NSW Legislative Council Hansard

Fair Trading Amendment (Responsible Credit) Bill

Extract from NSW Legislative Council Hansard and Papers Thursday 5 May 2005.

Second Reading

Ms SYLVIA HALE [2.35 p.m.]: I move:

That this bill be now read a second time.

Unfortunately, members of this House will be all too familiar with stories of vulnerable people being lured into completely unmanageable levels of personal debt, particularly credit card debt. In researching this bill I was told of old-age pensioners with no assets and no income other than the pension accumulating credit card debts of more than $50,000 and of unemployed students with four department store cards and three credit cards all "maxed out". There are reports of children barely out of school with crippling debts of tens of thousands of dollars.

Young people are particularly at risk with their have-it-now, deal-with-the-consequences-later mentality. They easily succumb to the aggressive marketing techniques of the finance industry. Mobile phones and credit cards are the main items pushing young people into unsustainable levels of debt. As long ago as 1999, Insolvency and Trustee Service Australia estimated that the average level of debt of 18 to 24 year olds was approximately $5,000, with 24 per cent of all people in the age group reporting difficulties servicing debt.

But it is not only young people who are at risk. The Reserve Bank reports that between 1999 and 2004 the number of personal, non-business bankruptcies rose from 4,994 to 16,441. That represents a fourfold increase in 15 years in the numbers of people whose levels of debt have become unmanageable. One of the biggest causes of these personal financial catastrophes is the credit card. The banking industry's own watchdog, the Banking and Financial Services Ombudsman, reported in 2004 that credit cards were the most complained about financial product in New South Wales, representing 81 per cent of all consumer finance complaints and financial counsellors report a sharp increase in the number of people with levels of credit card debt that they have no hope of ever managing to repay.

With interest rates on store cards being as high as 25 per cent and interest on most credit cards averaging 16 per cent, merely repaying the interest, let alone the capital, can cause serious financial difficulties. Credit card limits, which peg the total amount that cardholders can borrow, have surged. CPA Australia estimates that over the past 10 years the 13 per cent increase in credit limits has risen to a record $75.36 billion, meaning Australians can now borrow up to $75 billion on their credit cards. The Reserve Bank reports that in 2004 the total amount borrowed on credit and charge cards reached $28.2 billion. The Reserve Bank estimates that interest is being paid on approximately 75 per cent of this amount, that is, on the debt amounting to approximately $21 billion.

Visa International reports that only about 35 per cent of all credit card holders actually pay interest on their debt. Those able to pay off their credit cards within the interest-free period are not obliged to pay any interest at all. For the fortunate 65 per cent who accrue no interest, the service offered by credit cards is effectively free. But for the other 35 per cent the service is very expensive indeed. As the Visa and Reserve Bank figures demonstrate when taken together, the interest burden on the $21 billion of debt on which interest is being paid is being borne by the bottom 35 per cent of all cardholders—the customers who can least afford to bear the burden.

The poorer one is, the more one pays. Those who are able to make only minimum repayments could take 50 years to pay back a few hundred dollars. And the interest charged over that time would be many times the original amount borrowed. My parliamentary credit card account with the Commonwealth Bank, which charges 16.9 per cent annually, is a case in point. It would take me 129 years to pay off a $2,000 loan if all I made were the minimum repayments indicated on each monthly bill. And that is if I stop using the card—if I were to tear it up. It would take me 129 years to eliminate the original debt, in the course of which I would pay $6,348 in total, that is, $2,000 in principal and more than double that, $4,348, in interest.

Rising levels of unsustainable debt destroy people's lives. People who are already economically stressed make no-win financial decisions on a daily basis: decisions that trade off unbearable alternatives such as money for a bus ticket to get to a job interview, or food for the kids' school lunch. For people in this situation credit cards are not about buying luxury items but about providing the basic necessities of life. What would most people choose if the electricity disconnection notice arrived in the same mail as a pre-approved credit limit increase?

Using the Reserve Bank's conservative figures, 95,000 credit card customers are in extreme financial stress.

How do these people regain financial control of their lives? The simple answer is that in many cases they do not. They grind on for years struggling to cope, robbing Peter to pay Paul, often borrowing on one card to make minimum repayments on another. In the process some pay up to 50 per cent of their income in interest payments.

