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Introduction

Background

1.1 On 11 May 2011 the Selection Committee referred the National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011 (the Bill) to the committee for inquiry and report.

1.2 The Bill was introduced by the Government into the House of Representatives on 24 March 2011.

Purpose and overview of the Bill

1.3 The Bill amends the *National Consumer Credit Protection Act 2009* (the NCCP Act). The NCCP Act establishes a national consumer credit regime.

1.4 These reforms are part of an agreement by the Council of Australian Governments (COAG), made following its meetings on 3 July and 2 October 2008, to implement a two-phase implementation plan to transfer credit regulation to the Commonwealth and introduce new Commonwealth regulation to enhance consumer protection. The NCCP Act, passed in 2009, put into operation phase one of the implementation plan.[1]

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1 Australian Government, *Explanatory Memorandum, National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011*, p. 5.

1.5 This Bill supplements the regulation of lenders and brokers introduced by the NCCP Act and forms part of phase two of the COAG implementation plan.[2]

1.6 The Bill seeks to introduce major changes to the relationship between credit providers and consumers in respect of credit cards and home loans.[3] It forms part of the banking reforms announced by the Government designed 'to empower consumers, to support smaller lenders, and to secure the flow of credit to our economy.'[4]

1.7 The provisions contained in the Bill:

- introduce a requirement for lenders to produce a Key Facts Sheet for standard home loans. This would set out, in a standardised format, pricing and other information about their products, allowing consumers to readily compare different home loans;
- regulate the circumstances in which borrowers can exceed the credit limit on their card, and prohibit fees being charged by the credit provider where they do so (except where the consumer has opted to have a higher 'supplementary buffer' on which they can be charged fees);
- specify a hierarchy for payments made under credit card contracts, requiring credit providers to allocate repayments by the borrower to that part of the balance of their credit card on which they are charged the highest interest rate, unless they elect to have a different payment arrangement;
- restrict credit providers from making unsolicited invitations encouraging borrowers to increase the limit of their credit card (except when the consumer has consented to receive such offers); and
- introduce a requirement for lenders to provide a Key Facts Sheet for credit card contracts, making it mandatory for credit providers to include, in credit card application forms, key information about the annual percentage rate and other terms which would apply to a contract.[5]

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2 Australian Government, *Explanatory Memorandum, National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011*, p. 5.

3 Australian Government, *Explanatory Memorandum, National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011*, p. 5.

4 The Hon. Mr Wayne Swan, Treasurer, *House of Representatives Hansard*, 24 March 2011, p. 3137.

5 Australian Government, *Explanatory Memorandum, National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011*, pp. 5-6.

1.8 A large proportion of the Bill's operational provisions have been delegated to regulations. For example, it is intended that regulations be made under the NCCP Act requiring credit providers to notify customers of the consequences of only making minimum monthly repayments.[6] Regulations also may require a credit provider to notify a consumer that their credit card has been used in excess of their credit limit.

1.9 Regulations will also be made to:

- prescribe the circumstances in which a Key Facts Sheet for standard home loans needs to be provided and the information it needs to contain;
- prescribe the information to be contained in a Key Facts Sheet for credit card contracts, and any other requirements relating to the provision of the Key Facts Sheet;
- make provisions defining what type of written communication is a credit limit increase invitation;
- prescribe circumstances in which consent to the making of credit limit increase invitations can be given or withdrawn;
- prescribe the requirements for electing to not have a default buffer apply;
- define the circumstances surrounding the operation of a supplementary buffer, and the circumstances in which a credit provider can approve the use of a credit card in excess of credit limit;
- prescribe the requirements relating to how payments are allocated under credit card contracts.

1.10 In addition, regulations may require a credit provider to notify a consumer that their credit card has been used in excess of their credit limit.

1.11 The Bill aims to encourage the responsible use of credit cards by informed consumers and to assist consumers to make financial decisions in relation to home loans.[7] The Explanatory Memorandum states:

> These reforms will assist consumers by increasing their capacity to select products or use their credit cards in a way that reduces the level of fees and interest they are charged; and reducing the risk of

6 The Hon. Mr Wayne Swan, Treasurer, *House of Representatives Hansard*, 24 March 2011, pp. 3138-9.

7 The Hon. Mr Wayne Swan, Treasurer, *House of Representatives Hansard*, 24 March 2011, p. 3137.

> consumers being provided with credit cards limits where they may be unable to pay the total balance within a relatively short period of time.[8]

1.12 The Explanatory Memorandum also suggests that the reforms will place greater pressure on credit card industry participants to be competitive given that consumers will be able to make more informed choices upfront.[9]

Are reforms needed to the credit card and home loans industries?

