Submission to the Senate Economics Committee

Inquiry into the *Australian Securities and Investment Commission (Fair Bank and Credit Card Fees) Amendment Bill 2008.*

"…we have moved to a system where finance is readily available in the community.

That is in marked contrast to where we were in the 1970's where basically the average person had a great deal of difficulty getting money from a bank.

In the current system the onus is more now on the individual to be careful about accessing finance."

Ric Battellino, Deputy Governor Reserve Bank House of Representative Standing Committee on Economics Friday April 4 2008

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Summary

Greatly increased access to credit has significantly improved household wealth in Australia. At the same time, there has been a focus on the amount of debt we are carrying.

However, the question is not the quantum of household debt, but rather the ability to repay that debt. When a household exceeds sustainable debt limits, the financial stress is likely to produce the type of behaviours highlighted in Senator Fielding's bill.

Veda Advantage data shows some Australian households, particularly in outer metropolitan Sydney, Melbourne and Brisbane are suffering financial stress, failing to meet commitments, yet continue to record strong demand for further credit.

The broader question is "***do lenders have the best information to assess if a person can service additional credit repayments."***

The evidence is clear. Current laws prevent lenders identifying a borrower who is overcommitted and struggling to make payments – often resulting in yet more credit being given.

An allied concern is for people who have overcome financial difficulties.

Credit reporting laws prevent a person demonstrating they are once again financially stable and able to meet commitments. They remain hamstrung by defaults listed on their file for up to five years.

Hong Kong's recent move to comprehensive credit reporting has reduced the number bankruptcies in what has been described by the Hong Kong Money Authority (HKMA) as a *"conspicuous improvement in the problem of over-indebtedness".*[1]

Veda Advantage is calling for a modernising of Australia's credit laws. Better information is better protection for both consumers and lenders.

[1] "Benefits of sharing positive consumer credit data" Hong Kong Money Authority Quarterly Bulleting March 2006

Introduction

The Senate has before it a private member's bill to restrict penalty fees for non payments, bounced cheques and exceeding credit limits to no more than cost recovery.

Senator Fielding's Second Reading speech details his concerns that low income families in particular are hardest hit by penalty fees and calls for the introduction of credit cards with a fixed maximum credit limit.

Veda Advantage is Australia's largest credit reporting agency and while we do not issue credit cards or impose penalty fees, we do have substantial data on credit inquiries and defaults on credit cards, personal loans and mortgages.

We believe the Senate, in considering the nature of penalty fees allowable, should also be aware of the circumstances under which credit is initially provided. This can assist Senators to better understand how people end up suffering numerous penalty fees as a consequence of credit stress and owing unsustainable debt levels.

The Senate Economics Committee considered this issue in its 2005 Inquiry into possible links between household debt, demand for imported goods and Australia's current account deficit.

Subsequent to that Report, interest rates have increased seven times and the US sub prime crisis and world credit crunch have considerably altered the credit landscape.

Two current Inquiries, one by the Productivity Commission, the other by the Australian Law Reform Commission, contain recommendations impacting on credit laws in Australia.[2]

Senator Fielding's private members bill is a timely opportunity to update the members on the need for credit law reform.

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[2] Productivity Commission Inquiry into Australia's Consumer Policy Framework Draft Report issued 12 December 2007; a Final Report is due by 30 April 2008. The Australian Law Reform Commission Review of the Privacy Act 1988 issued a Draft Report 12 September 2007; a Final Report is due by 30 May 2008.

Credit use in Australia

For most Australians, easier access to credit has been good news

The last 25 years have seen significant improved access to credit.

Much greater competition and widespread innovation in credit products have contributed to a widening of the number of people able to access credit from mainstream lenders[3].

Credit has overwhelmingly been used to build up wealth, with the Reserve Bank[4] estimating 90 per cent has been used to acquire assets:

- houses (54%);
- investment properties (31%); and
- shares (5%)

The biggest increase in credit use has been in the highest income group and people in the 45-64 age demographic, using debt to buy investment properties, bigger houses and shares[5].

The recent period of low inflation, low unemployment and relatively low interest rates fuelled growth in household borrowing.

Twelve increases in the cash rate since 2001 have brought the health of Australian households' balance sheets into sharp focus.

While the total amount of borrowings is of less relevance than the capacity to repay borrowings, it is accurate to state that increasing the number of people in debt also increases the number of people who are potentially vulnerable, particularly at a time of rising interest rates.

In the current environment, the decision to extend another line of credit – and the basis on which that decision is made – becomes more critical.

