NAB's response to the

Credit cards: improving consumer outcomes and enhancing competition consultation paper

30 June 2016

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1. Introduction

National Australia Bank (NAB) values the opportunity to provide feedback and comment to the Treasury consultation paper: *Credit Cards: Improving consumer outcomes and enhancing competition.*

In compiling this response, NAB has considered each of the proposed actions and given consideration of the impact on the consumer, the credit card industry, and the bank. NAB has drawn on extensive internal data and analytics, and a body of consolidated NAB customer feedback.

NAB has worked with a leading provider of analytics information and solutions to consumer banks and their regulators, and performed a wide-ranging consumer and market impact analysis of the proposed actions 1 to 3. Furthermore, NAB has deepened this analysis to draw into consideration behaviours and responses observed in other comparable regulated markets.

NAB has also contributed to the submission made by the Australian Bankers' Association (ABA) and is supportive of the ABA's positions.

1.1 General overview

In the world of consumer finance, the credit card is a distinctive payments option providing consumers with a degree of flexibility of amount borrowed and repayments scheduled. Credit card issuers support this unique consumer offer by actively managing credit limits, pricing and product parameters, to reflect changing consumer circumstances and needs, as well as changing market conditions.

The vast majority of consumers manage their credit card relationship prudently and responsibly. These consumers value the inherent flexibility of their credit card and obtain significant benefit from the ability to manage their expenditure.

Nonetheless, NAB acknowledges that a relatively small group of credit card customers do experience financial difficulties. Less than 1% of NAB's credit card customers have been recorded as falling into a position of financial hardship over the past 12 months – a trend that is consistent across other credit products. Furthermore, 89% of customers who have fallen into financial hardship return to a normal non-hardship position within 30 days.

NAB is proactive in seeking to identify customers showing signs of financial stress and actively seeks to minimise the human and financial impact for customers in hardship circumstances. NAB believes it provides a world-class support and assistance program, developed in partnership with Kildonan Uniting Care.[1]

[1] Kildonan Uniting Care is an innovative and trusted community service organisation within one of Australia's largest welfare networks, Uniting Care Australia, and an agency of the Uniting Church.

All lending activity embodies a degree of default risk. Both borrower and lender enter into a credit agreement knowing there is a degree of risk associated with the relationship. It is unfortunate, but expected, that some consumers will fall into financial difficulty because of major adverse life events, such as the breakdown of a relationship or loss of employment. These events can significantly change consumers' circumstances.

NAB notes that the policies proposed in the consultation paper do not address the consumer difficulties associated with major adverse life events. Furthermore, NAB is concerned that the proposed actions will have unintended consequences as a result of the tightening of credit availability, particularly for higher risk and more vulnerable consumers. Accordingly, the proposals may have the effect of reducing access to affordable credit for more vulnerable consumers and increasing their risk of default.

1.2 Seeking better consumer outcomes

In this submission, NAB argues that a better consumer outcome will result from the use of predictive, data-driven models to make credit decisions throughout the lifecycle of a customer's account and that policy-based credit decisions typically provide a poorer consumer outcome than models.

NAB believes that actions, as proposed in the consultation, will detract from the application of statistically valid modelling that effectively determines the customer offer. The proposed actions will impede NAB's ability to offer customers the product and services that best fit the individual customer's circumstances as they change over time.

Furthermore, the proposed actions will place new restrictions on the bank's ability to manage the customer relationship, which may increase the likelihood of consumers seeking alternate providers. i.e. payday lenders. The bank believes this destabilising effect will result in a poorer customer outcome.

Each of the proposed actions will have revenue implications for card issuers. At a time when card issuers are digesting the recent changes to interchange rates, the imposition of further changes could result in price changes or the withdrawal of credit card products to some consumer segments.

NAB believes beneficial consumer outcomes will arise from a further strengthening of comprehensive credit reporting (CCR), which was enabled by the Privacy Act in March 2014. Notwithstanding the current slow industry adoption, NAB recommends the opportunities to accelerate broader industry support are explored. Access to a wider and less restrictive spectrum of credit bureau data, as available in the UK, to include detail of account balances and payment amounts, and an account level hardship indicator, will further support banks to continue to make responsible credit decisions.

2. NAB Response and Recommended Actions – Executive Summary

Proposed Actions	NAB Response and Recommended Actions
Phase 1	
1. Tighten responsible lending obligations to ensure card issuers assess suitability based on a consumer's ability to repay the credit limit within a reasonable period.	NAB is not supportive of a legislated approach for determining affordability. NAB believes that existing credit decision-making statistical models operate effectively to assess suitability; however, acknowledges that the proposal to calculate credit limits based on an instalment loan affordability model is a reasonable complementary solution.
2. Prohibit issuers from making unsolicited credit limit increase offers including the ability to seek prior consent.	NAB is not supportive of the proposed action and does not support proposals to regulate a card issuer's ability to deliver enhanced credit limits, which it believes form an important customer service. NAB recommends that a formal industry-wide adopted definition for 'customers in financial difficulties' would support a better industry focus on credit limit increases made to all customers. NAB is concerned that consumers will seek out alternative credit providers in lieu of credit limit offers from their mainstream-banking provider, which may result in an increased cost of borrowing. NAB believes that it finds no difference in its customers' subsequent ability to service a credit card debt regardless of whether a credit limit increase is *offered to* customers or *requested by* customers. The accounts will continue to perform with a similar risk and delinquency profile.

Proposed Actions	NAB Response and Recommended Actions
	NAB is supportive of an amendment to legislation to ensure a channel consistent approach regarding unsolicited credit limit increases.
3. Prohibit issuers from backdating interest charges and charging interest on the portion of the balance that has been paid.	NAB is not supportive of this proposal. NAB is supportive of greater industry transparency and support to aid effective consumer choice.
4. Require issuers to provide consumers with online options to initiate a card cancellation or reduce their credit limit.	NAB is supportive of a technology neutral position and not supportive of legislation to mandate improved technology solutions for managing credit cards.
Phase 2 (for consumer testing)	
5. Require that issuers provide information on the annual cost of a consumer's credit card use and to prominently display annual fees.	NAB is supportive of any changes that improve consumers' financial awareness and literacy, through education and/or improved transparency and clarity of information, that result in informed consumer choice.
6. Require issuers to clearly disclose in advertising and marketing material a card's interest rate and annual fee.	NAB is supportive of any changes that improve consumers' financial awareness and literacy, through education and/or improved transparency and clarity of information that result in informed consumer choice. In this case, NAB believes that Australian banks already support and abide by high levels of transparency and disclosure in advertising and marketing.
7. Require issuers to provide information about potential savings from switching to lower-cost products	NAB supports the evaluation of this proposal with reference to consumers who fall into the problem debt categories.

