Regulation Impact Statement: Fairer, Simpler Banking – Credit Card Reforms

Background

During the 2010 election campaign, the Government announced the *Fairer, Simpler Banking* election commitment. The Policy proposed a range of reforms in relation to credit card practices. The changes were aimed at improving fairness and consistency in the way fees and interest are charged, give consumers more say over credit card products, and improving disclosures to help them understand credit card products better.

Summary

There are two key problems for consumers who access credit through the use of credit cards:

- They have become a significant source of consumer indebtedness where borrowers carry high balances at relatively high interest rates for significant periods of time. For example, if a consumer has drawn down $10,000 on a card with an interest rate of 20 per cent, and can only afford to meet repayments of $200 per month, it will take them over 9 years to repay the debt.

- Particular features of the product make it difficult for consumers to make the most efficient use of these products (both in making an initial selection between competing products) and in their subsequent use.

It is proposed to address these problems by:

- requiring credit card providers to allocate repayments to that part of the consumer's debt which is incurring the higher interest charges;

- requiring credit card providers to calculate the way in which interest is charged in accordance with statutory requirements that allow consumers to compare the cost of competing products more easily;

- requiring credit card providers to include a clear summary of key features of the proposed product on their credit card application forms;

- requiring credit card providers to effectively inform consumers of the implications of only making the minimum repayments on their credit card accounts;

- prohibiting credit card providers from charging borrowers fees for exceeding their maximum limit except where the consumer has specifically elected to exceed their limit, and has agreed the lender can charge a fee should this occur;

- prohibiting credit card providers from making unsolicited offers to consumers to increase their credit limit, except where the borrower has specifically agreed the credit provider can send them such offers;
- requiring lenders, as part of their responsible lending obligations, to ask consumers to nominate their credit limit (as part of the inquiries lenders make to determine the extent of the consumer's need for credit); and
- requiring lenders to assess the amount of credit provided according to the capacity of borrowers to repay that credit within a reasonable period (as currently the only requirement is to assess the capacity of the borrower to meet the minimum repayments due under the contract.

It is expected that these measures will assist consumers by:

- increasing their capacity to select products or use their credit cards that reduces the level of fees and interest they are charged (for example, the NAB has already publicly stated that their reforms to credit cards will save borrowers $225 million annually);
- reducing the risk of consumers being provided with credit cards limits (either on application or through subsequent increases) where they may be unable to pay the total balance within a relatively short period of time.

It is considered these measures will have the following impact on lenders who provide credit cards:

- They will incur significant compliance costs, given that some of the measures (such as changes to the way in which interest is charged) may require substantial changes to their systems.
- They may face reduced revenue from credit card products, and seek to address this through introducing other fees or increasing interest rates. However, to the extent that consumers can make more informed choices upfront they will also be under greater pressure to be competitive.

Election commitment 1 – consumers are not charged over-limit fees unless they specifically agree that their account can go over the limit

This election commitment provides that credit card accounts will not be able to be drawn over their maximum limit unless the consumer specifically agrees to opt-in to the service.

Credit card providers generally allow accounts to go over their maximum limit and then the borrower is subject to an over-limit fee. While consumers can opt out, this is not well known and is often not made clear. Over-limit fees can be around $20-$25 if you exceed your maximum limit. Allowing consumers to opt-in rather than opt-out will mean they can avoid exceeding their credit limit and will be able to avoid over-limit fees.

As this proposal is an election commitment, other alternatives are not considered.

Problem identification

Some customers do not realise that banks may extend credit beyond their agreed credit limit, and are then charged a fee for doing so. This practice poses two problems. Firstly, card issuers are providing more credit than has previously been agreed with the customer. This may lead to consumers taking out more debt than anticipate on the mistaken belief that the credit would not be extended once they reach their credit limit. The 2008 ANZ Survey of Adult Financial Literacy in Australia, found that only 6 per cent of people take steps to not exceed limits on credit cards. This does not mean that the remainder borrow beyond their limit, as most users do not go near their credit limit. However it does demonstrate that only a small percentage of people carefully manage their credit to avoid going over their limit.

Secondly, cardholders are may be charged an overlimit exception fee even if they exceed their limit by a small amount. This adds an additional impost on those consumers who are under the greatest financial pressure.

Objective of election commitment

This election commitment has two primary objectives. By limiting the extent to which people can go over their specified credit limit, cardholders can limit their debt exposure, giving them more control over their debt. The second objective is to limit the cardholder's exposure to the overlimit exception fee.

Implementation Options:

Option	Impact on Consumers	Impact on Credit Providers
1. Impose a hard limit This option would prohibit lenders from authorising transactions that would take consumers over the credit limit specified in their credit contract.	Consumers would not be able to take out more credit for emergency purposes. This may cause consumers some discontent if they are declined for transactions that would only slightly take them above their specified credit limit.	
2. Allow a buffer This option will allow lenders to authorise transactions so that consumers will go over their limit, however this will be limited.	Consumers would still be able to take out credit beyond their credit limit up to a pre-determined limit. This would avoid consumer dissatisfaction if they are only slightly over their limit	Allows lenders to authorise transactions that may be over the limit.
3. Prohibit a fee for consumers obtaining credit in excess of the limit. Lenders will not be able to charge a fee to consumers who exceed their credit limit.	Consumers would be better off by not having to pay the fee (currently free to $20)	Credit providers will lose the ability to charge this fee. One major bank has already abolished this fee.
4. Require lenders to notify	Consumers would be better off by being advised of when they	There will be a cost to credit providers if they are required to

consumers Lenders will be required to notify consumers once they exceed their credit limit.	exceed their limit, and how they can address it.	notify consumers.

