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# Australian Consumers' Association
# Submission to the Senate Community Affairs Committee Inquiry into Poverty in Australia

## 1. Introduction

The Australian Consumers' Association (ACA) is an independently-funded, not-for-profit organisation dedicated to representing Australian consumers and advancing their interests. Through its publications CHOICE and CHOICE online, and through other media channels, ACA communicates with hundreds of thousands of Australian consumers, providing relevant information and a consumer perspective on a range of policy issues.

ACA welcomes the opportunity to make a submission to the Community Affairs Inquiry into Poverty in Australia. ACA has always sought to incorporate equity considerations into the formulation of consumer policy, in recognition of the need to protect those consumers made especially vulnerable by their lower-income status.

In particular, ACA recognises that the operation of markets in Australia may not advantage lower-income consumers, but that competition may actually operate to entrench their disadvantage relative to higher-income consumers. While ACA supports measures to ensure competitive markets in Australia, we also stress the need for protective mechanisms, especially in the context of essential goods and services, to ensure access for those consumers.

Rather than addressing each of the Terms of Reference in turn, this brief submission will highlight two sources of ACA concern, both illustrated by experience in the financial services sector.

## 2. Competition and low-income consumers

While competitive markets can be an excellent means of ensuring access to services, by itself, competition does not address many of the equity concerns which apply to poorer Australians and poorer communities and regions. The provision of telecommunications services is one such example, which has resulted in the implementation of a Universal Service Obligation on Telstra. This can be viewed as an example of successful external regulation of the provision of essential services.

A less successful attempt to ensure the universal provision of an essential service has been the attempt to negotiate a Basic Bank Account to provide a basic standard of transactional banking across the banking industry. ACA would contest any claim that the banking sector exhibits healthy competition, with the majority of transactional banking still concentrated among the 'Big Four' banks.

Any attempt to externally regulate the banking sector has met with stiff resistance from some of its members. Yet as the largest banks continue to redirect their banking activities towards wealth management and regaining their lost share of the home lending market, poorer customers find themselves bearing a disproportionate burden of the cost of banking.

Bank customers with mortgage or investment relationships generally qualify for fee-free transaction accounts. Most banks will also provide fee-free banking, to a degree, for Health Care Concession cardholding customers. However, those caught in the middle – lower-income earners, renters, younger customers and self-funded retirees continue to be charged high fees for accessing a basic transaction service.

There is little incentive for banks to 'chase' these customers – indeed, they are perceived as high-cost, low-return customers, and have been the subject of initiatives to drive them out of branches (the Commonwealth Bank's Ezybanking channel being one such example) with the clear implication that some banks are simply not interested in their business.

The Basic Bank Account initiative sought to introduce an industry-wide standard for affordable, accessible banking. The Australian Bankers' Association (ABA) submitted a draft model account to the ACCC for authorisation in 2002, which was subsequently rejected. While it is ACA's view that the majority of the ACCC's concerns could have been readily resolved, the ABA abandoned the initiative, to the great disappointment of the many consumer and welfare groups which had contributed to that process.

The failure of the banking industry to self-regulate to protect vulnerable consumers leaves the consumer movement with little alternative but to renew calls for external regulation. Access to essential services cannot be left to the vagaries of markets, where purchasing power is all too often the determinant of access.

## 3. Credit and Indebtedness

Rising household debt levels have become a source of alarm for ACA. Problems of overcommitment are not limited to low-income households, with an increasing number of Australians, across all income levels, reporting stress at their capacity to manage higher levels of debt.

However, it is clear from a number of analyses – set out below – that poorer households have been hit especially hard by the explosion in credit availability in this country over the past decade. This has resulted in the following:

- *Rising level of advances shown in the RBA data*

Five years ago, Total outstandings on credit cards in Australia amounted to just over $9 billion. As of April, that figure had risen to $23.32 billion.

- *Case experience, both formal and anecdotal*

Increasing numbers of people are presenting to financial counsellors and other case workers with credit card overcommitment. This has been reported anedotally and also in a formal survey of Financial Counsellors' of NSW case work by the Dr Margaret Griffiths and Bill Renwick from the University of Newcastle's Central Coast School of eBusiness and Management, released on November 15 last year.

