

BACKGROUND PAPER

A CONSUMER RESPONSE TO “THE CREDIT CARD REPORT: CREDIT CARD SPENDING IN PERSPECTIVE”

1. INTRODUCTION

In November 2002, Visa International released “*The Credit Card Report: Credit card spending in perspective*”. According to Visa, the report “has been prepared ... to facilitate objective discussion of credit card use in Australia”.¹

The conclusions of the report were widely reported in the media, and the overall picture presented was a rosy one of responsible credit use and responsible lending practices.

However, consumer groups have serious concerns about the validity of this report and the conclusions drawn from the data presented. To us, it is clear that the report was written with political ends in mind.

In particular, there appears to have been little effort made to collect or report anything other than information that supports Visa’s commercial interests. Most of the conclusions drawn in the report are unsupported, including the main themes or conclusions on p. 3, i.e. that:

- There is not excessive spending on credit cards by Australians.
- Consumer credit card limits are not set at inappropriate levels or indiscriminately.
- Consumers are not carrying excessive levels of debt and are better off today than 5 years ago.
- Low-income earners as a group are not susceptible to financial trouble due to credit card debt.

These conclusions also are inconsistent with the casework experiences of consumer advocates.

In addition, there is a glaring hole in the report’s failure to examine in any detail the group of cardholders for whom credit card debt is more likely to be problematic – those consumers who pay interest every month; and particularly those consumers in this group who are on low-incomes.

This paper explains the concerns of consumer groups in more detail, and suggests ways in which a more accurate picture of consumer credit card debt and its impacts could be obtained.

¹ Page 3.

2. GENERAL LIMITATIONS OF THE REPORT - USE OF DATA

A major disappointment we have with this report is that it fails to disaggregate the data in a way that enables the issues to be examined.

The Report states that concerns raised over the use of credit cards by “government, consumer groups, the media and many others in the community” were based on RBA data, but that this RBA data is too aggregated to draw firm conclusions. In particular, the report notes that the RBA data on the value of advances outstanding includes both interest bearing and non-interest bearing debt.²

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.

Despite acknowledging this problem, the report compounds it by making the majority of its claims based on a percentage of all credit card holders. This averaging of figures across all users significantly reduces the usefulness and credibility of the report.

Default rates and repayment rates will, of course, look impressive if the consumers who do not pay interest on their credit cards are added to the data pool. Many of the conclusions in the report, could be attributed simply to the fact that an increasing number of people are using credit cards as a payment facility, rather than to any improvement in credit assessment or reduced number of overcommitted consumers.

It is unhelpful to talk about the amount of borrowings, the rate of repayment or even defaults as a percentage of all credit card debt. Instead, a report such as this should focus on the 42.8% of cardholders³ (or the 35% of households⁴) who pay interest on their credit cards, who hold 75% of the advances outstanding.⁵ 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.

If the majority who simply used their card as a payment tool were removed, the report could have provided some helpful information on default rates, debt levels and credit limit increases of the consumers likely to get into trouble.

3. NET SPENDING ON CREDIT CARDS

The report concludes that: “*Australians are not spending excessively on their credit cards. Due to increasing incomes and substantial net worth, consumers have increased their overall consumption of goods and services. Concurrently, credit card’s portion of consumption spending has also increased due to many factors.*”⁶

² Page 26.

³ Page 28.

⁴ Page 5.

⁵ Page 26.

⁶ Page 3.

It is apparent from the data that, overall, consumers are increasingly paying for goods and services by credit card. Reasons for this change may include lower costs and increased flexibility compared to other forms of payment. However, there is no information in this report that supports the claim that “Australians are not spending excessively on their credit cards.”

Indeed, there is no analysis of what ‘spending excessively’ might mean.

For many consumers, credit card use does not cause financial hardship. However, there is at least anecdotal evidence that increased spending has caused hardship for some groups of consumers, and that this increased spending is facilitated by poor decisions by financial institutions in relation to credit limits and other matters. Nothing in this report refutes these concerns.