These options are not mutually exclusive. It is proposed to adopt options two, three and four. Under the proposed regime, consumers will be given a buffer of the lesser of 10 per cent or $500 in which the lender has discretion to authorise the transaction. This will avoid consumer dissatisfaction by having transactions that would take them only slightly over their specified limit declined.

In some cases consumers may not know that they have exceeded their specified limit. Therefore it is also proposed that consumers would not be charged a fee for going over their specified limit. This will benefit consumers of lenders who current charge such a fee. In addition, it is proposed to require lenders to take reasonable steps to notify consumers once their specified credit limit is reached and advise consumers of actions they may take to address this.

Impact Analysis

The election commitment addresses both problems identified in this chapter by limiting the extent that accounts to go beyond their approved credit limit and abolishing over-limit fees.

Impact on Consumers

Consumers will not unwittingly obtain much more debt than they had previous been approved. This option will allow consumers more control over their debts as they will not be able to access more debt than they had previously sought and agreed. Consumers will be advised when they reach their specified credit limit, informing them of their liabilities so they can take prompt action to address the situation. In addition, consumers will not be charged a fee for exceeding their credit limit.

Impact on Credit Card Issuers

The option to allow consumers to not go over their limits is currently offered by many credit card lenders, however there is currently no limit to which the specified limit can be exceeded. Lenders will only be able to lend amounts in accordance with the specified buffer.

A prohibition on overlimit fees will reduce revenue from those fees. In 2009 banks received $470 million[1] from total exception fees[2]. In 2009, the NAB[3] abolished its overlimit fee and with most other banks substantially reducing this fee from around $30 to $10.

[1] Many institutions reduced or removed over-limit exemption fees in late 2009. Some reduction in fees is likely to be reflected in the exception fee income for 2009, though it is likely that figures for 2010 will also be affected.

[2] Exception fees are may be charged when there are insufficient available funds to cover a transaction, resulting in a dishonour or approval to overdraw, credit card payments are late, or credit card limits are exceeded. Data obtained does not break down the total fees into those categories.

Consultation

Generally, consumer advocates view the ability for consumers to spend beyond their approved limits as inconsistent with responsible lending and support this element of the reforms. A common complaint received by their clients who have taken on more debt than they can handle is why they were allowed so much credit beyond their credit limit. The provision of a buffer with suitable constraints, and the absence of any fees, is accepted as an appropriate method of addressing this.

Credit card issuers were generally opposed to imposing a limit saying that the service allows consumers to manage their accounts with minimal fuss. The option is currently available to customers, but the take-up has been low. They prefer the option of a buffer which is largely consistent with existing industry practices.

Election commitment 2 – credit card providers must allocate repayments to higher interest debts first

A single credit card contract can contain a number of different interest rates, such as on promotional purchases, balance transfers, cash advances and standard purchases. Consumers may be unaware that, in many cases, their repayments are used to pay off balances attracting the lowest charges first, leaving other balances unpaid and accruing higher interest.

It is difficult for consumers to work out from the fine print how repayments are allocated, which makes it hard to compare different products and work out exactly what the charges will be on an account. Ensuring repayments are allocated to higher interest balances first will ensure consumers are not caught out and have to pay more interest than they expected.

As this proposal is an election commitment, other alternatives are not considered.

Problem identification

Credit card contracts can allow for the imposition of different interest rates for different liabilities such as balance transfers, purchases and cash advances. Currently, it is standard practice for card issuers to allocate repayments to the balances attracting the lowest interest rate first, leaving the higher interest balance unpaid for longer and attract more interest charges.

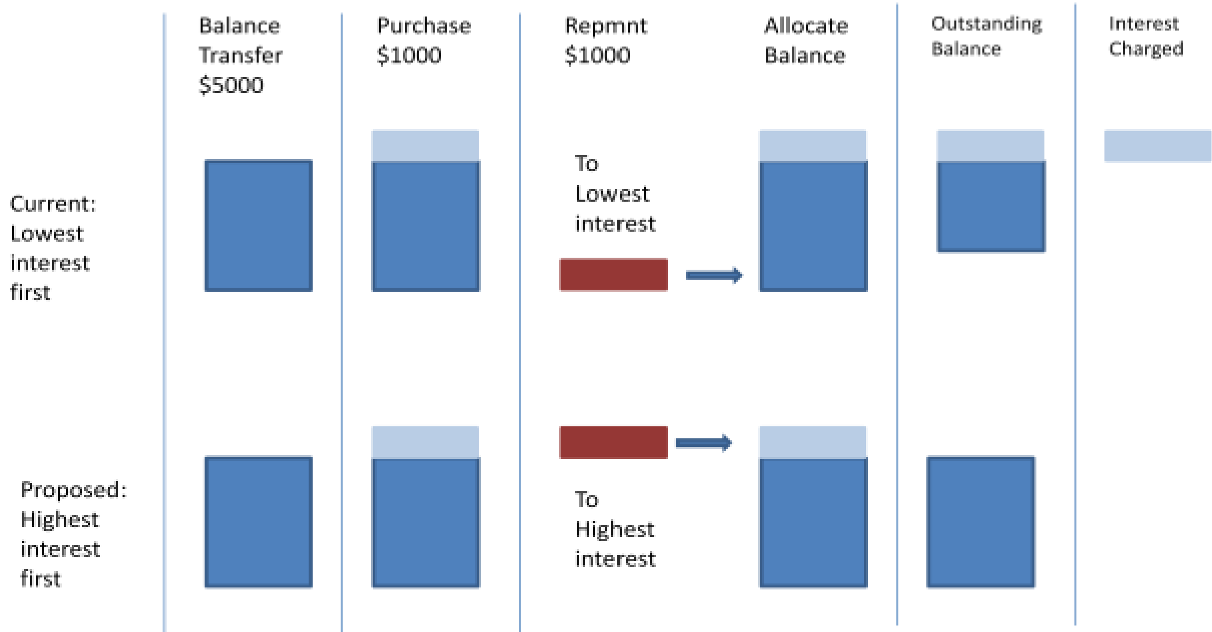
This is an issue for consumers who take on debt cash advances. For example, a credit card debt of $3000 comprising $1000 of cash advances (charged at a rate of 21.5 per cent) and $2000 of purchases (at a rate of 13.5 per cent). If the cardholder repaid $200 a month and that money was applied first to the purchases, the interest charged would be about $425 over the year. However, if the repayments were allocated to the cash advance and that was cleared first, the interest over the year would be $326, a saving of about $99 for the year.

