CUSTOMER OWNED BANKING ASSOCIATION

COBA submission to Senate Economics Committee Inquiry: Matters relating to Credit Card Interest Rates

14 August 2015


CUSTOMER OWNED BANKING ASSOCIATION
CUSTOMER OWNED ADIs
75 CREDIT UNIONS
$92 BILLION IN ASSETS
12 MUTUAL BANKS
23.4% WOMEN DIRECTORS
6 MUTUAL BUILDING SOCIETIES
MARKET LEADING CUSTOMER SATISFACTION
4,000,000 CUSTOMERS
5th LARGEST SHARE OF HOUSEHOLD DEPOSITS
100% PROFITS BENEFIT CUSTOMERS & COMMUNITIES
2ND LARGEST BRANCH & ATM NETWORK

Executive Summary

Credit cards offered by customer owned banking institutions have substantially lower average rates, more free days and lower annual fees compared to the big four banks.[1]

The credit card market is delivering competitive products and choice to consumers but the challenge is ensuring that consumers are informed and empowered to act in their own interests.

Independent consumer polling commissioned by COBA shows low awareness by consumers about their credit card interest rate and about who offers the lowest rate cards.

Government, and agencies such as ASIC, should devote resources to communications campaigns to ensure consumers are better informed about the diversity and range of offerings in the credit card market and the risks of high-rate cards.

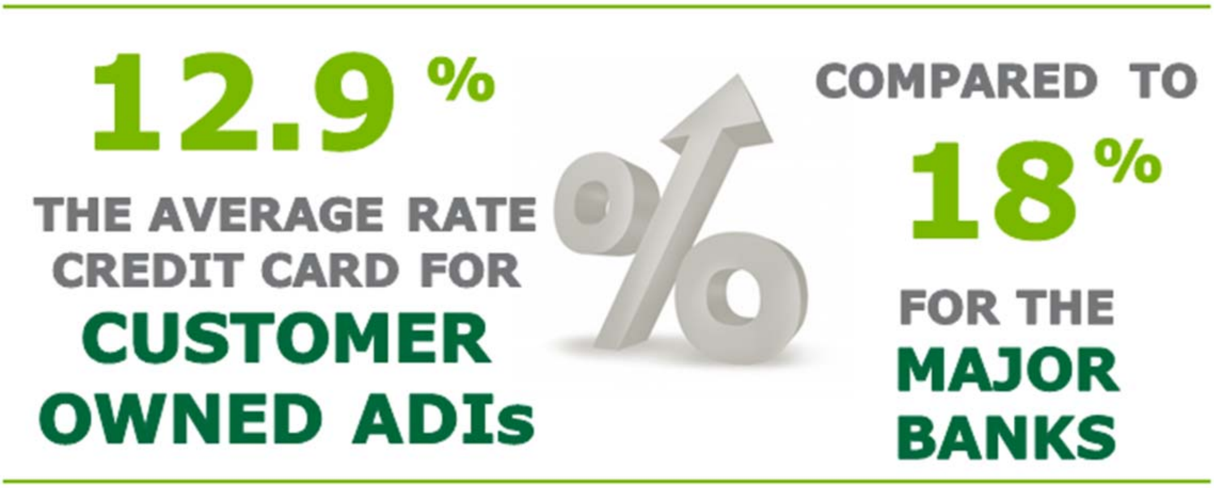
Competition can be improved in the credit card market. The credit card market, like the wider banking and financial services market, is dominated by the major banks. The recent Financial System Inquiry found that:

> *Some sectors of the financial system are concentrated. In particular, the banking sector is concentrated, with the four major banks being the largest players in many aspects of the financial system and having significant market influence. Such concentration creates risks to both the stability and degree of competition in the Australian financial system.*[2]

The FSI made 12 recommendations relating to competition, including measures to level the playing field in banking, increase regulator accountability and strengthen the focus on competition in the financial system.

Promoting competition and promoting consumer choice will improve consumer outcomes in the credit card market.

[1] Based on data sourced from Canstar Online Database, 22 June 2015.
[2] Financial System Inquiry Final Report November 2014



The credit card market is highly regulated and has been subject to consecutive waves of regulatory reform in recent years, with the impact of the latest regulatory initiatives still to be assessed.

Implementation of the pro-competitive FSI reform agenda in banking, the recent lowering of barriers to entry in credit card issuing, and the commencement of comprehensive credit reporting are all likely to further improve consumer outcomes in the credit card market.

