

Consumers' Federation of Australia



**Submission to the Consumer and Financial
Literacy Taskforce Discussion Paper:**

“Australian Consumers and Money”

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Consumers Federation of Australia
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About Consumers Federation of Australia (CFA)

CFA is the national peak body for consumer groups in Australia. CFA's 95 members include legal centres, health rights groups, local consumer organisations and public interest bodies.

CFA's role is to put the view of its member organisations to government and industry and advocate on behalf of consumers. Established in 1974, our focus is primarily on advancing the interests of disadvantaged or vulnerable consumers.

Introduction

We share the view that Australians should be concerned about high consumer debt levels, and the number of consumers who experience problems with financial services or who have been unable, for one reason or another, to make decisions that are right for them and their families.

However, we are not convinced that the level of financial literacy is a key part of this problem – nor are we convinced that financial education is a significant part of the solution.

We believe that Government needs to “step back” and identify:

- What the problems are;
- What factors are causing the problems; and
- Consider how to address the problems, taking all those factors into account.

What is the problem?

It's important to consider the actual problems that a commitment to “financial literacy” aims to address. We assume, based on the discussion paper and other sources¹ that those problems are:

- Consumer credit overcommitment;
- Consumers making financial decisions that are not in their best interests²;
- Consumers making financial decisions that are disastrous (ie susceptibility to scams).

We agree that these are major problems. However it important to consider the range of factors that might lead to these problems.

What Factors Contribute to The Problem?

Strictly speaking, we are talking about problems related to consumer decision making. However, as the paper suggests, these decisions are not made in a vacuum. – consumer behaviour is influenced by a broad range of personal and external factors. Personal factors, include values, beliefs, knowledge and understanding,

¹ For example flyer for Financial Literacy Taskforce public meeting

² This may include failure to make decisions (such as investing for the future), failure to plan, failure to budget appropriately, as well as paying more for goods or services and getting bad value for money.

communication and negotiations skills. However, external factors may play a much greater part. Social and financial circumstances may leave some consumers with a lack of choice of products.³ Government regulation and enforcement, industry structures (for example advisor remuneration by commission) and a range of industry practices that often encourage “bad” decision making by consumers.

The Consumer Behaviour Model

A consumer behaviour model, as appears in the Discussion Paper could be useful. However, it must be designed to reflect reality. We believe that the model oversimplifies the factors that impact on consumer decisions. We doubt, for example, that advertisers (who rely on a reasonable understanding of consumer behaviour) would apply such a model. More research is required (and perhaps some input from those involved in marketing and advertising) in order to establish a workable model that would take into account industry behaviour, account product and industry structures, and the impact of subtle messages from industry and other sources.

Industry factors

While the paper does refer to industry’s role, we believe that this role is more significant than suggested – not only in marketing complex products, but in the way products are sold, industry sectors are structured, and marketing strategies subtly influence our perceptions and values in relation to a range of behaviours.

For example, having increased equity in our homes has long been regarded as a positive thing by consumers. However, such a goal may not be profitable for industry, so lenders play around with this concept. Debt isn’t called “debt” any more, the spin encourages us to “access our equity”⁴. Those of us who are not borrowing more are made to feel that we are actually wasting our equity unless we borrow more money, and terms such as “equity mate”⁵ aim to change our perceptions about debt. The bank’s website suggests you can use your equity to fund renovations and such to “increase your wealth”, however the television campaign showed the consumer with a car and a boat as well as renovations.

What messages do consumers take from these promotions? Does “equity mate” bring an image to mind of building wealth through renovating – or does the picture of the television ad come to mind, of Spiros and his boat?

It is likely that campaigns such as this don’t only market a product, but they can gradually change our thinking and attitudes to debt –and make us more susceptible to the next marketing campaign.⁶ It is important to consider the role that industry plays in changing our attitudes, values and our perception of what financial behaviour is “normal” or “reasonable”.

³ Some consumers may have little choice than to “choose” high cost credit, and ASIC/ACA Quality of Advice Survey (See Choice March 2003) showed that consumers with small amounts to invest may be unable to obtain the services of a financial advisor.