Similarly, consumers who take out no or low interest balance transfers are often negatively impacted by the allocation of repayments. For example, a customer who takes out a $2,000 balance transfer (at a rate of 3 per cent) and then makes purchases of $1,000 (at a rate of 18 per cent- for simplicity assume no interest free period). If the consumer makes a repayment

[3] The NAB has around 12 per cent of credit cards in Australia. NAB is the only major lender to abolish this fee.

of $1,000 in the beginning of the next month, and that was applied to the lowest interest first, the interest charged for that month would be $17.50. However if it were applied to the purchase first, the interest would be $5 for that month, as saving of $12.50.The following diagram shows the difference between allocating repayments to the lowest interest first, compared with highest interest first.

Figure 1 – How the allocation of repayments can impact on the interest charged.



The method for calculating interest charges and allocating repayments is inconsistent across credit card products. However, the existing policies of most lenders maximise interest charges, often at the expense of the credit card user.

It is likely, due to these varying practices, changes in contractual arrangements over the life of a credit contract, most consumers do not know or are confused about how repayments are allocated to accounts where different interest rates apply. In a survey conducted as part of the Review of the Regulation of Credit and Store Cards undertaken by the UK Government, the allocation of repayments was considered to be the most important issue.[4]

While these practices are often disclosed under the terms and conditions of the credit contract, it is often difficult for consumers to understand the implications of how repayments are allocated, which makes it hard to compare different products and work out exactly what the charges will be on an account.

Objective of election commitment

The objective of this election commitment is to promote competition by applying a single standard way of applying repayments allocated to credit card accounts across the industry.

[4] 37% of consultation respondents to an online poll considered allocation of repayments the most important issue, second was minimum repayments at 20%.

Impact Analysis

This election commitment will result in repayments being allocated to higher interest bearing debts first. This addresses the problem identified in this chapter by adopting a single industry-wide approach to adopting repayments. It applies repayments to the debts the consumer would want them applied to, and therefore minimises the interest paid by the consumer. It would also minimise the impact of more expensive cash advances, by clearing those debts first, and maximise the benefit of cheaper balance transfers, by clearing those debts last.

Provision is to be made for consumers to consumers to be able to alter these arrangements on specific request (for example, where they want to pay off a purchase that is interest free for a specified period, prior to that debt accruing interest).

Impact on Consumers

Consumers with different interest bearing balances will pay less interest by being able to reduce higher interest bearing balances first. Consumers will be able to take maximum advantage of balance transfers. Consumers who take out cash withdrawals would be able to pay them off first, incurring less interest.

Impact on Credit Card Issuers

As higher interest balances will be lower (as repayments are allocated to them first) and therefore, interest charges will be lower, which will impact on revenue. As balance transfers may become less profitable, credit providers may be less willing to offer them or the attractiveness of the promotions may change. To implement this measure, lenders will also need to update their systems for allocating repayments. Business practices that will need to change and an estimate on compliance costs associated with those changes for all elements of the proposals are considered in a separate section before the conclusion.

One major bank has already adopted this approach. The NAB has announced that it will apply this approach to repayments for its customers from 14 January 2011. They estimate that if the rest of the industry adopted the same approach, Australians would save around $225 million a year in fees and interest. Competitive pressures may see all banks move in this direction.

Consultation

Generally, community groups and legal centres support this measure, as addressing an area where consumers have little awareness of the method of calculation, and where they can be disadvantaged. Others see the current practice as a way card issuers maximise profits at the expense of consumers.

Some credit card lenders and banks maintain that such policies are appropriately disclosed and any changes would stifle competition and innovation in the industry, as well as impose additional costs in moving to a new regime. They contend that this reform would reduce the availability of balance transfer offers and lead to the commoditisation of credit card offers where there is little to differentiate between products.

Election commitment 3 – interest charges are applied consistently under an industry-agreed standard, including when interest starts to accrue and on what balances

Credit providers can apply interest in various ways. There is no industry standard on how interest is calculated and charged on credit card balances. Therefore, the actual interest paid on some credit products can vary greatly even if the interest rate is stated as being the same. This is because credit issuers have different approaches in the way they apply interest, such as when interest starts accruing and balances on which it accrues. Addressing this will enable consumers to better compare interest rates on products, and identify the product that most suits their spending habits and financial circumstances.

As this proposal is an election commitment, other alternatives are not considered.

Problem identification

There are many variables that contribute to the amount of interest charged to a credit card account. The multitude of variables makes it difficult for consumers to compare one product with another.

Variables such as the interest rate and the number of interest free days are generally visible and commonly advertised. However, some other variables such as how repayments are allocated, the time and balance on which the interest applies also affect interest charges but their impacts are not transparent to the consumer. Even when disclosed to the consumer, their complex nature makes them difficult to compare products.

Such variables include:

- The date from which interest applies – some issuers apply interest from the purchase date while others apply interest from the date the statement is issued. This difference can be up to 30 days. The longer the period that interest is applied, the greater the interest charged.

- The balance on which the interest applies – some issuers apply interest to the purchase balance while others apply the interest only to the unpaid balance. Giving credit to amounts already paid off will reduce the interest charged.

The following table shows the impact each variable can have on the interest applied to a credit card account.