4. SETTING OF CREDIT CARD LIMITS

The report concludes that: *“Consumer credit limits are not set at inappropriate levels. Financial institutions do not indiscriminately set limits on credit cards. Factors such as income, credit history and wealth are considered. Assertions that increased credit limits are causing financial difficulty are inconsistent with the decrease in default rates.”*⁷

We dispute these claims. In particular, there is no evidence provided in the report for the statement that “Consumer credit limits are not set at inappropriate levels.” Nor is there such a clear relationship between financial difficulty and the changes in default rates as they are defined in the report.

Credit assessment and credit card limits

The report asserts there is a relationship between credit card limits and household income – as household income rises, so do credit card limits. This suggests that there is some logic to the setting of credit card limits. However, the report confirms our fears that these limits are set with regard to overall trends in income, without an assessment of an individual consumer’s financial circumstances.

The statement that “this suggests that financial institutions are taking changes in income into account when setting credit card limits – at least at an aggregate level”⁸ may be correct. However, this is the problem. Taking changes in income into account at an aggregate level means that a consumer who has become unemployed could be offered an increased limit simply because income levels overall have increased.

Similarly, the fact that the data presented shows a correlation between household net worth and credit card limits does not by itself demonstrate that credit providers are setting, or increasing, credit card limits on the basis of the net worth of an individual.

⁷ Page 3.

⁸ Page 17.

In any case, consumer advocates have some serious concerns about asset-based lending (see below).

Finally, there is simply no data presented in the report to support the conclusion that credit providers look at credit history in setting or increasing credit card limits.

Vulnerable consumers – “credit limit surfers”

As well as looking at credit card limits, it would be useful to examine whether some groups of consumers get into financial difficulties through what we have termed “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.⁹

In our experience, it is these consumers who hover near their credit limit who 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 the outstanding balance, and the small minimum payments that are required can mean that major problems of overcommitment can be masked for years.¹⁰

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.

The data presented in this report does not provide any information about whether increasing credit limits are causing financial hardship for this group of cardholders.

Decrease in default rates

The report suggests that the decreases in default rates are inconsistent with claims that increased credit limits are causing financial difficulty. However, the information provided on the default rate is based on the overall cardholder population, including non-interest payers. Including non-interest payers in the pool means that the information provided is of little assistance in assessing whether credit card use is causing financial hardship for some groups of consumers.

⁹ 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.

¹⁰ 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.

In addition, the default rate used measures only the overall default amount, and how that has changed over time.¹¹ It does not provide information on the *number* of interest-paying cardholders who have defaulted on their credit cards, and how this has changed over time. It is conceivable that a decrease in the default rate as defined in the report could be compatible with *either* an increase or a decrease in the number of cardholders defaulting. Unfortunately, the report does not examine the question of how many consumers defaulted. Without those figures, it is difficult to assert that consumers are not facing financial difficulty.

As well as information on cardholder defaults, there is a range of other information and indicators that could be examined to provide a more accurate picture of whether credit card use is causing financial difficulty for some groups of consumers (see section 7 of this paper). Unfortunately, this sort of information is not presented in the report.

5. LEVELS OF CREDIT CARD DEBT

The report concludes that: *“Consumers are not carrying excessive levels of credit card debt. Consumers are in better financial condition today than they were five years ago as shown by declining default rates. Additionally, the interest bearing portion of credit card debt accounts for only a small portion of total household debt.”*¹²

Better financial condition today?

In relation to the financial situation of consumers today, please see our comments on the measure of default rates above. As noted there, we believe that the default rate concept used in the report is too narrow to be an accurate measure of financial hardship.

In addition, the assertion that “consumers are in better financial condition today” again is based on overall figures. It is quite possible that, within those figures, some groups of consumers are in better financial condition, while others are in a much worse financial condition compared to 5 years ago. However, the data presented in this report does not enable such an assessment to be made.