⁴ HSBC website promotes a product that “Allows you to access your equity to fund investments, renovate, pay for school fees or take a holiday.”

⁵ Commonwealth Bank, <http://www.commbank.com.au/equitymate/>

Does Industry Really Want Financially Literate Consumers?

The Chairman rhetorically asks at Page ix “wouldn’t success in improving financial literacy be wonderful for all legitimate participants in our economy”. We are not convinced that this is the case. While the Chairman suggests the only losers may well be the “rip off” financial crooks, we believe that a much wider industry segment profits from uninformed, unassertive consumers. In fact, we believe that industry’s interest in exploiting consumers is such that if anyone found the “magic potion” to increase financial literacy and consumer assertiveness, industry would no longer support financial literacy. In fact, we believe that industry is currently enthusiastic about financial literacy because financial literacy presents a “solution” that presents the least challenge to current industry behaviour.

Far from wanting financially literate consumers, it can be in the interests of industry to cultivate consumers who are likely to make the “bad” choices.

Industry is Cultivating “unwise” consumers.

Industry publicly urges consumers to “use credit wisely” or “make credit work for you”. However, it is often those consumers who are less competent credit users who are the most profitable for industry – and the industry puts significant energy into cultivating this group. While this is clearly the case with scammers, it is also the case with many “mainstream” lenders.

Interest free credit is structured in a range of ways, however it is often used as a way of “hooking borrowers in” to very expensive credit. In some cases if the debt isn’t repaid in the interest free period, an interest rate of around 27% is applied – and the borrower may be given a credit limit many thousands of dollars more than the cost of the interest free purchase. In this case it is more profitable for the lender if the consumer doesn’t repay in the interest free period. Marketing, and the structure of these products (such as failing to advise the monthly payment required to repay in the interest free period) can be used to discourage repayment – therefore encouraging what might generally be considered to be “unwise” use of credit.

“Transfer your credit card balances” promotions could lead to some consumers transferring high interest debt to lower interest debt. However, this promotion often relates to a credit card with a low introductory rate⁷, and it is a way for lenders to “catch” a profitable group – those who have significant debt on their credit cards and who do not pay off in the interest free period.

Revolve rates (the proportion of credit card debt incurring interest) are important for the profitability of the credit card business. It is in the interests of the lenders that credit card consumers don’t use credit too wisely! We assume that a number of marketing strategies employed by industry aim to maintain – or increase – these revolve rates. For example, borrowers are offered pre-approved credit limit increases – and in case they have any doubts - are urged to accept them. For example, one bank

⁷ Introductory rate cards are another example of inappropriate marketing. Promotions often show the introductory rate in large type, hiding the normal rate in the fine print.

states in such an offer “While you may not use your new limit every day, it’s reassuring to know that it’s there if you need it”⁸. While on one hand lenders are keen to be seen to encourage responsible credit use, their marketing is aimed at overcoming consumer reluctance to obtaining more credit.

Of course, the above examples refer to “mainstream” lenders. There are many others in the finance sector who profit more from consumers who are financially overcommitted. These include lenders who lend at higher rates to those at higher risk, who offer debt consolidation, debt agreement administrators – and the burgeoning debt collection industry could collapse if we had significant reductions in credit over commitment. While it could be argued that industry is responding to a need, it is vital to many in the sector that the need continues.

Industry Structures

The paper raises the issue of complex products. In our experience it is not only the products that are becoming increasingly complex, but the structure of some sectors. The outsourcing of a range of “services” means that many consumers are dealing with a finance broker, a mortgage manager and a lender. In some cases it is difficult for consumer advice services to identify the role played by each of these parties in a transaction. The more that services are outsourced, the more complicated it becomes for consumers to understand their contracts or to obtain assistance when things go wrong.⁹

The role of various “players” can be difficult to understand, and financial literacy is unlikely to address this. Consumers often approach finance brokers or financial advisors because they need advice, and consumers who can’t afford advice (and even those who can) are obtaining advice from these sources without fully understanding the relationships between the various parties. Industry is developing new ways of marketing and structuring businesses all the time, and it is not possible for consumers to understand these changes.