Table 1 – Impact of variable methods of calculating interest

Issue	Assumptions	Variable	Interest
Timing of Interest	Interest rate of 20% Purchase of $1,000 made on 2 March Balance due date of 15 April	From Purchase date (2 March)	$24
		From Statement date (2 April)	$7
Balance on which interest applies	Interest applied from statement date Repayment of $800 made before interest is applied	On full balance	$7
		On partial balance	$1

The multitude of conditions and variables make it difficult for consumers to understand different consumer credit contracts. The detriment to cardholders is that they may pay more than they otherwise would if they fully understood the implications of all these variables, by either adapting their behaviour to minimise charges, or moving to other credit products more suited to their behaviour.

Also some of the variables may not be concurrent but may be excluded by disclaimers which may not be prominent enough for the consumer to be informed. For example, a 55 days interest free on purchases may be excluded where there is an outstanding balance transfer.

These differences not only disguise the true cost of credit and also make it difficult for credit card users to compare the true cost of credit products. Choice has a history of campaigning on credit card issues.[5] In August 2010, they reviewed the terms of 22 cards. Despite applying the same interest rate of 16 per cent, different credit card interest calculation methods meant the actual interest paid ranged from 9.9 per cent to 45.0 per cent. The comparison conducted by Choice showed at least 10 different billing methods being used by card providers.

Experiences of Choice members include one who underpaid their balance but was charged interest on the full balance "In one instance I underpaid by $1 – I keyed an incorrect figure – and the interest was nearly $10". Others have complained about how interest is backdated to previous purchases.[6]

[5] Choice as published articles on this specific issue in October 2006 (Card Games), January 2010 (Which Credit Card for You), May 2010 (Low Interest, High Anxiety) and August 2010 (Stings in the Tail).

Objective of election commitment

The objective of this election commitment is to promote comparability and competitiveness across credit card products and providers. An implementation objective is to balance those issues with the costs imposed on businesses.

The method of implementing this proposal is still the subject of consultation, so that the election commitment will be implemented through regulations rather than the Act itself.

Election commitment 4 – unsolicited credit limit extension offers are not allowed unless the consumer has agreed to the service

While credit card limit increases can only occur at the request of the consumer, credit providers are allowed to make unsolicited credit limit offers. Preventing these offers, unless the consumer has given permission, will mean consumers can choose whether or not they receive offers for more credit.

As this proposal is an election commitment, other alternatives are not considered.

Problem identification

Unsolicited credit limit increase (UCLI) offers or invitations allow consumers to obtain more credit easily. Under the responsible lending obligations, an offer for a credit limit extension can only be made where the increase has been assessed as not unsuitable. While assessments may conclude that a limit extension is not unsuitable (based on the consumers ability to service the minimum repayments), access to greater debt may place some consumers into a debt that they cannot repay or can only repay after incurring significant costs.

Consumer advocates view UCLI offers as causing significant consumer detriment including overcommitment leading to bankruptcy and loss of the family home, significant stress, harassment from debt collectors, and court proceedings leading to further stress.[7] In a case study provided by Legal Aid Queensland, one pensioner couple had a $5,000 credit card limit increase over a series of UCLI offers to $43,500, despite being on a pension and having no increase in income.

National Legal Aid commented that their casework experience was that UCLI offers have caused significant financial stress for many disadvantaged consumers. Given their social and economic situation, they are more likely to accept an offer for more credit to meet immediate financial needs without considering the long-term consequences.

A survey conducted by the Australia Institute found that 41 per cent of respondents earning less than $40,000 had received an unsolicited credit card extension limit offer. In addition 40.8 per cent of respondents not in paid work had received an offer to increase a credit card limit.[8]

A 2008 Consumer Action Law Centre report *Congratulations, You're Pre-Approved!* suggested that the way in which banks and credit providers present UCLI offers can be

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[7] Responses to Consumer Credit Phase 2 Green Paper.

[8] Money and Power, The Case for better regulation in banking, The Australia Institute submission to Green Paper, Page 18

designed to persuade, encourage, or convince customers to take up a credit card limit increase, often against their better interests or without evaluating the consequences. It found that UCLI were ‘low involvement’ means of attaining more credit as they do not require the customer to provide extensive information or evidence as required upon application. Therefore the customer does not fully appreciate the impact the additional debt would have on their finances, and may accept the increase and use it as a relatively high cost source of credit.

The report is consistent with a study undertaken by AC Neilson and ANZ bank in 2005, which acknowledged the lender’s role in influencing a person’s decision to take on more debt.[9] The majority of people in the study had received unsolicited credit limit increase offers and around half had accepted them. Acceptance was underpinned by a perception that “it must be okay” because the lender had sent it out. Such offers have been attributed to consumers increasing their debt levels.[10]

Responsible lending obligations under the Credit Act now apply to the assessment of applications for increases in credit limits resulting from these types of offers; credit card providers need to consider whether an increase in credit limit meets the consumer’s requirements or objectives However, these obligations do not specifically address this issue. Lenders can still provide an increase where the application has been encouraged by the lender through an UCLI offer. Lenders only need to consider whether the increase meets the consumer’s needs rather than being the best or optimal method of meeting them, and can therefore provide an increase notwithstanding that either cheaper forms of credit would also meet the consumer’s needs or that maintaining the existing limit reduces the risk of the consumer incurring interest charges for an extended period.

In addition the Office of the Privacy Commissioner, in their submission, expressed concern that information about customers are being inappropriately used in identifying customers who are targets of UCLI offers. Such information should be used to assess a customer’s application not for advertising or marketing purposes.

Objective of election commitment

This election commitment aims to allow consumers to have more control over their credit and debt levels by preventing cardholders from being sent offers to increase their credit limits without their consent. A further objective is to allow lenders to provide credit marketing services to borrowers wish to receive and can afford to repay them.

