the credit

profile of the borrower.[64] SocietyOne referred to the experience of peer-to-peer lending in the United Kingdom, and noted that the British government had provided crucial signals to the market that peer-to-peer lending was a legitimate and viable alternative to more traditional forms of consumer finance:

> At a policy level, the [Financial Services Authority][65] in the UK decided that there were a number of things that could be done to support the growth of marketplace lending and to present it as a credible alternative to the UK parliament's traditional high-street banks. Some of those initiatives included, at the time, a quite bold policy gesture: 'We will co-invest with investors dollar for dollar on these platforms.' It was a way of credentialing the fact that, from a policy point of view, this was a viable and important option to help drive credit growth and, therefore, job formation, small business development and individual empowerment in the economy.
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> The second thing that is interesting to note is they created some tax concessions for investors on those platforms to create some advantages that brought it into line with the advantages that are available for other retirement investment schemes. If you look at just those two things, you would say: in and of themselves neither of them are significant, but, as a signalling exercise to the market, it sent a very clear signal that this was a legitimate option for borrowers to consider and it had the support of the government.[66]

4.67 Mr Koch welcomed the emergence of peer-to-peer lending in Australia, and more broadly spoke in favour of differential lending rates for consumers based on their credit risk, both for credit cards and alternative products. He told the committee:

> …there needs to be encouragement for cards which set rates based on the credit rating of the user so good behaviour is encouraged. This business of high interest rates because it is unsecured but treating everyone the same just does not wash. They do it with insurance; why can't they do it with credit cards and make it fair across the population?[67]

4.68 Mr Greenwood suggested to the committee that the emergence of peer-to-peer lending might help to address the lack of microcredit for small business in Australia. The lack of microcredit, he explained, forced many small businesses to fund themselves with credit cards, despite the high expense and risks of doing so:

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64 Mr Matt Symons, Chief Executive Officer and Co-founder, SocietyOne Australia Pty Ltd, *Proof Committee Hansard*, 22 September 2015, pp. 24–25.

65 The Financial Services Authority was abolished in 2013, and its regulatory responsibilities were split between two new agencies: the Financial Conduct Authority and the Prudential Regulation Authority of the Bank of England.

66 Mr Matt Symons, Chief Executive Officer and Co-founder, SocietyOne Australia Pty Ltd, *Proof Committee Hansard*, 22 September 2015, p. 27.

67 Mr David Koch, Finance Editor, Seven Network, *Proof Committee Hansard*, 27 August 2015, pp. 35, 39.

> I would have to say there has probably been many a small business that has gone broke off the back of a credit card as well. That is a really important one to recognise, the lack of microcredit in our country. This is where maybe even peer-to-peer lending will come into it.[68]

4.69 In contrast to the optimism expressed by other witnesses, Ms Lane from the Financial Rights Legal Centre warned that differential pricing of credit would simply make it harder for people in financial hardship, as they would pay higher interest even if they were not in default.[69] Ms Lane was similarly sceptical about peer-to-peer lending, telling the committee:

> I am never against innovation but what I am in favour of at all times is sufficient consumer protection legislation, because consumers go out there and think these people are reasonable, and they may not be. We need to ensure that every consumer in Australia has confidence in financial services in Australia and that they will not be exploited or take out loans that are not properly regulated, with proper mechanisms in place for protection.
>
> So, by all means innovate, but the Australian government has to absolutely make sure that there is properly regulated consumer protection. And peer-to-peer lending is not properly regulated; I can categorically say that. It is not properly regulated currently. When the credit laws came in, it was not properly worked out. There has been no review. There should not be peer-to-peer lending—or, in fact, anything—until we work out whether people are protected.[70]

Committee view

4.70 While noting the need to carefully consider the regulatory and other risks presented by the advent of peer-to-peer lending, the committee is cautiously optimistic that this new and innovative form of lending will ultimately provide consumers with more and better choices when it comes to accessing consumer credit. The committee would encourage the government to carefully consider whether it could be useful and appropriate to provide clearer signals to the market regarding the legitimacy and viability of peer-to-peer lending.

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68 Mr Ross Greenwood, Business and Finance Editor, Nine Network, *Proof Committee Hansard*, 27 August 2015, p. 39.

69 Ms Katherine (Kat) Lane, Principal Solicitor, Financial Rights Legal Centre, *Proof Committee Hansard*, 27 August 2015, p. 5.

70 Ms Katherine (Kat) Lane, Principal Solicitor, Financial Rights Legal Centre, *Proof Committee Hansard*, 27 August 2015, p. 5.

Chapter 5

Helping Australians avoid the credit card debt trap

5.1 A primary concern of the committee in this inquiry is that too many Australians are 'revolving' credit card debt for extended periods of time and getting hit by high interest charges in the process. This chapter explores the problem of credit card debt, and suggests reforms that might help consumers better manage their credit card debt or, better still, avoid accruing it in the first place. The efficacy of existing responsible lending obligations, as they operate in relation to the credit card market, is also addressed.

5.2 An important reform suggested by a number of witnesses during the inquiry was mandating higher minimum repayments on credit card debt. This would better reflect the view that credit cards should ideally be used for transactions and short-term credit, rather than as a long-term debt facility. This chapter considers various options for reform in this regard.

5.3 Consideration is also given to whether the current prevalence of low or zero interest balance transfer offers in the credit card market, as currently structured and marketed, are hindering the capacity of consumers to manage and repay their credit card debt.

5.4 It is clear that some individuals end up in credit card debt because of poor decisions in choosing a card, using that card, and managing their card debt. Though individuals are expected to assume personal responsibility for the financial decisions they make, evidence received in this inquiry indicates that the credit card market is structured in such a way as to make it extremely difficult for individuals to make *informed* decisions about credit card debt. This chapter considers whether the credit card market is, in this respect, failing Australian consumers, and steps that could be taken to help consumers better understand the risks inherent in credit cards. Specifically, the chapter looks at existing financial literacy programs and tools, and weighs options for expanding or improving current offerings in this regard.

5.5 Finally, this chapter assesses the adequacy of existing supports for people experiencing financial hardship due to credit card debt.

Long-term credit card debt and responsible lending obligations

5.6 Ideally, cardholders would be able to pay their balance in full at the end of each statement period and thereby avoid interest charges. However, as ASIC rightly observed, the ability to pay less than the full balance each month (and even to make a very low minimum repayment in a particular month) provides important flexibility to consumers. This can be especially useful when a consumer incurs large expenses in a

particular month, and decides to pay less than the full balance on their card in order to free up cash for other expenses.[1]

5.7 However, a problem arises when a cardholder consistently fails to pay their outstanding balance at the end of statement periods, and ends up using their credit card as a borrowing facility, rather than to manage cash. In such instances, cardholders risk taking on significant levels of ongoing debt with little prospect of repaying it in the short to medium term. Given the high rates of interest often charged on credit card debt, they are unsuited as long-term debt facilities, particularly given more affordable products are often available.[2]

5.8 SocietyOne explained to the committee that the problem was not credit cards per se, but rather the use of credit cards as a long-term debt product:

> We think that they are in fact convenient and very useful short-term financing tools and, candidly, are probably one of the most widely used financial products anywhere in the world. The problem, as we see it, is when credit cards are used by consumers to provide something other than very short term financing—that is, medium or even multiyear funding. It is in that scenario that credit cards become some of the most, if not—apart from perhaps payday lending—the most expensive credit choice that is available to Australian consumers for unsecured financing purposes.[3]

5.9 As already discussed in chapter three, consumers often pay little notice to credit card interest rates when comparing the market. Card providers both reflect and reinforce this consumer inattention, inasmuch as they tend to market credit cards as payment systems, rather than as borrowing products.[4] In this sense, while consumers might apply for a credit card on the basis that it represents good value as a payment system, they often end up with what is, in effect, a decidedly poor value debt product without having ever given sufficient consideration to its suitability in this regard.

5.10 Banks acknowledged that credit cards were not an appropriate product for long-term debt. For example, Westpac told the committee:

> A credit card is a flexible line of credit designed to allow for periods of time where only small amounts of principal are being repaid. For the majority of our customers this feature is valuable. However, if the

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1 Australian Securities and Investments Commission, *Submission 16*, p. 7; Mr Michael Saadat, Senior Executive Leader, Australian Securities and Investments Commission, *Proof Committee Hansard*, 27 August 2015, p. 28.

2 Australian Securities and Investments Commission, *Submission 16*, pp. 7–8.

3 Mr Matt Symons, Chief Executive Officer and Co-founder, SocietyOne Australia Pty Ltd, *Proof Committee Hansard*, 22 September 2015, p. 24.

4 Australian Securities and Investments Commission, *Submission 16*, p. 10.

> minimum monthly payment is used over the long run, the credit card no longer offers enough value for the customer.[5]

5.11 Banks also suggested that consumers were already making appropriate, informed product choices with respect to credit cards and their borrowing needs more generally. For example, Westpac wrote that there is 'evidence that consumers are selecting the right product for their medium-term borrowing needs with Personal Loans growing faster than Credit Cards over the last few years'.[6] Westpac argued that debit cards were increasingly popular as a payment tool, and in fact over the past 12 months spending on debit cards had grown faster than spending on credit cards.[7] Taken together, Westpac concluded, these trends demonstrated that 'consumers are being more prudent with Credit Cards and using them more as a payment mechanism than a borrowing tool'.[8] As already noted in chapter four, the banks also argued that the increased take-up of low-rate cards was indicative of a customer base that was informed and capable of making solid financial decisions in the consumer credit space.

5.12 As explained further below, some witnesses challenged the banks contention that only very small numbers of cardholders were struggling to service their credit card debt, and argued that the incidence of long-term credit card debt was in fact indicative of a failure of the responsible lending obligations in relation to the credit card market.

5.13 The National Credit Act, as chapter two explained, sets out responsible lending obligations that apply to all forms of regulated credit, including credit cards. ASIC is responsible for administering the Act's responsible lending obligations, and its primary guidance in this respect is set out in RG 209. ASIC advised the committee that the responsible lending obligations are principles based, and it was incumbent on a lender to inquire into the financial situation of a borrower and ensure a loan was not unsuitable for that borrower. A loan would be deemed unsuitable 'if the borrower cannot repay the loan contract in circumstances other than with substantial hardship or where the loan contract does not meet the requirements and objectives of the borrower'. When it was put to ASIC that this appeared a rather subjective test, ASIC responded that it would characterise the test as 'scalable', in that:

> …it depends on the situation of the borrower; it depends on the type of loan contract that you are looking to provide the borrower; it depends on the information you already have about the borrower. So there are a range of

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5 Mr David Robert Lindberg, Chief Executive, Commercial and Business Bank, Westpac Group, *Proof Committee Hansard*, 16 October 2015, pp. 15–16.

6 Westpac, *Submission 21*, p. 5.

7 Westpac, *Submission 21*, p. 6.

8 Westpac, *Submission 21*, p. 7.

considerations that inform to what extent the lender has to make inquiries and conduct verification.[9]

5.14 ASIC further explained that the responsible lending obligations are:

> …very much a point-in-time obligation; the obligation applies when the consumer applies for a credit card, and the lender has to make an assessment at that time as to whether the credit contract is not unsuitable. Once the consumer has the credit card they may well use the credit card in a way that they did not initially expect to use the credit card, so they might end up in a lot more debt than they expected, or their circumstances might change. The responsible lending obligations do not address anything that happens once the credit is provided.[10]

5.15 Banks insisted that in issuing credit cards and setting credit limits they took the responsible lending obligations very seriously. Westpac reported that it approves less than 60 per cent of applications it receives for new credit, and less than 15 per cent of accounts are eligible for a credit limit increase at any point in time.[11] ANZ advised the committee that it 'filters and rejects on average 35 per cent of potential applicants and, where consumers apply for an unsuitable card, looks to suggest a more appropriate card option'.[12]

5.16 Westpac observed that since the introduction of the responsible lending obligations in the Consumer Credit Act and the subsequent additional reforms regarding credit card lending, key indicators of consumer behaviour showed positive trends. For instance, revolve rates had declined, and average monthly repayments had increased. On this basis, Westpac submitted that there was no need 'for any new regulatory changes to the operation of the consumer credit protection regime'.[13]

5.17 ANZ also argued that recent reforms, including the 2011 requirements regarding minimum repayment warnings, had been 'successful in reducing balances paying interest', and it expected this trend would continue over time.[14] ANZ further advised that in addition to meeting its responsible lending obligations, it also works

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9 Mr Michael Saadat, Senior Executive Leader, Australian Securities and Investments Commission, *Proof Committee Hansard*, 27 August 2015, pp. 24–25.

10 Mr Michael Saadat, Senior Executive Leader, Australian Securities and Investments Commission, *Proof Committee Hansard*, 27 August 2015, p. 28.

11 Westpac, *Submission 21*, p. 10.

12 ANZ, *Submission 27*, p. 5; Mr Graham Hodges, Deputy Chief Executive Officer, ANZ, *Proof Committee Hansard*, 16 October 2015, p. 60. The CBA made similar points. Mr Matthew Comyn, Group Executive, Retail Banking Services, Commonwealth Bank of Australia, *Proof Committee Hansard*, 16 October 2015, p. 10.

13 Westpac, *Submission 21*, pp. 11–12.

14 ANZ, *Submission 27*, p. 16.

with customers to review their needs and goals, including finding the most appropriate credit card for their circumstances and needs.[15]

5.18 Similarly, the ABA submitted that there are already strong protections in place for credit card customers. In addition to the existing responsible lending obligations, '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'.[16]

5.19 While card providers insisted they applied stringent criteria in issuing credit cards, the committee received some evidence suggesting that consumers were still being issued with cards with excessively high credit limits. Mr Les Banton told the committee of his struggles with credit card debt and advised that he had previously been jailed for fraud against the banks and declared bankrupt. He suggested that if he applied for an unsecured personal loan:

> …they would probably knock me back on 13 per cent. With my history and the fact that I am on [the Disability Support Pension]…they would knock me back. Yet they would give me a credit card of 20 per cent.[17]

5.20 The Consumer Action Law Centre and the Financial Rights Legal Centre also expressed concern that people were still being given credit limits that they were unlikely to be able to service. This, they submitted, suggested a failure in the operation of the responsible lending obligations as they applied to credit card lending. In particular, they argued that to the extent credit card providers were assessing the suitability of applicants based on their ability to service the minimum repayment, this was inconsistent with the intention of responsible lending laws and the guidance in RG 209:

> In RG 209 it states that for credit cards, there may be some risks associated with assessing a consumer as having the capacity to repay the contract based solely on being able to meet the minimum monthly repayments. According to ASIC, if by paying only the minimum monthly repayments the consumer is likely to take a long period of time to repay the maximum limit on the card, the credit provider should also consider whether this would meet the consumer's requirements and objectives (i.e. taking a number of years to repay a relatively small debt, and paying high amounts of interest on this debt).
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> While this is positive guidance, it is not a 'black and white' rule and thus has limited impact on credit card provider's behaviour. Currently, many credit

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15 ANZ, *Submission 27*, p. 16.