Consumer Factors

There appears to be a lack of evidence that low financial literacy is a key factor in poor financial decision making. In fact, even if we limit consideration to a consumer’s personal traits, it may be that other factors are more significant.¹⁰

Research undertaken by ASIC¹¹, while limited in its scope, suggests that a number of personal factors could be more significant than low financial literacy. ASIC surveyed 80 consumers who had called ASIC in relation to international cold calling investment scams – some who had been taken in, and others who had avoided being caught by

⁸ ANZ – letter to customer offering pre-approved credit limit increase from \$15,000 to \$18,000.

⁹ While the development of industry dispute resolution schemes have provided many benefits for consumers, it is often the case when things go wrong that the consumer (or advisor) cannot ascertain who is responsible for the problem and therefore whether a dispute scheme can deal with the complaint.

¹⁰ Paul Clitheroe on ABC Radio 27/7/04 referred to the puzzle as to why 2 siblings may handle money well and the third is poor at handling money.

¹¹ Hook Line and Sinker – Who Takes the Bait in Cold Calling Scams, ASIC 2002

the scam. ASIC aimed to find out why, when presented with similar information, some people chose to invest in the schemes and others didn't. The research also considered the factors that alerted consumers to the fact that this was a scam and how these factors were interpreted. This research tends to suggest that other factors may play a greater role than financial literacy. In fact in this group, educational background and financial experience were not key factors, with a similar number of accountants avoiding and being caught by the scam.¹²

“ Another surprising feature of this investigation was that, apart from whether they had handed over money or not, there was little to distinguish those who had invested from those who had not. Investors and non-investors were of similar age, educational background, and proportion owning shares.”¹³

This research also provides a warning about getting consumer information right. While consumers are often warned about the use of high pressure in scams, those running the scams appear to change their approach to suit the advice.¹⁴

Factors that appeared to be relevant included some consumers approaching investing as an “expression of identity” as well as a financial action. The consumer's assessment of his or her own financial sophistication (not knowing what they don't know) also appeared significant.

Even if government wants to address the consumer's role in financial decision-making, it can't be assumed that financial literacy levels are the main factor. It may be that financial literacy education should be placed within a psychology framework rather than a mathematical one – however more research needs to be done.

Problems with Current Information Provision

Even if consumers are “financially literate” or aware of the need to “shop around” or obtain information, they will find a lack of independent, trustworthy accurate and practical financial information. There is a significant problem with the large range of consumer finance information available, the number of sources of information and the variety in quality and practical applicability of much of that information. We believe that this problem should be addressed.

Lack of Reliable Consumer Information

Even if consumers are prepared to inform themselves, the lack of practical, independent information is a problem. The main problems are:

- Similar information from a range of sources;
- Consumers cannot accurately identify what information to trust;

¹² Hook Line and Sinker Page 17

¹³ Hook Line and Sinker page 70

¹⁴ “... although high-pressure techniques were mentioned, there was also frequent reference to the professionalism and dedication with which the callers conducted themselves..... the characterisation of scams in the popular imagination, as well as some of the current warning campaigns, as invariably high-pressure may need some adjustment.” Page 70

- Some marketing material is cleverly disguised as consumer information (or even published as a “how to” book);
- Even information from trustworthy sources is often inaccurate and impractical
- There is a lack of information that is practical.

Who Can Consumers Trust?

A quick browse of any bookshop will illustrate the difficulties consumers face in obtaining quality information. There are a plethora of books on financial matters – but there are as many traps here as there are out in the market place. Unfortunately, the publishing of a book is now often used as a marketing tool – and often for dangerous or expensive financial products. A number of financial “gurus” have published books. This can be a tool to get people along to the free seminar, and sign them up for the \$5,000 or \$10,000 seminar or “boot camp”. Many books appear to be “genuine” independent advice, but a closer examination shows that the book is a way of directing consumers to certain companies or products.¹⁵ Unfortunately, it is very difficult to separate out the good from the bad – and those who most need information, who are less informed, could not do it.