1.13 Evidence was given at the hearing that 'credit card debt is the No. 1 cause of financial stress and consequent psychological problems'.[10]

1.14 The need for reform has come about because of the implied imbalance between the incentives for lenders and the interests of consumers.[11] This legislation seeks to restore this balance in the interest of protecting consumers.

1.15 Industry raised two general arguments opposing the Bill. Firstly, the Australian Banking Association (ABA) questioned the policy intent behind the Bill because credit card debt had plateaued over the 12 months to the end of March this year.[12] However, the committee notes that this most likely reflects the widely reported increase in household saving rates, rather than going to the specifics of consumer credit.

1.16 Secondly, Visa noted that similar legislation in the United States had the following consequences:

- less credit for consumers;
- an increase in annual fees;
- higher borrowing costs for creditworthy customers; and

8 Australian Government, *Explanatory Memorandum, National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011*, p. 4.

9 Australian Government, *Explanatory Memorandum, National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011*, p. 4.

10 Mr Richard Brading, Wesley Mission, *Committee Hansard*, 25 May 2011, Canberra, p. 24.

11 Mr Geoff Miller, Treasury, *Committee Hansard*, 25 May 2011, Canberra, p. 10.

12 Mr Steven Munchenberg, ABA, *Committee Hansard*, 25 May 2011, Canberra, p. 15.

- little marketing for new accounts.[13]

1.17 The committee's view is that good regulation is a matter of balancing competing interests and that it is only to be expected that banks and other financiers would change how they conduct their business under this new regime. The discussion below demonstrates that there is a clear need for regulation. Given some of the banks' marketing practices, the committee is of the view that the Bill takes a balanced approach to this task. As with other systems of regulation, the provisions in the bill can always be refined over time.

Unsolicited credit card limit increase offers

1.18 The bulk of evidence from consumer groups concerned the prevalence of unsolicited credit limit increase offers and their potential to lead customers into a debt trap. The reforms contained in the Bill make it more difficult for customers to take on a credit card debt they are not able to repay.

1.19 Ms Karen Cox, the Coordinator of the Consumer Credit Legal Centre, gave evidence that credit cards have been the most common reason for people seeking assistance from the centre for the ten years she had been there.[14] She said:

> ...there is no doubt that credit cards are an enormous cause of pressure on families, and we have seen countless examples over the years of people on very low incomes who have accepted a series of credit limit increases.[15]

1.20 Representatives from the Finance Sector Union of Australia confirmed that over the past several years there has been an increase in the number of 'unsolicited marketing and other letters from finance providers suggesting people should increase their credit limit.'[16]

1.21 Although the majority of customers pay off their credit card balance monthly, the most profitable customers from the lender's perspective are

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13 Visa, *Submission 11*, p. 3.

14 Ms Karen Cox, Consumer Credit Legal Centre, *Committee Hansard*, 25 May 2011, Canberra, p. 25.

15 Ms Karen Cox, Consumer Credit Legal Centre, *Committee Hansard*, 25 May 2011, Canberra, p. 26.

16 Mr Rod Masson, Finance Sector Union of Australia, *Committee Hansard*, 25 May 2011, Canberra, p. 44.

those who cannot afford to pay back the full balance every month.[17] The Treasury stated:

> One of the issues with credit cards is that because you only have to make the minimum repayments the increases in the credit limit can place you in a position where you are carrying long-term credit card debts at credit card rates without ever necessarily being able to significantly reduce those debts.[18]

1.22 Research by consumer groups shows that banks have aggressively marketed credit cards.[19] For example, a study in 2009 showed that 84 per cent of Victorian credit card holders had received an unsolicited credit card limit increase offer. This rate was virtually the same for people who were unemployed (84 per cent), those studying (83 per cent) or those with a Health Care Card (82 per cent).[20]