- *Indebtedness generally*

Consumer debt is not confined to credit cards. The notable other area of consumer debt is in the area of housing loans. Our rapid increase in household debt has caught the attention of international analysts, with the Economist magazine warning Australians may be mirroring the 'irrational exuberance' of America prior to that country's 2000 stockmarket bust.

- *Goldman Sachs Consumer Vulnerability Index*

Just how vulnerable we are was demonstrated earlier this year, when Goldman Sachs released its first Consumer Vulnerability Index, which rates countries on the basis of their vulnerability on four counts: Household Leverage, Household Savings, Unemployment; and Disposable Income. Australia rated the worst with a score of 56 out of a possible 60.

**Credit cards**

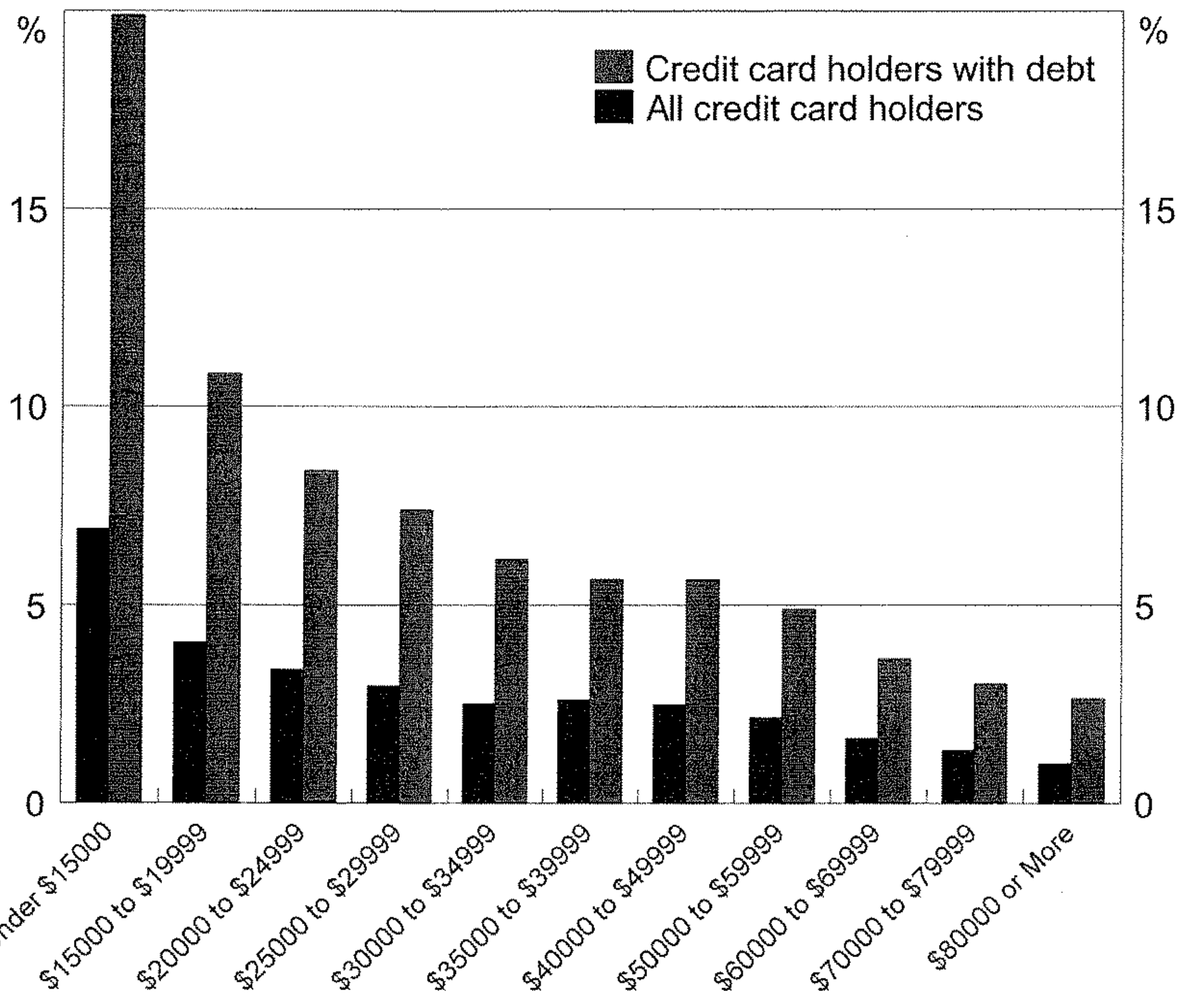
In October 2002, Visa released a report into credit card use in Australia, which purported to show that current credit card debt levels are sustainable, and that the overwhelming majority of Australian cardholders do not have a problem managing their credit. A more detailed analysis of this report is available at www.choice.com.au.