Proposed Actions	NAB Response and Recommended Actions
8. Require issuers to provide consumers with timely electronic notifications regarding the expiry of introductory offers and credit use	NAB is broadly supportive of this proposed action. NAB recommends that balance transfer notifications should be sent no less than 30 days prior to the expiry of an introductory offer. This will allow customers ample time to establish alternative options, if desired.
9. Require issuers to provide consumers with alternative payment tools, and proactively contact consumers who are persistently making small repayments	NAB does not support regulation to drive the provision of alternative payment tools. Customers of NAB can already access an easily understood tool that allows them to take control and commit to repayment amounts of their choice.
10. Substantially raise the level of minimum required repayments	NAB is not supportive of this proposal but is in agreement with the proposal that other actions to support responsible lending obligations would be more appropriate. NAB strongly believes that customers value the inherent flexibility of a credit card that allows them to personally manage their finances.

3. Detailed Response

In compiling this submission, NAB considers the recommendations in terms of the phases proposed in the consultation paper.

NAB has employed the services of Argus Information and Advisory Services, LLC.[2] (Argus), a leading provider of analytics, information and solutions to consumer banks and their regulators, to assist in the development of an understanding of the industry using syndicated study data.

The following findings are based on data that is representative of the Australian credit card market and, where appropriate, includes comparative UK credit card market data. The UK market was chosen due to a number of similarities to Australia, both in the nature of the product offerings, and also due to the active regulatory oversight in place. The Financial Conduct Authority (FCA) in the UK has for a number of years considered and made changes to the credit card market, and has currently initiated a number of studies which provide a useful platform for comparison.

3.1 Definition of Financial Distress

Throughout the consultation paper there are various terms, e.g. ‘financial distress’, ‘unmanageable credit card debt’, ‘over borrowing’ and more, used to describe consumers who are unable to service their credit card debt and, as a result, face emotional distress. There is no argument that a small group of credit card consumers do experience financial stress. NAB believes that the majority of these consumers fall into financial stress as a result of a loss or reduction in income and, consequently, the financial stress results from circumstances not normally within the consumer’s control. Indeed, the following findings support this statement:

- Step Change, a leading debt charity in the UK, maintains that its clients most often state unemployment as the reason for seeking debt advice.[3]
- Christians Against Poverty, a UK Christian charitable company, reports that people in financial difficulty give the primary cause as relationship breakdown, unemployment or long term illness.[4]
- NAB’s internal data indicates that more than 55% of customers who fall into financial difficulty do so as a result of a loss (or reduction) of income.

[2] Argus Information and Advisory Services is a Verisk Analytics Company (NASDAQ: VRSK) and the leading provider of analytics, information and solutions to consumer banks and their regulators. Argus provides industry-wide syndicated credit card benchmarking studies in Australia, UK, US and other geographies offering an external perspective by compiling and reporting product, performance and profitability information. Argus maintains the most comprehensive and granular direct observation database for credit card, debit card, and deposit transactions in the industry.

[3] Step change, ‘Personal debt 2014, yearbook findings’, 2014.

[4] Christians Against Poverty, ‘FCA credit card market study: Interim report’, November 2015.

In order to take a quantitative approach to reviewing the proposed changes, NAB believes it is beneficial to work with clear definitions of the various degrees of financial difficulty associated with credit card repayment.

Accordingly, for the purposes of this submission, NAB has adopted the 'indicators of financial difficulty' framework used by the FCA in the UK.[5] The FCA identified three main areas of concern:

1. The first and most clear concern is when consumers default or miss payments. The financial and non-financial implications in these cases are likely to be significant.
2. The second concern is persistent and long-term debt. Consumers in these cases may be able to meet repayments but have reached a level of debt that they are unlikely to be able to recover from, even over a sustained period of time. This cycle may begin with relatively minor incidents, but the cumulative welfare implications that follow may be large.
3. The third concern is when consumers are making minimum repayments while incurring interest charges. The low minimum repayment requirement of credit cards means that these consumers may not be struggling to meet the repayments but, over time, may be incurring high interest costs as a result of their repayment profile.

Throughout the body of this submission, NAB will frame its response to the proposed reforms using the FCA indicators of financial difficulty. It is believed that this will also support an insightful comparative analysis between Australia and the UK. Table 1 provides comparative data for Australia and the UK.

Table 1

Indicators of Financial Difficulties (at Dec-15)	Australia	UK
1. Severe Arrears - been in default or have been at least 6 months in arrears.	1.7%	1.9%
2. Serious Arrears - cardholders who have missed 3 or more repayments and are either in or have been in arrears in the last 12 months.	7.2%	4.9%
3. Persistent Debt – active cardholders with persistent high utilisation – defined as 90% utilised over 12 months while incurring interest.	6.8%	6.6%
4. Systematic Minimum Payments – active cardholders who made 9 or more minimum repayments in the last 12 months while incurring interest.	0.2%	5.2%
5. Non-problematic	84.2%	81.4%

[5] Ibid

It should be noted that it has not been possible to adjust the comparable data contained in Table 1 for the different UK/Australia practices regarding the write-off of bad debts. Accordingly, the data for Serious Arrears may be reflective of a more stringent UK practice regarding write-offs.

4. Phase 1

4.1 Reform 1 – Tighten responsible lending obligations to ensure card issuers assess suitability based on a consumer's ability to repay the credit limit within a reasonable period

Response NAB does not support a mandated approach for determining affordability.

NAB believes that existing credit decision-making statistical models operate effectively to assess suitability. However, acknowledges that the proposal to calculate credit limits based on an instalment loan affordability model is a reasonable complementary solution.

NAB believes that the adopted statistical modelling approach for credit cards results in the assignment of a conservative credit limit on both acquisition and throughout the subsequent lifespan of the credit card.

4.1.1Background

NAB believes that the most common causes of consumers' financial distress derive from circumstances beyond their control; however, we recognise that it is neither in the bank's or the consumer's interest to have debt that cannot be repaid. Accordingly, NAB is open to ideas and solutions to ensure more consumers are able to repay their borrowings and credit limit within a reasonable period.

The consultation paper correctly states that UK regulation defines a reasonable period with reference to typical personal loan terms. Whilst the UK regulations specifically refer to the assessment of a consumer's debt affordability, card issuers can choose alternative approaches to assessing a reasonable period.

NAB recommends that an examination of non-mandated approaches to the assessment of suitability, similar to that adopted in the UK, is considered as part of this consultation/policy development process.

UK banks use a mix of internal credit models and models based on a personal loan pay-down curve. However, in the UK, bank internal credit models that determined initial credit limits continue to be used as more powerful and representative determinants of the initial credit limit.

To illustrate this point, the chart in Figure 1 shows the average credit limit for newly acquired accounts between Jan-09 and Dec-15. It should be noted that the FSA (the prior UK regulatory body) issued affordability guidance in Mar-10. Despite credit cycle influences and a growth in near-prime lending, the average initial credit assigned to new cards exhibits a relatively static trend.