16 Australian Bankers' Association, *Submission 15*, p. 2. On the Code of Banking Practice, which is the banking industry's customer charter on best banking practice standards, see Australian Bankers' Association, webpage, 'Code of Banking Practice', http://www.bankers.asn.au/industry-standards/ABAs-code-of-banking-practice, accessed 4 December 2015.

17 Mr Les Banton, private capacity, *Proof Committee Hansard*, 27 August 2015, p. 5.

> card providers are effectively assuming that consumers will carry long term debt by making minimum monthly repayments in assessing the suitability of a credit contract. To reduce the likelihood that consumers will continue to pay interest over a long period of time, we recommend that credit card providers be required to assess whether a consumer can afford to repay the entire credit limit within three years.[18]

5.21 Ms Kat Lane from the Financial Rights Legal Centre stated that it was absurd that credit card debt and repayment terms were structured in such a way that it could potentially take decades to clear a debt. Yet, as she noted, the idea that a small credit card debt might be repaid over decades was now considered normal:

> My point here is: it is long-term debt and it should not be, and we need to structurally reform that. A line of credit should not be long-term debt. The banks have managed to put that in and we all accept it as long-term debt—they have pulled a swiftie. We need to fix that. They have well and truly Jedi mind-tricked us into thinking that credit card debt should be long term when it should not.[19]

5.22 Ms Lane concluded by suggesting that it was imperative people only be given credit card limits that they could afford to repay in a reasonable period of time. Ms Lane reiterated the Financial Rights Legal Centre's position, set out in a joint submission with the Consumer Action Law Centre, that three years would constitute a reasonable period in this regard.[20]

5.23 Ms Denise Boyd, the Consumer Action Law Centre's Director of Policy and Campaigns, suggested that in implementing this reform it was necessary to be mindful of the risk that preventing certain people from accessing credit cards could push them 'towards even more unaffordable forms of credit'.[21] It was therefore necessary, Ms Boyd stressed, to tackle both the issue of credit cards and other forms of lending together:

> There are some issues there—we appreciate that—but the worst thing you can do is go and take out an expensive line of credit, whether that is a credit card that you cannot afford to pay the debt on or a payday loan.[22]

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18 Consumer Action Law Centre and Financial Rights Legal Centre, *Submission 13*, p. 16.

19 Ms Katherine (Kat) Lane, Principal Solicitor, Financial Rights Legal Centre, *Proof Committee Hansard*, 27 August 2015, p. 6.

20 Ms Katherine (Kat) Lane, Principal Solicitor, Financial Rights Legal Centre, *Proof Committee Hansard*, 27 August 2015, p. 7.

21 Ms Denise Boyd, Director of Policy and Campaigns, Consumer Action Law Centre, *Proof Committee Hansard*, 22 September 2015, p. 14.

22 Ms Denise Boyd, Director of Policy and Campaigns, Consumer Action Law Centre, *Proof Committee Hansard*, 22 September 2015, p. 14.

5.24 Treasury also suggested, as one option for policy reform, exploring how the responsible lending obligations were operating in the credit card market, with particular reference to:

> …the assessments required of the consumer's capacity to make repayments and of their requirements and objectives. Ensuring credit card providers assess serviceability based on repayments required to pay off debt within a reasonable period could reduce the incidence of credit card distress.[23]

Committee view

5.25 The committee found the evidence received during this inquiry about people struggling with long-term credit card debt deeply concerning. This evidence, which was provided by, among others, consumer groups, financial counsellors, community support groups, and individuals, clearly suggests that too many Australians are struggling under the weight of high-interest bearing credit card debt that they have no prospect of repaying in the short-to-medium term. As such, the committee does not agree with the banks that there is no need to review or refine the responsible lending obligations as they are currently operating in relation to credit card lending. In particular, the committee believes card providers should be explicitly required to evaluate credit based on a consumer's ability to repay their credit limit over a reasonable period, rather than on their ability to meet minimum repayments. While some witnesses have submitted that a 'reasonable period' in this regard would be three years, the committee considers that the exact period should be determined by government in consultation with industry, consumer groups and other interested stakeholders.

Recommendation 6

5.26 The committee recommends that the responsible lending obligations, as they apply to credit card lending, be amended so that serviceability is assessed on the basis of the borrower's ability to pay off their debt over a reasonable period. The government should consult with industry, consumer groups and other interested stakeholders to determine what constitutes a 'reasonable period' in this regard.

Minimum repayments and amortisation periods

5.27 In discussing the problem of long-term credit card debt, many witnesses noted very long amortisation periods are only possible because minimum repayment levels are set so low. While card providers are currently able to set their own minimum repayment levels, as the ABA explained these are typically set at about 2 per cent per month, with a minimum flat repayment between $10 and $25.[24]

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23 Treasury, *Submission 17*, p. 1.

24 Mr Anthony Pearson, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association, *Proof Committee Hansard*, 22 September 2015, p. 15.

5.28 Ms Turner from CHOICE criticised the fact there is no standardised form for monthly repayments:

> For a consumer with an average balance, if they are with, I think it is, ANZ, their minimum monthly repayment means they will be paying off an average debt for a little over 17 years. Because Westpac sets it differently, for the same amount of debt you will be paying it for over 26 years.
>
> That is the difference between two per cent or $25, whatever is greater, and two per cent or $10, whatever is greater. That small change adds a decade of debt. Adding some sort of standardisation would really assist consumers.[25]

5.29 CANSTAR advised the committee it had previously rated low minimum payments as a positive feature of credit cards because this provided added flexibility to the cardholder. However, its position had changed, and its method for rating cards had evolved with it:

> Some years back our credit card methodology in rating viewed the world as 'the greater the flexibility of the product in the hands of the consumer the better it is as a product'. I think that is a sound first principle. This meant we rewarded lower minimum repayments. We looked at the methodology a few years back and said, 'Now this is getting a bit silly.' They are reducing the minimum repayment down to 2.5 per cent, and we said that that was really wrong, because consumers will never repay the debt. So we bumped it up and said that any card that is not actually at least covering interest charges on the minimum repayment is not a good card for a consumer, because they will never by repaid, by definition.
>
> Would a minimum repayment solve a problem? It could induce a level of awareness for the consumer because it is a trigger—it is one of those market triggers. Because being on the wrong card and paying a very high rate is still the bigger issue, I think. It forces people to go backwards faster and further. But I think it is a nice market trigger that says that if my minimum repayment is looking really ugly because the interest rate is too high, then maybe it will induce me to look for a better deal.[26]

5.30 According to the banks, in any month only a small proportion of cardholders make the minimum repayment or less, and even fewer cardholders will only make minimum repayments or less consistently over extended periods. For example, Westpac told the committee that only 4 per cent of its customers make the minimum

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25 Ms Erin Turner, Campaigns Manager, CHOICE, *Proof Committee Hansard*, 27 August 2015, pp. 55–56.

26 Mr Stephen Henry Mickenbecker, Group Executive, Ratings and Financial Services, CANSTAR Pty Ltd, *Proof Committee Hansard*, 22 September 2015, p. 37.

repayment continuously over a 12 month period.[27] These customers, it noted, are not exclusively low-income earners, and indeed low-income earners 'tend to pay off their balances more often than higher income earners'.[28] Westpac argued that for cardholders who are 'revolvers', the existing card product meets their borrowing and payment needs.[29]

5.31 The ABA also advised the committee that few cardholders were actually making minimum repayments on an ongoing basis:

> [T]he number of people we are talking about—I am quoting from memory, but I think this is a ballpark figure—I think we said three to four per cent make the minimum repayment in any month, but the number of people who only ever make the minimum repayment, month by month, in a year is very tiny. The industry data suggests it is less than one per cent. There are not that many people out there who only ever make the minimum repayment, and, for most people making minimum repayments, a couple of months later they are back paying more than that.[30]

5.32 Although the banks suggested few cardholders were in fact only making minimum repayments, they nonetheless indicated they would either support or welcome further consideration of a requirement for higher repayments. CBA suggested a minimum repayment standard would 'help customers pay down their debt in a timely and responsible manner'.[31] NAB told the committee that while the matter was complex, 'from our perspective minimum repayments is a topic and an area that we are more than happy to enter into a discussion on'.[32] ANZ also indicated it would

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27 Westpac, *Submission 21*, p. 9. There appears to be a wide variation in some of the figures given to the committee in this regard, to such an extent that this perhaps suggests different approaches to measurement rather than variations from provider-to-provider. For instance, while Westpac reported that 4 per cent of its customers 'make the minimum repayment continuously over a 12 month period', NAB told the committee that only 2 per cent of customers had made the minimum payment or less in any month in the past 12 months, and that only 0.17 per cent of low-rate cardholders and 0.04 per cent of standard rate cardholders had paid minimum repayments or less every month for the last 12 months (Mr Antony James Cahill, Group Executive, Product and Markets, NAB, *Proof Committee Hansard*, 16 October 2015, p. 26). The ABA suggested that the proportion of customers who only pay the minimum payment in any given month was in the order of 3 to 4 per cent (Mr Anthony Pearson, Chief Economist and Executive Director, Industry Policy, ABA, *Proof Committee Hansard*, 22 September 2015, p. 9).

28 Mr David Robert Lindberg, Chief Executive, Commercial and Business Bank, Westpac Group, *Proof Committee Hansard*, 16 October 2015, p. 15.

29 Westpac, *Submission 21*, p. 10; Mr Antony James Cahill, Group Executive, Product and Markets, National Australia Bank, *Proof Committee Hansard*, 16 October 2015, p. 26.

30 Mr Anthony Pearson, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association, *Proof Committee Hansard*, 22 September 2015, p. 15.

31 Mr Matthew Comyn, Group Executive, Retail Banking Services, Commonwealth Bank of Australia, *Proof Committee Hansard*, 16 October 2015, p. 1.

32 Mr Antony James Cahill, Group Executive, Product and Markets, National Australia Bank, *Proof Committee Hansard*, 16 October 2015, p. 30.

be 'happy to see [the minimum repayment] higher', while noting that the implementation of such reforms would be critical (as discussed further below).[33]

5.33 Some of the discussion during the inquiry focused on minimum repayment reforms introduced in the United Kingdom in 2011. As a result of these reforms, all card accounts opened from April 2011 have a minimum repayment of at least the total of any interest, fees and charges, plus 1 per cent of the outstanding balance.[34] Coles spoke in support of a higher minimum repayment, and referred in this regard to the UK reforms:

> We also have looked at the UK position, and we would be supportive of changes to repayment terms. We think it would be sensible for customers because, at the end of the day, credit cards are designed for short-term borrowing; they are not really designed for long-term borrowing.[35]

5.34 Westpac told the committee that while the idea of higher minimum repayments was 'directionally correct', it recommended the committee consider:

> …something stronger and more targeted: that all credit card issuers provide an option for customers to pay off their debt within a period of time chosen by the customer—for example, one, three or five years. This would become a new feature of the product in our industry. As an alternative, issuers can proactively offer to targeted customers another product that allows for faster repayment of long-term debt, such as a personal loan. All customers should have an easy way to move balances into a shorter amortisation period. This creates an effective payment plan for the customer. We believe that this should be a point of mandatory conduct for all credit card issuers.[36]

5.35 Westpac argued against simply lifting the minimum repayment levels:

> We do keep making improvements and I think here we have an opportunity for a small set of customers to make further improvements. But what I would argue is that simply moving the minimum payment up, whilst it is directionally correct, would unduly affect the 95 per cent of customers who I think are getting value. But at the same time, and more importantly, moving the minimum payment from two per cent to three per cent, or to 2.5 per cent or four per cent, misses the point, I think. The point is that if we were to give the best advice to someone with long-term debt we would try to get them into an amortisation period that was much shorter than that,

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33 Mr Graham Hodges, Deputy Chief Executive Officer, ANZ, *Proof Committee Hansard*, 16 October 2015, p. 67.

34 The UK Cards Association, webpage, 'Minimum repayments', http://www.theukcardsassociation.org.uk/individual/minimum_repayments.asp, accessed 3 December 2015.

35 Mr Richard Wormald, General Manager, Coles Financial Services, Coles, *Proof Committee Hansard*, 16 October 2015, p. 46.

36 Mr David Robert Lindberg, Chief Executive, Commercial and Business Bank, Westpac Group, *Proof Committee Hansard*, 16 October 2015, p. 16.

> which is why I think we need to have a mandatory feature on all credit cards so that the customer can simply say, 'This is the balance I am revolving on and I can move it and make monthly repayments that actually make headway.' That is why I suggest something that is quite a bit stronger than the direction even of increasing the minimum payment.[37]

5.36 A number of witnesses, including those advocating higher minimum repayments, warned that policymakers needed to tread carefully in designing and implementing reform in this area. For example, ASIC warned that if the end result was to exclude certain consumers from accessing credit cards, this could simply push them into even more expensive and riskier forms of borrowing.[38]

5.37 CBA also cautioned that any shift to higher repayments would need to be managed in such a way that it did not inadvertently hurt vulnerable customers or, indeed, push them into financial hardship, observing that when it had itself increased its minimum repayments in 2008 from 1.5 per cent to 2 per cent, this had created difficulties for a small number of customers. The bank maintained that these issues were far from insurmountable.[39]

5.38 ANZ indicated that while it would support higher repayments, 'we need to be careful that it does not affect the people you do not really want to impact'.[40] It emphasised that that implementation of any higher repayment would be critical. This was particularly so given the risk that people might be driven to payday lenders and the like:

> If you make it too onerous you have got to remember that some people are a little more on the fringe there, and if you suddenly jack it up you are going to cause some issues for people.[41]

5.39 Treasury also sounded a note of caution on the design and implementation of higher minimum repayments:

> Where that amount might be set—and if there was going to be investigation along those lines—you would also want to make sure that we were thinking through all the unintended consequences in the event that people who, as

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37 Mr David Robert Lindberg, Chief Executive, Commercial and Business Bank, Westpac Group, *Proof Committee Hansard*, 16 October 2015, p. 16.

