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Committee Secretary
Parliamentary Joint Committee on
Corporations and Financial Services
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Dear Committee Secretary

Inquiry into the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011

National Legal Aid (NLA) represents the Directors of the eight State and Territory Legal Aid Commissions (Commissions) in Australia. The Commissions are independent statutory authorities established under respective State or Territory enabling legislation. They are funded by State or Territory and Commonwealth governments to provide legal assistance to disadvantaged people.

NLA aims to ensure that the protection or assertion of the legal rights and interests of people are not prejudiced by reason of their inability to:

- obtain access to independent legal advice;
- afford the appropriate cost of legal representation;
- obtain access to the federal and state and territory legal systems; or
- obtain adequate information about access to the law and the legal system.

NLA welcomes the opportunity to comment on the proposed Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011.

Support for the Bill

NLA welcomes and strongly supports the Federal Government's proposed legislation which provides enhanced consumer protection particularly in relation to reverse mortgages and maximum chargeable fees and interest for credit contracts.

NLA is uniquely placed to comment on the importance and effectiveness of the fringe lending measures in this Bill as legal aid commissions span State jurisdictions that have interest rate caps protecting vulnerable consumers and those jurisdictions which do not currently have the same protections.

The reform addresses some of the worst exploitative behaviour such as debt spirals caused by loans which are continuously rolled over and usurious rates of interest that featured in NSW, the ACT and Queensland prior to their State and Territory comprehensive interest rate caps.

The anti-avoidance provisions are necessary to ensure that a new national cap is effective.

The key features addressing payday lending include:

- (a) Prohibition on payday loans being continuously rolled over and/or refinanced. Without this vulnerable consumers are often trapped in a debt spiral that entrenches social and financial exclusion.
- (b) Prevention of multiple payday loans at any one time through provisions such as those which prohibit a further short term loan being offered by a lender when they know or are reckless about the fact that the consumer already has a loan.
- (c) Stopping usurious annual rates of interest of anywhere between 100% and 1500% being charged by lenders.
- (d) Addressing the brokerage model currently favoured by many payday lenders (where fees are increased because a broker also bills the consumer).
- (e) Improving the protection being provided to vulnerable consumers through provisions that prevent security over assets being taken for small amount loans.
- (f) Providing certainty to both vulnerable consumers and the industry about the type and amount of fees and charges that a lender is permitted to charge in relation to a small amount loan.

The following case studies illustrate the exploitative practices in the payday lending industry that NLA believes will be successfully addressed through the Bill.

Case Study 1

Mr T is a 25 year old single male on a disability pension because of mental illness. He has been in receipt of a disability pension since 2005 and since that time has lived with his mother. He approached Legal Aid Queensland (LAQ) via a financial counselor as he did not have enough money to live on, despite having low living costs as those costs are shared with his mother. When he approached the financial counselor he apparently had 4 current payday/high cost loans. The lenders were attempting to use anti avoidance techniques so that the cap would not apply to these loans. LAQ asked for documents to ascertain how many loans he had with the one provider or series of providers. As a result of those inquiries LAQ became aware that there were 35 high cost/payday loans entered by the client between November 2008 and July 2010. 21 of those loans were entered in a 7 month period between January and July 2010, demonstrating an increasing debt spiral.

Case Study 2

Mrs K is a 40 year old woman who originally took out a \$1,000 loan over a 9 month period. At the end of the 1st month she was informed that to keep the loan current, she would have to take out a new loan and pay a \$150 application fee. This process continued 8 times over the next 10 months and meant the loan was not paid off over 2 years later.

Case Study 3

Mr L approached a pay day lender for a small loan of \$400. He was informed that if he wanted a loan he would have to purchase a "Financial Package" for \$800 to be paid back with interest. As part of the financial package he received CD 1 and CD 2 from a series of Money Management CDs.

Case Study 4

Mr P suffers from an acquired brain injury. He sought a \$200 loan from a local payday lender to help with basic expenses. He was given a 1 month loan for \$270, payable back in 17 weekly payments which included a brokerage fee of \$70 for a broker that played no active role in the loan. He struggled to repay the debt.

Case Study 5

Mr H suffers from a mental illness and is on a disability pension working limited hours. Mr H took out his first payday loan to assist him to pay for basic living expenses. Unable to meet these expenses he approached the neighbouring payday lender and was granted a second payday loan which he used to pay the first payday loan. By the time he sought legal advice, Mr H had 3 payday loans, the second and third were being used to pay for the earlier payday loans.

Prior to the introduction of a 48% interest rate cap in Queensland, clients of LAQ reported paying interest rates of 240% and more.

One lender told clients on the phone that the interest rate was 20% monthly. Our clients were comforted to know that their payday lender was charging favourable rates comparative to mainstream credit card rates. These clients were bewildered to find that 20% monthly meant 240% per annum and that this rate was at that time legal.

NLA is concerned small amount loans could be marketed as “*One up front fee, and only 2% per month!*” which would cause similar confusion amongst vulnerable consumers.