The report was based on analysis of Roy Morgan consumer behaviour data. However, the data aggregated interest-bearing and non-interest-bearing accounts. Separating those accounts where interest is paid from those where it is not, is vital to understanding credit card use and problems. While some consumers swap between the two categories, many do not. Those who never pay interest will differ significantly in their spending and payment behaviour and problems experienced, than those who always pay interest.

Questions of whether spending, limits or debts are excessive, inappropriate or unsustainable are best answered by focussing on 42.8% of cardholders (35% of households) whose accounts are interest bearing, and who hold 75% of outstanding balances.

These figures suggest that as at June 2002, around 2.6 million households had an average interest-bearing debt on personal credit cards of around $6000, and paid annual interest of around $9000. This is clearly the group that should be analysed if there is a genuine desire to identify and understand those at financial risk from credit card use.

**Average Personal Credit Card Debt to Household Income Ratio**




As well as examining the ratio of credit card debt to total household debt, it is important to examine whether consumers are managing to repay that debt without financial difficulty.

It is the view of ACA and the experience of financial counsellors and consumer credit legal centres around the country that credit is not being made available on a responsible or sustainable basis.

Case Study 1:

> Ms C obtained a credit card of a $300 limit at the urging of her family to cover emergencies. She was at the time of application a permanent disability pensioner. Over the course of 7 years, Ms C received 5 unsolicited limit increase offers to her card. She visited a financial counsellor when her limit reached $9000, and she was using most of her pension to pay the interest, with only a small amount left which was inadequate for food, let alone utilities. She had tried unsuccessfully to get the Bank to reduce payments and/or hold fees.

2683 such case studies were last year analysed by the University of Newcastle for the Financial Counselling Association of NSW. The findings are a stark counter to bank claims that current debt levels are sustainable.

Of those 2683 case studies (spanning 2001), credit card debt was the most frequently reported type of credit among overcommitted financial counselling clients. Characteristics of that client group were:

- lower-income single adult (including one parent) households;
- residing in housing they did not own (either with or without mortgage);
- more than half relied on government cash benefits as their main source of income

*<u>Household type:</u> credit card debt most frequently reported cause of overcommitment across all types*

- *Singles 63%*
- *Couples 67%*
- *Single with children 56%*
- *Couple with children 63%*

*<u>Income group:</u> The major cause of overcommitment in low-income households.*

- *<$10,000: 59%*
- *$10,001 – 20,000: 55%*

These findings are supported by an analysis of the Roy Morgan data relied upon by Visa, with non-interest-bearing accounts removed from consideration:

Characteristic of interest-bearing credit card account-holders:

- *Young people not working (either looking for work or studying);*
- *Single parents;*
- *Young married couples with children;*
- *Renters*

When we drill down further into the demographics of revolvers, survey evidence from Roy Morgan suggests that the respondents most likely to have credit card interest-bearing debt are generally young people who are not working (either looking for work or studying), single parents and young married couples with children. The high proportion of renters with credit card debt indicates that these people are unlikely to have significant assets.