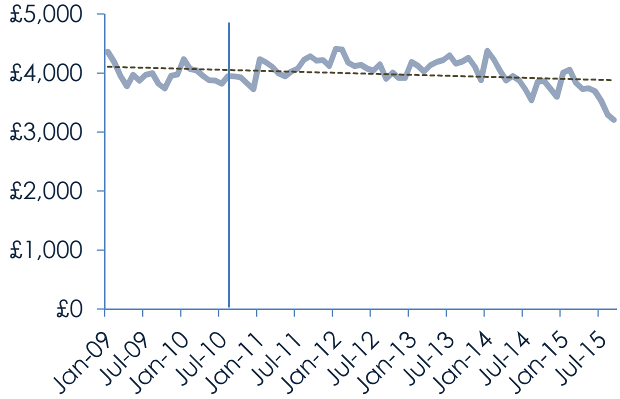

Figure 1 - Average initial credit limit - UK industry - Jan-09 to Dec-15

The significant decline in average initial credit limits, exhibited in Figure 1, is a reflection of the expansion of the UK market for low-rate and sub-prime credit cards. The growth in this market segment has suppressed the average initial credit limit in the first half 2015.

In comparison, as in Figure 2 below, Australia has seen a general increase in assigned initial credit limits, reflecting an average growth over the period of 7% per annum.

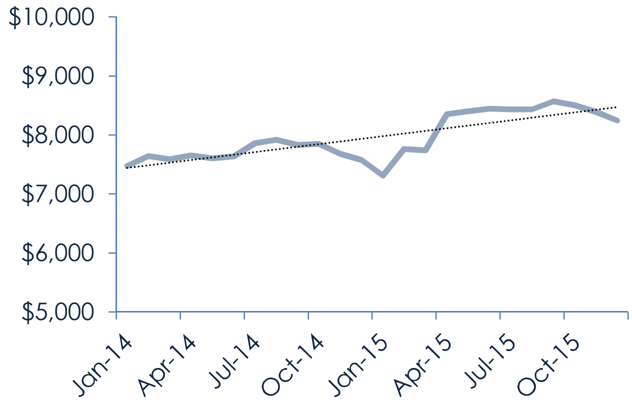

Figure 2 - Average initial credit limit - Australian industry - Jan-09 to Jan-15

NAB believes the industry data presented in this document supports a non-mandatory approach to defining a reasonable period within the regulatory framework. NAB's preference is a requirement that customers should be able to repay the maximum amount of credit available in a reasonable period of time, and that banks may have regard to the typical term of a personal loan.

The recent FCA publication, *Creditworthiness and affordability: common misunderstandings* clarifies that the FCA is providing guidance to regulated card issuers in these matters,[6] and the requirements for card issuers to implement processes and policies to ensure that their approach complies with the framework. This document reinforces that card issuers may have multiple and different approaches to delivering the solutions that fit their business, and that the FCA does not dictate the checks or approach that should be made by card issuers when considering creditworthiness; instead establishing principles.

NAB believes that existing industry solutions operate effectively. These solutions are based on comprehensive statistical models for the forecast of affordability and likelihood of default, and have been developed and improved over many years. These credit decision-making models are a workable and effective way for card issuers to make both an initial assessment of suitability and meet ongoing responsible lending obligations.

Applying a 'one-size fits all' rule to the market could constrain diversification of offers and products, deter new market entrants and reduce availability of affordable credit to certain segments of society. For example, the diverse range of strategies, products and offers available in the UK – from sub-prime to super-prime – is evidence of the application of relevant credit models and strategies by segment, delivering consumer credit at rates representative of the risk. Furthermore, the market provides consumers with a clear path to lower cost credit from alternative providers as their credit quality improves.

4.1.2Calculation of affordability using a personal loan type model

The personal loan type affordability model estimates a consumer's disposable income as an upper cap to the amount that the consumer can afford to pay each month. This affordable payment typical, in conjunction with personal loan durations and interest rates, is used to determine an equivalent personal loan figure, which would equate to the upper cap of a consumer's affordable credit limit.

To understand any difference between the current decision-making model approach and the proposed reform approach, NAB has developed affordability criteria for the Australian and UK markets using the proposed reform rules. In a two-step process, NAB considers the average contractual term for typical loan amounts, which would be equivalent to the pay-down period and calculates the equivalent advance for the affordable amount.

NAB believes the application of an upper affordability calculation will provide consumers with flexibility to change their repayment amounts (e.g. pay more or less than the calculated affordable amount) in line with changing personal circumstances. This is a more flexible consumer solution than the alternative of

[6] FCA, 'Understanding consumer credit – credit worthiness and affordability: common misunderstandings', <http://www.fca.org.uk/static/fca/documents/consumer%20credit-understanding-cc-creditworthiness-affordability-web.pdf>, 2015

increased minimum payments, which by itself may prompt consumer card default.

Figure 3 below illustrates the typical duration for a personal loan by amount advanced for the UK market. Figure 4 below illustrates the relationship of affordable payment to the personal loan advance, which under the proposed reform would be the maximum credit limit available.

NAB finds that the UK examples and calculations are also broadly equivalent to Australian experience.

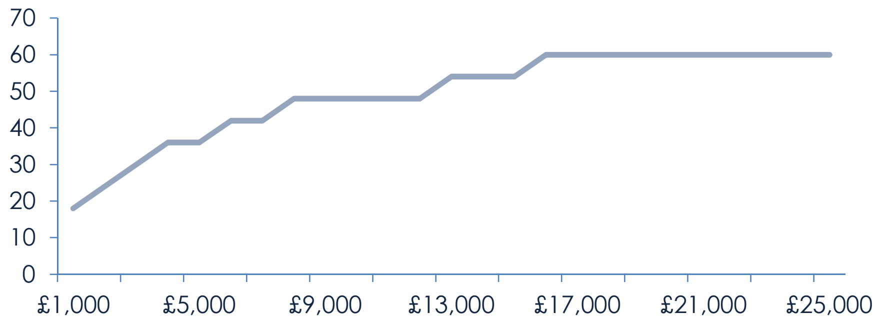

Figure 3 - Average contractual loan term by advance - UK industry

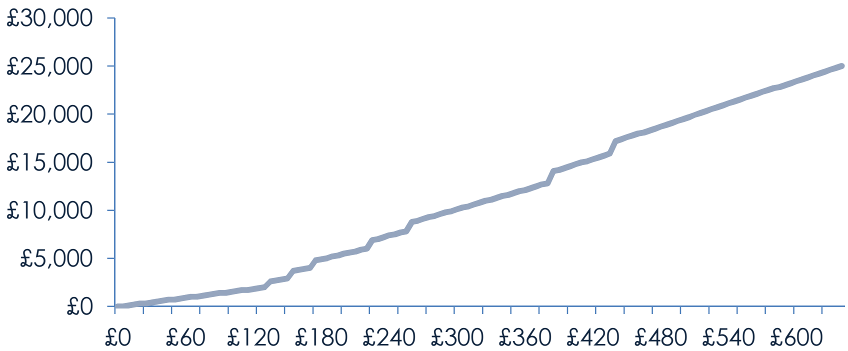

Figure 4 - Maximum affordable credit limit by payment for a 19.9% loan

It can be seen from Figure 4 that a disposable income of £500 would equate to a maximum affordable loan of approximately £20,000.

NAB has identified that two significantly different credit limit results arise according to whether the loan term is based on a contractual schedule (i.e. the time between draw down date and contractual end date) or based on typical payment behaviour of the personal loan (i.e. the actual customer payment behaviour). Accordingly, guidance on the proposed approach will be necessary to comply with a mandated solution.

