10 August 2015

Committee Secretary
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Secretary

Inquiry into Matters Relating to Credit Card Interest Rates

1. Introduction

Consumer Credit Legal Service (WA) Inc. (**CCLSWA**) is a not-for-profit community legal service that provides free legal advice to Western Australians in the areas of credit, banking and finance. CCLSWA also engages in law reform, case work and community legal education. CCLSWA seeks to provide legal assistance to low income, vulnerable and disadvantaged consumers in order to help resolve their disputes with banks, financial service providers and suppliers of consumer goods and services. In its service delivery, CCLSWA also aims to advance public interest.

2. Summary of our submission

CCLSWA welcomes the opportunity to comment on matters relating to credit card interest rates. Our submission focuses on **part d** of the *Terms of Reference* (**TOR**): the costs to consumers because of the difference between cash rates and credit card interest rates. In particular, we offer comments that a high interest rate gap places disproportionate and unfair costs on low income, vulnerable and disadvantaged consumers. We ultimately conclude that legislative reform is required to limit or reduce credit card interest rates.

3. Credit card interest rates and the cost to consumers

3.1 Function of credit card facilities

CCLSWA recognises the important function that credit cards serve, such as by providing a means through which consumers can smooth expenditure patterns, afford household goods and services and manage their payments on other obligations. The demand for credit cards is evidenced by Australia's high rate of credit card ownership, with 87% of the Australian adult population holding and using credit cards, in September 2011.[1]

Credit cards are also often vital to consumers during certain unexpected life events, such as relationship breakdowns, periods of transitional employment, illness or injury, family deaths,

[1] Paul Ali, Cosima McRae and Ian Ramsay, 'Consumer Credit Reform and Behavioural Economics: Regulating Australia's Credit Card Industry' (2012) 40 *Australian Business Law Review* 126, 126.

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income shocks as well as other times of financial difficulty. In these circumstances, credit cards provide consumers with the ability to continue to function on a practical level, with the flexibility to repay their debt in the future when they are hopefully in a stronger financial position.

3.2 Disproportionate and unfair cost

While it is obvious that consumers who incur debt through credit card facilities are required to repay the debt with added interest and fees, CCLSWA believes that the current gap between cash rates and credit card interest rates places an unfair and disproportionate cost on low income, vulnerable and disadvantaged consumers. These consumers include, but are not limited to, those with poor financial literacy, poor English language skills, limited cash flow, health problems including mental illness, the recently unemployed, as well as the elderly and pensioners.[2]

CCLSWA regularly receives calls from low income, vulnerable and disadvantaged consumers who have used credit cards as a necessary means of support and are subsequently left with large debts at high interest rates because of circumstances largely beyond their control. This is of particular concern for consumers who may not understand the full legal consequences of a credit card and how interest is calculated, or who may underestimate the cost of credit card facilities.

The cost and impact placed on these consumers is disproportionately larger and more severe than on ordinary, less advantaged consumers. The financial costs are significant and can exacerbate existing debt problems, which can lead to long term financial hardship and damage to their credit files, hence their credit ratings. There are also emotional costs associated with the burden of the growing debt and repayments, often causing consumers significant distress. Further, in some cases the consequences are extremely long-term and severe, such as causing consumers to petition to bankruptcy,[3] or requiring them to sell their family homes.

If no action is taken to limit or reduce the gap between cash rates and credit card interest rates, 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.[4]

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[2] Fair Trading NSW, *Responsible Lending Practices in Relation to Consumer Credit Cards* (August 2008).
< http://www.fairtrading.nsw.gov.au/pdfs/About_us/Resolving_issues/Responsible_lending_RIS_2008.pdf>
[3] The Insolvency and Trustee Service (ITSA) released data in 2009 showing that 21% of unsecured debt owed to financial institutions by individuals declaring bankruptcy was credit card debt, and that 53% of all unsecured debt owed by debtors to financial institutions by agreement was credit card debt. ITSA, *Profiles of Debtors* 2009 (Canberra, 2010), pp 14, 26 < https://www.afsa.gov.au/resources/statistics/profiles-of-debtors-documents/profiles-of-debtors-2009>.
[4] Above n 13.

Case study 1

One of our clients was a functionally illiterate woman who was required to go overseas for a few weeks with her husband at the last minute due to a likely death in the family. Her son, who suffered from schizophrenia, was expecting a child with his partner and the client wanted to leave her son enough money in case of an emergency while she was away.