1.23 The Consumer Action Law Centre advised that research in 2008 showed that the industry uses various forms of psychological manipulation to encourage consumers to accept an increase offer. This includes the use of the term 'pre-approved' which implies a form of ownership. The letters are also signed by managers and senior staff, which implies expertise and that the individual in question can afford the increase.[21]

Profit maximisation

1.24 Financial groups and Treasury stated that it was not in the interests of lenders to have consumers default on their credit cards, as this would result in a financial loss for the lender.[22] They argued that lenders were therefore unlikely to over-extend credit to customers who could not afford it. However, evidence was given by both Treasury and consumer groups that customers can be in financial difficulty or carrying large amounts of debt before they default on their card.[23]

1.25 The Wesley Community Legal Service, Wesley Mission, told the committee:

17 Mr Richard Brading, Wesley Mission, *Committee Hansard*, 25 May 2011, Canberra, p. 28; Abacus Australian Mutuals (Abacus), *Submission 4.1*, p. 1.

18 Mr Christian Mikula, Treasury, *Committee Hansard*, 25 May 2011, Canberra, p. 36.

19 In evidence, Abacus stated that the mutuals sector is less aggressive than banks in relation to credit cards: Mr Mark Degotardi, Abacus, *Committee Hansard*, 25 May 2011, Canberra, p. 40.

20 Consumer Action Law Centre, *Submission 12*, p. 2.

21 Consumer Action Law Centre, *Submission 12*, p. 2.

22 Mr Christian Mikula, Treasury, *Committee Hansard*, 25 May 2011, Canberra, p. 9.

23 Mr Christian Mikula, Treasury; Mr Richard Brading, Wesley Mission, and Ms Carolyn Bond, Consumer Action Law Centre; *Committee Hansard*, 25 May 2011, Canberra, pp. 11 and 28.

> The actual default rate compared with those who get into difficulty is really quite low. And that is one of the reasons why credit cards in Australia are pushed so vigorously. As a nation we are actually very conscientious in repaying debts and it is only a very small percentage of people who actually do not ultimately pay back their credit card debts.[24]

1.26 The Consumer Action Law Centre reinforced this argument:

> ...with credit card debt it is misleading just to focus on the defaults, because the monthly payments are so low compared to other credit. People are often under stress well before they default and in fact we see people who, for example, pay their pension into their credit card when they get it and then use the credit card to live on.[25]

1.27 It is profitable then for lenders to have customers paying interest on higher credit card loans. As the committee heard, the number of people defaulting on their credit cards is quite low.[26] It can therefore be inferred that the amount defaulting customers would cost a lender is not significant compared to profits made from interest charges across its whole customer base.

1.28 In other words, financial institutions, especially those owned by shareholders, are maximising their profits. Having a small number of borrowers default is not a major issue if these practices allow the lender to make a greater return across the rest of their customers. Further, having a borrower default on a $20,000 credit card debt is only a statistical disturbance for a bank, whereas it is traumatic for the individual. This demonstrates the imbalance between financial institutions and consumers. The committee accepts the ABA's point that only 1 per cent of credit card customers are in difficulties.[27] The problem is that it is a traumatic situation for the consumer for which their bank is partly responsible.

Responsible lending

1.29 During the hearing questions arose as to whether the legislation was necessary as it duplicated the responsible lending obligations which came

24 Mr Richard Brading, Wesley Mission, *Committee Hansard*, 25 May 2011, Canberra, p. 28.

25 Ms Carolyn Bond, Consumer Action Law Centre, *Committee Hansard*, 25 May 2011, Canberra, p. 28.

26 Mr Steven Munchenberg, ABA; Mr Richard Brading, Wesley Mission; *Committee Hansard*, 25 May 2011, Canberra, pp. 17 and 28.