4.1.3 Comparison of personal loan affordability calculation to current approach – new accounts

In order to better understand the difference between the application of existing credit decision-making models and the proposed personal loan based 'affordability' calculation, NAB commissioned Argus to perform an exercise using syndicated study data, Argus has estimated a consumer's disposable income as being the difference between the minimum contractual repayment and actual repayment. In this way, Argus has calculated an 'affordable' credit limit using the personal loan type approach.

This approach may understate disposable income but is instructive in determining the overall magnitude of the 'affordable' credit limit.

Argus has taken the data relating to the contractual affordable limit and compared this with data on credit limits extended by credit card issuers for new acquisitions. This will support observations across a number of different perspectives between the proposed reforms and the current decision model-based approach.

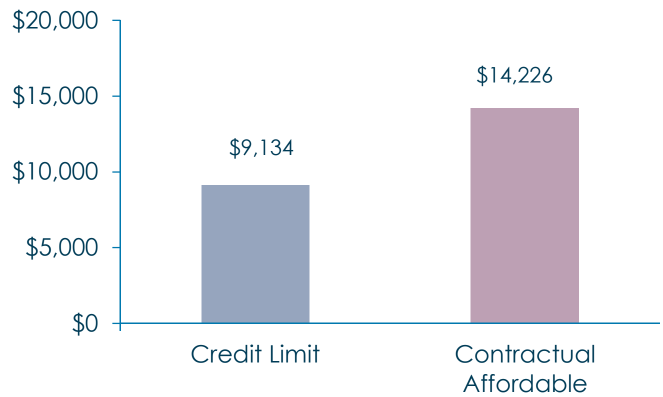

Figure 5 - Average initial credit limit – assigned vs. affordable – 1Q15 - Australia

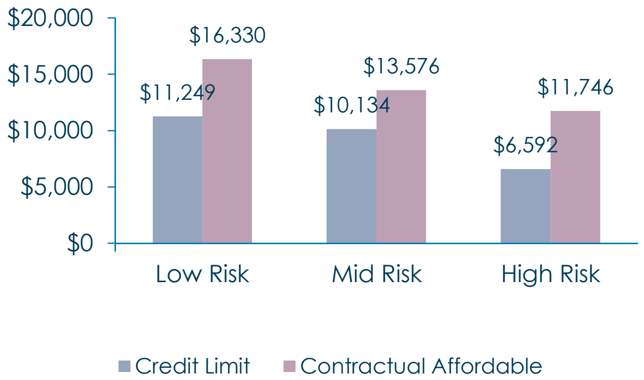

Figure 6 - Average initial credit limit by credit risk[7] – assigned and affordable – 1Q15 - Australia

Figure 5 above demonstrates that credit limits for the Australia market are currently considerably below the affordable limit.

NAB concludes from this that the current industry approach is both effective and conservative, and does not necessarily encourage excessive debt. It also notes that the Australian market is operating at a more conservative level than its UK counterpart, where the assigned limits are more closely aligned to the estimated affordability levels.

Figure 6 clearly illustrates that current industry decision-making models have a strong alignment of assigned credit limit to risk. This chart shows that the industry is operating conservatively by providing credit limits that are well within the contractual affordable limits for new applicants across a range of risk profiles.

4.1.4 Comparison of personal loan affordability calculation to current approach – accounts with credit limit increases

In order to better understand the difference between decision modelled credit limits against affordable credit limits over the lifetime of a credit card, Argus has revisited the analyses. For the purposes of this review, Argus has extracted data at an Australian industry level for customers who have received a credit limit increase in the 1Q15.

[7] Risk is defined on the basis of an account's probability of write-off in the next 12 months.

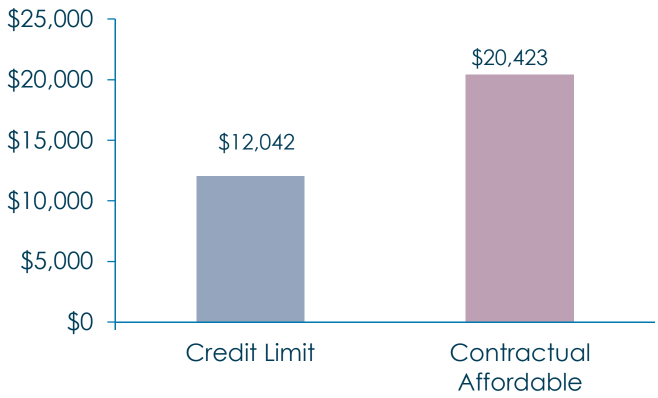

Figure 7 - Average credit limit for existing active accounts with a credit limit increase – assigned vs. affordable – 1Q15 - Australia

Figure 7, shows that the existing decision model credit limits, even after credit limit increases, fall well within the contractual affordable limits.

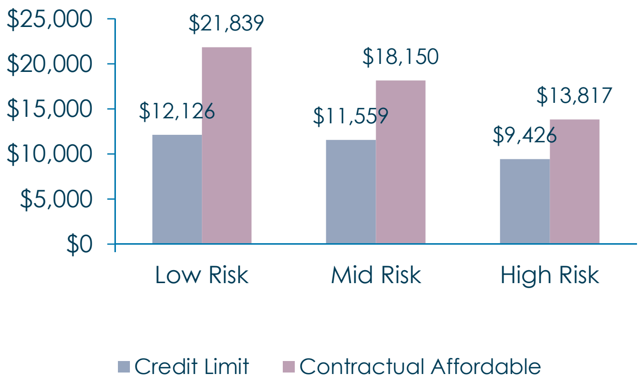

Figure 8 - Average credit limits for accounts with a credit limit increase in 1Q15 by credit risk – assigned and affordable – 1Q15 - Australia

Again, Figure 8 demonstrates strong alignment of credit limits to risk profile within the Australian market, and further demonstrates conservative credit limit assignment, even after a credit limit increase. All risk categories are seen to have assigned limits that are materially below the contractually affordable limits.

4.2 Reform 2 – Prohibit issuers from making unsolicited credit limit increase offers including the ability to seek prior consent

Response NAB does not support the proposed action or proposals to regulate an issuer's ability to deliver enhanced credit limits, which it believes form an important customer service.

NAB recommends that a formal industry-wide adopted definition for 'customers in financial difficulties' would support a better industry focus on credit limit increases made to all customers.

NAB is concerned that consumers will seek out alternative credit providers in lieu of credit limit offers from their mainstream-banking provider, which may result in an increased cost of borrowing.

4.2.1Background

A credit card is a unique financial product; one that is capable of meeting a consumer's changing needs for credit over the consumer's lifetime. No other financial product provides the consumer with this continuous flexibility. To maintain relevance, and prevent attrition to competitor products, a credit card issuer has to actively manage all aspects of a credit card offer on an ongoing basis - including credit limits as well as pricing and other offers and incentives.

As demonstrated in the preceding section (4.1.3), Australian card issuers adopt a cautious and conservative approach to setting initial credit limits on new accounts. However, this approach is predicated on the industry's ongoing ability to increase credit limits to consenting customers – based on clear evidence of a customer's ability to responsibly manage an incremental credit limit and their ability to repay their debts. This approach is determined through reliable statistical models, which have been developed and improved over long periods. Credit limit increases are only offered/accepted after rigorous and thorough credit behavioural modelling.