On the other hand, additional regulatory imposts on credit card providers are likely to be counterproductive. The cost of regulation is ultimately imposed on consumers and can have a chilling effect on competition, choice and innovation. Regulatory compliance imposes a disproportionately heavy burden on smaller players.

The Reserve Bank’s suggestion it may significantly reduce credit card interchange fees, if implemented, would mean that costs for services provided to merchants would have to be absorbed by card issuers or passed on to card holders in the form of higher interest rates or higher fees.

COBA recommends that the Committee:

1. **supports allocating resources to communications campaigns to inform and empower consumers in the credit card market;**
2. **supports prompt implementation of the FSI’s recommendations to improve banking competition;**
3. **rejects increasing the regulatory compliance burden on card issuers; and**
4. **supports card issuers being able to continue to recover costs through interchange fees for benefits provided to merchants.**

Introduction

The Customer Owned Banking Association (COBA) welcomes the opportunity to provide a submission to this Inquiry.

COBA is the peak body for customer-owned banking institutions: credit unions, building societies and mutual banks.

Collectively the sector has $92 billion in assets and has the largest share of the household deposits market outside the four major banks.

Customer owned banking is banking that gives back – to Australian families and their communities. More than four million Australians bank with a customer owned bank, credit union or building society.

We bring a fundamentally different model to the market, a model where customer interests are not in conflict with shareholder interests.

Customer-owned banking is distinguished by:

- prioritising customer benefit over profit maximisation;
- conservative business models and prudent risk management; and
- a deep community engagement and strong customer loyalty.

The sector's singular focus on its customers is demonstrated by its market leading average credit card interest rate for standard cards of 12.9% compared to 18% for the major banks (excluding subsidiaries).[3]

Customer owned banking institutions offer more interest free days and lower annual fees than the major banks, as shown in Figure 1.[4]

Figure 1: Credit cards offered by customer owned banking institutions offer lower rates, more free days and lower annual fees.

	Interest rates	Free days	Annual fee
Customer Owned ADIs	**12.89%**	**53.6**	**$38.50**
4 Major Banks	**18.06%**	**49.9**	**$60.40**

The Canstar Online Database also shows that of the 241 personal credit cards subject to analysis, and excluding bonus or introductory rates, 19 of the 20 lowest rate personal credit cards on the market are offered by customer-owned banking institutions.[5]

Quay Credit Union has the cheapest card on the market with a low rate of 7.99% and up to 55 days interest free on purchases.[6]

Quay is also waiving the annual fee for the first year and offering 0% on balance transfers for 6 months.

With great offers like this in the market, there is no need for customers to be paying exorbitant interest rates.

[3] Canstar database, 6 August 2015.
[4] Canstar database, 22 June 2015.
[5] Canstar database, 6 August 2015.
[6] Canstar database, 6 August 2015.

Figure 2 - Community First's low rate credit card is a consistent award winner for outstanding value

Community First Credit Union's low rate visa card has one of the lowest rates in the market, and is a consistent award winner for outstanding value. It has a rate of 8.99% on purchases, cash advances and balance transfers.

The product also has a ground breaking partnership with one of Australia's best known and respected charities. Half the annual fee goes to the McGrath Foundation to fund Breast Care Nurses across Australia and this initiative has raised more than $300,000 for communities across Australia.

As well as highly competitive pricing, our sector also offers innovative products for niche markets. For example, Beyond Bank offers an Arts Card that allows customers to purchase artwork on their card with a 12 month interest free period. The regular interest rate is the same low rate as Beyond Bank's other credit cards, 12.49% on cash purchases.

Figure 3 - Beyond Bank's Arts Card offers supports the Arts and offers customers a great deal

In this way, Beyond Bank is supporting the Arts in Australia and offering its art-loving customers a great deal.

CHOICE has been running a campaign since October 2014 encouraging consumers to switch away from major bank credit cards and pointing to the genuinely low-rate cards on offer from customer-owned issuers such as Community First Credit Union, Victoria Teachers Mutual Bank, Maritime Mining & Power Credit Union and bankmecu.[7]

CHOICE believes consumers are distracted from very high interest rates by major banks putting a focus on rewards schemes, interest-free periods, balance transfers and 'low' annual fees.

Consumer awareness of interest rates

Treasury's 25 March 2015 Ministerial Brief on credit card interest rates notes that "many credit card users do not pay attention to the interest rate because they expect not to pay any interest."[8]

Independent consumer polling for COBA by Essential Research conducted in January 2015 (see COBA media release[9]) shows that two-thirds of people don't know who offers the lowest credit card interest rates and half the population don't know what they're paying in interest on their credit cards.