**Profile of credit cardholders with personal credit card debt** [1]

| | Likelihood they have debt | Proportion with credit card debt | Average credit card debt | Average credit card debt to household income ratio |
|---|---|---|---|---|
| *Age:* | | | | |
| 18-24 | 138 [2] | 57% [3] | 1,350 [4] | 1.87% [5] |
| *Work status:* | | | | |
| Retired | 77 | 32% | 2,143 | 7.24% |
| Students | 121 | 50% | 1,560 | 3.18% |
| Looking for work | 124 | 52% | 2,365 | 5.76% |
| *Respondent lifecycle:* | | | | |
| Single 14-34 no children | 123 | 51% | 1,633 | 2.12% |
| Single 14-34, with children | 150 | 62% | 1,801 | 4.11% |
| Married 14-34, with children | 115 | 48% | 2,269 | 3.49% |
| Single 35+ , with children | 129 | 54% | 2,354 | 5.15% |
| *Home ownership:* | | | | |
| Renting | 128 | 53% | 2,105 | 3.52% |

**Explanatory notes:**
For each category, all variables that increase the likelihood of having credit card debt by at least 15% have been included.
12: Interpretation: 18-24 year olds are 38% more likely to have credit card debt than credit cardholders in general.
13: 57% of credit cardholders between the ages of 18-24 have credit card debt
14 Interpretation: The average personal credit card debt of 18-24 year old credit cardholders with debt is $1,350.
15: Interpretation: The average personal credit card debt to household income ratio for 18-24 year old credit cardholders with debt is 1.87%.

**Other credit management problems:**

- *Vulnerable consumers – 'credit limit surfing'*

In our experience, some consumers regularly spend close to their credit limit, but rarely pay off the outstanding balance. In fact, sometimes they are trapped, only able to make small payments that barely cover the interest accruing. However, if only small repayments are made, it can take years to repaying a relatively small outstanding debt.[6]

These consumers often receive "pre-approved" credit limit increases – they spend up to their $2,000 limit, then accept an offer of $3,000 limit – they spend up to that and 6 months later accept an offer of $4,000 limit. However, rarely are they able to make a significant dent in

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[6] Calculations done by CCLS a few years ago in relation to one major card showed that if a consumer makes only the minimum monthly payment it would take 9 years to pay off a $2,000 debt and 15 years to pay off $5,000, assuming no further purchases were made.

the outstanding balance, and the small minimum payments that are required can mean that major problems of overcommitment can be masked for years.[7]

These consumers are often vulnerable to unexpected life events such as illness, relationship breakdown or unemployment. In many cases it is that event that has finally brought about the crisis, but credit use patterns in the past have left the consumer less able to cope with the event.

- *Cost of making only minimum monthly repayments*

Calculations done by the Consumer Credit Legal Service a few years ago in relation to one major card showed that if a consumer makes only the minimum monthly payment it would take 9 years to pay off a $2,000 debt and 15 years to pay off $5,000, assuming no further purchases were made.

- *Creeping overcommitment*

Some of these "credit limit surfers" get into financial trouble very gradually, as the credit limit creeps up.For example, one 80-year-old pensioner had continued to accept "pre-approved" credit card limit increases on two credit cards with the same bank – and ended up with a total of $30,000 debt that he and his wife couldn't pay. It was frightening that the credit limit had crept up and up each year as the new offers were made.

This figures shows the ratio of the average interest-bearing credit card debt to household income when credit cardholders without credit card debt are excluded. On average, low-income revolvers have a debt to income ratio of 19%.

- *Assets illiquid*

The Visa report compares credit card indebtedness to net worth, and some of the conclusions are frightening. "The net worth of cardholders in households earning less than $15,000 per year is $194,180. This means they can draw on $236 for each $1 of interest bearing credit card debt".[8] However, given that 82% of these assets are illiquid,[9] what does it mean that they can "draw on $236...?". Sell their house to pay their credit card debt?

Similarly, the report compares credit card debt to net worth of all cardholders, and suggests that, for every $1 of interest bearing debt, cardholders have around $250 worth of net assets, on average, that can be used to repay that debt should a long-term financial crisis strike the household.[10] Again, the only meaning we can read into this is that consumers can sell their homes to repay debt if necessary.