Increased interest in financial literacy by industry has led to an increase in the amount of information available – however more information doesn’t guarantee accuracy or quality. Even sources of apparently independent information can produce information that appears designed to market product rather than provide clear information to consumers.¹⁶

We would encourage industry to provide helpful consumer information about their products, but there is always a risk that there will be a marketing element to this. However, we don’t believe that consumers should be encouraged to trust industry to provide broader consumer advice and information.

Government can also be limited in the information it can provide. Information is often less helpful than it could be, because the risk of harming “good” businesses by warning about some general problems or scams. In order to be practical, the writers must have information from consumers who have first hand experience or those who are providing advice and support to consumers.

Consumer groups and advice services also provide consumer information. These groups often have “on the ground” experience, often enabling them to provide practical advice. However, the resources are not available to allow these groups to play a lead role in information provision.

¹⁵ A book “How to be mortgage free in 4 easy steps” - makes claims that are of concern to consumer advocates, that you can “own your home years sooner and save thousands of dollars in interest without making extra repayments”. In fact the book refers consumers to a website that offers software products and finance broker services.

¹⁶ For example, consumer advisors are concerned that a line of credit calculator produced by Infochoice (and used by a number of brokers and lenders) is designed to promote line of credit mortgages, rather than to provide useful information for consumers – despite the fact that Infochoice claim to “provide unbiased information” which “allows consumers to make easy, meaningful comparisons”.
www.infochoice.com.au

Quality of Independent Information

As a brief example of some of the problems with the range and quality of information, we refer to the following information that has all been obtained from websites of regulators/consumer affairs agencies. This is not a criticism of the information being provided, but the range of sources makes it difficult to put resources into improving the quality of information available.

“Many retail stores and department stores offer interest free loans. The credit is usually provided by a finance company through the retail outlet. These loans are interest free only if the loan is completely paid within the time stated – usually six months.

If you don’t pay the entire amount off within the six months, you will have to pay interest from the date the loan was taken out.”

Wrong – we are unaware of any interest free products with terms such as these (at least over the past 10 years).

“Finance brokers are go-betweens who arrange loans for people for a fee.”

Misleading – Many, if not most, finance brokers are remunerated by commission – not fee paid by the consumer.

Make sure you're fully informed before you commit yourself by shopping around. Compare terms and conditions to find the credit or lease arrangement that best suits your needs.

Vague – This type of “motherhood” information is too vague to be of assistance. How do you compare loans? How do you compare terms and conditions? This information is often difficult to obtain.

“The Consumer Credit Code ensures that you get the information you need to compare different credit schemes and make an informed choice. It does this by making credit providers give the following informationThis information must be presented in the Pre-contractual Statement .”

Unhelpful – This is similar to the information presented on many websites, and isn’t practical. The pre-contractual statement is only provided after the consumer applies

The Need for Practical Information

The most common advice given to consumers is to “shop around”¹⁷. In many cases (and particularly in relation to financial products) shopping around is not easy, and practical information about how to “shop around” is important.

For some consumers, shopping around can leave them exposed to high-pressure tactics, or a feeling of obligation to the person who spends significant time explaining products. Some information is difficult to obtain when shopping around (such as credit terms and conditions – or even the interest rate).

The concept of shopping around assumes that the consumer has some understanding about the product and can compare product and price. However, how does a consumer shop around for advice on something they don’t understand – for example a

¹⁷ A “google” of gov.au sites for the words “shop around” comes up with 2,260 results!

financial advisor or mortgage broker. It appears that if consumers do shop around for these services, they choose the person they feel most comfortable with – however this may be no indication of the quality of advice.

Even shopping around for credit can be difficult – and despite the repeated advice to shop around for car loans, we could find no practical information about how to do this. While lenders now have to make available information about comparison rates, there may be a range of rates – and the consumer may not know which rate will apply to them until they actually apply for credit. In some cases consumers must apply for credit in order to discover the actual fees and charges - requiring payment of an application fee and a change to their credit report for 5 years.

Disadvantages of a Focus on Financial Literacy

It might be argued that promoting financial literacy can only be positive – and in any case, it can't do any harm.

However, the risks are that significant energy is spent on a “solution” that is not effective, and we ignore some of the more important issues. The blame for bad decisions is placed on consumers. Industry can push credit at those who can't afford it – as long as we educate consumers to use credit wisely!

