



A Submission to

SENATE ECONOMICS COMMITTEE

ON

**THE CONSUMER CREDIT AND CORPORATIONS LEGISLATION
(ENHANCEMENTS) BILL 2011**

October 2011

**SUBMISSION TO THE SENATE ECONOMICS COMMITTEE ON
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1.0 Executive Summary

- 1.1 Cash Converters submits that the imposition of caps on fees and charges for consumer credit is premature. It is being undertaken before the impact of the Phase One reforms has been evaluated.
- 1.2 Cash Converters submits that the imposition of caps on fees and charges for consumer credit is the wrong approach. It has been shown not to work and it is counter-productive.
- 1.3 Alternatively, Cash Converters submits that, should the Government proceed with its capping proposal, the imposition of caps on fees and charges should be properly targeted at vulnerable consumers. The restrictions should not indiscriminately affect an entire market.
- 1.4 Alternatively, Cash Converters submits that, should the Government proceed with its capping proposal, the level at which the caps are imposed should genuinely permit the industry to remain viable with a proper return on investment.
- 1.5 Cash Converters submits that the introduction of responsible lending provisions under Phase One reforms already restricts re-financing and multi loans and that further prohibitions outlined in this Bill are misguided and ill-conceived and may lead to unintended consequences.

2.0 Introduction

Cash Converters has 140 outlets and employs more than 2,000 staff. As a public company, listed on both the Australian and London Stock Exchanges, Cash Converters complies with the highest standards of corporate governance and ethical conduct and is an exemplary corporate citizen.

Some twelve years ago Cash Converters identified a need in the short-term small-amount loans sector which had been deserted by the banks. It was an opportunity to provide, via our franchised network, a service to borrowers that was no longer available in the mainstream credit market.

Each year more than 625,000 short term loans are provided to Cash Converters customers with a total value of more than \$250 million. It is a highly valued credit facility and the company works to ensure maximum satisfaction in meeting the short term financial needs of customers with minimum risk for them and the Cash Converters network of stores.

Over the past four years Cash Converters has worked with and supported the Federal Government in its move towards the introduction of national uniform consumer credit laws.

We have been an active participant in this reform process, consulting with Government and submitting information and comment when required.

So far we have welcomed the reforms, which are gradually being introduced under Phase One of the process, seeing these measures as an opportunity to strengthen consumer protection and provide greater certainty to industry.

During the process, we consistently argued against the imposition of a cap on fees and charges and have provided documentation in the form of a number of independent reports to the government which support this view.

Notwithstanding the evidence available in this documentation, we acknowledge the Government has come under great pressure, in particular from consumer advocate groups, to introduce a national capping regime.

“Payday lending is the focus of consumer activism in Australia. It is not sure why this is the case as there is no readily available evidence to suggest it is associated with more problems than other forms of short term lending.”

Page 14, “Background paper of small amount, short term for-profit lenders in Australia”,
by David Cousins from Monash University

We are disappointed because the Government now appears to have ignored the evidence based research contained in these reports, placed greater weight on the argument of the consumer advocates, and proposed a 10% + 2% capping regime.

Cash Converters believe one of the main distortions in capping arguments, results from the great “annual percentage rate” myth. Advocates take a rate charged for a one month loan and convert it into an annual rate and then declare the APR to be “outrageous”. This is a false comparison because loans for one month are never intended to run for a year. This is the equivalent of assessing the \$8.00 rate which a taxi charges to take a customer 2 kilometres as being “outrageous” because it would amount to \$60,000 if you spent a year doing all your travel by taxi. No-one travels 15,000 km per annum by taxi. No-one buys a house with a micro-lender’s cash advance.

We think that Phase One reforms should have had time to take effect before any decision was made on the capping issue. These reforms should address most, if not all, of the concerns expressed in the Minister’s second reading speech.

We note the Minister has indicated in his second reading speech that he understands that “short term loans do have a role in the Australian economy and should be part of everyday life” and that he is seeking more consultation and negotiation on the Bill.