Much of the problem stems from unsolicited, pre-approved, credit limit increases. Lenders mail out offers to increase credit limits without first assessing whether the cardholder actually has the capacity to repay the loan. One unemployed woman had her credit increased incrementally from $2,000 to $10,000 without any assessment of her financial situation being undertaken. Financial counsellors report that it is common to find people with no income other than a government benefit with credit card limits greater than their entire annual income. As long as minimum repayments are made each month lenders are prepared to push people further into debt. As a marketing strategy it is highly profitable. It is also highly unethical. The banks and credit card lenders know this. The Banking and Financial Services Ombudsman, whose activities are underwritten by 30 banks and 17 non-bank financial institutions, acknowledged the problem in the 2004 annual report:

For Credit Card accounts the main problems identified were unauthorised transactions and maladministration in providing credit. Maladministration arises when credit is provided to a customer in circumstances where they had no reasonable prospect of servicing the repayments.

Yet, despite identifying the problem, the industry has done nothing to fix it. Following recommendations from the Australian Bankers Association in 2001, the Banking Code of Practice was amended to place some responsibility on lenders prior to increasing credit limits. This measure, however, has had virtually no impact because the code is a voluntary one and is self-administered by the industry, with no mechanisms in place for compliance or enforcement. Moreover, the code applies only to banks and not to the multitude of other financial institutions that now offer credit cards. Rather than accepting responsibility for conducting adequate assessments and protecting vulnerable customers from becoming enmeshed in dangerous levels of debt, the industry defends its practices.

The sector places the onus onto individuals to manage their own affairs, arguing that people should take personal responsibility for their own spending habits and financial management. And, in an ideal world, they would. The Greens do not dispute this. But what the personal responsibility argument conveniently does is to shift all responsibility from those who have the resources, skill and capacity to manage money onto those who do not. To exploit the young, the vulnerable, the poor—to take advantage of those in straitened circumstances—may be commercially astute, but it is also immoral. And this is what this bill addresses. Its purpose is to transfer a fair and reasonable level of responsibility and accountability back onto credit providers. I will now deal with the specific provisions of the bill. The most significant provision requires lenders to conduct an assessment of a debtor's ability to repay the loan before a contract is issued or a credit limit increased. Currently, credit providers conduct such checks only when a new customer applies for an account. As long as that customer meets the monthly minimum repayments credit can be quickly increased to unsustainable levels without any further checks being undertaken. The financial institution makes the brave, and I believe disingenuous, assumption that because a customer is meeting minimum monthly repayments he or she can afford more debt. And so they offer more. But keeping up with interest payments and paying off principal are not one and the same thing. The current system used by credit card providers actively pushes people into unmanageable debt. This provision of the bill will mean that credit providers cannot provide credit or increase a credit limit if they know, or ought to have known after reasonable inquiry, that the debtor could not repay the loan without incurring substantial hardship.

The term "financial hardship" is consistent with terminology used elsewhere in the Consumer Credit Code, but the bill goes further. It stipulates that substantial hardship in this instance means that the creditor must be satisfied—based on its assessment of the applicant's ability to pay—that the debtor has the ability to repay the loan in full within a five-year period. This does not mean that all credit card debt must be repaid within five years. Rather, it means that the credit provider, in its assessment of financial capacity, must assume that debtors have the ability to repay the debt within this period and decline either to issue the card or to increase the limit if that reasonably appears to be beyond the capacity of the borrower. A five-year loan at 17 per cent interest constitutes a very substantial loan.

The 2004 annual report of the Banking and Financial Services Ombudsman referred to the case of an old age pensioner whose financial institution permitted her to run up a debt of $74,000 because she was meeting the minimum monthly repayments. She was doing this by placing her entire pension into her credit card account each month. Such a situation should never have been allowed to happen. Yet under the current legislation there is nothing to stop it. Credit checks are hardly a new practice. We are not asking the finance industry to learn new tricks, or perform a costly new function.

We are asking them to do something that they already do when they first assess an application for a credit card. All the bill requires of the industry is for credit card providers to assess the ability to pay each time an increase in credit limit is sought and to make an informed and reasonable decision in the light of that assessment.

The bill also includes a compliance mechanism. Rather than a penalty in the form of a fine, the bill stipulates that where credit providers fail to assess a debtor's ability to repay, and where that customer subsequently runs up a bill that a prior check would have revealed they had no realistic capacity to repay, then the liability will rest with the credit provider and not the customer and there will be no obligation on the customer to repay the debt. If the credit provider has been reckless and has failed to carry out appropriate checks, then that provider should live with the consequences.