38 Mr Michael Saadat, Senior Executive Leader, Australian Securities and Investments Commission, *Proof Committee Hansard*, 27 August 2015, p. 30.

39 Mr Matthew Comyn, Group Executive, Retail Banking Services, Commonwealth Bank of Australia, *Proof Committee Hansard*, 16 October 2015, pp. 1, 3.

40 Mr Graham Hodges, Deputy Chief Executive Officer, ANZ, *Proof Committee Hansard*, 16 October 2015, p. 67.

41 Mr Graham Hodges, Deputy Chief Executive Officer, ANZ, *Proof Committee Hansard*, 16 October 2015, p. 65.

> Senator Dastyari said before, are relying on lines of credit were not tipped out of the transparent market into the non-transparent market.[42]

5.40 Asked about the risk that reforms to shift people from using credit cards as long-term debt facilities would push people into even more risky forms of lending, CHOICE responded:

> Any changes we are looking at here do need to come in tandem with changes to payday loans. There is a review just under way into small-amount credit contracts. There is a lot of work to clean up that industry and associated industries, whether that is rent-to-buy industries that are making people pay more for appliances or whether it is pawnshops connected to payday lenders. There is a lot of reform needed in that market.
>
> Ultimately, in terms of outcomes and what we are looking for, it is not to push people into worse products it is to get the big banks to offer better products for consumers.[43]

ANZ's proposed low-fee, low-interest, low-limit, high-repayment card

5.41 The committee welcomes the fact that during the inquiry several of the banks actively considered how they might structure their products to help customers avoid getting trapped into long-term credit card debt. In addition to Westpac's aforementioned proposals regarding nominated amortisation periods on credit card debt, ANZ made a notable contribution by announcing the development of a low-fee, low-interest, low-limit and high-repayment credit card.

5.42 ANZ explained that if disadvantaged and vulnerable consumers were prevented from accessing the credit card market entirely, this risked reinforcing their financial exclusion and could force them into even risker forms of borrowing, such as payday lending. ANZ told the committee financial counsellors argue that access to small-balance credit is often critical in helping vulnerable people manage unexpected costs or get through short periods of particular financial pressure. ANZ advised that in an effort to help vulnerable consumers better manage their expenditure, it had begun work on a low-rate, no-fee, low-limit and high-repayment card. This product, it suggested, could help vulnerable customers avoid or work through periods of financial hardship, and steer clear of payday lenders.[44]

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42 Mr Trevor Power, Principal Adviser, Financial Systems and Services Division, Department of the Treasury, *Proof Committee Hansard*, 22 September 2015, p. 58.

43 Ms Erin Turner, Campaigns Manager, CHOICE, *Proof Committee Hansard*, 27 August 2015, p. 56.

44 Mr Graham Hodges, Deputy Chief Executive Officer, ANZ, *Proof Committee Hansard*, 16 October 2015, pp. 61–65.

Committee view

5.43 Evidence presented during the inquiry suggests that consumers would likely benefit from a requirement for higher minimum repayments on credit card balances. The committee is mindful of the need to design and implement any reforms in this regard without inadvertently hurting disadvantaged or vulnerable consumers. In particular, the committee would be concerned about any reforms that inadvertently pushed disadvantaged or vulnerable consumers into even riskier and costlier forms of borrowing, such as payday lending. At the same time, the committee does not believe these risks are insurmountable, and would encourage the government to work with industry, consumer groups and other interested stakeholders to determine how reform in this area can be best designed and implemented.

5.44 The committee further recommends that the government consider alternative approaches to reducing the use of credit cards as long-term debt facilities. In this connection, the committee notes that while it did not have an opportunity to fully consider Westpac's recommended approach to credit card debt amortisation, it believes the idea has merit and is worthy of further consideration.

Recommendation 7

5.45 The committee recommends that the government consider introducing a credit card minimum repayment requirement and alternative means of reducing the use of credit cards as long-term debt facilities.

Balance transfers

5.46 Balance transfer offers, which allow a cardholder to transfer existing credit card debt to a new card at a discounted interest rate for a specified 'honeymoon' period, are a longstanding and common feature of the Australian credit card market. While the interest rate and terms of duration for balance transfers vary widely, zero per cent offers for an extended period are not uncommon. A September 2015 CANSTAR analysis found that at least 46 cards were seeking to attract new customers with balance transfer offers of zero per cent for 12 months or longer.[45]

5.47 The same CANSTAR analysis cautioned cardholders considering a balance transfer to check the interest rate that would apply to any outstanding amount on a balance transfer at the expiry of the honeymoon period (the 'revert rate'). CANSTAR noted that for the 46 cards it had identified that were offering zero per cent balance transfers, the revert rate ranged anywhere from 10.99 per cent to 21.99 per cent.[46]

45 CANSTAR, 'Balance transfer deals on offer', 7 September 2015, http://www.canstar.com.au/balance-transfers/terrific-balance-transfer-deals-on-offer/ (accessed 25 November 2015).

46 CANSTAR, 'Balance transfer deals on offer'.

CHOICE indicated in its submission that the average revert rate for balance transfer offers, which it called the 'sting in the tail', was in fact 20.09 per cent.[47]

5.48 The revert rate, and the incidence of people taking up a balance transfer offer only to find they have made little headway in repaying the balance within the honeymoon period (or, worse still, found themselves deeper in debt), was a significant area of concern for this inquiry. The committee received evidence from a range of witnesses suggesting that balance transfer offers encouraged (or at least facilitated) poor consumer behaviour and, by extension, represented a potential debt trap for the average cardholder.

5.49 For instance, ASIC submitted that balance transfers played on the behavioural biases of consumers:

> Optimistic present biased consumers may take up these offers because they believe they will take advantage of the introductory period to pay off their existing balances, when in fact their financial situation and imperfect self-control makes it likely that they will continue to borrow at a much higher interest rate. Behavioural biases such as overconfidence and present bias are known to influence how consumers make decisions about financial offers.[48]

5.50 Mr Pape made a similar point, emphasising that without any change in behaviour on the part of the cardholder, balance transfers—or, as he termed them, 'credit card roulette'—simply placed the cardholder at risk of falling deeper into debt.[49]

5.51 Similarly, Mr Clitheroe told the committee that balance transfer offers presented a 'debt trap' to consumers who failed to change their behaviour upon accepting an offer. If a cardholder was transferring a balance, he suggested, this was likely indicative of an inability to pay off the balance. As such, Mr Clitheroe suggested that a balance transfer should trigger a process in which the card provider, as a responsible lender, seeks to engage with and support the consumer to change their financial behaviour.[50]

5.52 Ms Lane from the Financial Rights Legal Centre also noted that cardholders often took up a balance transfer, only to further add to their debt on their new card.

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47 CHOICE, *Submission 10*, p. 10.

48 Mr Michael Saadat, Senior Executive Leader, Australian Securities and Investments Commission, *Proof Committee Hansard*, 27 August 2015, p. 23.

49 Mr Scott Pape, Chief Executive Officer, Barefoot Investor, *Proof Committee Hansard*, 22 September 2015, p. 9.

50 Mr Paul Clitheroe, Chairman, Money Magazine, *Proof Committee Hansard*, 27 August 2015, p. 38.

She suggested that responsible lending obligations should be amended to address this problem.[51]

5.53 The Consumer Credit Legal Service (WA) Inc., a community legal centre that regularly works with disadvantaged and vulnerable consumers struggling with credit card debt, took an even stronger position against balance transfers. It argued that balance transfer offers:

> …take advantage of consumers with low levels of financial literacy, who do not understand or consider the actual impact of interest rates until it is too late. Further, while banks are able to offer honeymoon interest period credit cards to lure in vulnerable consumers, there is little incentive for these banks to reduce credit card interest rates in order to become more competitive.[52]

5.54 A joint submission from the Consumer Action Law Centre and the Financial Rights Legal Centre recommended that zero per cent balance transfer offers should be offered for a minimum of two years, and 'for interest-free periods to apply not only to the balance transfer but to new purchases'. They recommended that card providers should:

> …be required to set the minimum repayment amount on the basis that the consumer will repay the transferred balance within the 'teaser' period. In the alternative, there should be restrictions on using the card for new purchases until the transferred debt is repaid.[53]

5.55 CBA advised the inquiry that zero per cent balance transfer cards should be banned outright. The bank is the only one of the major banks that does not offer zero per cent balance transfers. Echoing the abovementioned arguments, CBA told the committee:

> The experience here, and in other markets around the world, is that customers increase their debt and many do not pay off the debt before the end of the offer period. It has been our view that such arrangements are not the right thing for our customers. We believe the committee should consider a total ban on zero per cent balance transfers, a move that would have our full support.[54]

5.56 Questioned by the committee, CBA advised that with up to one third of new applications in the market going to cards offering zero per cent balance transfers, its decision not to offer zero per cent balance transfers made it 'very hard for [CBA] to compete on a long-term basis'. However, CBA maintained that it did not offer

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51 Ms Katherine Lane, Principal Solicitor, Financial Rights Legal Centre, *Proof Committee Hansard*, 27 August 2015, p. 2.

52 Consumer Credit Legal Service (WA) Inc., *Submission 12*, p. 7.

53 Consumer Action Law Centre and Financial Rights Legal Centre, *Submission 13*, p. 13.

54 Mr Matthew Comyn, Group Executive, Retail Banking Services, Commonwealth Bank of Australia, *Proof Committee Hansard*, 16 October 2015, p. 1.

zero per cent balance transfer because such offers were ultimately not in the best interests of customers.[55]

5.57 Balance transfer offers are widely seen by card providers as a means of attracting new customers and increasing their market share. Mr Graham Hodges, ANZ's Deputy CEO, confirmed that balance transfers were a loss leader for the bank, but were nonetheless seen as a valuable means of attracting and retaining customers.[56] The call by CBA—the bank with the largest share of the credit card market in Australia—to ban zero per cent balance transfers was met with some scepticism by some other card providers. In particular, Mr Cahill from NAB told the committee that it was 'interesting that the bank with the largest market share does not support zero balance transfers'. Balance transfers, Mr Cahill argued, were very much a part of the 'competitive mix' in a market that was 'highly competitive'.[57]

5.58 Mr Cahill also challenged the view that customers utilising balance transfers offers were financially vulnerable or likely to be worse off as a result of having accepted an offer. According to Mr Cahill, balance transfer customers were in fact 'four times less likely to move into delinquency that a standard credit card holder'.[58] In light of this finding, NAB took the view that:

> …zero dollar balance transfer can be an extremely useful tool for customers. It allows them to consolidate debt and get their finances under control. We do not believe it leaves the customers…in financial stress. So we support zero balance transfers as part of a competitive industry.[59]

5.59 ANZ also took issue with the notion balance transfer offers represented a 'debt trap', telling the committee that about 70 per cent of its clients on balance transfers (which made up 15 per cent of its total outstanding balances) paid off the balance in full by the end of the balance transfer period. (This figure, it noted, included those people who transferred their outstanding balance elsewhere.)[60] Mr Graham Hodges, ANZ's Deputy CEO, argued that balance transfers were a 'legitimate area for

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55 Mr Matthew Comyn, Group Executive, Retail Banking Services, Commonwealth Bank of Australia, *Proof Committee Hansard*, 16 October 2015, p. 2.

56 Mr Graham Hodges, Deputy Chief Executive Officer, ANZ, *Proof Committee Hansard*, 16 October 2015, p. 66.

57 Mr Antony James Cahill, Group Executive, Product and Markets, National Australia Bank, *Proof Committee Hansard*, 16 October 2015, pp. 27–28.

58 Mr Antony James Cahill, Group Executive, Product and Markets, National Australia Bank, *Proof Committee Hansard*, 16 October 2015, p. 28.

59 Mr Antony James Cahill, Group Executive, Product and Markets, National Australia Bank, *Proof Committee Hansard*, 16 October 2015, p. 33.

60 Mr Graham Hodges, Deputy Chief Executive Officer, ANZ, *Proof Committee Hansard*, 16 October 2015, pp. 65–66; ANZ, *Submission 27*, p. 7.

competitive activity'; if they were banned, he suggested, competitive activity would simply shift elsewhere within the market.[61]

5.60 Mr Lindberg from Westpac took what might be described as the middle position, suggesting that while zero per cent offers could be useful for customers, their duration should be limited in order to encourage customers to reduce debt faster:

> Balance transfers are an effective way to consolidate and get on top of debt. In my experience, however, they are being used too often to extend debt, and all too often debt continues to build, even during the transfer period. We should encourage customers to face their outstanding debts sooner. This may reduce industry balances, but we believe it is the right thing to do for customers.[62]

5.61 Westpac suggested it was trying to balance the value that many customers enjoyed from balance transfers with the fact that other customers simply end up 'kicking the can down the road' rather than addressing their underlying debt:

> What we want to do is find a way to support customers to face into their debt, give them a reasonable period of time—but not such a long period of time that it goes to the back of their mind—and then move forward.
>
> That is why we are suggesting that we do something to limit balance transfers. We gave real consideration to whether we should make a recommendation to this committee to stop them altogether. We decided that that would not be in the best interests of customers because there are so many who use it appropriately. So we tried to balance the two by saying, 'Let's have some limits.'[63]

Committee view

5.62 The committee shares the concerns expressed by a range of witnesses that balance transfer offers can present a 'debt trap' for consumers. In the worst instances, a consumer may take out a new card in order to take advantage of a seemingly compelling balance transfer offer, and not only to fail to pay off the balance in the honeymoon period but also run up further debt on their old card (which they have not cancelled) and their new card. Equally, the committee notes that balance transfers *can* be used to a consumer's benefit, and do appear to be an important part of the competitive mix in the Australian credit card market.

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61 Mr Graham Hodges, Deputy Chief Executive Officer, ANZ, *Proof Committee Hansard*, 16 October 2015, p. 66.

62 Mr David Robert Lindberg, Chief Executive, Commercial and Business Bank, Westpac Group, *Proof Committee Hansard*, 16 October 2015, p. 16.

63 Mr David Robert Lindberg, Chief Executive, Commercial and Business Bank, Westpac Group, *Proof Committee Hansard*, 16 October 2015, p. 23. Westpac suggested such limits should be considered alongside its aforementioned suggestion that customers be encouraged to set an amortisation period on their credit card debt.

5.63 In order to balance the potential benefits and risks of such offers, the committee believes serious consideration should be given to implementing new obligations on card providers in relation to balance transfers. In particular, credit card providers should be required to notify customers when an interest free period is about to expire, and if there is an outstanding balance remaining on the card, to actively engage with the customer to ensure the card is the most appropriate product for them.