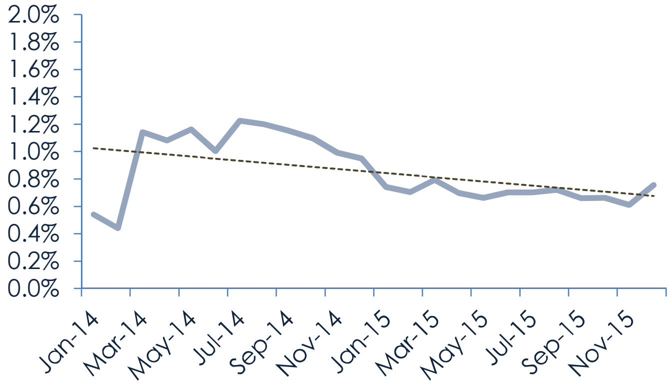

Figure 9 - Frequency of credit limit increases in Australia - Jan-14 to Dec-15

Figure 9 demonstrates the relatively low frequency of credit limit increases in Australia (below 1%) and shows a downward trend in such activity over the past 18 months. In 2015, Australian card holders benefited from credit limit increases amounting to $2.1bn, or 2.9% of their starting credit limit.

This compares to other markets, such as the UK, where an average of 2.1% of active accounts receive a credit limit increase each month. Whilst not shown on the graph, it is known that approximately 10% of Australian cards see a credit limit increase each year compared to a figure of circa 20% in the UK. Furthermore, Australian issuers also reduce credit limits for circa 3% of consumers each year.

In NAB's view, the existing requirement to obtain customer consent prior to offering a credit line increase provides an effective tool for customers to control their access to credit. Inhibiting banks from offering consenting customers lifetime credit limit increases creates a material risk that the Industry will provide initial limits much closer to the affordable limit from the outset of a new relationship.

4.2.2Industry credit limit increases: targeting and performance

NAB finds that there are significantly fewer credit limit Increases applied to Australian accounts in comparison with similarly developed card markets, such as the UK (Figure 10).

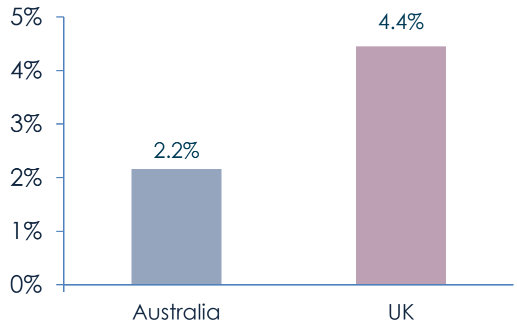

Figure 10 - Percentage of active accounts with a credit limit increases - 1Q15 - Australia and UK

The majority of Australian credit card accounts and credit limit increases (either as a result of customer request or bank offers) are granted to customers in low or medium risk categories. Accounts classified as high risk comprise 6% of total accounts however, a mere 3% of all credit limit increases were provided to customers in this group - evidence that banks do not actively target this group of customers.

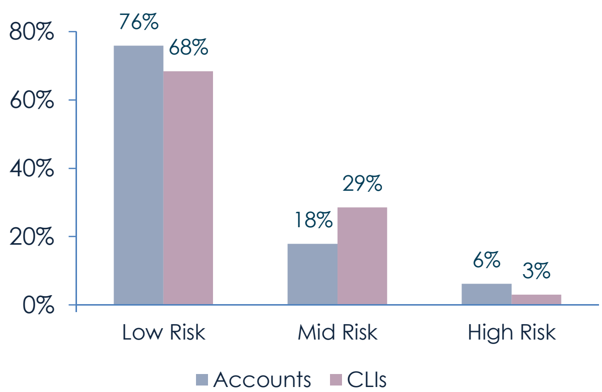

Figure 11 - Distribution of accounts and credit limit increases by risk - 1Q15 - Australia

To understand whether the establishment of a credit limit increase results in increased debt and write-off, Argus has compared the credit risk performance of a set of Australian customers who received a credit limit increase in 1Q15 (both customer requested and bank offers), against a similar set of customers with no credit limit change. Both samples were normalised (as much as possible) in terms of behaviours, to enable comparisons and conclusions to be drawn.

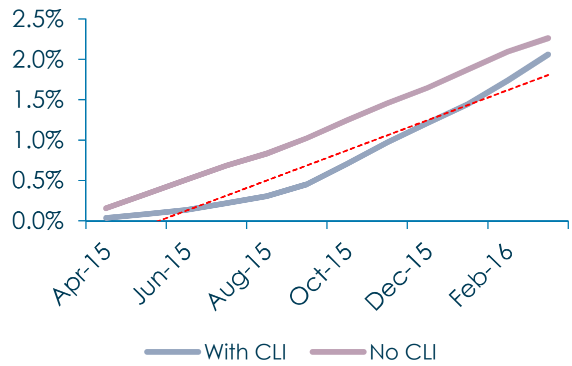

Figure 12 - Asset write-off rate for accounts with credit limit increase versus accounts with no credit limit increase - 1Q15 - Australia

At an industry level, Argus found that customers who take advantage of a credit limit increase demonstrate a better overall risk measures and write-off performance than those who did not. Figure 12 compares the asset write-off rate of customers who have received a credit card Increase against those who have not. It shows that for the 15 months following a credit limit Increase, a customer typically demonstrates better overall risk measures and write-off performance, with performance normalising over time.

NAB concludes from this analysis that credit limit increases are provided to customers able to afford them in a responsible manner, otherwise the analysis would reveal higher rates of delinquency and write-off.

4.2.3Credit limit increases and impact on problem debt

Using the financial difficulty categories, as determined by the FCA, Argus has determined the level of credit limit increases provided to consumers on an industry credit card basis in each of the categories.

This data had been examined to determine whether these customers transitioned to a ‘worse’ financial difficulty state over the subsequent 12 months.

The results were then compared to the remaining industry customers to understand whether the application of credit limit increases precipitated any deterioration in financial difficulty status.

Table 2

Distribution of accounts by financial difficulty status at Jan-15 (Australian Industry)	With credit limit increase	No credit limit increase
1. Severe Arrears	N/A	N/A
2. Serious Arrears	3.1%	6.4%
3. Persistent Debt	16.1%	7.0%
4. Systematic Minimum Payments	0.0%	0.1%
5. Non-problematic	80.8%	86.5%

The relatively high percentage of customers in the persistent debt category with credit limit increase may appear inconsistent with previous statements in this response; however, this category – by its nature – is defined by high utilisation and, therefore, is most likely to include customers who seek to optimise the flexibility provided by enhanced credit limits, and this does not necessarily align to unaffordable debt.

NAB believes that a formal definition of financial difficulty should be adopted by the industry and this will support greater scrutiny of credit limit increases to customers who fall within this definition.

In a further interrogation of the data, the performance of customer accounts is tracked in each of the financial difficulty categories of serious arrears and persistent debt. The following table shows a 12 month performance for accounts with credit limit increases and without credit limit increases; informing how customers migrate between different degrees of financial difficulty..