Impact Analysis

This election commitment addresses the problem identified in this chapter by preventing UCLI offers being sent to consumers unless they have specifically agreed to this service. Any consumer wishing to increase their credit limit would need to approach the lender, not the other way around.

[9] ACNielson, ANZ, Understanding Personal Debt and Financial Difficulty in Australia, Nov 2005, p4

[10] Congratulations, You’re Pre-Approved! Consumer Action Law Centre 2008.

Impact on Consumers

Consumers have more control over how much they borrow. Consumers do not receive offers that they do not want and may not afford. Consumers who would usually take advantage of this offer and use credit responsibly, will now need to approach the bank themselves to change the credit limit, when they have themselves determined they need a higher limit.

Impact on credit card issuers

Credit card issues will save on direct marketing costs. Credit card issues may adopt other more different marketing techniques to 'sell' more credit. The impact on lender's revenue is unquantifiable but is expected to be low. Consumers who require a higher credit limit are likely to actively seek it.

Consumers who may not necessarily require a higher credit limit and accept the higher limit based on the offer may not seek it and therefore the lender may have a reduction in the growth of their credit card balances. However, to the extent that these consumers are taking on credit that they do not need, it may be desirable to limit this element of growth. The number or proportion of CLI acceptances by people not actively seeking a higher credit limit is unquantifiable.

Consultation

Community groups and legal centres are strongly in favour of prohibiting unsolicited credit limit extension offers. They view UCLI offers as the cause of significant consumer detriment including over-commitment, stress, harassment and court enforcement proceedings. They view terminology used in those offers, such as "pre-approved", give consumers the perception that they are entitled and can afford the increased limits.

Credit card lenders and banks maintain that additional regulation is not necessary as they apply their own credit scoring systems to filter out customers for whom unsolicited credit limit extension offers are inappropriate. Because of these credit scoring procedures, lenders view that UCLI offers can be made responsibly and are a function of customer service by anticipating the changing or future needs of consumers.

Election commitment 5 – consumers are given more say over nominating their own credit limit, subject to responsible lending obligations

Giving consumers more say in setting credit limits will give them more power over their own debt management practices and will safeguard them against card issuers granting credit in excess of that requested by them.

This measure will be consistent with the responsible lending conduct provisions. Under these provisions, credit providers are unable to offer consumers a limit above a responsible amount.

As this proposal is an election commitment, other alternatives are not considered.

Problem identification

The new responsible lending conduct obligations require lenders to make reasonable inquiries about a borrower's needs and requirements before entering into a credit contract or increasing a credit limit. While some lenders have interpreted the new responsible lending conduct obligations to require asking an applicant their preferred credit limit, the legislation is not explicit about this requirement.

However, it is difficult to see how a lender could adequately understand the needs and requirements of the consumer, as required in providing a product that is not unsuitable, without first asking the consumer how much they are willing to borrow (even if the answer is the maximum possible). The application of this requirement to credit card contracts raises particular issues because consumers may nominate a credit limit that is quite high, in the expectation that they will be able to pay off the balance in full each month. Where this is not the case in practice the consumer will be at risk of paying relatively high interest charges. The reform therefore complements election commitments 4 and 6, and reduces the risk of borrowers having unnecessarily high credit limits.

The responsible lending conduct requirements in some cases, will require, the lender to offer a lower limit than that nominated by the consumer. It would then be up to the consumer to accept the lower amount or not accept any credit at all.

If lenders interpret the responsible lending conduct obligations as not requiring asking an applicant of how much credit they want, the lender may provide credit well in excess of that sought by the applicant. This may place some consumers into more debt than they originally want, increasing the costs of their debt.

Objective of election commitment

This election commitment aims to allow consumers control the amount of credit they take on and feel comfortable with when they apply for a credit card or a credit limit increase. A further objective is to provide additional guidance to lenders of their responsible lending conduct obligations.

Impact Analysis

The impact of introducing this election commitment would be limited as most industry participants have indicated that, as a result of the responsible lending obligations introduced in Phase One of the National Credit Reforms, they will be required to ask consumers to nominate their credit limit. The election commitment would make it a statutory requirement, which would provide more certainty to industry.

Lenders would be required to specifically as the applicant to nominate a credit limit. Responses to the Green Paper indicate that at least some lenders have interpreted the new responsible lending obligations as requiring such inquiries. There was general consensus amongst all respondents to the Green Paper, from both consumer groups and lenders, that consumers should be able to nominate credit limits when applying for credit cards. This was seen as an essential tool to help consumers manage their credit, require applicants to consider their credit needs, and complement the responsible lending obligations of lenders. This approach would not restrict credit providers from offering less credit than requested by the consumer, where, for example, the lender assessed the nominated credit limit as unsuitable.

Impact on consumers

Consumers will need to think about how much and why they are seeking credit which may lead to more financially responsible spending. Consumers will not have easy access to credit that they have not previously requested.

Impact on credit card issuers

Credit card issuers may not be able to offer as much credit to consumers as they previously did. Additional costs would be incurred in redesigning applications and updating systems to incorporate an amount requested by the consumer, however many lenders have already done so to meet existing responsible lending conduct obligations. There will be no additional revenue impacts for credit card issuers from their existing obligations under the *National Consumer Credit Protection Act 2009*.

Consultation

This election commitment had broad appeal from consumer groups and lenders. Community groups and legal centres are supportive of these requirements and see this proposal as encouraging better financial literacy and management of money. Lenders commented that this complemented and was consistent with existing approaches to responsible lending and was therefore unproblematic; they noted that the issuer would retain the right to set the limit in consultation with the applicant. A number of banks indicated that this feature had been available to their customers prior to responsible lending.