Recommendation 8

5.64 The committee recommends that 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 customer's current credit card and, where appropriate, provide advice on alternative products.

Financial literacy

5.65 Treasury underlined the importance of financial literacy in helping people avoid or manage credit card debt, telling the committee:

> Where consumers have low levels of financial literacy or suffer from behavioural biases, high credit card interest rates can contribute to debt traps for those on lower incomes.[64]

5.66 There are a range of financial literacy programs and informational tools relevant to credit cards that are currently available to consumers and provided by both industry and government. The banks have their own programs and initiatives to help improve general financial literacy, including the use of credit cards. For example, ANZ told the committee that it had invested over $34 million over the last ten years in financial literacy programs such as MoneyMinded and Saver Plus, which were delivered in partnership with government and community organisations. The programs, ANZ reported, 'have a demonstrated track record of improving the basic budgeting, saving and money management skills of lower income participants, including the use of credit cards'.[65]

5.67 The ABA advised the committee that individual banks and the industry as a whole (through the ABA) was already making 'a very significant investment into financial-literacy programs'. According to the ABA, the major banks typically invested between $90 million to $300 million per year in financial literacy and financial inclusion programs.[66] The ABA advised the committee that, in addition to

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64 Mr Michael Willcock, Acting Deputy Secretary, Markets Group, Department of the Treasury, *Proof Committee Hansard*, 22 September 2015, p. 55.

65 ANZ, *Submission 27*, p. 3; Mr Graham Hodges, Deputy Chief Executive Officer, ANZ, *Proof Committee Hansard*, 16 October 2015, p. 61.

66 Ms Diane Tate, Executive Director, Retail Policy, Australian Bankers' Association, *Proof Committee Hansard*, 22 September 2015, p. 14.

legislative and regulatory protections for credit card customers, 'the ABA has augmented these protections with a number of initiatives to improve the financial literacy and understanding of customers'.[67]

5.68 ASIC's MoneySmart website also provides information and other resources to customers to assist them in the selection and management of credit cards. In addition to information about how to avoid fees and charges, the website provides a credit card calculator to help consumers calculate how much they could save be making higher repayments.[68]

5.69 More broadly, ASIC has national responsibility for co-ordinating financial literacy, and works to this end with the Australian Government Financial Literacy Board. As part of this role, ASIC developed and published the *National Financial Literacy Strategy 2014–17*. According to a foreword by the then Parliamentary Secretary to the Treasurer, the Hon Steven Ciobo MP, the strategy 'provides a practical framework for action for stakeholders across the government, business, community and education sectors over the next three years'.[69]

5.70 Notwithstanding the current financial literacy offerings, both in relation to credit cards specifically and financial literacy more broadly, some witnesses suggested there was a need for more targeted efforts to improve understanding about credit cards for particular consumer cohorts. For example, Mr Symons for SocietyOne told the committee that it would be worth exploring:

> …whether there are not things that we could be doing that are not so much just general literacy and awareness raising but really more laser targeted efforts at people who potentially have these carry-forward balances. We could apprise them of options other than the ones that they have today.[70]

Financial literacy in schools

5.71 Mr Scott Pape, also known as the 'Barefoot Investor', argued that even with strong disclosure requirements and general financial literacy efforts, shifting the financial behaviours of adults was 'incredibly hard':

> Jenny Craig and I will never be out of business so long as people enjoy eating and spending. That is what I have learned over the past 12 years of being the Barefoot Investor, and the banks understand this better than anyone, which is why they basically went 'meh' in 2012 when the government began forcing them to include a minimum repayment warning table on statements, saying that a $5,000 credit card debt will take you 33

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67 Australian Bankers' Association, *Submission 15*, p. 2.

68 Australian Securities and Investments Commission, *Submission 16*, p. 6.

69 Australian Securities and Investments Commission, *National Financial Literacy Strategy 2014–17* (September 2014), p. 1.

70 Mr Matt Symons, Chief Executive Officer and Co-founder, SocietyOne Australia Pty Ltd, *Proof Committee Hansard*, 22 September 2015, p. 28.

> years to pay, at which time you would have paid 17 grand. Shocking? Yes. Did it make a difference? No. Today we have a $51 billion credit card problem, and it is growing. The truth is that successfully managing your money is 20 per cent knowledge but 80 per cent behaviour and, as I have said, change is really hard.[71]

5.72 For this reason, Mr Pape stressed the importance educating young people whose financial behaviours are not yet fully formed:

> At schools, kids learn some basic life lessons. They are taught to avoid the sun because it can cause skin cancer and they are taught that smoking is bad for them because it can cause heart disease and lung cancer, yet they are not taught about the dangers of credit cards and how they can cause financial cancer. Get that message across and young people may start to see the truth. If you spend less than you earn, credit cards are irrelevant.[72]

5.73 Mr Pape was particularly critical of the banks taking a lead role in educating children about finance. He contended that having CBA teach children about money through its Dollarmites program was akin to having 'Ronald McDonald teaching our kids about nutrition'.[73] Mr Pape added that when it came to teaching financial literacy in schools, programs such as ASIC's MoneySmart Schools initiative were better placed to provide 'independent, unbiased financial literacy and education'.[74] He added that financial literacy is:

> …a core life skill. It is the one thing that, when you get out of school, and even before you get out of school, you will be tested on every day of your life. It is far too important not to be a core part of the schooling process. It is far too important to allow banks to dictate and hand out their marketing material in schools.[75]

5.74 Ms Pam Mutton, a financial counsellor with Bentleigh Bayside Community Health who appeared before the community with the Consumer Action Law Centre, echoed Mr Pape's concerns regarding the CBA's Dollarmites program:

> The Commonwealth Bank practises cradle-to-grave banking. It starts in school, and you go all the way through. They also use the fact that they

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71 Mr Scott Pape, Chief Executive Officer, Barefoot Investor, *Proof Committee Hansard*, 3 September 2015, p. 1.

72 Mr Scott Pape, Chief Executive Officer, Barefoot Investor, *Proof Committee Hansard*, 3 September 2015, p. 1.

73 Mr Scott Pape, Chief Executive Officer, Barefoot Investor, *Proof Committee Hansard*, 22 September 2015, p. 1.

74 Mr Scott Pape, Chief Executive Officer, Barefoot Investor, *Proof Committee Hansard*, 22 September 2015, p. 3.

75 Mr Scott Pape, Chief Executive Officer, Barefoot Investor, *Proof Committee Hansard*, 22 September 2015, p. 4.

> have the engagement through that Dollarmites accounts. When kids turn 18, they send them the application for their very first credit card.[76]

5.75 However, when asked whether financial institutions or ASIC should deliver financial education in schools, Ms Mutton responded that they should work in cooperation:

> I think it needs to be across the legislative framework and the actual institutions need to take some responsibility. At the institutional end, if they learn to have some responsibility about the information they are providing to their consumers from a very young age, then they will take that through their corporate ideologies, and ASIC underpins that. [77]

5.76 ASIC, it should be noted, already runs a MoneySmart Schools Program, which delivers financial literacy and education in schools. According to ASIC's website, 42 schools across the nation are currently registered as MoneySmart Schools.[78] ASIC's MoneySmart Teaching program also provides cost-free professional development and resources for teachers to enable them to effectively teach young people about money. ASIC has indicated that it hopes to provide professional development to more than 20,000 teachers across Australia by 2017.[79]

5.77 It should be emphasised that the teaching of financial literacy in schools is by no means limited to ASIC's MoneySmart programs. On the contrary, the teaching of consumer and financial literacy is part of the Australian Curriculum, and is guided by the nationally endorsed education learning framework, the National Consumer and Financial Literacy Framework.[80] Nonetheless, it might be noted that while there are currently around 42 schools nationally registered as MoneySmart Schools, the CBA's School Banking program (of which the Dollarmites account is only one component), is currently delivered to around 275,000 students nationally, and CBA is currently investing a further $50 million to expand the program and expects it will reach 500,000 students in 2016.[81]

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76 Ms Pam Mutton, Financial Counsellor, Bentleigh Bayside Community Health, *Proof Committee Hansard*, 3 September 2015, p. 15.

77 Ms Pam Mutton, Financial Counsellor, Bentleigh Bayside Community Health, *Proof Committee Hansard*, 3 September 2015, p. 16.

78 MoneySmart, 'MoneySmart Schools', https://www.moneysmart.gov.au/teaching/moneysmart-schools, accessed 3 December 2015.

79 MoneySmart, 'Professional development', https://www.moneysmart.gov.au/teaching/professional-development, accessed 3 December 2015.

80 Australian Securities and Investments Commission, *National Financial Literacy Strategy 2014–17* (September 2014), p. 18.

81 Commonwealth Bank of Australia, webpage, 'Financial education', https://www.commbank.com.au/about-us/who-we-are/in-the-community/financial-education.html, accessed 3 December 2015; Commonwealth Bank of Australia, *Submission 23.1*, p. 1.

5.78 CBA refuted the criticisms of the School Banking program, telling the committee that the program was intended to 'help children achieve their educational potential', was offered on an opt-in basis to both schools and parents, and was loss-making. The main purpose of the program, according to CBA, 'is to provide young children with a basic understanding of core financial values and money management skills'. CBA also strongly rejected 'any suggestion that School Banking encourages poor financial management practices or encourages children to adopt credit cards'.[82]

5.79 CBA added that it did not 'capture data as part of our school banking program and integrate it into the rest of our banking program'. Rather, the data captured through the School Banking program was maintained in a separate database. CBA advised the committee that unless a customer had an existing home loan, they did not market credit cards to 18 to 21 year olds.[83] They also stated that when a customer turned 18, there was no flag to indicate they had become a CBA customer through the School Banking program.[84]

Committee view

5.80 The committee believes that financial literacy tools and programs could have an important role in helping Australians better understand credit cards and the risks inherent in credit card borrowing. The committee encourages the government and industry to work together to ensure these programs and tools are carefully targeted toward those consumers most at risk of using credit cards as a long-term borrowing facility.

5.81 While there are opportunities to better target financial literacy tools and programs to help improve the behaviours of some adult credit card customers, the committee agrees that financial literacy efforts should have a priority focus on educating young people about personal finance, including, but by no means limited to, credit cards. While the committee notes the concerns expressed during the inquiry about industry involvement in school banking programs, it considers banks can and do make a valuable contribution in helping children learn about personal finance. However, the committee considers that government should take a lead role in ensuring children are learning about personal finance, including the risks of credit card borrowing. The committee welcomes initiatives such as ASIC's MoneySmart Schools Program, and considers there is merit in rolling programs such as this out more broadly.

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82 Commonwealth Bank of Australia, *Submission 23.1*, p. 1.

83 Mr Matthew Comyn, Group Executive, Retail Banking Services, Commonwealth Bank of Australia, *Proof Committee Hansard*, 16 October 2015, p. 11.

84 Mr Matthew Comyn, Group Executive, Retail Banking Services, Commonwealth Bank of Australia, *Proof Committee Hansard*, 16 October 2015, pp. 8–9.

Recommendation 9

5.82 The government should consider expanding financial literacy programs such as the Australian Securities and Investments Commission's MoneySmart Schools Program.

Hardship supports for people struggling with credit card debt

5.83 The committee received evidence from a number of community support bodies and financial counselling agencies, and from people who had personally struggled with credit card debt. Ms Katherine Temple, a policy officer with the Consumer Action Law Centre in Melbourne, provided the committee with some insight into its work with people struggling with credit card debt, and by extension the scale and severity of the problem in the community:

> Consumer Action's free telephone financial counselling service, MoneyHelp, receives at least 15 calls per day from people struggling with credit card debt. Over 50 per cent of our callers have credit card debt exceeding $10,000, over 28 per cent have debts exceeding $20,000 and nearly every week we get a call from someone with credit card debt exceeding $100,000. However, the number of people contacting MoneyHelp for assistance is likely to be only a small proportion of those who are struggling with credit card debt.[85]

5.84 The committee also heard how the harm caused by credit card debt can be devastating for individuals and the broader community. Ms Temple told the committee that credit card debt:

> …can lead to and exacerbate the marginalisation of struggling consumers. It can result in significant financial hardship and, in some cases, bankruptcy and the loss of the family home. At an acute level, credit card debt can lead to family violence, breakdown and a deterioration in health, including mental health. It can also have a long-term impact on the capacity to provide for health, retirement and education. These are serious and profound impacts. Taking appropriate steps, including regulation, should be an absolute priority for policymakers.[86]

5.85 Westpac told the committee that it had 'proactively offered' 277,000 credit card holders personal loans where the bank believed it might be a more appropriate product. Cardholders in this category included those who are only making the minimum repayment each month for a prolonged period of time.[87]

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85 Ms Katherine Temple, Senior Policy Officer, Consumer Action Law Centre, *Proof Committee Hansard*, 3 September 2015, p. 11.

86 Ms Katherine Temple, Senior Policy Officer, Consumer Action Law Centre, *Proof Committee Hansard*, 3 September 2015, p. 11.

87 Mr David Robert Lindberg, Chief Executive, Commercial and Business Bank, Westpac Group, *Proof Committee Hansard*, 16 October 2015, p. 15.

5.86 Similarly, NAB told the committee that it sought to 'proactively identify customers showing signs of financial stress'. When customers did enter hardship, NAB told the committee, they were provided with 'support through a world-class assistance program that was developed in partnership with the Kildonan UnitingCare'.[88] NAB indicated that less than one per cent of all credit card customers had entered hardship in the previous 12 months, and that the overwhelming majority of these customers had returned to commercial terms within a short period (89 per cent within 30 days, and 95 per cent within 90 days).[89] NAB's advice was consistent with industry data referred to by the ABA, which indicates:

> …less than one per cent of all customers, not just credit card customers, are in a hardship arrangement with their bank. Most customers experiencing financial difficulty have their financial situation restored within three to six months.[90]

5.87 ANZ advised that it had a well-defined process for customers experiencing hardship. This process, ANZ explained, might include discussions with customers about how to minimise the level of interest paid on current debt, and fixed payment plans that might assist in this regard.[91] Appearing before the committee, ANZ further advised that:

> …0.3 per cent of our credit card customers have sought assistance through our hardship program. Nine out of 10 of those customers that are in hardship are there because of unexpected events and, primarily, loss of income from unemployment or divorce or illness, not because of financial over-commitment at the time the card was issued.[92]

5.88 For its part, American Express advised the committee that it actively monitored accounts to help its cardholders avoid hardship:

> It is part of our service ethos. If it is clear that a card member is in difficulty—for example, they are revolving more than they have in the past or their spend patterns are changing dramatically—we contact them proactively and offer support if required. We do not wait until we are asked.[93]

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88 Mr Antony James Cahill, Group Executive, Product and Markets, National Australia Bank, *Proof Committee Hansard*, 16 October 2015, p. 26.