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[3]"*In short, deregulation, innovation and lower inflation have simultaneously increased the supply, and reduced the cost, of finance to households, and not surprisingly, households have responded by increasing their use of it*." Address by Ric Battelino, Deputy Governor to Finsia- Melbourne Centre for Financial Studies 25 September 2007.
[4]Ibid.
[5]Ibid.

Accessing credit in Australia

“In the current system the onus is more now on the individual to be careful about accessing finance.”[6]

A Galaxy Research survey[7] on debt commissioned by Veda Advantage revealed:

- On average, Australian households have 1.5 credit facilities;
- Those with a household income below $40,000 have an average of one credit facility,
- Those with a household income over $90,000 have an average two credit facilities

In response to current difficulties in the Australian economy, Australian households are reducing credit commitments.

Overall, credit demand has eased. For the first time in four years, growth in the number of credit card and personal loan applications decelerated.

However, in those areas already suffering financial stress – as demonstrated by a high number of defaults – demand for credit remains strong.

Nationally, for the half year July to December 2007, the number of overall consumer credit (credit card and personal loan) applications decreased year-on-year by 2% to 3.19 million, almost 70,000 less than the same period in 2006.

Inquiries[8] specifically for credit cards recorded a three-year low, falling by 3.8% or more than 70,000 to 1.77 million in the last six months to December 2007 when compared to the same period in 2006.

But closer examination reveals strong demand for further credit remains in those areas already under financial stress.

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[6] Ric Battellino, Deputy Governor Reserve Bank House of Representative Standing Committee on Economics Friday April 4 2008.
[7] Galaxy Research telephone surveyed 1000 Australian households in September 2007 and again in March 2008
[8] Veda Advantage’s credit demand index measures the number of credit checks received by Veda for particular lines of credit.

Of the 20 electorates with the highest proportion of reported defaults, more than half are also in the 20 electorates having the highest proportion of credit applications (bolded):

1. **Chifley NSW**
2. **Reid NSW**
3. **Rankin QLD**
4. Blaxland NSW
5. **Sydney NSW**
6. **Lalor Vic**
7. **Moncrieff QLD**
8. Calwell Vic
9. Werriwa NSW
10. Watson NSW
11. **Holt Vic**
12. **Blair QLD**
13. **Oxley QLD**
14. Wakefield SA
15. **Gorton Vic**
16. Fowler NSW
17. **Melbourne Vic**
18. Longman QLD
19. Lindsay NSW
20. **Fadden QLD**

In mortgage belt electorates, [where more than 30 per cent of households have mortgages] there is a strong correlation between a high number of credit applications and a high number of defaults.

Of the ten mortgage belt seats suffering the highest proportion of defaults, eight were also in the top 20 electorates for credit inquiries (bolded).

1. **Chifley NSW**
2. **Rankin QLD**
3. **Lalor Vic**
4. **Calwell Vic**
5. Werriwa NSW
6. **Holt Vic**
7. **Blair QLD**
8. **Oxley QLD**
9. Wakefield SA
10. **Gorton NSW**

Credit law reform will help households

Better information is better protection for <u>both</u> consumers and lenders

Reserve Bank data attests to the growing fortune of Australian households even while household debt levels rises to historically high levels[9].

However, the question is not the amount of household debt, but rather the ability to repay that debt.

Rising interest rates have brought this question sharply into focus.

According to a Galaxy Research survey commissioned by Veda in September 2007, four out of five Australians are concerned about meeting their debt payment obligations over the coming 12 months[10].

A follow up Galaxy survey in March 2008 revealed 16 per cent are finding it difficult to cope and 1 per cent are unsure how they will make their next repayment.

In these circumstances, Australian borrowers and lenders need the **best credit information** and **better consumer protection** to help manage risk.

Information on credit files should identify people who are potentially over-committed and to whom additional credit should not be extended.

Yet Australian laws currently prevent lenders seeing whether a borrower is over-committed.

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[9] Ric Battelino Ric Battelino, Deputy Governor to Finsia- Melbourne Centre for Financial Studies 25 September 2007.

[10] *"How difficult are you currently finding it to repay your debts as they fall due?"*Galaxy Research telephone survey.

An individual with credit cards maxed out but making minimum repayments can apply for another credit card – and based on the absence of defaults on their credit file may be granted additional credit.

Lenders can only rely on the credit file, their own data on a borrower and what the borrower tells them – and the Galaxy survey commissioned by Veda revealed one in five people have exaggerated or lied on an application for credit[11].