Credit card debt as a proportion of total household debt

The report notes that the interest-bearing portion of credit card debt relates to only a small portion of total household debt.¹³ While this may be true, it is important to note that the interest rates associated with credit card debt are much higher than interest rates associated with other household debt, particularly housing. The fact that consumers have large home mortgages, increasing in line with the increasing costs of housing, is not overly helpful in assessing whether credit card debt causes financial hardship.

¹¹ See page 30.

¹² Page 3.

¹³ Page 26.

Also, the proportion of credit card debt to total household debt has almost doubled between 1994 and 2002.¹⁴ The report does not examine the change in ratio for interest bearing debt as a proportion of household debt, and it would be interesting to know whether this has increased or decreased over time.

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. This information is not available in the report.

6. IMPACT ON LOW-INCOME CONSUMERS

The report concludes that: *“Low-income earners as a group are not susceptible to financial trouble due to credit card debt. Only a small proportion of low-income earners have a credit card. Low-income earners are just as likely to pay interest as many other income groups, and they have substantial net worth on which to draw if needed.”*

This theme is perhaps the most important theme of the report for consumer advocates. Unfortunately, however, the information presented does little to explore the issues for low-income consumers in relation to credit card use. In particular, there is no evidence provided in the report to support the statement “Low-income earners are not susceptible to financial trouble due to credit card debt.”

Proportion of low-income consumers with credit cards

The statement that “only a small proportion of low-income consumers have a credit card” appears to be supported by the Figure 3. This shows that cardholders in households with incomes under \$15,000 account for only 6% of the credit cards in Australia, and cardholders in households of incomes of at least \$15,000, but less than \$30,000 account for 13% of the credit cards in Australia.

However, what is missing from the commentary in the report is an acknowledgement of the fact that, within these low-income groups, a significant number of consumers hold credit cards.

According to Figure 2, almost 30% of consumers with an income of less than \$15,000 have a credit card. The proportion of credit card take-up in other low-income groups is similarly significant:

- approximately 35% of consumers with household incomes between \$15,000 and \$20,000 have a credit card;
- just over 40% of consumers with household incomes between \$20,000 and \$25,000 have a credit card; and
- approximately 45% of consumers with household incomes between \$25,000 and \$30,000 have a credit card.

¹⁴ See page 26.

Issues surrounding credit card use and debt are therefore relevant for a significant portion of low-income consumers.

Net Worth Issue

The report spends some time on comparing 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”.¹⁵ However, given that 82% of these assets are illiquid,¹⁶ what does it mean that they can “draw on \$236...?”. Sell their house to pay their credit card debt perhaps?

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.¹⁷ Again, the only meaning we can read into this is that consumers can sell their homes to bail themselves out of debt if necessary.

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.

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 in the case of unexpected life events

The report 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 example, figure 17 shows that the vast majority of cardholders with household incomes of less than \$15,000 have limits that are greater than 15% of income. The report also shows that, on average, cardholders in lower income households could spend almost half of their income on repaying credit card debt if they spent up to their credit limit.¹⁸

¹⁵ Page 28

¹⁶ Page 29

¹⁷ Page 29

¹⁸ Page 19: “... for a cardholder in a household earning less than \$15,000 per year, each \$100 of household income secures \$44.27 of credit limit per account ...”

Figure 25 shows that cardholders in households earning less than \$15,000 year hold interest-bearing debt equivalent to 11% of income. In contrast, cardholders on incomes of between \$60,000 and \$69,000 hold interest-bearing debt equivalent to 2% of household income. The proportion is even lower for higher income households.¹⁹

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.

7. WHERE TO FROM HERE?

The report released by Visa has little in it to enable policy makers to fully understand the level of financial hardship caused by credit card use. Further research is needed.

As an outline, we believe that 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 holders²⁰ and 35% of all households using credit cards²¹), 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.

¹⁹ Page 27.

²⁰ Page 28.

²¹ Page 5.

- *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 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?

Collecting the data to answer these questions, and comparing the changes over time, would enable a much more informed debate to take place.

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