89 Mr Antony James Cahill, Group Executive, Product and Markets, National Australia Bank, *Proof Committee Hansard*, 16 October 2015, p. 26.

90 Mr Anthony Pearson, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association, *Proof Committee Hansard*, 22 September 2015, p. 10.

91 ANZ, *Submission 27*, p. 17.

92 Mr Graham Hodges, Deputy Chief Executive Officer, ANZ, *Proof Committee Hansard*, 16 October 2015, p. 61.

93 Mrs Rachel Stocks, Managing Director, American Express Australia Ltd, *Proof Committee Hansard*, 22 September 2015, pp. 39–40.

5.89 In addition to the financial hardship processes and initiatives implemented by individual financial institutions, the industry as a whole has taken a number of steps to improve hardship supports. The ABA advised the committee:

> In 2013 the banking industry implemented its financial hardship initiative in consultation with Financial Counselling Australia and other organisations to help vulnerable and disadvantaged Australians. We released an industry guideline going beyond legal requirements to help these customers. This year the banking industry further strengthened this initiative. Consumers can now get more information about the type of support that is available, including when a debt reduction or debt waiver may be appropriate. Banks also provide a range of resources, including the *Doing it tough?* website, to give consumers access to information about assistance and the contacts for banks' hardships teams. Australia's banks provide a range of products and services to consumers, including credit cards, and it is in both parties' interests that people's financial obligations can be met.[94]

5.90 The Consumer Action Law Centre welcomed the fact that the banks had put real effort into training their staff in the management of customers experiencing hardship. However, the Centre suggested that, in general, a conversation about hardship still needed to be initiated by a customer, and a customer often needed to explicitly state that they were experiencing hardship before hardship processes could commence.[95] The Centre argued that this was a particular problem for cardholders who might be making minimum repayments on time, yet still struggling to manage their credit card debt. Such customers, it noted, were unlikely to:

> … self-identify as being in hardship. The system is set up so that, if you make your minimum repayments, which could mean it will take decades before you pay off your debt, you are still 'paying your bills on time'.[96]

5.91 Mr Greenwood suggested that if a customer had only made minimum repayments for an extended period (for instance, six or 12 months) this should trigger some sort of mandatory intervention on the part of the card provider. This could take the form of engagement between the card provider and the customer to ascertain whether the customer needed additional support or advice:

> For example, if a person has got into 10 grand worth of credit card debt and they have not paid it back over 12 months, the fact is that somebody at the bank or some form of communication with that person should reach out and say, 'We think you've got a problem.' And I think you could do that. I do not

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94 Mr Anthony Pearson, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association, *Proof Committee Hansard*, 22 September 2015, p. 10.

95 Ms Pam Mutton, Financial Counsellor, Bentleigh Bayside Community Health, *Proof Committee Hansard*, 3 September 2015, p. 14.

96 Ms Katherine Temple, Senior Policy Officer, Consumer Action Law Centre, *Proof Committee Hansard*, 3 September 2015, p. 15.

> think that that would be a problem at all in terms of trying to be proactive in trying to control the real problems inside credit card debt.[97]

5.92 While hardship processes and support from card providers are very important, the committee also heard from a number of witnesses about the critical role played by the financial counsellors. A joint submission by the Consumer Action Law Centre and the Financial Rights Legal Centre recommended increased funding for the 'promotion and delivery of financial counselling and support services to assist those struggling with credit card debt'.[98] CHOICE also told the committee:

> We desperately need greater funding for financial counsellors. This is a bit of an 'ambulance at the bottom of the cliff' problem, but it is currently a very underfunded ambulance that is dealing with a very big problem.[99]

Committee view

5.93 The committee welcomes the steps that a number of financial institutions and the industry as a whole have put in place to support customers struggling with credit card debt. At the same time, the committee is concerned that consumers who are struggling with credit card debt but not actually in default, are not receiving adequate support and advice from their bank to help them manage their credit card debt.

Recommendation 10

5.94 The committee recommends that 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 on interest bearing balances, and thereby initiate a discussion about product suitability and alternative lending products.

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97 Mr Ross Greenwood, Business and Finance Editor, Nine Network, *Proof Committee Hansard*, 27 August 2015, p. 44.

98 Consumer Action Law Centre and Financial Rights Legal Centre, *Submission 13*, p. 6.

99 Ms Erin Turner, Campaigns Manager, CHOICE, *Proof Committee Hansard*, 27 August 2015, p. 56.

Chapter 6

Interchange fees, surcharges and competitive neutrality in the payments system

6.1 This chapter considers the related issues of interchange fees, credit card surcharges and whether current regulatory settings in relation to the payments system are competitively neutral.

6.2 Interchange fees are fees charged by financial institutions when credit cards are used in a purchase. They are often not directly seen by the person who uses a credit card to purchase an item but some merchants attach a 'credit card surcharge' to credit card purchases or to specific credit cards. The credit card surcharge represents the cost to the merchant of the interchange fee charged by the purchaser's credit card issuing financial institution against the merchant's financial institution. Interchange fees and credit card surcharges are not necessarily directly related to the cost of making a financial transaction or selling a product or service.

6.3 It has been argued that interchange fees ultimately result in higher costs for all consumers and should be subject to more stringent regulatory limits than currently imposed. Critics of interchange regulation claim that merchants are not passing on any savings from lower interchange fees to consumers, and argue that regulation has only served to increase the costs of credit cards in the form of higher fees and interest charges. Interchange fees in the MasterCard and Visa systems are regulated; the interchange-like fees in the American Express companion card system are not, though the RBA has recently taken steps to bring the American Express companion card into the regulatory environment.

6.4 It is claimed that some merchants are imposing surcharges in excess of their actual payment costs. In particular, evidence regarding credit card surcharges imposed by Australian airlines has been considered in this inquiry. Interchange fees, credit card surcharges and relevant regulations have been subject to recent governmental inquiries and reviews. In particular, the Financial Systems Inquiry (FSI) Final Report provided commentary and recommendations in relation to interchange fees and surcharging, and, in response, the RBA commenced an ongoing review of the regulatory framework for card payments in March 2015. The government has also issued its response to the FSI final report, and recently introduced legislation directed at banning excessive surcharging. These processes, and their relationship to the matters considered by the committee have been noted and have informed this inquiry.

Overview of interchange fees, merchant fees and surcharges

6.5 Interchange fees are one of three sources of revenue for credit card providers. Credit card fees and interest charges make up the other two. The RBA explained how interchange fees work in its submission. Put simply, an interchange fee is charged by the financial institution on one side of a payment transaction to the financial

institution on the other side of the transaction. Typically, a credit card transaction will involve four parties: the cardholder, the card-issuing financial institution ('issuer'), the merchant's financial institution ('acquirer'), and the merchant. In most cases, the interchange fee is paid by the acquirer to the issuer.[1]

6.6 While interchange fees are collected by banks, they are set by credit card issuing institutions (Visa and MasterCard) according to categories of transaction within a schedule of interchange rates.[2] For card schemes subject to RBA regulation, interchange rates cannot exceed a weighted average of 0.5 per cent. However, the specific rates applying to each transaction will depend on factors including: the type of merchant (with larger 'strategic' merchants often receiving discounts); the type of card (with premium, high-feature rewards cards typically attracting higher interchange fees); the nature of the transaction (whether it is SecureCode, contactless, and so on); and the value of the transaction. Individual interchange rates can range from around 0.2 per cent for transactions with large 'strategic' merchants to 2 per cent for transactions using the highest level of premium card. Transactions with 'strategic' merchants will typically attract relatively low interchange fees regardless of the type of card used, whereas for transactions with merchants not deemed 'strategic' (usually smaller merchants) the use of premium cards will generally attract higher interchange fees.[3]

6.7 MasterCard told the committee that the interchange fee 'pays for fraud losses and fraud preventions; it pays for the 55-day interest-free period immediately after the cardholder makes a purchase; and, importantly, it pays for the credit loss when a transaction goes bad'.[4] The RBA noted that interchange fees are also used to finance rewards programs.[5]

6.8 There is a direct relationship between interchange fees and surcharging on credit card transactions. To cover interchange fees paid to a cardholder's financial institution by the merchant's financial institution, the merchant's financial institution will impose a fee on the merchant. The merchant is then able to recoup the cost of the merchant fee by imposing a surcharge on customers who use a credit card.

6.9 Rather than impose a surcharge, a majority of merchants prefer to 'absorb' the cost of merchant fees, although this cost is arguably passed on to all customers in the

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1 Reserve Bank of Australia, *Submission 20*, p. 11. For a more detailed explanation, see Reserve Bank of Australia, *Review of Card Payments Regulation: Issues Paper* (March 2015), pp. 6-8.

2 Reserve Bank of Australia, *Submission 20*, p. 12. As explained later in this chapter, while interchange fees are not applied in three-party card schemes such as American Express and Diner's Club, interchange-like fees do apply for American Express companion cards, but these fees are not currently regulated by the RBA.

3 Reserve Bank of Australia, *Submission 20*, p. 7.

4 Mr David Masters, Head of Public Policy, Asia Pacific, MasterCard, *Proof Committee Hansard*, 22 September 2015, p. 46.

5 Reserve Bank of Australia, *Submission 20*, p. 12.

form of higher prices, regardless of whether they use a credit card or not. In this sense, while interchange fees are interbank fees, the cost is passed through the system to the merchant and may in turn be passed on to the consumer, either in the form of surcharges or higher prices.

Designated and regulated payment systems

6.10 The RBA is empowered to 'designate' and regulate payment schemes under the *Payment Systems (Regulation) Act 1998*, and has a mandate to 'promote efficiency and competition in payments systems consistent with the overall stability of the financial system'. Consistent with this mandate, the RBA's Payment Systems Board (PSB) regulates card payment schemes in relation to matters such as interchange fees, surcharging and scheme access.[6]

6.11 The RBA designated the MasterCard and Visa payment schemes in April 2001, and, as explained in the next section, both schemes have been subject to interchange and other regulations since 2003. Three-party systems—most notably American Express and Diners' Club, but also China UnionPay, JCB and PayPal—are not designated (although, as noted below, American Express companion cards have recently been designated).

6.12 The committee heard testimony that the inconsistency in the regulatory treatment of the systems has undermined the competitive neutrality of Australia's payments system. This inconsistency is in part due to historical factors. When first regulated, Visa and MasterCard were both operated as member associations of banks, and the RBA was concerned that access arrangements 'were more restrictive than necessary to ensure the stability of those systems'.[7] However, as the RBA explained in a 2014 paper on payment card Access Regimes:

> The environment has now changed significantly. Most importantly, MasterCard and Visa have now both changed corporate structure to become publicly listed companies rather than member associations of banks. This suggests that the schemes are likely to be more open to new types of participation, while the emergence of new business models is creating stronger interest in direct membership.[8]

6.13 On 15 October 2015, the RBA designated the American Express companion card system. As the RBA explained in its accompanying media release, designation does not impose regulation, but rather is 'the first of a number of steps the Bank must take to exercise any of its regulatory powers'.[9]

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6 Dr Malcolm Edey, Assistant Governor, Financial System, Reserve Bank of Australia, *Proof Committee Hansard*, 27 August 2015, p. 10.

7 Reserve Bank of Australia, *Submission 20*, p. 7.

8 Reserve Bank of Australia, *Payment Card Access Regimes: Conclusions* (March 2014), p. 1.

9 Reserve Bank of Australia, ' Review of Card Payments Regulation: Designation of Payment Systems', 15 October 2015, http://www.rba.gov.au/media-releases/2015/mr-15-19.html.

6.14 The question of competitive neutrality in the regulation of the payments system, specifically as it applies to interchange fee regulation, is considered later in this chapter.

Payment systems reform in the early 2000s

6.15 Starting in 2003, the RBA introduced a series of reforms aimed at improving the efficiency and competition in the Australian card payments system. These reforms included the regulation of interchange fees for designated card schemes. In order to reduce interchange fees on these schemes, the RBA set the abovementioned standard which provides that interchange fees cannot exceed a weighted average of 50 basis points. The reforms also enabled merchants to apply surcharges on card transactions 'so that cardholders were more likely to face prices that reflected the cost of the card they were using'.[10] The RBA also took steps to improve access to the scheme by entities wishing to issue cards or provide card payment services to merchants.[11] In a submission to a 2007–08 Payment Systems Board review of the reforms, the RBA concluded that the reforms had improved transparency and led to more appropriate price signals to consumers.[12]

6.16 CHOICE noted in its submission that as a result of the 2003 reforms, average interchange fees for MasterCard and Visa were reduced from an average of 0.95 per cent to 0.5 per cent. According to CHOICE, this has 'had a predictable flow-on effect to merchant service fees which have reduced, on average, from 1.44% for MasterCard or Visa transactions in March 2003 to 0.84% now'.[13]

6.17 As discussed below, a number of witnesses argued that the 2003 reforms had only served to increase the costs and decrease the benefits of credit cards, without any corresponding decline in consumer prices.

Views on interchange fees

6.18 In its submission, the RBA argued that interchange payments, along with the loyalty programs they finance, ultimately 'increase the costs of payments for merchants and accordingly drive up the final prices of goods and services for all consumers, including for consumers who do not use credit cards'.[14] The RBA pointed out that competition in payment card networks can actually have the effect of driving interchange fees higher:

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10 Reserve Bank of Australia, *Submission 20*, p. 12.

11 Reserve Bank of Australia, *Submission 20*, p. 2; Reserve Bank of Australia, *Review of Card Payments Regulation: Issues Paper* (March 2015), p. 5.