Election commitment 6 – credit card application forms include a clear summary of key account features

Information such as the amount of credit, fees and repayments must already be disclosed in credit card contracts. However, the lengthy and technical nature of most contracts means it is easy to miss important information. A summary of key features on the application form will draw important terms and conditions to the attention of consumers before they commit to credit cards.

As this proposal is an election commitment, other alternatives are not considered.

Problem identification

The National Credit Code regulates credit contracts including precontractual disclosure and the credit provider’s obligation to account. Despite these mandated disclosures, consumer groups contend that more can be done in improving disclosure to make it more accessible.

Submissions to the Green Paper have expressed the view that a consumer’s understanding of the core features of the credit product and contract is shaped by their level of financial literacy.[11] Therefore, disclosures should be made as simple and clear as possible for consumers with low levels of financial literacy. In addition disclosures should also be made at a time in the selection process that is useful for the consumer to make well informed decisions about their credit.

[11] Sheehan, G Wilson, T and Howell, N Coming to grips with credit contracts – Steps to protect vulnerable borrowers, Brotherhood of St. Laurence and Griffith University, November 2008, pp 4-5

A study by Griffith University for the Brotherhood of St Laurence focusing on vulnerable borrowers, found that the language and length of credit contracts as barriers to consumers understanding them.[12] Participants in the study said they felt overwhelmed with the amount of information and that their limited education limited their understanding of the credit contracts. The Study recommended that contracts be tailored to meet the needs and capacity of consumers such as providing a summary that would highlight key terms.

A report prepared for the Standing Committee of Officials of Consumer Affairs by Uniquest found significant gaps in consumer comprehension under existing disclosure requirements. When the Revised Disclosure Model documents were given to consumers, individuals were more likely to answer questions about key features correctly.[13] The Revised Disclosure Model is a summary of key features which refers to the credit contract for more substantive information. The improvement in comprehension of key features can be seen from the table below.

Table 3: Correct answers to individual questions for the credit card sample for participants who read CDM, PDM or RDM documents.

Question	CDM[14]	PDM[15]	RDM[16]
Interest rate on credit card	60%	80%	100%
Maximum interest rate on credit card	37%	50%	80%
Term of the loan	13%	73%	80%
Cost of late payment	70%	87%	100%

Objective of election commitment

This election commitment aims to improve consumer comprehension in two ways: first, by key features of their credit card accounts being presenting in a uniform, simple and easy to understand table on application forms; and secondly by providing this information earlier in the life cycle of the transaction (on application rather than just before entering into the contract). An implementation objective is to balance those issues with the costs imposed on businesses.

[12] Genevieve Sheehan, Therese Wilson and Nicola Howell,, Coming to Grips with Credit Contracts, Brotherhood of St Laurance

[13] O'Shea, Paul, Simplification of Disclosure Regulation for the Consumer Credit Code: Empirical Research and Redesign, UniQuest, March 2010

[14] CDM is the Current disclosure model which is the current disclosure mandated by the Code. It can be a separate document but is usually a copy of the loan contract and includes a financial table or schedule.

[15] PDM is the Proposed Disclosure Model proposed in the 2005 Uniform Consumer Credit Code Management Committee consultation package. It consists of a Financial Summary Table and a Statement of Other Information.

[16] RDM is the Redesigned Disclosure Model. It consists of a redesigned Financial Summary Table which refers to the contract schedule. It also includes a set of standard terms.

Impact Analysis

In addition the content of the pre-contractual statement will need to be considered to avoid duplication and unnecessary documentation. Key features would include the amount of credit advanced, the interest rate, and any fees or charges possible or likely to be charged. This proposal address the problem identified in this chapter by increasing consumer comprehension of key terms and conditions of their credit cards.

A Standing Committee of Officials of Consumer Affairs on precontractual disclosure recommended a redesigned disclosure model which consisted of a Financial Summary Table (otherwise known as a Schumer box). A Schumer box is a standardised disclosure box that features consistent terms and conditions for credit card offers. The aim of the Schumer box is to allow consumers to compare credit cards in a consistent manner. Specific terms and conditions are required to be spelled out for consumers when applying for credit cards.

As seen in table 3 Consumer testing found that the redesigned disclosure model was a more meaningful document for consumers in explain the cost of credit more clearly and referring to accompanying documentation when further information is sought.[17] The study found improvement in the comprehension of credit card features when presented with a summary of key information when consumers were exposed to a financial summary table.

Impact on consumers

Consumers are more likely to receive information that is relevant and understandable to them, and make more efficient choices when selecting credit cards. Any additional costs of disclosure may be passed on to consumers.

Impact on credit card issuers

Consumers will be better informed so that consumer complaints about certain features of credit cards are likely to reduce. Greater transparency may benefit those with more competitive products. Changing disclosures will require systems upgrades in redesigning communications. Business practices that will need to change and an estimate on compliance costs associated with those changes for all elements of the proposals are considered in a separate section before the conclusion.

It will also be necessary to consider some transitional arrangements, as there will be a period in which current paper application forms continue to be in circulation, after the introduction of this requirement.

Consultation

General, community groups and legal centres are strongly in favour of a short, standardised summary of terms and conditions but have noted that disclosure alone provides insufficient protection. They believe it will enable consumers to make informed financial decisions with confidence and easily compare different products to source the best product to meet their specific needs.

[17] SCOCA Simplification of Disclosure Regulation for the Consumer credit Code: Empirical Research and Redesign – Final Report, March 2010, p6

Some credit card lenders and banks maintain that additional disclosure may not be necessary or provide clear consumer benefits will simply mean financier's costs are passed onto consumers. The additional paperwork may not be well received by consumers and further disclosures may be counterproductive, particularly where they repeat information already set out in the pre-contractual statement.

Election commitment 7 – consumers are informed about the implications of only making minimum repayments on their credit card

Consumers will have to be informed of the implications of making minimum repayments on their credit card bills. Making sure consumers are made aware of the long-term implications of making minimum repayments on their credit card statements will help them manage their finances.