Of course, the finance sector will not like this provision. I have no doubt that this is precisely why this bill will provide an effective incentive to action, far more effective than the current voluntary code of practice, in ensuring that the industry thinks twice before extending credit irresponsibly in the first place. This penalty provision is necessary because the only currently available avenue of redress for a debtor is to take legal action, or to threaten legal action, against a financial provider if the debtor believes the provider has been wilfully negligent. Not surprisingly, this seldom occurs because distressed customers, already in a state of deep financial hardship, seldom have the financial or emotional wherewithal to take on the banks.

The bill also improves disclosure about fees and charges. It is true that monthly credit card statements already show interest charged and standard fees and charges, but more can be done. Surveys show that approximately 81 per cent of customers do not know the interest rate being charged or the cost of other charges incurred. Most people do not understand or cannot conceive that making the minimum monthly repayment on a $2,000 credit card debt means that it will take them 129 years to pay it off. This bill requires that a clear explanation of, first, how much interest is being charged; second, how much interest will be charged on the outstanding balance; and, most important, third, how long it will take a customer to repay a loan if all they do is to make the minimum monthly repayment stipulated on the statement. Improved disclosure and more information being provided to the customer is not a panacea for all the problems that credit cards present. But the more information a customer has, the better equipped he or she will be to manage their use of credit cards responsibly.

I would like to turn now to the final provision of the bill, namely extending credit beyond the limit set down in the contract. Once again, it is extraordinary that this even occurs, but let me assure honourable members that it does. Under the Consumer Credit Code lenders are not permitted to extend the limit set down in the contract without the written consent of the debtor. This is why unsolicited credit limits require the borrower to sign and return the letter accepting the credit before the new credit limit takes effect. While it may be the law that credit lenders cannot extend the credit limit without first obtaining written consent, to all intents and purposes the industry is flouting this requirement.

Gone are the days when a customer went to use a credit card, only to be told at the cash register that they had reached their limit. Many credit providers today simply extend credit beyond the limit stipulated in the contract. So, although credit providers are not permitted to alter the contract without written consent, they regularly extend credit beyond the level set in the contract. The Banking and Financial Services Ombudsman's guidelines covering credit card complaints detail the case of an unemployed woman with a credit limit of $3,000, who managed to run up a bill of $13,000 without the financial institution doing anything to stop purchases on the card, despite knowing about the problem as soon as the account was 10 per cent overdrawn. Why was a stop not put on her account?

This situation was first raised by the Ombudsman in 1995, yet virtually nothing has been done in the nine years since then to rein in the practice. In fact, things have gone backwards. In recent years many credit card providers have introduced a new penalty fee known as an "over limit" charge. So, rather than the banks doing their job and customers being told at the cash register that they cannot exceed their limit, now they are hit with a penalty fee and at the same time offered even more credit, pushing people further into unsustainable debt. This bill will put a stop to this practice.

Proposed section 62A reaffirms that a credit limit cannot be extended without the written consent of the debtor. It goes further to require that credit not be extended more than 10 per cent above the level of the limit set in the written contract. The bill sets a 10 per cent buffer to allow some flexibility for accounting fluctuations and minor variations resulting from items such as overseas currency conversions, or incidental fees and charges associated with direct debits. But the credit card providers would no longer be able to countenance, encourage and in fact connive in the running up of debts of $13,000 on a card with a $3,000 limit.

Let me say that these problems are well known. Financial counsellors and key organisations working on these issues at a policy level, organisations such as the Consumer Legal Credit Centre and the Council of Social Service of New South Wales, have been calling for reform for some time. These reforms are not radical. A bill very similar to this was introduced by the Australian Capital Territory Government in 2002.

The Greens are not opposed to credit per se. Borrowing capital is a time-honoured way to create wealth and get ahead in life. But there are different ways of borrowing money. Credit cards can be extremely handy but they are also very expensive. They give consumers tremendous flexibility and enable people to manage their purchases and cash flow in their own way, in their own time. But credit cards, by their very nature, lure people into spending more than they otherwise might. Once the purchase has been made, consumers are then hit with one of the most expensive ways of borrowing money. Paying 16 per cent interest over 10 years on a $10,000 credit card debt is not the most effective way of managing money.

Pushing people into unmanageable levels of debt is not ethical. Nor is it in the interests of the broader community. It is time for credit card providers to start shouldering their share of the responsibility for a fair and just credit system. It is time they helped to extricate people from crippling levels of debt, by putting steps in place to ensure they do not get into unmanageable debt in the first place. This bill puts the responsibility back onto credit card providers by forcing them to conduct an assessment of a customer's ability to repay. It demands greater disclosure of fees and charges, and stops financial institutions flouting credit limit requirements and issuing never-ending credit. All these provisions are eminently sensible and I urge members of the House to support the bill.