27 Mr Steven Munchenberg, ABA, *Committee Hansard*, 25 May 2011, Canberra, p. 15.

into effect on 1 January 2011.[28] The ABA was of the opinion that time ought to be given for the operation of those provisions to be assessed before further legislation was enacted. The ABA stated:

> The responsible lending laws would seem to deal with most of the government's stated concerns with credit cards, particularly on credit limit increases. However, those laws were not even in force before the government added the additional regulation in the bill before the inquiry.[29]

1.30 Treasury officials and consumer groups gave evidence that this legislation was in fact complementary to those reforms.[30] It was necessary because it specifically addresses some of the particular practices around credit cards that occur because of their unique features, including that only minimum repayments need to be made.[31]

1.31 The Consumer Action Law Centre summed up the difference between the existing provisions and those in the Bill:

> I think with credit increases limit offers we are actually looking at what we regard as a dangerous and irresponsible marketing technique that often really urges people to take more credit than they want. That is a separate issue to the responsible lending, which is when the bank comes to assess whether they are going to provide that increase or not.[32]

1.32 The Treasury confirmed that, despite the introduction of the responsible lending provisions, lenders had continued to make unsolicited credit increase offers.[33]

Conclusions

1.33 The committee concludes that reforms to existing practices are needed. It is clear that credit card debt is a continuing problem for many people, and that current legislation does not adequately protect consumers from increasing their debt to a dangerous level. These reforms will assist those people who need the most help with their financial management.

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28 Mr Steven Munchenberg, ABA, *Committee Hansard*, 25 May 2011, Canberra, p. 18.

29 Mr Steven Munchenberg, ABA, *Committee Hansard*, 25 May 2011, Canberra, p. 15.

30 Mr Christian Mikula, Treasury; Mr David Coorey, National Legal Aid; Ms Karen Cox, Consumer Credit Legal Centre; *Committee Hansard*, 25 May 2011, Canberra, pp. 37, 25, and 29.

31 Mr Christian Mikula, Treasury, *Committee Hansard*, 25 May 2011, Canberra, p. 37.

32 Ms Carolyn Bond, Consumer Action Law Centre, *Committee Hansard*, 25 May 2011, Canberra, p. 30.

33 Mr Christian Mikula, Treasury, *Committe Hansard*, 25 May 2011, Canberra, p. 36.

Consultations

1.34 Treasury conducted consultations to guide the development of the Bill. Consultation meetings were held individually and collectively with banking industry representatives, consumer groups and other relevant stakeholders. They took place over five months, from September 2010 to March 2011.[34]

1.35 Following this period of consultation an exposure draft of the Bill was released by Treasury in March 2011. Interested parties were invited to make submissions on the exposure draft, and submissions were received from peak consumer groups, financial institutions and industry groups.

1.36 Numerous changes were made to the final draft of the legislation as a direct result of concerns raised in these submissions. Provisions were introduced in the Bill to allow customers to ask for a higher buffer if they were prepared to pay fees for the service. Changes were also made to the operation of the Key Facts Sheet for home loans to make them more straightforward, and broader regulation making powers were introduced to clarify the definition of unsolicited credit limit extension invitations.

1.37 One of the issues raised by parties, in relation to the consultation process, was the short time frame permitted for submissions to be made. The exposure draft was released by Treasury on Friday 4 March 2011 and the closing date for submissions was Tuesday 8 March 2011. The Australian Bankers' Association (ABA) articulated a concern that 'the banking industry has not been able to fully assess the potential impact or the likelihood of unintended consequences of these new rules.'[35]

1.38 There has now been sufficient time since the legislation was released for parties to adequately assess its effect, and for any further concerns to be articulated to this committee. In addition, Treasury continues to consult with parties on the regulations, which will ultimately contain many of the details of the reforms.[36]

34 Mr Geoff Miller, Treasury, *Committee Hansard*, 25 May 2011, Canberra, p. 14.

35 ABA, submission on exposure draft Bill, p. 1.

36 Mr Christian Mikula, Treasury, *Committee Hansard*, 25 May 2011, Canberra, p. 9.

Committee objectives and scope

1.39 The objective of the inquiry is to scrutinise the technical adequacy of the Bill and its ability to deliver the policy intent.

Conduct of the inquiry

1.40 Details of the inquiry were placed on the committee's website. A media release announcing the inquiry and seeking submissions was issued on Tuesday 17 May 2011.

1.41 Fourteen submissions were received which are listed at Appendix A. Four exhibits were received which are listed at Appendix C.

1.42 A public hearing was held in Canberra on Wednesday 25 May 2011. A list of the witnesses who appeared at the hearing is available at Appendix B. The submissions and transcript of evidence were placed on the committee's website at http://www.aph.gov.au/house/committee/economics/index.htm.