12 Reserve Bank of Australia, *Submission 20*, p. 8.

13 CHOICE, *Submission 10* (supplementary), p. 2.

14 Reserve Bank of Australia, *Submission 20*, p. 12.

> Where the market structure is such that there are two payment networks whose cards are accepted very widely (i.e. merchants accept cards from both networks), and where consumers may hold one network's card but not necessarily both, competition tends to involve offering incentives for a consumer to hold and use a particular network's cards (loyalty or rewards programs, typically). A network that increases the interchange fee paid by the merchant's bank to the cardholder's bank enables the cardholder's bank to pay more generous incentives, and can increase use of its cards. However, the competitive response from the other network is to increase the interchange rates applicable to its cards.[15]

6.19 CHOICE claimed that this dynamic is the reason card schemes have been pushing for higher interchange fees. It explained:

> There is pressure for interchange fees to increase as card schemes compete for banks to issue their brand of card. The higher the interchange rate, the more attractive it is for a bank to issue a certain scheme's card.[16]

6.20 CHOICE argued that lower interchange fees would result in lower merchant fees, and ultimately lower costs to the consumers, even if these cost reductions were too small to directly observe.[17] In summarising its position, CHOICE wrote:

> The interchange debate is about who pays for our payments system. Do we want a high-cost payment system with some of the funds going towards 'special' features like rewards points that only high-spending customers can benefit from? Or do we want a lower-cost system that will reduce costs for all merchants and should lead to lower costs for consumers across the economy?[18]

6.21 CHOICE acknowledged that reduced interchange fees would likely result in a reduction in the value of rewards programs. However, CHOICE suggested that this was not in itself a bad thing: rewards programs, although overwhelmingly operating to benefit higher income earners, were in effect paid for by all consumers because the costs of higher interchange were passed through the system to the consumer.[19]

6.22 Both MasterCard and Visa were critical of the current limits on interchange fees, and argued strongly against any further lowering of those limits on the basis this would increase costs to credit card customers in the form of higher fees and interest

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15 Reserve Bank of Australia, *Submission 20*, pp. 11–12.

16 CHOICE, *Submission 10* (supplementary), p. 1.

17 CHOICE, *Submission 10* (supplementary), p. 4.

18 CHOICE, *Submission 10* (supplementary), p. 8.

19 CHOICE, *Submission 10* (supplementary), p. 6.

charges.[20] It is important to emphasise here that while Visa and MasterCard set interchange fees (in reference to the RBA's weighted average standard) they advise that they do not earn revenue on the fees. However, both companies have a strong interest in how the fees are set because they have a bearing on the extent to which their schemes are used. MasterCard explained:

> If interchange is set too low, as it is in Australia frankly, the economics of the system are broken and issuers find other ways to recover the costs of issuing cards. If it is set too high, retailers and businesses simply would not accept our products. So our interest is in getting the level right so that it is not too high and not too low, but is set at the correct level so that the payment system here in Australia can operate as efficiently as others around the world, and do so in a way that ensures consumers are protected from increased fees—and effectively paying for the value that merchants receive.[21]

6.23 MasterCard contended that the RBA's regulatory intervention in 2003 had broken 'what was until then an efficient value chain'. MasterCard added that this had created economic pressure through the system, including on interest rates, and had not reduced consumer prices as the RBA and others had claimed.[22] It argued for the removal of interchange regulation, or failing that, redefining the RBA's remit so that it was required to 'look at any future regulation through the lens of the consumer, which it is not required to do in its remit today'. As discussed further below, MasterCard also suggested that if interchange regulation was not removed, then it should at least apply equally to all card schemes, including American Express.[23]

6.24 Mr Zinn argued that there was no evidence or research 'to show that the merchants have passed on any benefit from having a lower interchange fee where that has been regulated'.[24] The Australian Taxpayers' Alliance (ATA) pointed to three reasons the lower merchant service fees resulting from lower interchange fees were not passed through to consumers:

> Firstly, there might be resale markets which are just not very competitive. Secondly, the amounts we are talking about here might be so small that they do not shift the pricepoints. If something is priced at $9.99, a very marginal reduction in the cost might not be enough to justify shifting to another pricepoint. Finally, for a large and increasing share of transactions, cards

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20 Mr David Masters, Head of Public Policy, Asia Pacific, MasterCard, *Proof Committee Hansard*, 22 September 2015, pp. 49, 54; Mr Stephen Karpin, Group Country Manager, Australia, New Zealand and South Pacific, Visa Inc, *Proof Committee Hansard*, 16 October 2015, p. 71.

21 CHOICE, *Submission 10* (supplementary), p. 47.

22 Mr David Masters, Head of Public Policy, Asia Pacific, MasterCard, *Proof Committee Hansard*, 22 September 2015, p. 47.

23 Mr David Masters, Head of Public Policy, Asia Pacific, MasterCard, *Proof Committee Hansard*, 22 September 2015, p. 47.

24 Mr Christopher Zinn, private capacity, *Proof Committee Hansard*, 27 August 2015, p. 49.

> are cheaper than cash. Given that there is a regulatory—or, often, a customary—requirement to take cash, the pricing, in order to avoid a loss for retailers, may be to the cash cost rather than the card cost. Therefore, changes in the card cost do not lead to reductions in prices.[25]

6.25 Visa argued that if interchange regulation was maintained, then the weighted average approach—which allows for a range of interchange rates to be set—should be maintained, rather than any move toward a flat rate. It added that the weighted average should not be set any lower. The flexibility of the current rate model, Visa argued:

> …provides for a greater range of product choice for cardholders and it also presents the flexibility to foster better merchant acceptance, expanding electronic payment acceptance, enhancing security of payments and accepting credit from those who might otherwise not get access to it in the event that interchange were lower.[26]

6.26 The Australian Payments Clearing Association (APCA) also argued against reducing the overall level of interchange fees:

> Australia has low interchange fees compared to other developed credit card markets, such as those in North America. Further, APCA believes the Australian payments industry is exhibiting high levels of competition and innovation, with the rapid uptake of contactless payments and the introduction of new mobile-based and online payment offerings. Drastic change to the economics of retail payments runs the risk of disrupting existing market dynamics and innovation, with costs ultimately borne by cardholders and merchants.[27]

6.27 A joint submission from ATA and the International Alliance for Electronic Payments (IAEP) suggested that the interchange fees are 'the subject of increasingly stringent regulation that is restricting the development of the credit card market and harming consumer welfare'. The ATA and IAEP claimed that interchange fees deliver significant benefits to merchants, in the form of increased sales, a guarantee of payment, and a shifting of credit risk to financial institutions. These benefits, they argued, are reduced by regulation. The ATA and IAEP characterised the RBA's regulation of interchange fees as an unjustifiable 'interference in a functioning market'. If interchange fees were subject to lower limits, the ATA and IAEP argued, this would lead to increased interest rates and fees, and reduced interest-free periods. Smaller card providers would also have 'reduced capacity to offer low-cost cards'.[28]

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25 Mr Matthew Sinclair, Advisor, Australian Taxpayers' Alliance, *Proof Committee Hansard*, 16 October 2015, pp. 36-37.

26 Mr Stephen Karpin, Group Country Manager, Australia, New Zealand and South Pacific, Visa Inc, *Proof Committee Hansard*, 16 October 2015, p. 69.

27 Australian Payments Clearing Association, *Submission 22*, p. 1.

28 Australian Taxpayers' Alliance & the International Alliance for Electronic Payments, *Submission 8*, p. 2.

6.28 COBA argued against any changes that would lower the limit on interchange fees, and asserted this would reduce the capacity of smaller card issuers to offer low-rate cards. In the event interchange limits were lowered, COBA wrote that card issuers would 'be forced to absorb the reduction in income or recover it from card holders in the form of higher rates or higher fees'.[29]

6.29 CHOICE conceded that it was 'difficult to accurately assess the claims that fees will rise and that low interest cards will not be able to be provided if interchange is lowered'. However, it observed that low-rate cards remained available in foreign markets where interchange fees had been lowered. More broadly, CHOICE concluded that it was 'spurious to suggest that reducing interchange is somehow going to create new costs for consumers; the costs already exist, they are simply submerged in business-to-business transactions over which consumers have little visibility or opportunity to respond'.[30]

Competitive neutrality and interchange fees

6.30 While interchange fees in designated four-party schemes (MasterCard and Visa) are subject to regulation by the RBA, three-party schemes (most notably American Express and Diners Club) are not subject to interchange regulation.[31] The FSI Interim Report explained that in three-party schemes, the scheme takes the role of acquirer and issuer. As 'no interchange fees are involved, these schemes are not covered by interchange regulation'.[32] However, three-party scheme companion cards, which are typically operated through the American Express scheme and issued by banks, operate much like four-party schemes, and the service fees that companion card schemes pay to issuers are economically equivalent to interchange fees in four-party payment schemes.[33] Despite the existence of interchange-like fees, American Express companion cards are not currently subject to interchange regulation, although as noted earlier the system was designated on 15 October 2015.[34]

6.31 The RBA noted in its recent Consultation Paper on card payments regulation (discussed later in this chapter) that critics of current regulatory settings—most notably, Visa and MasterCard—have argued that the different regulatory treatment of three- and four-party schemes has 'contributed to the issuance of American Express companion cards and an increase in the market share of three-party schemes over the

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29 Customer Owned Banking Association, *Submission 19*, p. 10.

30 CHOICE, *Submission 10* (supplementary), p. 8.

31 MasterCard, *Submission 2* (attachment 4), p. 3.

32 The Treasury, *Financial System Inquiry: Interim Report* (July 2014), section 2, p. 26.

33 The Treasury, *Financial System Inquiry: Interim Report* (July 2014), section 2, p. 26.

34 Reserve Bank of Australia, media release, 'Review of Card Payments Regulation: Designation of Payment Systems', 15 October 2015, http://www.rba.gov.au/media-releases/2015/mr-15-19.html.

past decade'.[35] According to the RBA, most merchants also support bringing companion cards into the regulatory system. In contrast, American Express and some companion card issuers:

> …argued that fee arrangements for companion cards were negotiated bilaterally and therefore were of a different nature to multilateral interchange fees, so should remain outside the regulatory framework. More generally, it was argued that concerns about 'competitive neutrality' had been overstated because American Express had a much smaller share of the cards market than the two largest four-party card schemes; and because American Express cards are not considered 'must take' cards by many merchants, and/or are more often subject to a surcharge.[36]

6.32 The views reported in the RBA's recent consultation paper align with the evidence received by the committee on this subject. American Express's 'strong view' was that American Express branded cards should not be subject to interchange fee regulation.[37] In contrast, MasterCard argued that if interchange regulation was not removed (something it argued for) then the regulations should at least apply equally to all schemes, including American Express.[38] Mr David Masters, a representative of MasterCard, explained the company's concerns regarding the apparent lack of neutrality in the application of interchange regulation:

> The great frustration for me is that the absence of American Express being included in the regulation has meant that reward points are higher on those products because their version of interchange within the GNS business [Global Network Services—that is, American Express companion cards] is higher than ours, which effectively means you have this perverse scenario in Australia where the most expensive card for a retailer to accept is the card that a cardholder is virtually incentivised to pay with. That is broken regulation.[39]

6.33 Like MasterCard, Visa argued for a level regulatory playing field:

> As a consequence of American Express sitting outside the current regulatory environment, we are seeing consumers pay more surcharging at

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35 Reserve Bank of Australia, *Review of Card Payments Regulation: Consultation Paper* (December 2015), p. 9.

36 Reserve Bank of Australia, *Review of Card Payments Regulation: Consultation Paper* (December 2015), p. 10.

37 Ms Luisa Megale, Vice President Asia, International Public Affairs and Communications, American Express, *Proof Committee Hansard*, 22 September 2015, p. 41.

38 Mr David Masters, Head of Public Policy, Asia Pacific, MasterCard, *Proof Committee Hansard*, 22 September 2015, p. 47.

39 Mr David Masters, Head of Public Policy, Asia Pacific, MasterCard, *Proof Committee Hansard*, 22 September 2015, p. 48.

> the checkout and a substantial growth of Amex market share since the regulatory imbalance in their favour eventuated in 2003.[40]

6.34 Visa added that American Express companion cards were a four-party model analogous to Visa and MasterCard cards. American Express had grown its market share significantly in recent years, and this growth was largely attributable to the current regulatory imbalance in the market.[41]

Views on surcharging

6.35 As noted above, merchants have some ability to recoup the cost of merchant fees through credit card surcharges. The RBA argued that the ability to surcharge 'is important to promote efficiency in the payment system and is also a means by which merchants can exert some downward pressure on the cost of payments'. However, like several other witnesses, the RBA noted its concern that some firms in particular industries may be surcharging excessively, and indicated that the matter was part of its current review of the Card Payments Regulation (which is discussed further below).[42]

6.36 MasterCard called the effect of surcharging on consumers 'abhorrent'.[43] Visa indicated that its preference was for surcharging to be banned. In the event it was not banned, Visa recommended that there should be 'clear limits related to cost recovery only, backed with the enforcement of a government agency'.[44]

6.37 American Express referred to surcharging as a 'tax on payment at point of sale', and contended that surcharges had 'done absolutely nothing to benefit consumer outcomes'.[45] While surcharging is justified as a way for merchants to recoup the cost of accepting a credit card payment, a range of witnesses noted that merchants also enjoyed substantial benefits by being able to use credit cards. Referring to the specific example of the hotel industry, where surcharging is common, American Express observed:

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40 Mr Stephen Karpin, Group Country Manager, Australia, New Zealand and South Pacific, Visa Inc, *Proof Committee Hansard*, 16 October 2015, p. 69.

41 Mr Stephen Karpin, Group Country Manager, Australia, New Zealand and South Pacific, Visa Inc, *Proof Committee Hansard*, 16 October 2015, p. 70.

42 Reserve Bank of Australia, *Submission 20*, p. 14.

43 Mr David Masters, Head of Public Policy, Asia Pacific, MasterCard, *Proof Committee Hansard*, 22 September 2015, p. 48.

44 Mr Stephen Karpin, Group Country Manager, Australia, New Zealand and South Pacific, Visa Inc, *Proof Committee Hansard*, 16 October 2015, p. 69.

45 Ms Luisa Megale, Vice President Asia, International Public Affairs and Communications, American Express, *Proof Committee Hansard*, 22 September 2015, p. 40.