Households in financial stress

When a household exceeds sustainable debt limits, the financial stress is likely to produce the type of behaviours highlighted in Senator Fielding's bill - bounced cheques and exceeding credit limits resulting in monetary penalties.

The next step – where households default on bills – has more significant long-term deleterious results.

Defaults can result in significant difficulties getting credit, including basic necessities such as getting a phone or finance to purchase a family car.

Defaults on a credit file stay on file for five years, regardless of whether the bill is subsequently paid. And current credit laws prevent any positive data being recorded on a credit file.

By not allowing positive information, people who have recovered from a period of financial difficulty cannot prove they are once again credit worthy.

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[11] *"have you ever exaggerated your financial situation, even if only a little, to try to get credit"*- respondents most commonly underestimated expenses, overestimated assets recorded a more stable work history, underestimated other credit commitments and overstated income. Galaxy Research September 2007

Credit law reform will help the economy

"…financial institutions are in a better position to avoid lending to borrowers on the verge of bankruptcy." *Hong Kong Money Authority, following the introduction of positive credit reporting*[12].

Despite growing wealth among most Australian households, a significant and growing number are experiencing financial stress, partly as a result of taking on more debt.

Over the last 30 years credit has been growing fast - faster than GDP.

Figure 1 Credit growth in Australia as a percentage of nominal GDP

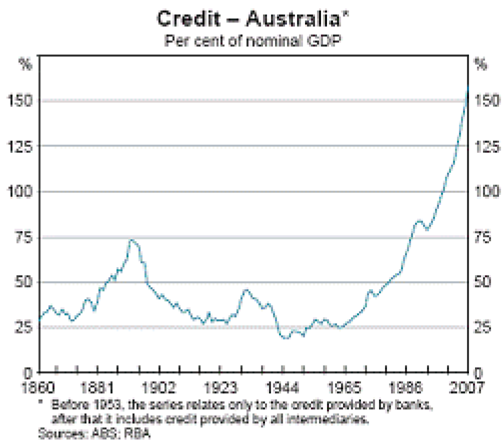
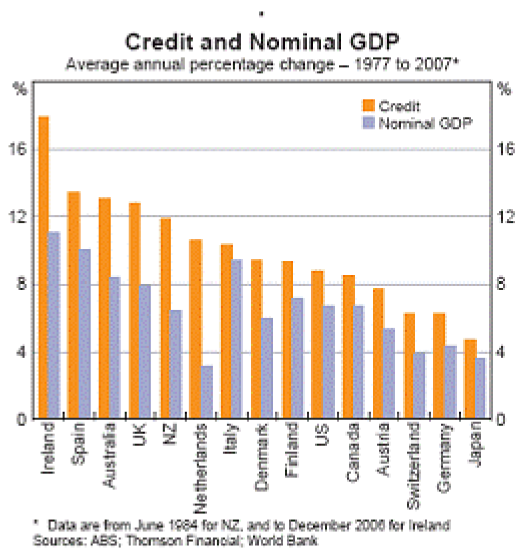


Figure 2 International credit growth and nominal GDP growth



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Interest rates have been increasing since 2001, yet Australian households are still geared more highly than at any time in our history[13].

This has been to the benefit of the vast majority of Australians, enabling accumulation of assets (especially housing) and increasing the number of Australians investing in financial products such as shares.

Innovation in products and increased competition has meant credit is provided by mainstream lenders on much better terms to a broader range of people.

The laws governing credit provision in Australia are now twenty years old and Australia, New Zealand and France are the only countries in the OECD to rely on negative reporting.

In the past five years Hong Kong, Belguim, Greece and India have moved to comprehensive credit reporting.

In Hong Kong, a negative credit reporting regime failed to prevent a huge surge in consumer bankruptcies amid similar credit tightening in 2002, with bankruptcies peaking at 25,328[14].

More comprehensive credit reporting was then introduced in August 2003, helping consumers and their lenders manage risk better, resulting in:

- The number of bankruptcies dropped by 45 per cent in 2004[15].
- By 2005 the average indebtedness of bankrupts had declined from over 35 times a bankrupt's monthly income to 25 times – described by the Hong Kong Money Authority (HKMA) as a "conspicuous improvement in the problem of over-indebtedness"[16].

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[13] Ric Battelino Ric Battelino, Deputy Governor to Finsia- Melbourne Centre for Financial Studies 25 September 2007.
[14] Official Receivers Office, Compulsory Winding Up and Bankruptcy Statistics
[15] Ibid
[16] Hong Kong Money Authority Quarterly Bulletin March 2006.