- *Danger of asset-based lending rather than income and capacity to repay*

Many consumer advocates are concerned about an increased in asset-based lending (i.e. lending solely on the basis of assets, without regard to income and capacity to pay). This report, and the discussion of net worth, confirms our fears that credit providers are comfortable with such lending practices.

[7] Some of these "credit limit surfers" get into financial trouble very gradually, as the credit limit creeps up. For example, one 80-year-old pensioner had continued to accept "pre-approved" credit card limit increases on two credit cards with the same bank – and ended up with a total of $30,000 debt that he and his wife couldn't pay. It was frightening that the credit limit had crept up and up each year as the new offers were made.

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- *Forced sales scenario*

The assumption here is that sale of liquid and non-liquid assets can be used to prevent insolvency for credit card debt. However, this is a very blunt tool. Forcing the sale of homes is hardly an appropriate policy response to credit card debt, particularly in cases where the debt has become unmanageable due to poor practices in credit assessment and management.

- *Vulnerability to unexpected life events*

The Roy Morgan data clearly shows that cardholders in low-income households have:

- significantly higher ratios of credit limit to household income; and
- significantly higher ratios of debt levels to household income,than cardholders in higher income households.

For low-income households, the danger of such a high reliance on credit cards is that those households often have very few options for managing their debt if changes in circumstances (eg unemployment, illness, relationship breakdown) reduce their available income. The higher the credit limit or debt level compared to income, the more vulnerable the cardholder is to financial distress arising from unforeseen changes in circumstance.

In addition, any interest payments will have a much bigger impact on low-income consumers than on higher income households, and these consumers will be more vulnerable to interest rate changes.

**Further information required**

ACA believes more work is needed to understand the experiences of those who pay interest on credit cards (according to the Visa report, 42.8% of all credit card holders[11] and 35% of all households using credit cards[12]), particularly those who are on low-incomes or are otherwise disadvantaged.

The Visa report already includes some pointers to where this additional research might be found. In fact, the relevance of some of the information in the report would be greatly improved if it were further disaggregated by income level and excluded those cardholders who do not pay interest.

For example, information along the following lines may already be available through the Roy Morgan Research dataset used by Visa:

- the default rate (using the definition in the report) for different income levels, and as a percentage of the group of cardholders that pay interest;
- the debt turnover rate for different income levels, and as a percentage of the group of cardholders that pay interest.

Additional research on interest-paying cardholders should also examine the following:

- *Consumers in default* – For example, the number and proportion of cardholders who are in default (have an advance outstanding for more than 90 days, or have amount outstanding written off), both overall and by income level; the average default amounts for cardholders of different income levels.

- *Unsolicited and pre-approved credit limit increase offers* – What proportion of credit limit increases result from unsolicited approaches to the cardholder? What proportion of limit increases were initiated by cardholder? What are the characteristics of the cardholders that receive these offers? (For example, Do these cardholders routinely pay

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interest? Does their balance reduce to less than 75% of limit regularly? How often do they repay the total balance on the account?) What assessment do lenders make of ability to repay when making such unsolicited offers?

- *Rates of repayment* of outstanding amounts for interest-paying cardholders, disaggregated by income levels.

- *Balances outstanding compared to liquid assets* for interest-paying cardholders, disaggregated by income levels.

- *Credit card debt and hardship* – What percentage of interest-paying cardholders use credit cards to pay for essential goods and services (food, housing, utilities)? How many consumers use a different form of credit (eg personal loan, payday loan) to repay credit card debts? What proportion of cardholders pay off their credit card debt in total no more than once a year? What proportion of cardholders never reduces their outstanding balance below 75% of their credit card limit? What proportion of cardholders pay only the minimum monthly balance each month?

The rapid uptake of credit and frightening rate of increase in household debt levels suggests this work needs be done as a matter of some urgency, to better understand the impact of high-cost credit on low-income households, and the extent to which that debt is entrenching poverty and exacerbating its effects.

On behalf of ACA, I would be pleased to discuss any aspect of the submission, and can be reached on 0411 670 329, or at cwolthuizen@choice.com.au

Yours sincerely

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