> Hotels would not survive without taking that swipe [on a credit card] up-front as a security against you trashing their room or skipping out in the middle of the night. So they get a huge benefit from a credit card.[46]

Airline credit card surcharges and fees

6.38 Critics of surcharges often focus on surcharging in specific industries, and the Australian airline industry has been the subject of particularly strong criticism in this regard. Qantas imposes a flat credit card surcharge 'as a means of recovering a substantial part of its cost of card acceptance'. According to Qantas, Jetstar does not levy credit card surcharges, but rather a 'Booking and Service Fee' which is 'not linked to the cost of card acceptance'.[47] Virgin Australia charges a 'Booking and Service Fee' for bookings made using a credit card, debit card or PayPal. It claims the fee 'covers a range of costs, activities, fees and charges in relation to the booking, including (among other things) the reasonable costs of accepting card payments'.[48]

6.39 Mr Klaus Bartosch, who has led an online campaign and petition against airline credit card surcharges, presented evidence to the committee that he claimed showed the airlines were 'profiteering' on credit card surcharges. He argued for an outright ban rather than a legislated cap on surcharges.[49]

6.40 Qantas claimed that it recovers only 81 per cent of its reasonable cost of card acceptance, as defined by the RBA, through its card surcharges. Qantas stressed that the costs of accepting credit cards went 'beyond merchant service fees, which vary between card types, and include people costs, processing costs, infrastructure, equipment, fraud, fraud prevention and other measures'. Qantas also noted that it offers passengers a range of other booking options that enable them to avoid paying the surcharge.[50]

6.41 Qantas advised that it charged a flat credit card surcharge, as opposed to a percentage of the purchase price, because of the administrative simplicity of the approach and the increased transparency it provider to customers. Qantas also indicated that while merchant service fees were percentage based, other costs involved in processing credit card payments were fixed.[51]

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46 Ms Luisa Megale, Vice President Asia, International Public Affairs and Communications, American Express, *Proof Committee Hansard*, 22 September 2015, p. 45.

47 Qantas, *Submission 32*, p. 2. For fees, see http://www.qantas.com.au/travel/airlines/schedule-of-fees/au/en.

48 For fees, see Virgin Australia, http://www.virginaustralia.com/au/en/plan/fees-surcharges/.

49 Mr Michael Michael, private capacity, *Proof Committee Hansard*, 11 September 2015, pp. 1–3.

50 Mr Andrew James Parker, Group Executive, Government and International Affairs, Qantas Airways Ltd, *Proof Committee Hansard*, 11 September 2015, pp. 8–9.

51 Mr Andrew James Parker, Group Executive, Government and International Affairs, Qantas Airways Ltd, *Proof Committee Hansard*, 11 September 2015, p. 9.

6.42 Similarly, Virgin Australia maintained that its use of a flat fee reflected the fact that its card processing costs were both fixed and variable, and, moreover, that a flat fee is the 'simplest and easiest mechanism for consumers to understand and also for the company to administer'. Virgin Australia also advised the committee that the revenue collected through its 'Booking and Service Fee' was less than the cost of accepting card payments.[52]

Financial System Inquiry and government response

6.43 Interchange fees and surcharging were addressed in the FSI, and as discussed further below, the government has accepted the recommendation made in the FSI Final Report on these matters. Specifically, the FSI Final Report made the following recommendation (recommendation 17) in relation to interchange fees and customer surcharging:

> Improve interchange fee regulation by clarifying thresholds for when they apply, broadening the range of fees and payments they apply to, and lowering interchange fees.
>
> Improve surcharging regulation by expanding its application and ensuring customers using lower-cost payment methods cannot be over-surcharged by allowing more prescriptive limits on surcharging.[53]

6.44 On the issue of surcharging limits, the FSI Final Report suggested that:

> …the current reasonable cost surcharge rules are difficult for system providers to enforce, potentially complex for merchants to comply with and can cause frustration for consumers, as evidenced by the more than 5,000 submissions the Inquiry received on the matter. The rules are complex because each merchant needs to calculate its acceptance costs, which can involve subjective judgements about a number of factors. The rules are difficult to enforce because system providers have limited visibility of these calculations.[54]

6.45 On 20 October 2015, the government released its response to the FSI Final Report. In relation to the recommendation on interchange fees and surcharging, it stated:

> We will increase the efficiency of the payments system and ensure it achieves fairer outcomes for consumers, merchants and system providers by phasing in a legislated ban on excessive card surcharges. The ACCC will be responsible for enforcing these rules.
>
> The Payments System Board will pursue policies to address problems with interchange fees and provide clarity around what constitutes excessive

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52 Mr Adam Thatcher, General Counsel, Group Executive Corporate Risk, Virgin Australia Airlines Pty Ltd, *Proof Committee Hansard*, 11 September 2015, p. 18.

53 The Treasury, *Financial System Inquiry: Final Report* (November 2014), p. xxiv.

54 The Treasury, *Financial System Inquiry: Final Report* (November 2014), p. 175.

> customer surcharges on card payments. The Payments System Board released a consultation paper on these issues in March.[55]

6.46 The government further indicated that it expected the Payment Systems Board to complete its work on interchange fees and customer surcharging by mid-2016 (the Payment System Board's review is outlined below).[56]

Competition and Consumer Amendment (Payment Surcharges) Bill 2015

6.47 On 3 December 2015, the government introduced the *Competition and Consumer Amendment (Payment Surcharges) Bill 2015* into the Parliament. Consistent with the commitment given by the government in its response to the FSI Final Report, the bill will:

> …establish a legislative and regulatory framework to ban surcharges imposed in respect of particular payment methods that exceed the cost of acceptance for those payment methods. The amendments will apply to excessive surcharges in respect of payments covered by a Reserve Bank standard or by regulations made for this purpose. Surcharges will be excessive where they exceed the permitted amount specified in the Reserve Bank standards or in the regulations.
>
> The amendments also ensure that the Australian Competition and Consumer Commission (ACCC) is the primary enforcement agency for the ban and that it has appropriate powers of enforcement.[57]

6.48 As explained below, the RBA's consultation paper, released on the same day as the bill sets out a draft standard on surcharging.

Reserve Bank of Australia Review of Card Payments Regulation

6.49 In March 2015, the RBA commenced a review of Card Payments Regulation in response to the FSI Final Report's discussion and recommendations regarding the payments system. An Issues Paper was released in March, followed by a consultation process. The review considered:

- the decline in transparency for some end users of the card systems, in part due to the increased complexity and the wider range of interchange fee categories;
- whether there is scope for interchange fees to fall further, consistent with falls in overall resource costs and as was contemplated in the conclusions to the 2007–08 Review; and

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55 Australian Government, *Improving Australia's Financial System: Government response to the Financial System Inquiry* (2015), p. 6.

56 Australian Government, *Improving Australia's Financial System: Government response to the Financial System Inquiry* (2015), p. 16.

57 Explanatory Memorandum, *Competition and Consumer Amendment (Payment Surcharges) Bill 2015*, p. 3.

- widespread perceptions that card surcharges remain excessive in certain industries.[58]

6.50 On 3 December, the RBA released a Consultation Paper, which sets out the preliminary views of the RBA and new draft standards in relation to the regulation of surcharges on card payments and interchange payments in card systems. The RBA has invited written submissions on its Consultation Paper by 3 February 2016, and has indicated that it does not expect the Board will make any formal decision on changes to interchange standards before its May 2016 meeting. However, the RBA suggests it may be a position to make an earlier decision in relation to the surcharging standards.[59] The RBA's preliminary views and the draft standards are summarised below.

Interchange limits

6.51 As noted above, interchange fees vary widely, with transactions with larger 'strategic' merchants often subject to significant discounts. Higher interchange fees have a corresponding effect on fees levied on merchants by their financial institution. As the RBA explained in its submission, 'the cost of the high interchange rates on premium or commercial cards falls entirely on small merchants and other merchants that do not benefit from special rates.[60]

6.52 The RBA has not proposed any change to the current system of weighted-average interchange benchmark of 50 basis points. However, it does propose supplementing the benchmark with caps on individual interchange fees, and proposes that no credit card interchange fee be able to exceed 0.8 per cent. These changes, it suggests, 'are expected to significantly reduce the extent to which small and medium-sized merchants are disadvantaged relative to a group of preferred merchants in the MasterCard and Visa interchange systems'.[61]

Competitive neutrality

6.53 The RBA raised the issue of competitive neutrality in its Issues Paper, and in the subsequent consultation process heard arguments both for and against extending the current regulatory framework to include bank-issued companion cards. In its Consultation Paper, the RBA has proposed modifying the credit card interchange standard so that the issuance of American Express companion cards will be subject to

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58 Reserve Bank of Australia, *Review of Card Payments Regulation – Issues Paper* (March 2015), http://www.rba.gov.au/payments-system/reforms/review-of-card-payments-regulation/review-of-card-payments-regulation-issues-paper.html.

59 Reserve Bank of Australia, media release, 3 December 2015, http://www.rba.gov.au/media-releases/2015/mr-15-24.html.

60 Reserve Bank of Australia, *Submission 20*, p. 13.

61 Reserve Bank of Australia, media release, 3 December 2015, http://www.rba.gov.au/media-releases/2015/mr-15-24.html.

the same interchange fee regulation that applies to the MasterCard and Visa schemes.[62]

Surcharging

6.54 The RBA consultation paper reiterated the RBA's view that the ability of merchants to levy surcharges was 'an important mechanism for promoting the efficient allocation of resources in the payments system'. However, it noted that:

> …in a small number of cases in particular industries, surcharge levels on some transactions appear to be well in excess of the merchants' likely acceptance costs. This is particularly evident for certain lower-value transactions on which fixed-rate surcharges are levied, as in the airline industry.[63]

6.55 The RBA's preliminary view, as expressed in the Consultation Paper, was that the system would be improved by:

> …moving away from a limit on surcharges based on 'the reasonable cost of acceptance' to one based on fees paid by a merchant to its acquirer (or payment facilitator), and obliging the provision to merchants of information on average acceptance costs for each system. This will be accompanied by the Government's amendments to the *Competition and Consumer Act 2010*, which will ban excessive surcharging and provide enforcement powers to the ACCC.[64]

6.56 The RBA has further suggested that the information provided by banks to merchants on card acceptance costs should be expressed in percentage terms, unless the cost for a particular payment method was genuinely fixed for all transaction values. This, it argued, 'should eliminate the practice—currently common in the airline industry—of charging the same dollar surcharge on transactions with very different costs to the merchant'.[65]

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62 Reserve Bank of Australia, media release, 3 December 2015, http://www.rba.gov.au/media-releases/2015/mr-15-24.html. As noted earlier, the RBA designated the American Express companion card system on 15 October 2015.

63 Reserve Bank of Australia, *Review of Card Payments Regulation: Consultation Paper* (December 2015), p. 8.

64 Reserve Bank of Australia, *Review of Card Payments Regulation: Consultation Paper* (December 2015), p. 37.

65 Reserve Bank of Australia, *Review of Card Payments Regulation: Consultation Paper* (December 2015), pp. 33-34.

Committee view

6.57 One of the committee's primary concerns in relation to interchange fees is the lack of transparency in how they are levied and, in turn, how the costs are passed through to merchants and consumers. The committee therefore welcomes the RBA's consideration in its current review of the regulatory framework for card payments on 'the decline in transparency for some end users of the card systems'. It is the committee's view that its own inquiry, and in particular the contributions made by witnesses on both sides of the debate, has greatly helped bring the complex subject of interchange fees more clearly into public view. The committee notes that the regulation of interchange fees is a matter that affects almost all Australian merchants and consumers, and it would encourage interested organisations and members of the public to engage with the RBA in its current review process.

6.58 On the more specific question of whether interchange fees are too high, too low, or indeed whether they need to be regulated at all, the committee notes that there are strong arguments on both sides of the debate. This by no means should be taken to suggest that the committee considers all arguments in this debate are of equal merit. The committee considers that the optimal regulatory response is likely to be one which carefully balances the role interchange revenues play in supporting the provision of credit card products, and the need for regulatory limits on those fees to improve efficiency and equity outcomes in the payments system. On a very preliminary reading, the committee considers the draft standards suggested in the RBA's Consultation Paper appear to achieve this balance.

6.59 With regard to the credit card surcharges imposed by Australian airlines, the committee acknowledges that the airlines claim that they under-recover their credit card processing costs through their surcharges and other booking fees. However, the committee does not consider that the surcharge costs are fairly or appropriately shared across the airlines' customer base. In particular, the committee considers the application of a flat surcharge unjustifiably disadvantages consumers purchasing less expensive tickets, and contends that there is no justification for multiplying the surcharge for several tickets when payment is made using a single card transaction. The committee welcomes the government's recent moves to introduce a legislative ban on excessive surcharging. The committee is particularly encouraged by the related proposed changes to the RBA's standards on surcharging, which the RBA has suggested will help ensure airlines and other merchants no longer apply flat credit card surcharges or fees.

6.60 Finally, the committee notes that the RBA is responsible for payments regulation under the *Payments Systems (Regulation) Act 1998*, but given the RBA's independence, legislators do not have a direct influence on its regulatory decisions about the payments system. The committee would appreciate an additional perspective about the value and competitive neutrality of payments regulations, and recommends that the government consider a Productivity Commission inquiry into regulation of the payments system, with a particular focus on interchange fees.

Recommendation 11

6.61 The committee recommends that the government consider a Productivity Commission inquiry into the value and competitive neutrality of payments regulations, with a particular focus on interchange fees.

Senator Chris Ketter

Chair

Additional Comments by Coalition Senators

1.1 Coalition Senators wish to thank all those who participated to this inquiry and in particular the Committee Secretariat for producing such a thorough report on an important issue. While the majority report includes a number of sound recommendations, we would like to make additional comments to complement these outcomes.

1.2 The Government has already commenced addressing some of the 11 recommendations by implementing actions as a result of the Financial System Inquiry, including addressing interchange fees and customer surcharging. The Government has moved to legislate a ban on surcharges that exceed the 'reasonable costs' faced by merchants in accepting cards.

1.3 The Government announced in its 2015–16 Budget earlier this year a pilot financial inclusion action plan for vulnerable individuals as part of Australia's G20 commitments.

1.4 However, in considering the most appropriate responses to the problems of ensuring an appropriate regulatory regime for credit cards a number of considerations are important.

1.5 First, the evidence presented to the inquiry shows that the vast majority of Australians use their credit cards responsibly and the proportion of individuals using their credit cards for long term debt is small. Evidence provided during the hearings indicated that low income earners generally managed their credit cards well.

1.6 Given this, the most effective regulatory response will address the problems of misuse of credit cards while not imposing wider costs across the economy and society.

1.7 As part of its red tape reduction agenda the Government has committed to an ongoing process of reducing the cost of unnecessary or inefficient regulation imposed on individuals, business and community organisations. In addressing the very real problems identified for some credit card users we need to ensure that the regulatory approaches adopted are 'fit for purpose' and targeted.

1.8 Credit cards are not in essence an amortising financial tool. They are a revolving line of credit that helps households manage cash flows. As such they are both important and complementary to other financial products available to consumers.

1.9 Consideration must be given to ensuring credit limits are tailored to each client's circumstances. The Committee heard that the model used in the United Kingdom assesses credit card applicants against more stringent requirements and includes a minimum repayment formula that sees repayments calculated on the basis of interest, fees and 1% of the principle. Coalition senators feel this deserves further research as an option in Australia.