Such information will include the period of time to pay all the debt and the total interest payable if only minimum repayments are made. It will let consumers know how long they could expect to be indebted if they only make minimum repayments. As this proposal is an election commitment, other alternatives are not considered.

Problem identification

Only making minimum repayments considerably extends the time debt is held by the consumer and therefore the interest paid. For example, on a $1,000 debt, making minimum repayments based on a typical minimum repayment of 2 per cent of the outstanding balance, it would take over 26 years to repay that debt, at a cost of $3,102 in interest (red line in the diagram below). Making higher repayments for example, $40 a month, would reduce the time to repay to under 3 years, and the total interest cost would be $305 (the blue line in the diagram below), a saving of $2,797.

Figure 1 – Impact of making a 2 per cent repayment and $100 repayment on a $1000 balance

Table 4 – Impact of minimum repayments on repayment period and total interest

Credit type	Interest Rate	Repayment	First monthly repayment	Repayment period	Total Interest
Credit Card	20 per cent	1.5 per cent	$15	Does not pay off	Not applicable
Credit Card	20 per cent	2 per cent	$20	26 years, 5 months	$3,102
Credit Card	20 per cent	5 per cent	$40	6 years, 1 month	$446
Credit Card	20 per cent	10 per cent	$100	3 years, 2 months	$191
Credit Card	20 per cent	20 per cent	$200	7 months	$53

Some cardholders may only make the minimum repayments, because they do not appreciate fully how much this behaviour would cost them in the long term. The Financial Literacy Foundation's Australians understanding money survey of 1,500 Australians in 2007 found:

- 72 per cent of adults reported having at least one credit card;
- 20 per cent of adults fail to regularly pay off the total balance owing on credit cards; and
- 13 per cent say they usually pay only the minimum owing.

However, for low income earners (those earning less than $20,000), the percentage of people saying they only pay the minimum amount owing rose to 16.2 per cent.

The SCOCA report on Simplification of Disclosure Regulation for the Consumer Credit Code, identified minimum monthly payment on the credit limit, time to pay off the credit and the amount of interest paid on fully-drawn credit limit the least understood of all credit card features.

Table 5 – Correct answers to individual questions in relation to repayments for participants who read CDM, PDM or RDM documents.

Question	CDM[18]	PDM[19]	RDM[20]
Minimum monthly payment on credit limit	13%	17%	100%
Time to pay off the credit	13%	7%	100%
Amount of interest paid on fully-drawn credit limit	13%	70%	80%

As can be observed from the table, significant improvements in consumer's understanding of the implications of making minimum repayments where they were provided with a warning.

However, borrowers who make only minimum repayments are not the only category of credit card users likely to benefit from this disclosure. Borrowers who make partial repayments may also be motivated to pay off their credit cards faster by showing implications of making lower repayments or alternative repayment scenarios.

Objective of election commitment

Consumers are informed about the consequences of only making minimum repayments and may therefore pay off credit card debts more quickly. An implementation objective is to balance those issues with the costs imposed on businesses.

Impact Analysis

This proposal address the problem identified in this chapter by increasing giving consumers information and making them more aware of the implications of making minimum monthly repayments. The election commitment will introduce a "health warning" on monthly statements to give visible and tailored information to consumers of the implications of making minimum monthly repayments on their outstanding debt. The warning would be prominently displayed on the monthly statement and would include the time it would take the

[18] CDM is the Current disclosure model which is the current disclosure mandated by the Code. It can be a separate document but is usual a copy of the loan contract and includes a financial table or schedule.
[19] PDM is the Proposed Disclosure Model proposed in the 2005 Uniform Consumer Credit Code Management Committee consultation package. It consists of a Financial Summary Table and a Statement of Other Information.
[20] RDM is the Redesigned Disclosure Model. It consists of a redesigned Financial Summary Table which refers to the contract schedule. It also includes a set of standard terms.

for consumer to clear their current debt, assuming they make monthly minimum repayments, and the total interest payable over that period.

This would give consumers the information at the point where they are considering their repayments. While this information may be of limited value for those making full, it would assist habitual minimum payers to reconsider the implications of their repayment habits. For people who make partial repayments, it may also be of benefit by demonstrating the impact of making additional repayments (than they otherwise would) or showing how much they would need to repay to clear their debts within a certain amount of time.

The introduction of this requirement by the US Credit CARD Act of 2009 has resulted in reduced debt levels. A study conducted in July 2010 by the Consumer Reports National Research Centre showed that consumers carried about $1,100 less debt than in 2009. In addition, 23 per cent of respondents to the survey said they were motivated to pay off their credit cards faster by the Minimum Payment Warning on their bills mandated by the US Credit CARD Act of 2009[21].

Impact on consumers

Consumers will receive more information so they understand the full costs and implications of holding onto debt, and make informed decisions accordingly. However, any additional costs of disclosure may be passed on to consumers.

Impact on credit card issuers

If consumers do decide to pay off debts more quickly, they will pay less interest and profits may decline. Changing disclosures, and in particular tailoring this information to different consumers, would require significant systems upgrades. Business practices that will need to change and an estimate on compliance costs associated with those changes for all elements of the proposals are considered in a separate section before the conclusion.

Consultation

Generally, community groups and legal centres are strongly in favour of placing a warning, advising consumers about the effect of paying only minimum repayments on monthly credit card statements. Some said that the information will give customers the capacity to consider other options available to them to complete their purchases and that having such a warning would likely motivate a consumer to make extra repayments.

Credit card lenders and banks maintain this type of disclosure is of limited benefit as the number of customers making minimum repayments is small.