The research poll found a significant proportion of younger Australians wrongly think the big four banks offer the best rates - 16% of people aged 18-34 nominated the big 4 banks compared to just 7% of those aged 55 and over.

These results show there is a lack of consumer awareness about the best rates on offer and how to access them.

[7] https://www.choice.com.au/about-us/media-releases/2014/october/banking-on-the-lazy-tax
[8] Treasury Ministerial Brief MS15-000931, obtained under FOI, 25 March 2015, p.5
[9] Accessible at http://bit.ly/1K1CdUE

Treasury's Ministerial Brief describes how many credit card holders who become 'revolvers' (i.e. they carry credit card debt and pay interest) believed at the time they applied for their credit card that they would be 'transactors' (i.e. they would pay no interest, taking advantage of the interest-free period).

> *Numerous studies examine the behavioural biases that lead card users to become revolvers. Two commonly cited causes are overconfidence in one's ability to resist purchasing too many goods and services on credit and a tendency to underestimate the potential for future events to disrupt one's repayment abilities.*[10]

All stakeholders can play a role in increasing financial literacy across the community but another wave of regulation of card issuers is not the appropriate response to problems arising from consumer behavioural biases.

Awareness-raising campaigns funded by government would help to address these problems by empowering consumers and therefore driving more effective competition in the credit card market.

Competition in banking

Treasury's Ministerial Brief notes that there is a high degree of concentration among credit card issuers, with the four major domestic banks accounting for around 80 per cent of total credit card balances outstanding.

> *This reflects the concentration of the Australian banking system more generally rather than being a unique feature of the credit card market.*[11]

COBA strongly supports Treasury's observation that implementation of the FSI reform blueprint will improve competition in banking.

> *Successful implementation of reforms to level the playing field on capital requirements could have a substantial impact on competition dynamics in the household lending market, including the credit card market.*[12]

A fairer regulatory framework will enable smaller banking institutions to compete more effectively, to gain market share and to increase their visibility to consumers.

The FSI recommended that regulators focus more on competition. The banking prudential regulator, APRA, is already required to consider competition and contestability in its decisions but in COBA's view APRA does not prioritise competition.

For example, APRA has just this week formally banned credit unions and building societies from using the term 'banking' in a registered corporate, business or trading name or internet domain name. This is a baffling and contradictory decision by the prudential regulator because the business of credit unions and building societies is 'banking'.

Restricting use of the term 'banking' by some banking institutions but not others undermines competition and competitive neutrality in the banking sector. APRA acknowledges that all ADIs, including all credit unions and building societies, engage in banking business. Indeed, APRA allows all ADIs, including credit unions and building societies, to use the term 'banking' in marketing and branding material to describe their banking activities. However, APRA's legislative instrument[13] issued this week restricts only credit unions and building societies from using 'banking' in their name. The instrument's Explanatory Statement says: "This restriction ensures that smaller ADIs do not present themselves as banks. While all ADIs conduct banking business not all are banks." The point about "smaller ADIs" adds another question to this confusing and unwelcome regulatory move because a number of COBA's member institutions that are credit unions and building societies are significantly larger than some banks.

[10] Treasury Ministerial Brief MS15-000931, obtained under FOI, 25 March 2015, p.5
[11] Treasury Ministerial Brief MS15-000931, obtained under FOI, 25 March 2015, p.5
[12] Treasury Ministerial Brief MS15-000931, obtained under FOI, 25 March 2015, p.2
[13] https://www.comlaw.gov.au/Details/F2015L01254

APRA's legislative instrument was not accompanied by a Regulation Impact Statement.

The FSI called for better reporting of how regulators balance competition against their core objectives.

> *The Inquiry's philosophy places a high level of trust in regulators to make judgements that balance the efficient, stable and fair operation of the financial system. While acknowledging that regulators often have a difficult task, there is room for improvement.*

Recent regulatory reform

There have been significant developments in the regulation of consumer credit since 2009, resulting in tighter lending standards and increased consumer protection.

The National *Consumer Credit Protection Act 2009* (NCCP Act) established a single and nationally consistent standard which regulates the provision of certain types of credit including credit cards.

The NCCP Act imposed significant consumer protections that all lenders must comply with in the management of consumer credit contracts. The most critical aspect of the NCCP Act was to legally require lenders to ensure new borrowers do not overstretch themselves.