The client went to the bank and requested a personal loan of $5000. The bank refused her application and instead offered her a credit card with a limit of $10,000 with her son as the secondary card holder. The bank informed the client that a note would be left on the account to restrict the credit limit to $5000.

Upon returning from her trip, the client discovered that her son had spent up to the maximum limit on the credit card; in fact, he spent over the $10,000 limit. The son did not contribute towards repayments. The client was unable to meet the interest repayments and made an offer to the bank explaining she could only afford to make $100 weekly repayments, but the bank refused it. The debt was subsequently passed onto a debt collector, who after adding fees and interests, commenced court proceedings and entered a default judgment against the client. The judgment debt exceeded $20,000.

The client was unable to repay this judgment debt. By the time she contacted CCLSWA, the debt collector had commenced bankruptcy proceedings against her.

As the above study indicates, clients who are uneducated and in poverty are particularly vulnerable to high credit card debts and the subsequent burdens of repayments. The consequences in this case were severe, with the debt collector forcing the client towards bankruptcy.

Case study 2

The client was a pensioner who, in 2004, had a credit card of a $9000 limit. In the next seven years the client increased her credit limit six times through unsolicited offers of credit limit increases, until her credit card limit reached $35,000. During this time the client had been in a domestically violent relationship, and her then husband had spent up to the maximum limit on the credit card. The husband did not contribute towards repayments.

By November 2010 the client had separated from her husband but still had $32,000 in debt owing on the credit card. The client was using the entirety of her pension to meet her repayments and she required her children to help pay for her living costs. CCLSWA sought to negotiate with the bank in 2011 in order to establish a repayment plan that the client could afford, however the bank rejected the offer.

In February 2012 the debt was assigned to a debt collector who pursued the client for the outstanding debt. In October 2012 the client advised us that she was petitioning for bankruptcy, as she could not afford to repay the debt.

In this case, it was predominantly the actions of a domestically violent partner who had placed the client in debt through her credit card. The client's situation was also worsened by the ease through which she could obtain credit limit increases. The consequences were once again long-term and severe, with the client resorting to bankruptcy to escape the severe debt burden.

Case study 3

The client was co-borrower with her now ex-husband on two home loans. The ex-husband left the family home in 2007 and ceased providing any financial support to the family in 2008. In 2009 the ex-husband cut his loan repayments in half and the client, who was on a disability pension, was unable to meet the repayments. In 2010, Family Court and Children's Court proceedings were commenced between the client and the ex-husband.

The client sought to recommence employment as a casual relief teacher to gain income, however due to her many legal appointments related to the matters on foot in the Family and Children's Court, her ability to work was limited.

During this time, the client used her credit card from another financial service provider to pay off the arrears owing on her home loans. Further, during this time the client received default notices for failing to meet her repayments on a number of her debts.

CCLSWA regularly receive calls from clients who have used credit cards to make repayments on other existing debts as well as to support themselves and their families during crises such as relationship breakdowns. During such times, it is often extremely difficult for each partner to co-ordinate and manage their separate financial affairs and these clients may be forced to rely on their credit cards to support any dependent children.

3.3 Mental illness

Consumers suffering from mental illness are particularly vulnerable to debt related problems. Mental illness can significantly affect a consumer's ability to earn income as well as impair their understanding and judgment relating to contracts, finance, debt and risk.[5] CCLSWA regularly receives a large number of telephone calls from clients suffering from mental illness, ranging from bipolar disorders and schizophrenia to mild depression and anxiety. Many such clients had agreed to inappropriate credit arrangements, leading to debt burdens they could not bear.

[5] Good Shepherd Youth & Family Services, *'Mental Illness and Debt – Information for Mental Health Professionals'* (September 2010), p 1-2<http://www.goodshepvic.org.au/Assets/Files/Mental_Illness_Debt_-_Information_for_Mental_Health_Professionals.pdf>

The issues relating to mental illness and credit cards are wide and varied. Loan officers or bank employees may be unable to determine whether a consumer suffers from a mental illness based on the consumer's appearance or behaviour when deciding to issue them a credit card. And with the prevalence of faceless online loan transactions, it is nearly impossible for lenders to assess potential borrowers' health. Consumers may also not have been diagnosed with a mental illness until after they have already entered into a credit card loan, and may not themselves be aware of their mental illness until after they have already incurred a large debt. Further, in our experience it is also common for clients with mental illness to be living in poverty and for their financial burdens to become the responsibility of their family or carer.

