

4<sup>th</sup> January 2005

The Secretary  
Senate Economics References Committee  
Suite SG.64  
Parliament House  
CANBERRA ACT 2600

Dear Sir/Madam

Thank you for the opportunity to make a submission to the Economics Committee.

The Financial Counsellors' Association of NSW Inc., (FCAN) is the body that oversees financial counselling in New South Wales. FCAN accredits training for financial counselling and accredits financial counsellors in NSW.

In relation to the terms of reference please see comments below:

- a. It seems that household debt levels are increasing to a level where it is becoming extremely difficult for some to maintain payments on an ongoing basis. Financial counsellors see examples of this all the time and the damage it does to individuals and families with financial over commitment. With easy credit available it seems this problem will only increase if nothing is done to curb the marketing of credit.
- b. The factors leading to financial over commitment include the lending practices of financial institutions. Unsolicited offers and increases tempt people to take credit without assessing their ability to service the debt. Many people do not understand that most forms of credit such as credit cards from financial institutions have daily compounding interest. Many also feel that paying minimum payment required by a credit card statement will repay the debt only to find out down the track that this is not the case. Making the minimum payment will keep the debt out of the court debt recovery process, as it is the required payment, but may only cover interest and a small amount of the principal. It may take years to fully repay a credit card debt if only the minimum required payment is made.
- c. The cost of goods whether imported or not would contribute to household debt levels if that household was purchasing beyond its means.
- d. We are not in a position to comment on whether demand for imported goods contributes to the current account deficit.
- e. The risks for a household with a high household debt level is that unless the household is able to increase its income there is a good chance that the court debt recovery process will follow. This can result in garnishee of wages leaving very little to live on, sheriff taking possessions, which is very distressing for the consumer or personal insolvency and bankruptcy may follow. This is not good for the consumers involved or the economy. Encouraging consumers to live

within their means is important to avoid bankruptcies that result from credit over commitment. It is also better for lenders if consumers are able to repay debt and no doubt better for the economy.

- f. FCAN considers that there is an urgent need to address the lending practices of financial institutions. Unsolicited offers of credit and increased credit limits are very tempting for consumers who sometimes feel “if the financial institution sent me this offer then I must be able to afford the credit.” It can be the case that the consumer has never done a comprehensive money plan to assess expenditure against income or, as stated previously, the consumer may think that relying on minimum payment will service the debt. Some financial institutions charge quite high interest on lines of credit, which means that consumers relying on only making minimum payment may not be able to service the debt on an ongoing basis if they get behind and the minimum required increases.

There are also short-term lenders who only require identification and a payslip to lend to the consumer. These lenders often do not require a disclosure by the consumer of other liabilities to be met, as a debiting authority is required on the consumers’ bank account to repay the loan. It is often the case due to other commitments that the debit authority fails as money has been used for other commitments. The fees and charges as well as interest on the short-term loan can mean it will become very difficult to repay. People borrowing in this situation will borrow thinking they can repay the next payday but if all commitments haven’t been taken into account this may not happen. This type of lending can be very attractive for people in desperate need of money. People who have gambling problems are often attracted to this type of easy lending.

Interest free periods are also a risk. The advertising does not inform the consumer that if they defer the payment then they will pay interest from day one of the repayment time. There needs to be more information in the advertising of interest free periods to ensure people make an informed decision.

- g. Sound financial literacy is lacking in Australian society. We are aware that there are moves to have financial literacy included in some school curriculums. While this is a very positive move and hopefully will address the financial literacy of school aged children so they will be more aware when as adults they borrow money, it doesn’t address the adult population’s needs in this area. It is important to curb the marketing of financial products in light of the fact that there are some in society who don’t have enough financial literacy to make a sound judgment.
- h. As the Commonwealth Government regulates a number of financial institutions, especially the banks FCAN would like to see regulation to restrict the marketing programs for credit products. FCAN would like to see the required disclosure of not only the interest rate but also how that interest is charged. For example a credit card and line of credit is charged daily and compounding. FCAN would like an explanation to the consumer of what that actually means, that your interest will be added each day and then the next day you will be charged interest on your balance plus the interest EACH DAY.
- i. FCAN would like to see advertising around interest free period loans include information on what happens if the loan is not paid in the interest free period. If the loan is not paid in the interest free period the loan becomes a line of credit, which has compounding interest. Consumers are able to defer the start of the loan to the end of the interest free period, therefore they pay interest. FCAN does not think it should be possible to defer the payment; the loan should be required to be paid in the interest free period. Consumers are often unaware of all the facts surrounding interest free period loans.

- j. The Financial Counsellors Association of NSW Inc., (FCAN) has recently completed a four-year study with the University of Newcastle looking at credit over commitment and I enclose the final report of that study for your information.

Should you wish to discuss any of the above points please contact me on 02 9951 5559.

Yours faithfully

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