[21] Consumer Reports, Consumer Reports Survey Finds Credit Card Issues Improving In Wake of Credit CARD Act of 2009: But Some Perils Linger, www.consumersunion.org

Example 1 – Repayment Information Box[22]

Balance Outstanding: Your closing balance is **$1,000**

Late payment warning: If we do not receive your minimum payment by **26/8/2010**, you will be charged a late fee of **$20** in addition to any interest charges.

Minimum Payment Warning: If you make only the minimum payment each period, you will pay more interest and it will take you longer to pay off your balance. For example:

If you make no additional charges using this card and each month you pay...	You will pay off the Closing Balance shown on this statement in about ...	And you will end up paying an estimated total interest of...
Only the minimum repayment of $25	5 years, 7 months	$662
$93	1 year	$111 (saving of $551)

If you would like information about credit counselling services call (XX) XXXX XXX

Impact Analysis – systems changes for credit card issuers

This section expands on the impact analysis on systems changes for credit card issuers. As noted in each relevant section, credit card issues will incur costs to implement these changes from either discontinuing certain activities, to major IT systems rebuilds and staff training. These costs are in addition to impacts of decreased revenue (eg. from no longer changing over-limit fees) or for the potential for reduced business (eg. from no longer sending unsolicited credit limit increases) as outlined in each relevant section.

It is impossible to obtain an exact implementation cost for these changes. These systems will be different from business to business and the costs of changing these systems will vary. They will also depend on the exact nature of the changes (where consultation is still required to choose between different options). The systems adopted by credit card issuers are a source of competitive advantage for issuers and therefore information about systems which may need to be changed are matters of intellectual commercial property and must be treated as commercial-in-confidence. However, a limited impact analysis considering what changes may need to change is provided.

Changes required to comply with one minor aspect of Phase One of the National Credit Reforms required a number of systems and interface have run into the millions. Changes proposed by the *Fairer Simpler Banking* policy would require more substantial changes and could easily be expected to be between $10 and $20 million.

In addition to implementation of Phase 1 of the National Credit Reforms, most credit card issuers are also implementing or preparing for systems changes in relation to Personal

[22] The example is based on an interest rate of 20% per annum.

Property Securities reforms, and changes to the Privacy laws, particularly Positive Credit Reporting.

Most major credit card issuers' IT systems are based on build 'windows' meaning any changes will require long lead times for IT systems builds – up to 12 months. Changes are required to both systems administering products and documentation for those products. In addition, some banks have noted that there is a lack of suitably qualified personnel to conduct change programs within their business. Any changes adopted before that time would require issuers to employ contractors, at significantly higher expense, to work on systems changes. It is for these reasons any changes should commence no earlier than 2012.

Consultation Processes

Consultation with industry commenced after the shortly after the confirmation of the 2010 election result. Meetings with the broader National Credit Reform Implementation Group in which these reforms were discussed were held on:

- 10 September 2010, Sydney; and
- 18 October 2010, Sydney.

Treasury established a specialist credit card implementation group as a forum to obtain views on the reforms. Membership of the group comprised all major lenders, three industry bodies (the Australian Bankers Association, ABACUS Mutuals and the Australian Finance Conference), the three two major payment system providers (Visa, Mastercard and AMEX), and three consumer representatives (Consumer Action Law Centre, Choice, Consumer Credit Legal Centre NSW). Each of the election commitments was discussed in detail at a series of meetings and teleconferences between November 2010 and February 2011. Meetings with the Credit Card Reform Implementation Group were held on:

- 3 November 2010, Sydney;
- 1 December 2010, Sydney;
- 17 December 2010, teleconference; and
- 2 February 2010, teleconference.

Conclusion

The measures announced as part of the *Fairer, Simpler Banking* policy and additional credit card reforms will make credit cards cheaper to use, credit card debt easier to control, and make credit card features easier to understand. They are likely to be effective in addressing the problems identified in this RIS. All the proposals addressed in this proposal should be implemented.

Prohibiting credit card accounts from being drawn over their maximum limit will be effective in limiting the debt consumers obtain from their credit cards to an amount that they have agreed and have been assessed as being able to afford. This reform would have minimal impact on lenders as they already offer this service to their customers.

Allocating repayments to the highest interest first will be effective in helping consumers minimise their interest and pay off more expensive debts first. This reform will impact on lenders as they will receive less interest and will need to adjust their IT systems.

Greater standardisation of interest rates will be effective in allowing compare the price of different products, and in some cases, will help consumers save money on interest

Banning unsolicited credit limit extension offers will be effective in limiting the amount of credit offered to people. This measure will support responsible lending conduct requirements by requiring borrowers to actively seek more credit if they require it. This measure will reduce the likelihood of low income or government benefit recipients from being offered credit beyond their capacity to service the debt.

Requiring lenders to ask applicants to nominate their preferred credit limit will clarify existing responsible lending requirements for credit cards. This measure will give consumers more say in their level of indebtedness. Most lenders have already moved to adopt this approach in light of the responsible lending conduct obligations.

Disclosure of key features on credit card applications will be effective in enhancing consumer comprehension of the pricing, important fees and charges of credit cards for which they are applying. Consumers will benefit from know how best to use their cards. Issues may incur some addition costs in redesigning their applications to incorporate the changes.

Disclosure of the impact of minimum repayments will encourage consumers that do not repay their credit card balances, to make higher repayments and minimise their interest. It will explain to consumers who make minimum repayments how much interest they will repay and the time it will take for them to repay it. For people making partial repayments it will give them an additional incentive to make higher repayments. If they do so, this measure may reduce the interest revenue of lenders.

Imposing a statutory requirement to assess a consumers' capacity to repay within a reasonable amount of time will support responsible lending requirements so that capacity to repay assessments are made in line with consumer's requirements.

These changes will benefit consumers in controlling the pricing of credit, controlling the amount of credit they receive, and enhance their understanding of credit cards. For these reasons these proposals should be supported.