It is also important to recognise that debt may be both a cause and a consequence of mental illness.[6] The added anxiety and stress of debt, as well as the social consequences such as shame and embarrassment, can be sources of mental illness.[7] Notably, the emotional consequences of debt can exacerbate or intensify a mental illness, further affecting a consumer's ability to earn income and make financial decisions.

CCLSWA strongly believes that consumers suffering from mental illness are particularly vulnerable to the costs and risks associated with credit card facilities and are also less able to take advantage of available services and regimes to protect themselves. It is because of this relationship between mental illness and debt that when credit card interest rates increase, consumers suffering from mental illness and those who care for them will bear a significant financial and emotional cost. Further, the impact of financial hardship on consumers suffering from mental illness can be more severe than on other consumers.[8]

3.4 Credit reporting

Consumers with credit cards debts who are in default for 60 days or more risk their lenders' listing the default on their credit files (when the requisite notices have been issued). Default listings generally remain on a consumer's credit files for a maximum of 5 years and can adversely affect the consumer's ability to obtain future credit.[9] When interest rates and repayments are higher, it follows that the likelihood of default and subsequent damage to credit ratings will also be higher.

CCLSWA has noticed a rise in 'credit repair companies' (**CRC's**), which typically claim to repair consumer credit files and charge excessive fees for what is essentially a service that consumer advocates could provide for free or that the consumer could do for themselves.[10] CRC's often target consumers with bad credit ratings. CRC's make unrealistic promises

[6] Ibid 2.
[7] Ibid 2-4.
[8] Ibid.
[9] *Privacy Act* 1988 (Cth).
[10] Energy & Water Ombudsman (NSW) ('EWON'), *Consumers' Use and Experience of "Credit Fix" Agencies* (September 2012) <http://www.ewon.com.au/ewon/assets/File/EWON%20Credit%20Repair%20Report_2012.pdf>.

about the likelihood of a successful outcome, taking advantage of these consumers' financial stress.[11] Increasingly, CCLSWA receives calls from consumers who are desperate to repair their credit files and have entered into agreements with CRC's, often paying large fees with no result, and ultimately adding to the consumers' financial hardship.

As interest rates increase and financial hardship becomes more widespread, the demand for CRC's will also increase.[12] This is an additional cost that will be passed onto low income, disadvantaged and vulnerable consumers who may be more likely to have default listings on their credit files and who may lack sufficient understanding of Australia's credit reporting laws in order to question the legitimacy of a CRC.[13]

Case study 4

This client had entered into a $5000 credit card debt with a bank. She was able to meet the repayments for the first 3-4 years; however her financial circumstances changed significantly after she developed post-natal depression. The client began to struggle with her repayments and after several defaults the bank listed a default on her credit file.

The client later repaid the outstanding debt, however the default listing remained. Years later, after the client had recovered from her condition, she applied for a home loan but was rejected on the basis that she had a default listing on her credit file.

The client wished to have the default listing removed. She researched and located a website for a credit repair company that claimed to have a 99% success rate at restoring credit records and that this would be done within 45-60 days. The client signed an agreement with the credit repair company for their services and paid $2000 upfront. However after six months nothing happened.

As the above case study illustrates, certain consumers may become unable to meet their credit card repayments for reasons beyond their control – such as a health condition - and end up with default or other negative listings on their credit files.

In the above case CCLSWA assisted the client and negotiated with the bank, leading to the removal of the default listing. The bank accepted medical evidence of the post-natal depression. However, despite CCLSWA's best efforts, the CRC was recalcitrant and refused to refund any of the substantial fees paid by the client.