Lack of disclosure makes it difficult for clients to compare products on a like for like basis.

NLA is aware that s.153 of the *National Credit Code* specifically prohibits the advertising of interest rates unless they are expressed as an Annual Percentage Rate (APR). However, the small amount lending formulae is based on the percentage of the amount borrowed and not an APR and therefore would not be caught by the provisions of s. 153.

NLA recommends that this difficulty could be addressed through the following recommendations:

1. Requiring that the APR must be disclosed for small amount loans to enable comparison between like products.
2. Requiring that the annual percentage rate be disclosed for small amount loans in the small amount loans provision.
3. Placing a prohibition on advertising small amount loans along the lines of “*One up front fee, and only 2% per month!*”

Certainty of maximum recoverable amount by a lender

NLA supports the intention of s.39B to provide certainty for both the lender and the consumer about the maximum amount that can be recovered. The reasoning behind the provision is that there is a risk that the costs associated with recovering a loan might increase well beyond any reasonable amount given the size of the loan.

Costs once court proceedings are initiated are supervised by that court; however, collection costs prior to proceedings ought to be caught by the maximum recoverable amount to prevent abuse of this potential loophole to the reform.

This is consistent with the common law position that collection expenses are not normally recoverable for debt recovery.

NLA recommends that s.39B be amended to ensure that the maximum amount recoverable includes enforcement expenses (including debt collection and legal fees).

Consumer Leases

NLA's direct experience is that many high cost lenders in States with comprehensive interest rate caps have abandoned traditional short term loan contracts and opted for business models based on credit cards (continuing credit contracts) and leasing.

By regulating the cost of credit for loans, credit contracts and traditional hire purchase, the amendments will make consumer leases more attractive to high cost lenders because the caps on credit do not currently extend to these products.

NLA welcomes the amendments to the credit legislation through the National Credit Code (NCC) that have widened the scope of regulated contracts. Previously there was some doubt as to whether some high cost hire purchase contracts were regulated, because they did not disclose a cost of credit, but on examination the lender's cost recovery was premised on an inflated price of goods.

The *National Credit Code* now provides in s.9 that leases over goods on hire-purchase are regulated loans and provides that the cost of credit is the amount payable over the term of the contract less the cash price of the goods (definition in Part 13).

This strengthened definition of cost of credit meant that some high cost lenders changed from offering goods on hire purchase to consumer leases, effectively meaning that they went from no regulation to "lighter-touch" legislation and were outside the ambit of 48% interest rate caps applicable to hire-purchase contracts.

In NLA's view, there is no reason to artificially distinguish between goods that retain some value to the lender at the end of a consumer lease and goods which are paid for entirely by the borrower who takes ultimate possession.

The cost of credit for a consumer lease ought to be regulated by the interest rate caps. This could be done by amending the *National Credit Code* to ensure that the cost of credit is defined as the amount payable over the term of the lease less the cash price up-front using the *Part 13* definition and the market value of the goods (if any) upon termination.

Consumer leases currently contain formulae to define the market value of the goods upon termination. However, there could be assumptions about values for classes of

consumer goods. For example, household goods and computers would retain negligible value over extended leases.

NLA recommends extending protection offered by the Bill to consumer leases. The amendment makes consumer leases more attractive and it is noted that there is no capping of interest rate, fees and charges applicable to consumer leases.

Remedies for consumers

It is NLA's understanding that the provisions relating to the 48% cap on interest rates are key requirements of the *National Consumer Code* where breaches are subject to civil penalties. However, the proposed provisions relating to small amount loans are not similarly captured. NLA supports civil penalties applying to the provisions relating to the cap but submits that the civil penalties provisions should be extended to small amount lending.

The civil penalty regime provides an incentive for consumers to complain about non compliant loans and gives an opportunity for borrowers to be compensated for aberrant unlawful conduct. Whilst s.23A voids any monetary liability where there is non compliance the regime is based on individuals taking individual action. The civil penalty regime allows classes of consumer to apply for relief and significantly apply for damages beyond the void monetary liability provided for in s.23A.

NLA recommends that the new sections relating to small amount loans are key requirements under the National Credit Code in order to attract the civil penalty regime to enable borrowers on their own and the regulator (on behalf of all affected consumers) to enforce the provisions and negotiate favourable consumer outcomes.

Summary of Recommendations

Whilst supportive of the Bill, NLA recommends the following:

1. Requiring the disclosure of annual percentage rates in the small amount loan provision to ensure there is no doubt lenders must disclose this.
2. Extending all protections in the Bill to consumer leases.
3. Clarification of s.39B that the maximum amount recoverable includes enforcement expenses (including debt collection and legal fees)
4. That the new sections relating to small amount loans be key requirements under the National Credit Code in order to ensure the civil penalty regime applies to these loans. This change would enable borrowers on their own and the regulator (on behalf of all affected consumers) to enforce the provisions and negotiate favourable consumer outcomes.

Conclusion

Thank you for the opportunity to make this submission. Should you require any further information, please do not hesitate to contact us.

Yours faithfully

Andrew Crockett
Chair