Table 3

Financial Difficulty Status	With credit limit increase			No credit limit increase		
	Worsen	Improve	Same	Worsen	Improve	Same
2. Serious arrears	0.0%	64.5%	35.5%	10.8%	41.3%	48.0%
3. Persistent debt	13.0%	41.6%	45.3%	15.9%	34.6%	49.6%

The table demonstrates that the allocation of a credit limit increase does not have a detrimental effect.

In the aforementioned Sections 4.2.2 and 4.2.3, which evaluate industry-wide performance of accounts, all data is a consolidation of customer requested and bank offered credit limit increases. Industry data cannot distinguish between the two types of credit limit increases.

4.2.4 Performance differences between customer requested and bank initiated credit limit increases

Using NAB credit card data, NAB has determined that regardless of whether a credit card Increase is customer requested or bank offered the change does not drive adverse customer behaviour.

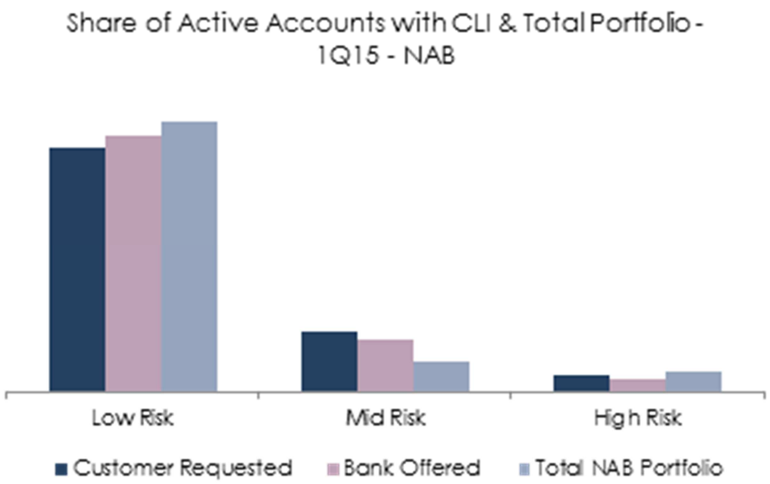

Figure 13 - Indexation of credit limit increases by category to active accounts - 1Q15 - NAB

Figure 13 allows for a comparative analysis of customers who have requested a credit limit increase, customers in receipt of a bank offered credit limit increase, and total NAB card customers. Total customers for each aforementioned definition are distributed according to their risk category. Absolute values have been masked to protect the confidentiality and business sensitivity of the data.

The analysis highlights that bank offered credit limit increases are both more likely to be in the low-risk category, and significantly less likely to be in the high-risk category than customer requested changes.

NAB has tracked the performance of customers in both sets of credit limit increase categories, from 12 months prior to the credit limit increase to 12 months subsequent, to determine differences in performance at a total segment, and also for each category of financial difficulty. NAB found no material difference between customer requested and bank offered performance across any segment, which provides confidence that bank models are working reliably and provide customer offers to segments where customers may need, and would use, additional credit reliably.

The following charts demonstrate performance differences between consumer requested and bank initiated credit limit increases. The data relates to NAB customers who received a credit limit increase in 1Q15. All charts and timelines have been aligned to show the credit limit increase as allocated in month 0.

Figure 14 - Monthly retail spend per active account by credit limit increase category - 1Q15 – NAB

Figure 14 demonstrates similar increases in customer spend patterns to coincide with the assignment of the credit limit increase. The spend pattern reverts back to pre-credit limit increase levels within three to four months. This pattern is consistent regardless of whether the customer requested or the bank offered the credit limit increase.

Figure 15 - Monthly average balance per active account by credit limit increase category - 1Q15 – NAB

Figure 15 demonstrates that customer behaviour in respect of average daily balance follows a similar growth pattern regardless of whether the bank offered or customer requested a credit limit increase.

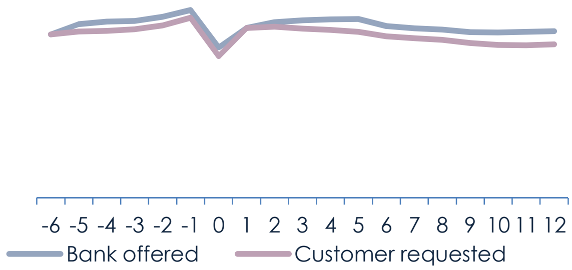

Figure 16 - Monthly credit limit utilisation by credit limit increase category – 1Q15 – NAB

Figure 16 illustrates how credit limit utilisation, not unsurprisingly falls immediately following the application of a credit limit increase but also progressively declines to lower levels than were observed before the credit limit increase. Again, the performance data demonstrates no material difference in overall risk or behavioural profiles for customer requested and bank offered credit limit increases.

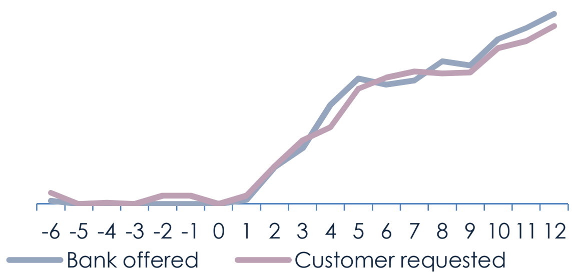

Figure 17 - % of assets 2+ cycles past due by credit limit increases category - 1Q15 - NAB

Figure 17 illustrates the percentage of balances that are delinquent by more than 60 days (two cycles). The chart demonstrates that there is no difference in risk behaviour between the two categories of customer requested and bank offered.

In each of the illustrations above, NAB has demonstrated that the behaviour of bank offered and customer requested credit limit increases is very similar. This supports NAB's belief that appropriate decision-making models and strategies exist to identify those customers who need and would benefit from extended credit. It confirms that NAB provides additional credit to customers who have the ability to repay an extension.

NAB believes this information shows that the proposal to regulate a card issuer's ability to deliver enhanced credit limits is unnecessary.

NAB is supportive of an amendment to legislation to ensure a channel consistent approach regarding unsolicited credit limit increases.

4.3 Reform 3 – Prohibit issuers from backdating interest charges and charging interest on the portion of the balance that has been paid

Response NAB does not support this proposed action.

NAB is supportive of greater industry transparency and equivalence to aid effective consumer choice.

Whilst NAB acknowledges that the interest calculation is potentially a source of confusion for some customers, this change would be beneficial to only a small number of consumers. Based on NAB's entire card portfolio, in a typical month only 5% of customers would find this change beneficial. More importantly, such a change would benefit a very small number of customers in financial difficulty. NAB believes only 0.2% of NAB card customers would benefit.

NAB does not believe it is appropriate for the pricing policies of credit providers to be mandated through statute.

UK regulators have examined this area on several occasions. Indeed, as part of a recent FCA market study it had access to account-level data for a number of issuers but did not deem it worthy of further action.