3.5 Honeymoon interest periods

Many banks and financial service providers offer credit cards which include a 'honeymoon interest period', where a low interest rate applies for a brief period of time before reverting

[11] Paul Ali, Lucinda O'Brien and Ian Ramsay, 'A Quick Fix? Credit Repair in Australia' (June 10, 2015). *Australian Business Law Review*, Vol. 43, No. 3, p 180.
[12] Ibid 179-205.
[13] Ibid.

back to a higher standard interest rate. For example, National Australia Bank (**NAB**) currently offers a 'NAB Premium Card' which offers 0 per cent interest per annum on purchases for 12 months before reverting to 13.99 per cent interest per annum.[14]

Credit card issuers of low interest honeymoon periods 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.[15] Further, while banks are able 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.[16]

CCLSWA believes credit cards with honeymoon interest periods place disproportionate costs on disadvantaged consumers and are part of the problem relating to the current gap between cash rates and credit card interest rates.

3.6 Payday lending

Higher credit card interest rates and increased damage to credit files may create an incentive for consumers to rely on less reputable sources of credit, such as payday loans. Payday lending has experienced rapid growth in Australia since the late 1990's,[17] and has been identified by the Federal Government as 'holding specific risks of financial detriment or harm to vulnerable consumers'.[18]

Payday loans are typically short-term loans used to finance living costs which often carry excessive fees and interest, making them an extremely expensive form of credit.[19] Payday loans generally appeal to low income, vulnerable and disadvantaged consumers with poor credit histories and who are in financial need.[20] As a result of the burdensome nature of the fees and interest, consumers often resort to using more payday loans in order to meet their repayments.[21] This repeat borrowing can lead to long-term financial hardship and in extreme cases, bankruptcy.[22]

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[14] www.nab.com.au (2015), *Credit Card Affiliate – Low Rate – NAB*. [online] available at <http://www.nab.com.au/personal/campaigns/credit-card-affiliate-low-rate [Accessed 6 Aug, 2015]>.
[15] Ian McAuley, 'Behavioural Economics and Public Policy: Some Insights' (2013) 4 *International Journal of Behavioural Accounting and Finance* 1, 22.
[16] Ibid.
[17] Sally Andersen, 'Mapping the Terrain: The Last Decade of Payday Lending in Australia' (2011) 39 *Australian Business Law Review* 5, 11.
[18] Australian Securities and Investment Commission (ASIC) Report 426, *Payday Lenders and the new small amount lending provisions*, (March 2015).
< http://download.asic.gov.au/media/3038267/rep-426-published-17-march-2015.pdf>
[19] Paul Ali, Cosima McRae and Ian Ramsay, 'The politics of payday lending regulation in Australia' (2013) 39 *Monash University Law Review* 2, 411. 422.
[20] Ibid.
[21] Ibid 422-425.
[22] Ibid 425; Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Inquiry into Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011* (2011) 60–1, [5.44]–[5.45].

CCLSWA believes legal reform is required to limit the gap between cash rates and credit card rates, as a failure to do so will lead to an increased market for payday lending which will ultimately cause greater financial hardship to low income, vulnerable and disadvantaged consumers. However it is important to note that any measures undertaken to limit or reduce credit card interest rates may indirectly result in stricter credit card application processes, which could adversely affect credit card applicants. These applicants may then become tempted to obtain credit through payday loans. Any potential changes in the law should also seek to address this risk.

3.7 Substituted increase in fees

If action is taken to limit or reduce the gap between cash rates and credit card interest rates, banks and other financial service providers may seek to increase credit card fees as a means of compensating for lost profits. This is of particular concern for consumers who may not understand how fees are calculated due to language problems, lack of education, poor financial literacy or mental illness.[23] These fees would likely place a disproportionate and unfair cost back onto low income, disadvantaged and vulnerable consumers.

We submit that any action taken as a result of this inquiry to limit the gap between cash rates and credit card interest rates will need to take into consideration this risk and create a solution that does not simply result in the same unfair and disproportionate costs being placed back onto the same vulnerable, disadvantaged and low income consumers.

4. Conclusion

In light of the comments outlined above, CCLSWA believes legal reform is required to limit or reduce credit card interest rates with the qualification that consideration is given to issues such as credit repair companies, honeymoon interest periods, potential increases in payday lending and increased fees on credit card facilities.

CCLSWA is grateful for the opportunity to comment.

Yours sincerely,
Consumer Credit Legal Service (WA) Inc.

Per
Faith Cheok
Principal Solicitor

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[23] Glenn Canner and James Fergus, 'The Effects on Consumers and Creditors of Proposed Ceilings on Credit Card Interest Rates' (1987) *Board of Governors of the Federal Reserve System;* 154 *Federal Bulletin Reserve* 783-784.