ASIC RG209 outlines the responsible lending obligations that sit underneath the NCCP Act. In order for lenders to meet ASIC's guidelines, they are required to take three steps:

- make reasonable inquiries about the consumer's financial situation, and their requirements and objectives;
- take reasonable steps to verify the consumer's financial situation; and
- make an assessment about whether the credit contract or consumer lease is 'not unsuitable' for the consumer (based on the inquiries and information obtained in the first two steps).

These significant reforms have resulted in much tighter regulation around the provision of credit cards.

Since the NCCP Act was introduced, there was a further wave of credit card reforms in 2011. These reforms, combined with the increasing use of debit cards and the growing availability of discounted balance transfer offers, appear to have had a positive impact on card holder behaviour.

Treasury's briefing notes that:

> *...the proportion of credit card balances accruing interest (or the proportion of 'revolvers') has fallen quite significantly since early 2011.*[14]

Key elements of the 2011 credit card reform package were:

- Credit card key fact sheets now provide a standardised layout of key information.
- Customers are asked to nominate a credit limit when they apply for a card.
- Over-limit fees are banned unless a customer specifically agrees that their lender can charge a fee for the service.
- Customers have to be notified when they have exceeded their credit limit.
- Credit card providers are required to direct repayments to the most expensive part of a customer's credit card debt first - making it easier for consumers to reduce their debt faster.
- Offers by card providers to increase a customer's credit limit are banned unless the customer expressly agrees to receive them.

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[14] Treasury Ministerial Brief MS15-000931, obtained under FOI, 25 March 2015, p.6.

- Consumer's monthly statements include personalised information such as how long it will take them to pay off their entire balance if they only make minimum repayments. This reform helps consumers make more informed decisions about how much to pay off each month.
- Credit card providers need to clearly show how their interest free periods work. This makes it easier for customers to take advantage of these offers and benefit from the reduced amount of interest charged.

The evidence suggests that these reforms are having an impact.

The 2015 ANZ Survey of Adult Financial Literacy in Australia shows that credit card usage is lower post-GFC. The number of people paying for goods and services on a credit card has fallen from 71% (2011) to 64% (2014). At the same time, there has been increasing usage of debit cards (up 6 points to 76%).[15]

There has also been an increase in the proportion of people who feel 'very comfortable' or who 'don't owe any money' (47%), which was higher than in 2005 (39%) and 2008 (42%).[16]

There are clearly several positive trends in the use of credit cards since 2011. COBA suggests that the 2011 reforms are partly responsible for this. These reforms should be given more time to take effect before contemplating any further regulation.

Lower barriers to entry

In 2015 a new regime was introduced to open up access to the credit card schemes for new issuers. This was done by removing the requirement that issuers had to be ADIs. Banking regulation was judged to be more onerous than necessary to manage the risk associated with card issuing (and acquiring).

> *Opening up access to non-ADIs is likely to increase competition and innovation in card issuing and acquiring, resulting in downward pressure on fees and charges, and better service to merchants and end users (which include consumers, business and government). Non-ADI issuers and acquirers will also not be subject to the ongoing costs associated with supervision by the Australian Prudential Regulation Authority.*[17]

Comprehensive credit reporting

Comprehensive credit reporting (CCR) is likely to have a significant positive impact on the credit card market, spurring competition. Credit is likely to be extended to more consumers without increasing default rates, and consumers will be less likely to over-extend themselves.

CCR changes the type of consumer credit information that can be used by credit providers to assess credit. Previously, Australia had a negative reporting system. This meant that consumer credit reports only contained 'negative' information such as if the customer had applied for credit, credit payment defaults and serious credit infringements. Under the new CCR system, positive data is able to be included on credit reports, providing a more complete picture of a customer's credit commitments.

Although the change came into effect in early 2014, positive data has yet to be exchanged by credit providers. Credit providers and bureaus are awaiting the finalisation and necessary approvals for the industry code regulating comprehensive credit reporting.

Once data begins being exchanged, CCR will bring positive changes in the credit card market. Consumers will have more information to demonstrate their credit worthiness and manage their credit profile. This will allow consumers to highlight good credit behaviour and more quickly recover from adversity by demonstrating good behaviour, potentially countering the impact of a default. This will result in fairer access to credit.

[15] 2015, ANZ Survey of Adult Financial Literacy in Australia, p.27
[16] Ibid, p.57
[17] https://www.comlaw.gov.au/Details/F2014L01710/Explanatory%20Statement/Text

CCR has the potential to increase competition and put downward pressure on credit card interest rates. The Financial System Inquiry recognised this, arguing that more comprehensive sharing of credit data would reduce information imbalances between lenders and borrowers as well as facilitate borrowers switching between lenders and greater competition among lenders.[18]

Credit providers will have more information about consumers, which means they will be able to better match credit types and amounts to borrower capacity. Lenders will have capacity to more accurately price credit relative to the risk profile of the borrower.