In consideration of this proposed remedy, NAB has reviewed the potential financial and timing implications of such a change. An alternative method of calculation is not currently supported by NAB systems. Given the unique nature of the changes, NAB believes any change will require extensive testing. Initial estimates of timing indicate a minimum of 12 months for development, testing and release. This development work and the subsequent marketing and communication costs would be a substantial expense burden.

Overall, NAB believes the cost required to implement this reform far outweighs the very small consumer benefit it would deliver.

4.4 Reform 4 – Require issuers to provide consumers with online options to initiate a card cancellation or reduce their credit limit

Response NAB is supportive of a technology-neutral position but does not support mandating improved technology solutions for managing credit cards.

NAB is committed to providing consumers with a choice of preferred channels to manage their credit card. NAB Internet Banking already delivers an online option for customers to request a reduction in their credit card limit. In the future, NAB anticipates delivering this option across all digital applications.

A significant number of NAB's customer interactions have moved rapidly into a digital environment. NAB will continue to invest in the development of new technological solutions and digital options. And it is against this background that the provision of a digital option to initiate the cancellation of a credit card is considered an appropriate next step. However, it should be borne in mind that the cancellation of a card is rarely as simple as 'click and close'. The account will, in all probability, have an outstanding balance and there may be direct debits established with various merchants. The customer will need to talk to the bank about repayment of the outstanding debt and put in place alternative payment methods for their merchant services. NAB believes most customers will still need to talk to their bank in order to cancel their credit card, meaning a mandated online cancellation process is not appropriate.

In a world of rapid technological advances, NAB supports a technology-neutral position. Namely, legislation should not determine the specific channel through which consumers transact certain transactions.

4.5 Impact statement

To conclude our feedback in response to the specific recommendations contained in Phase 1 of the consultation paper, NAB would like to highlight the overarching financial impact on consumers and card issuers.

By employing the services of Argus to analyse syndicated industry data, NAB has gained valuable insight into the potential impact on the industry of the implementation of all the proposed remedies. The impacts are illustrated by reference to the following:

- Loss of revenue.
- Implementation and ongoing management expense.
- Impact on annual percentage rates (APR) for all interest bearing customers.
- Impact on annual fees payable by all credit card accounts.

In seeking to demonstrate the potential customer and industry impacts, NAB is not suggesting how the industry would respond to these proposals.

Table 4

Industry revenue impact $MM	How incurred	Industry expense impact $MM	How incurred
$240 - 260	- Reduced balances - Reduced interest charges	$30	- System costs to comply - Customer communication costs - Increased costs for acquisition & retention for dissatisfied customers
Customer impact if issuers were to maintain income at current levels:			
Average annual cost increase per customer:			$17-20

The above revenue impacts were derived using input from Argus to estimate the changes to industry portfolios (for reforms 1 and 2) and interest calculations (reform 3) should these reforms be introduced. In addition an estimate of project costs was made, utilising NABs own internal experience in delivering projects of this nature, and extrapolated across the industry.

To illustrate the potential impact on customers, if this was to be passed on by the banking industry, NAB has employed a simple formula as follows:

$280m (total industry impact) / 16m (credit card customers) = $17.50

This impact could be recovered either through increased fees or through interest from revolving customers, however, as an average it is unlikely to be applied evenly across the total portfolio; or it could be partially absorbed.

5. Phase 2

5.1 Reform 5 – Require that issuers provide information on the annual cost of a consumer's credit card use and to prominently display annual fees

Response NAB is supportive of any changes that improve consumers' financial awareness and literacy, whether through education and/or improved transparency and clarity of information that result in informed consumer choice.

The consultation paper acknowledges that a large number of customers do not look at their monthly statements despite the multitude of electronic and non-electronic tools that are available to assist in the management of finances and which simultaneously disclose fees and charges.

These tools include internet banking, monthly account statements, online product descriptions, online resources on fees and charges, and numerous other interactive tools and calculators that are freely available for customers to use. In addition, there are third party independent comparison websites to provide consumers with information to help in their credit card choice.

NAB believes a digital solution to present this information to customers will be more cost effective and environmentally sustainable. However, the mere provision of information will generally not deliver an intended outcome. NAB believes information provision should be supplemented with appropriate tools for customers to utilise and analyse the information. NAB encourages consideration of the broader question of how different 'independent' tools provide a consistent experience.

Credit cards are often offered as part of banking product packages. NAB notes that many of its card customers have a wider bank relationship, which results in a reduction in their annual credit card fee.

Fees and interest charges are also linked with other features and benefits that customers consider when selecting a credit card. Credit cards commonly include many different features and benefits, including reward programs, interest free days, travel insurance, purchase protection insurance, extended warranty and more. NAB encourages consideration on how to represent the complexity of additional benefits associated with a credit card as part of consumer testing.

5.2 Reform 6 – Require issuers to clearly disclose in advertising and marketing material a card's interest rate and annual fee

Response NAB is supportive of any changes that improve consumers' financial awareness and literacy, whether through education and/or improved transparency and clarity of information, that result in informed consumer choice.

NAB believes Australian banks already support and abide by high levels of transparency and disclosure in advertising and marketing. The annual fee and interest rate information is already prominent in marketing and advertising materials, and in website content. The information is also available to customers during the application process, letter of offer, and card statement.

Australia is a mature credit card market and NAB believes that consumers generally understand the different characteristics of low rate versus rewards cards.

Annual fees and interest rates are key credit card features; however, there are other card features and benefits available to customers. A focus on clearer disclosure of annual fees and interest rate may not deliver the best financial outcome for all consumers. Many consumers' choice of credit card will be influenced by their wider bank relationship. For example, half of the annual card fees (by value) that NAB would ordinarily expect to collect, according to the credit card terms and conditions, are offset as a result of the customer's wider NAB bank relationship.

5.3 Reform 7 – Require issuers to provide information about potential savings from switching to lower-cost products

Response NAB supports the evaluation of this proposal with reference to consumers who fall into the problem debt categories (refer section 3.1).

NAB believes the majority of NAB customers choose an appropriate product for their needs and make a proper comparison of card products by consideration of both financial and non-financial inclusions e.g. travel insurance on purchases.

NAB feels that credit card statements already contain substantive repayment information. Statements indicate the term and interest that will be paid if only the minimum payments are made; comparing this to a repayment profile over two years. See figure below:

The following warning is a legislative requirement intended to provide you with more information about the consequences of making minimum repayments. The examples provided do not replace the minimum payments required shown in the Payment Details section.
Minimum Repayment Warning: If you make only the minimum payment each month, you will pay more interest and it will take you longer to pay off your balance.

For Example...	If you make no additional transactions using this card and each month you pay...	You will pay off the closing Balance for this statement in about..	And you will end up paying estimated total interest charges of...
1.	Only the minimum payment	9 years 8 months	$1,076.62
2.	$104.50	2 years	$229.74, a saving of $846.88

Figure 18 – NAB credit card statement information

NAB believes that any information about potential savings from transferring to lower-cost products would need to be clearly defined to avoid being misleading or construed as product advice.

NAB supports the evaluation of this proposal with reference to consumers who fall into the problem debt categories (refer Section 3.1). NAB believes a targeted evaluation for the problem debt segment rather than introducing an all-encompassing disclosures approach would be beneficial.