There is also a risk that consumer education material can be subtly biased towards industry (for example by showing industry as a benign player, or focussing on scams rather than unfair practices by mainstream industry). This is potentially a greater problem than material that is clearly biased.

Some of the risks of a government, industry and community focus on financial literacy include:

- Drawing focus (and resources) away from issues that are more important for consumer protection;
- Being used in industry “spin” when responding to criticism of their practices;
- Offering “credibility” for some industry players (consumer education issues are often embraced by companies that are “under fire”);
- Enabling some industry players to promote their own agendas under the umbrella of “financial literacy”¹⁸; and
- Supporting a case for less regulation.

¹⁸An example is a recently formed coalition of industry members that aims to address the debt default problem by assisting to alleviate debt problems, educating the community and lobbying for change to Australia's credit reporting system. There is little doubt that the main agenda is changing credit-reporting laws to suit industry – and other issues (such as education) are simply dressing up this industry campaign.

Potential for Bias

Even if education can have an impact on financial decision-making, there are risks in allowing the industry, which has its own messages it wants to push, to play a role in consumer education. While bodies can be established to approve educational material, and vet material for industry bias, these biases can be very subtle. For example, information can be presented in a way that paints the industry sector as “safe” and “trustworthy”. The risks of scams can be highlighted, while the dangers of dealing with mainstream industry can be minimised.

Conclusion

There is significant concern in Australia about poor financial decision-making by consumers, and we do not doubt that many in government, industry and the community are genuine about their approach to this problem. Initiatives that are genuinely designed to improve consumer understanding, particularly if informed by research, can contribute to addressing these problems, however we question the level of resources that should be targeted towards financial literacy.

There is little known about the extent to which low levels of financial literacy contribute to poor financial decision making. In fact, we believe that a range of other factors may be more significant.

A broad section of the industry relies on a lack of consumer financial competency to make a profit. This includes “mainstream” as well as more marginal industry members, for example, in relation to credit providers it includes those providing products such as:

- high interest credit cards (including banks),
- debt consolidation; and
- interest free credit.

“Financial literacy” can often be embraced by industry for ulterior purposes - to promote their reputations and products, to promote reduced regulation or to push their own agendas.

We would need significant evidence about the benefits of a national approach to this issue before we supported financial literacy as a priority for Government.

Recommendations

We recommend that:

- Government and industry address industry conduct (through regulation if necessary) that contributes to, and encourages, consumer problems and poor financial decision making:
- Government resource a central information provider (such as ASIC) to provide independent, accessible, practical and up to date financial information; and

- Government encourage research to increase understanding of the range of factors that lead to consumer financial problems (where appropriate, taking into account the experiences of consumers and consumer agencies).

Regulation

There is a need for industry to take responsibility for the problems they cause – and for Government to reign in the excesses of the finance sector. Details of some issues that need to be addressed are at: www.consumersfederation.com.

Independent Information

There is a need for practical, independent consumer finance information and advice. This refers to practical information, for example that consumers might access when considering products, rather than broader educational material.

We believe that Government should resource one central agency to provide independent, practical, consumer finance information (rather than a “clearing house” to co-ordinate a wide range of education and information material). The agency would ideally be an agency with experience in consumer finance issues, such as ASIC.

The agency would have adequate resources to develop information on a range of consumer finance topics. It would seek input from “hands on” advice agencies and would trial information to ensure that it was relevant to consumer needs. Other Government departments and organisations could use the information and tailor it to suit the needs of their particular target groups. However, the importance of having one key resource would be that the community would become aware of one independent source of information, and that would have the resources to do the job properly. This should also include the provision of up to date comparative information about financial products in the way provided by the Financial Services Authority in the United Kingdom.

We believe that this proposal would be relatively easy to implement and would be cost effective.

Research

Considerable information about causes of problems for consumers is available from a range of sources, including regulators and organisations that assist consumers with disputes. However, before devoting resources to programs to educate consumers, or attempt to change consumer behaviour, it is important that we have a much better understanding about what are often complex factors that contribute to poor financial decision making.