CCR will also assist lenders to meet their responsible lending obligations. A KPMG Report on the benefits of CCR stated:

> *A further benefit associated with enhanced exchange of credit data relates to responsible lending – i.e. ensuring that borrowers have access to credit on reasonable terms and are not provided with credit which they cannot readily service, especially in periods of financial stress.*[19]

Role of interchange fees

The Reserve Bank of Australia (RBA) is currently reviewing card payments regulation, including a proposal to reduce interchange fees.

Any significant reduction in credit card interchange fees would have a negative impact on card holders and is unnecessary given the RBA's observation that "Australia now has a relatively low cost payments system by international standards."[20]

COBA agrees there is a case for some modest amendments to the interchange fee regulatory framework to address the negative impact on small merchants of some interchange fee trends.

The problem that the RBA is attempting to solve by proposing to lower interchange fees is the cost disadvantages faced by smaller merchants compared to large, 'strategic' merchants. The solution should be targeted at the problem and should not result in negative outcomes for smaller card issuers offering low-rate credit cards.

Cutting average interchange fees will reduce the capacity of smaller card issuers to continue to offer low-rate cards. Card issuers will be forced to absorb the reduction in income or recover it from card holders in the form of higher rates or higher fees.

The official regulatory model for calculating interchange fees is based on 'eligible costs' of benefits provided by card issuers to merchants.

Transaction processing and authorisation, fraud and fraud prevention and the provision of an interest-free period are significant benefits provided to merchants that come with significant costs to issuers. These costs should continue to be recovered through interchange fees.

Merchants should pay for benefits they enjoy. If merchants don't bear the cost of services provided to them by issuers, it is likely card holders will end up paying – and that is not fair.

COBA does not oppose targeted measures to address the negative impact on small merchants of some interchange fee trends. However, any changes should be limited, with due consideration to avoid complexity, unnecessary cost, unintended consequences, confusion for consumers, and higher costs for issuers of low-cost, low-rate credit cards and their customers.

[18] Financial System Inquiry – Final Report, November 2014, p191.
[19] KPMG, Report to the Australian Retail Credit Association: The benefits of enhanced credit data exchange, January 2015, p.20
[20] RBA's Issues Paper on premium cards, interchange fees and merchant service fees, March 2015

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Risks of further regulation

It is likely that some stakeholders will recommend that the Committee should call for new regulatory measures in the credit card market.

COBA does not see a need for additional regulation at this time, given the extent of recent regulatory reform.

The cost of regulation risks increasing prices for consumers and, where it imposes additional barriers or restricts innovation, it can have a chilling effect on competition and choice. While the benefit of additional regulation is debatable, there is no doubt that it imposes significant additional costs.

Treasury has recognised the danger of too much regulation to credit cards, stating that any reforms to credit card lending should not compromise the competitiveness of industry or restrict consumer access to credit cards

> *It is therefore important to consider the impact any additional requirements would have on the availability of credit and ensuring downward competitive pressures on cost of credit.*[21]

Increasing the regulatory compliance burden increases fixed costs for all players but smaller players are disproportionately impacted. This means that increasing the regulatory compliance burden effectively provides the largest players with a competitive advantage. Excessive regulatory burdens artificially reinforce the advantages of scale and undermine competitive pressures.

COBA also notes that adding new regulations which limit the capacity of ADIs to serve customers in this space may simply force those customers to seek out products in less heavily regulated sectors, undermining the very purpose of the regulation.

For example, if changes to the regulatory framework make it harder for customers to get a credit card that meets their needs, they may instead look to payday lenders. The fees and charges associated with these products are far more costly than even the most expensive credit cards, and it would be difficult to argue that this would in any way be a positive outcome for the customer.

COBA believes that instead, Government intervention should focus on empowering consumers to make informed decisions. We note that Treasury has suggested that there would be value in

> *…highlighting the diversity of product offerings in the credit card market – including the availability of low-rate cards and free balance transfer offers – and encouraging consumers to actively pursue the most competitive offerings.*[22]

To discuss any aspect of this submission please contact:

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[21] The Treasury, National Credit Reform: Enhancing Confidence and Fairness in Australia's Credit Law, Green Paper (July 2010), p.31
[22] Treasury Ministerial Brief MS15-000931, obtained under FOI, 25 March 2015, p.2

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