1.10 Second, elements of recommendation 3, while having merit in their intent at least, appear to be unduly prescriptive and likely to stifle beneficial innovation and growth by firms seeking to meet market needs for more information.

1.11 Third, recommendation 4, which relates to mechanisms to facilitate switching in the credit card market and account number portability, which have been previously examined in Australia and elsewhere at times with adverse findings, does however bear further investigation in our view. Account number portability offers, at least in theory, significant consumer benefits through the encouragement of competition, as evidenced by similar measures implemented in the mobile telephone market. On that basis we feel the concept is deserving of further inquiry.

Senator Sean Edwards
Economics Committee Deputy Chair

Senator Matthew Canavan
Committee Member

Additional comments by Senator Nick Xenophon

Are the banks having a lend of us on credit cards?

1.1 Mr Ross Greenwood, Business and Finance Editor, Nine Network, hits the nail on the head when he describes a system where 'some of the poorest and most vulnerable in our community subsidise the wealthiest in our community'.[1] The system adopted by credit card providers has in practice provided more benefits to those who are well off and has often come at a heavy price for those who are less well off.

1.2 The Committee heard that for some, quite possibly those who grew up with positive financial role modelling and those fortunate enough to receive some level of financial education, paying down the complete outstanding balance on a credit card at the end of each month results in a useful and often free service. As Mr Greenwood states 'a good customer pays nothing for their credit card'[2] and is also rewarded with points or other benefits associated with the loyalty schemes of their providers.

1.3 Sadly for many Australians, this is not the case. Mr Greenwood also described the plight of those at the other end of the spectrum:

> If you go to the Insolvency and Trustee Service Australia, which records part X bankruptcies and also broad bankruptcies in Australia, what it has found over a period of time is that those people most prone to bankruptcy in Australia are males under the age of 28, at an amount of less than $5,000. It is credit card debt. What happens is that those people—males under the age of 28, and increasingly females as well—for amounts of less than $5,000, are now mostly going to part X, so they are going into schemes as distinct from going bankrupt, but they are subsidising…people who pay off our credit card balances each month.
>
> …
>
> [T]he point is that the person who is suddenly in that position—who gets the offer through the mail and whose car has just broken down but who has to go to work—in the real world has to say, 'I've got to fix the car; I've got to put new tyres on the car; I've got to do whatever I do.' It is sheer desperation.[3]

1.4 The Committee heard of the practices adopted by banks that employ behavioural science techniques to target 'the perfect credit card customer…somebody

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1 Mr Ross Greenwood, Business and Finance Editor, Nine Network, *Proof Committee Hansard*, 27 August 2015, p. 37.

2 Mr Ross Greenwood, Business and Finance Editor, Nine Network, *Proof Committee Hansard*, 27 August 2015, p. 37.

3 Mr Ross Greenwood, Business and Finance Editor, Nine Network, *Proof Committee Hansard*, 27 August 2015, p. 37.

who is responsible enough to pay off the interest but too indebted to ever pay off the principal'.[4]

1.5 Mr David Koch, Finance Editor, Seven Network, highlighted the predatory behaviour of banks, informing the Committee that 'the stats say you are more likely to get divorced than you are to change banks'.[5] With this knowledge, banks entice new customers with interest free periods at a loss, knowing that once the customer is reeled in, they will potentially stay with the bank for life.

1.6 I commend the Committee for acknowledging, in Recommendation 6 of the report, the need to apply credit card lending on the basis of the borrower's ability to repay the debt. The committee heard, at a public hearing on 26 August 2015, of the relative ease and necessity of differential lending rates:

> **Senator XENOPHON**: I have a question to David Koch. You talk about lower interest rates for the good risks. Firstly, how easy would it be, with algorithms, to objectively rate the risk and set the rate? Secondly, is the flip side of that higher interest rates for bad risks, or should those bad risks not have the same access to credit cards or at all?
>
> **Mr Koch**: The information is readily available on every single Australian through their credit report and their credit score. It means a financial institution would actually have to treat a credit card customer as an individual to make a decision, rather than one of five million customers—'You've all got to pay the same rate and we're just going to hose out increases in credit card limits because that is what we get rewarded for internally: the more customers that borrow more, the bigger the profits are going to be.' Getting that information to build a risk-based pricing system is pretty easy these days. If an insurance company can do it with your premiums, your own bank can, which has your own financial life on the screen in front of them. But it means you are going to have to focus. This is why I believe that there should be no unsolicited credit cards or increases in limits. When a customer comes to you and says, 'I would like a credit card,' they have made a decision and you have got to make, as a financial institution, an individual decision based on that customer. I think then we start to get a bit of a marrying of the minds.
>
> **Senator XENOPHON**: So it is not so hard.[6]

1.7 Mr Koch aptly states that a credit card is a 'dream merchant'[7]—they offer easy money, enticing and enabling Australians to spend beyond their means. Is this responsible lending?

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4 Mr Ross Greenwood, Business and Finance Editor, Nine Network, *Proof Committee Hansard*, 27 August 2015, p. 37.

5 Mr David Koch, Finance Editor, Seven Network, *Proof Committee Hansard*, 27 August 2015, p. 38.

6 *Proof Committee Hansard*, 27 August 2015, p. 52.

7 Mr David Koch, Finance Editor, Seven Network, *Proof Committee Hansard*, 27 August 2015, p. 39.

1.8 Mr Paul Clitheroe, Chairman, Money Magazine, acknowledges that:

> …credit cards are a wonderful thing (and) lower fees and charges are great but at the end of the day we as a community of people need to say that the big institutions have all the marketing power and the poor little consumer wants all of this stuff and has no idea of the consequences.[8]

1.9 Institutions seem to be getting a disproportionate amount of revenue from credit cards used by those who can least afford it and rewarding those that never pay a cent of interest with loyalty program points.

1.10 Mr Alan Kirkland, Chief Executive Officer, CHOICE, informed the Committee that:

> …the evidence from the caseworker organisations is that although a lot of disadvantaged people end up with long-term debt that is not the intention when they first engage with credit cards; it is just that it turns into long-term debt because they are given too high a credit-limit increase that builds up over time. They are not sent the signals, through their statements, that alert them to the risk early in the interactions with their credit card account. If we can protect people at the front end then we can stop that, what is overwhelmingly short-term debt initially, turning into long-term debt.[9]

1.11 I am encouraged by the report recommendations to increase product disclosure and transparency, greater provision of consumer credit card usage data on statements and contacting consumers and discussing the suitability of their credit card. However more can be done.

1.12 Mr Koch and Mr Greenwood suggest consumer warnings, such as those found in gambling venues and on cigarette packaging. Mr Christopher Zinn, a consumer advocate suggests calling credit cards 'debt cards', 'because frankly that is what they are'.[10]

1.13 I call for greater scrutiny of the ethical behaviour of our lending institutions. Rather than using manipulative techniques to groom consumers to become dependent on debt, institutions should be held responsible.

1.14 It is essential for the sake of millions of Australian consumers that the recommendations contained in the Committee's report be acted upon as soon as possible.

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8 Mr Paul Clitheroe, Chairman, Money Magazine, *Proof Committee Hansard*, 27 August 2015, p. 43.

9 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Proof Committee Hansard*, 27 August 2015, p. 56.

10 Mr Paul Clitheroe, Chairman, Money Magazine, *Proof Committee Hansard*, 27 August 2015, p. 46.

Recommendation 1

1.15 Consideration should be given, in conjunction with consumer groups and experts, to providing appropriate warnings on credit card statements and credit card advertisements.

Nick Xenophon

Independent Senator for South Australia

Appendix 1
Submissions received

1. Mr Peter Mair
2. MasterCard
3. Ms Melissa Ellis
4. St Vincent De Paul Society
5. Good Shepherd Australia New Zealand
6. Australian Retailers Association
7. bankmecu
8. Australian Taxpayers' Alliance & the International Alliance for Electronic Payments
9. National Retail Association
10. CHOICE
11. Confidential
12. Consumer Credit Legal Service WA
13. Consumer Action Law Centre and Financial Rights Legal Centre
14. Independent ATM Industry Group (IAIG)
15. Australian Bankers' Association
16. ASIC
17. The Treasury
18. National Australia Bank (NAB)
19. Customer Owned Banking Association
20. Reserve Bank of Australia
21. Westpac Group
22. Australian Payments Clearing Association (APCA)
23. Commonwealth Bank of Australia (CBA)
24. Australian Finance Conference (AFC)
25. Financial Counselling Australia
26. Business Council of Co-operatives and Mutuals (BCCM)
27. ANZ
28. Mr Christopher Zinn
29. Uniting Communities
30. Confidential
31. Mozo
32. Qantas
33. Mr Joel Gibson
34. Mr Klaus Bartosch
35. Confidential
36. Name Withheld
37. Mr Jeff Leddin

Appendix 2

Public hearings and witnesses

Sydney, 27 August 2015

BANTON, Mr Les, Private capacity
BRENNAN, Mr Pat, General Manager, Policy Development, Australian Prudential Regulation Authority
CLITHEROE, Mr Paul, Chairman, Money Magazine
EDEY, Dr Malcolm, Assistant Governor, Financial System, Reserve Bank of Australia
FLOOD, Mr Darren, Deputy Head, Payments Policy Department, Reserve Bank of Australia
GREENWOOD, Mr Ross, Business and Finance Editor, Nine Network
KIRKLAND, Mr Alan, Chief Executive Officer, CHOICE
KOCH, Mr David, Finance Editor, Seven Network
LANE, Ms Katherine, Principal Solicitor, Financial Rights Legal Centre
MAGUIRE, Ms Fiona, Senior Specialist, Australian Securities and Investments Commission
MINHINNICK, Ms Marianna, Financial Counsellor, Financial Rights Legal Centre
RICHARDS, Dr Anthony, Head, Payments Policy Department, Reserve Bank of Australia
RICHARDS, Ms Heidi, General Manager, Industry Analysis, Australian Prudential Regulation Authority
SAADAT, Mr Michael, Senior Executive Leader, Australian Securities and Investments Commission
TURNER, Ms Erin, Campaigns Manager, CHOICE
ZINN, Mr Christopher, Private capacity

Melbourne, 3 September 2015

BOYD, Ms Denise, Director of Policy and Campaigns, Consumer Action Law Centre
CORRIE, Ms Tanya Louise, Development Lead, Financial Security Specialist, Good Shepherd Australia New Zealand
LAWLER, Mr Luke, Head of Public Affairs, Customer Owned Banking Association
MUTTON, Ms Pam, Financial Counsellor, Bentleigh Bayside Community Health

PAPE, Mr Scott, Private capacity

TEMPLE, Ms Katherine, Senior Policy Officer, Consumer Action Law Centre

VALADKHANI, Professor Abbas, Department of Accounting, Economics and Law, Swinbourne University of Technology

YARDLEY, Mr John, Chief Operating Officer, Bank Australia

Canberra, 22 September 2015

GAMBLE, Mr Rohan, Managing Director, Mozo

GREGSON, Mr Scott, Executive General Manager Consumer Enforcement, Australian Competition and Consumer Commission

MASTERS, Mr David, Head of Public Policy, Asia Pacific, MasterCard

MEGALE, Ms Luisa, Vice President Asia, International Public Affairs and Communications, American Express

MICKENBECKER, Mr Stephen Henry, Group Executive, Ratings and Financial Services,

CANSTAR Pty Ltd

PEARSON, Mr Anthony, Chief Economist and Executive Director, Industry Policy, Australian Bankers' Association

POWER, Mr Trevor, Principal Adviser, Financial Systems and Services Division,

Department of the Treasury

STOCKS, Mrs Rachel, Managing Director, American Express Australia Ltd

SWIERINGA, Dr John, Senior Advisor, Macroeconomic Modelling and Policy Division, Department of the Treasury

SYMONS, Mr Matt, Chief Executive Officer and Co-founder, SocietyOne Australia Pty Ltd

TATE, Ms Diane, Executive Director, Retail Policy, Australian Bankers' Association

WILLCOCK, Mr Michael, Acting Deputy Secretary, Markets Group, Department of the Treasury

Sydney, 16 October 2015

BENTON, Mr Stephen Roy, Head, Consumer Finance and Emerging Businesses, Westpac Group

BERRY, Mr Duncan, Chief Executive Officer, GE Capital Australia & New Zealand

BON, Ms Vicki, Manager, Government and Industry Relations, Coles

CAHILL, Mr Antony James, Group Executive, Product and Markets, National Australia Bank

COBB, Ms Rachel, Managing Director, Consumer, GE Capital Australia & New Zealand

COMYN, Mr Matthew, Group Executive, Retail Banking Services, Commonwealth Bank of Australia

GIBSON, Mr Joel, Campaign Director, One Big Switch

GILFILLAN, Mr Angus, Executive General Manager, Consumer Lending, National Australia Bank

HODGES, Mr Graham, Deputy Chief Executive Officer, ANZ

KARPIN, Mr Stephen, Group Country Manager, Australia, New Zealand and South Pacific, Visa Inc

KOHNE, Mr Marco, Head of Customer Management and Strategy, ANZ

LANE, Mr Aaron, Spokesman, Australian Taxpayers' Alliance

LINDBERG, Mr David Robert, Chief Executive, Commercial and Business Bank, Westpac Group

POTTS, Professor Jason, Academic Fellow, Australian Taxpayers' Alliance

SINCLAIR, Mr Matthew, Advisor, Australian Taxpayers' Alliance

SULLIVAN, Mr Angus, Executive General Manager, Retail Products and Strategy, Commonwealth Bank of Australia

WORMALD, Mr Richard, General Manager, Coles Financial Services, Coles

Canberra, 9 November 2015

BAKUNOWICZ, Mr Peter, General Manager, Financial Services, Qantas Loyalty, Qantas Airways Ltd

BARTOSCH, Mr Klaus Michael, Private capacity

FINCH, Mr Andrew John, General Counsel and Company Secretary, Qantas Airways Ltd

HOFFMAN, Miss Kerri Anne, General Manager, Corporate Transactions, Virgin Australia Airlines

ORSZACZKY, Mr David, Head of Sales and Commercial Planning, Qantas Airways Ltd

PARKER, Mr Andrew James, Group Executive, Government and International Affairs, Qantas Airways Ltd

SCHUSTER, Mr Karl Josef, Chief Executive Officer, Velocity Frequent Flyer Pty Ltd
STOKES, Mr Anthony, General Manager, Revenue Management, Virgin Australia Airlines Pty Ltd
THATCHER, Mr Adam, General Counsel, Group Executive Corporate Risk, Virgin Australia Airlines Pty Ltd