5.4 Reform 8 – Require issuers to provide consumers with timely electronic notifications regarding the expiry of introductory offers and credit use

Response NAB is broadly supportive of this proposed action.

NAB recommends that balance transfer notifications should be sent no less than 30 days prior to the expiry of an introductory offer. This will allow customers ample time to establish alternative options, if desired.

Upon request, NAB provides customers with regular weekly, fortnightly or monthly email account balance alerts, at no additional fee. This service was introduced in response to customer feedback. Customers can also request a credit card payment reminder in advance of the payment due date via either email or SMS.

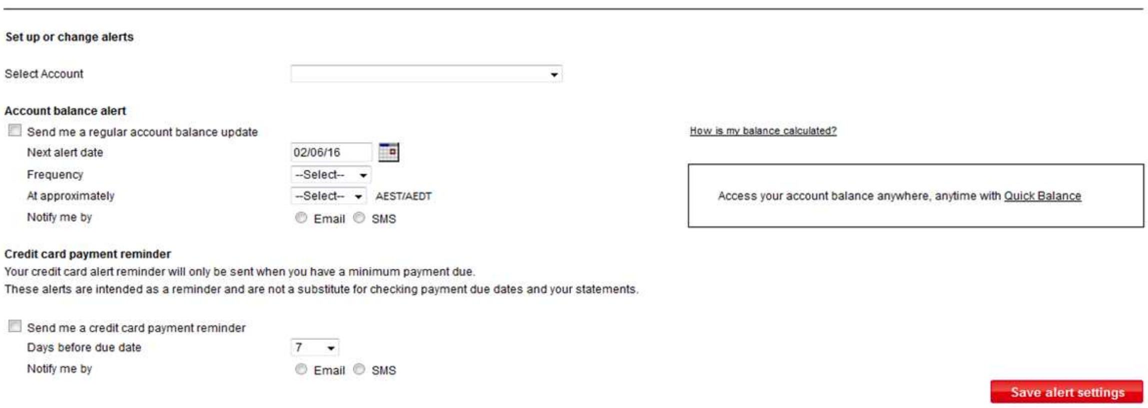

Figure 19 – Source: NAB Internet Banking

NAB's experience, in contrast to the consultation paper, is that customers coming off a balance transfer offer generally exhibit a significantly better subsequent payment record than other customers.

However, NAB recommends that balance transfer notifications be sent no less than 30 days prior to the expiry of an introductory offer. This will allow customers ample time to establish alternative options if desired.

NAB recommends the communication of monthly balance or card utilisation alerts at a utilisation level (of card limit) determined by the customer. Credit card accounts with a 70% utilisation are found to perform better than accounts with a 90% utilisation. Accordingly, if a trigger were appropriate, NAB would recommend an alert trigger at the 90% utilisation. NAB believes the majority of customers would prefer to receive this information by either Internet banking or mobile banking applications.

5.5 Reform 9 – Require issuers to provide consumers with alternative payment tools, and proactively contact consumers who are persistently making small payments

Response NAB does not support this proposal.

NAB does not support regulation to drive the provision of alternative payment tools. Customers of NAB can already access an easily understood tool that allows them to take control and commit to repayment amounts of their choice.

The inherent flexibility of a credit card supports consumers to adjust their repayment behaviour as they choose. NAB has, for some time, provided customers with an easily understood online tool that allows them to take control and commit to a repayment amount of their choice. See figure below.

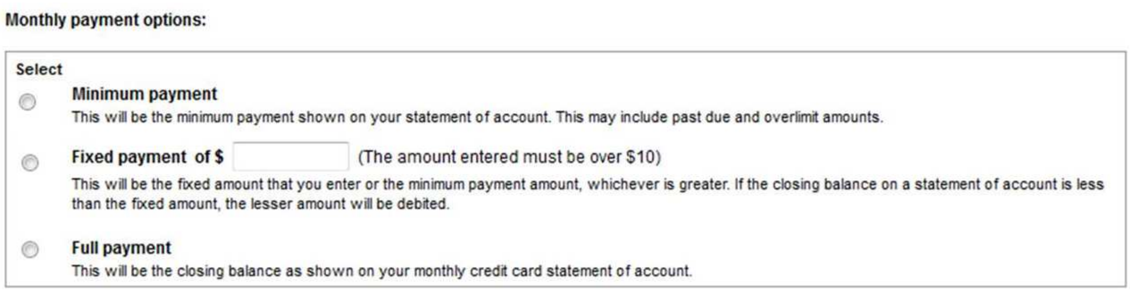

Figure 20 - Source: NAB Internet banking

The consultation paper references two repayment tools and instalment options offered by overseas credit card issuers. NAB understands that the core example – a free credit card debt management tool offered by Chase – has a low take up rate. Since the launch in 2009, approximately 0.5% of cardholders have opted to use the feature. It is conceivable that the increasing complexity such features introduce are a deterrent to all but the most financially literate consumer.

Table 5

Indicator of Financial Difficulties	UK	Australia
Systematic minimum Payments – active cardholders who made 9 or more minimum repayments in the last 12 months while incurring interest.	5.2%	0.2%

Table 5 illustrates that the number of customers who are making systematic minimum payments is significantly lower for NAB and Australia overall compared to the UK experience.

In this case, NAB believes that the proposed reforms exceed the magnitude of the problems identified and NAB does not support regulation to drive the provision of alternative payment tools.

5.6 Reform 10 – Substantially raise the level of minimum required repayments

Response NAB does not support this proposal but agrees that other actions to support responsible lending obligations would be more appropriate. NAB strongly believes that consumers value the inherent flexibility of a credit card that allows them to personally manage their finances.

The majority of consumers value the inherent flexibility of a credit card, which affords them choice in their schedule of repayments. NAB believes a retrospective application of this proposed action will disadvantage the majority of consumers.

Industry data indicates that cardholders who make continuous minimum repayments are few in number. Information contained in Table 1, shows that active cardholders that have made nine or more minimum repayments in the last 12 months form an extremely small percentage of total cardholders.

NAB agrees with the consultation paper's assertion that other measures giving greater effect to the responsible lending obligations to credit cards will deliver greater overall benefits.

Existing NAB customers have credit limits that have been assigned according to affordability calculations using the current minimum repayment amount. This affords the customer flexibility in managing their finances according to variations in their income and outgoings. The consequence of implementing this proposal is that an immediate change to the minimum required repayment could significantly impact a customer's ability to meet the monthly payment.

Banks typically (this is reflective of NAB's approach) establish the minimum payment as the greater of either 2% of the outstanding balance or a minimum dollar value – typically $25. NAB systems are configured to calculate a single minimum monthly repayment percentage on this basis.

Rather than changing the percentage due, NAB believes it would be more helpful to increase the minimum dollar value. This would significantly reduce the time required to repay a card balance for persistent debt customers.

6. Conclusion

NAB would welcome the opportunity to work with Treasury in considering and developing the proposals presented in this paper. We would be pleased to discuss the NAB submission in further detail. Please contact Aron Whillans, NAB Government Affairs & Public Policy (aron.j.whillans@nab.com.au) should this be of interest.