We take this opportunity to submit our thoughts on the Bill to the Committee.

3.0 Phase One Reforms

Phase One of the reforms to consumer credit has seen the introduction of a vast range of new regulation and reform.

These reforms include:

- a licensing regime which requires participants to be qualified and trained to certain standards;
- a wide ranging set of general conduct obligations;

- a responsible lending regime which requires thorough scrutiny of every application with severe sanctions if unsuitable credit is provided;
- free access to the External Dispute Resolution scheme, principally operated by Credit Ombudsman Services Limited; and
- the position of a compliance officer and a complaints officer who need to be able to verify compliance with the Phase One reforms.

The combination of these broad statements of principle and detailed itemisation of practical requirements mean that the industry faces the most highly regulated and circumscribed trading environment imaginable.

To make a loan of \$100, a broker who refers a client to a lender must provide the client with a Credit Proposal, a Credit Quote, a Credit Guide and a Preliminary “not unsuitable” Assessment and the lender must then provide a Credit Guide and a Final “not unsuitable” Assessment. After all this, one can then present the contract which must contain a long list of disclosures (most of them repeated from the other documents mentioned). Go through all this and you can finally give “Mr Jones” \$100! There is much more paperwork for a \$100 loan than there is for a loan for a car or a house.

These reforms are still being implemented and their impact on the economy, on consumer protection and on the health of the industry should be allowed to take effect before any further reform decision is made.

“..while much of the literature argues there is a need to adopt a regulatory approach to stem ‘predatory lending’, the extent to which the problems have now been resolved under the National Consumer Credit Regime remains untested.”

Page 6, “Phase Two of the National Credit Reforms Examining the Regulation of Payday lenders”, by Professor Stephen Corones, Denise McGill and Rebecca Durrant from Queensland University of Technology (March 2011)

“In conclusion there appears to be no evidence that the general projections in the NCCP and the ASIC Act and the remedies they make available to payday borrowers are inadequate. On the contrary, we believe they are comprehensive and sufficient.”

Page 56, “Phase Two of the National Credit Reforms Examining the Regulation of Payday lenders”, by Professor Stephen Corones, Denise McGill and Rebecca Durrant from Queensland University of Technology (March 2011)

We already know that the Phase One reforms have greatly increased the cost to industry and that this new regulatory environment will afford consumers a much higher level of protection against unscrupulous lenders.

However, before Parliament and ASIC can accurately measure whether these reforms have addressed the problems they were intended to address, the industry is now confronted with a proposal to introduce a 10% + 2% capping regime.

Imposing caps at this point begs the question why Parliament bothered with Phase One because strict compliance with the caps, renders Phase One an expensive waste of time.

Before proceeding with Phase 2, decision makers need to take into account that the substantial compliance costs associated with Phase One reforms have to be recouped from the very consumers which the reforms are supposed to help.

In light of the fact that the impact of Phase One reforms have not been assessed, we question why Phase Two is being rushed through. Is this simply an ideologically driven assault on the viability of the industry?

4.0 Interest Rate Caps

There is a wealth of reports which argue that while there has been scant investigation on the effect of caps, the evidence that is available indicates they do not work. These high level reports compiled by well qualified, independent authorities have been available to the Government but it appears little regard has been shown to their findings.

“We have considered the case for price controls for pawnbroking, payday loans, home credit and rent-to-buy credit and have concluded that they would not be an appropriate solution to the particular problems found in these high-cost credit markets.”

Page 4, “Review of High Cost Credit” by Office of Fair Trading, UK (June 2010)

Some of the many reports include:

- **“Phase Two of the National Credit Reforms Examining the Regulation of Payday lenders”**, by Professor Stephen Coronos, Denise McGill and Rebecca Durrant from Queensland University of Technology (March 2011)
- **“Background paper of small amount, short term for-profit lenders in Australia”**, by David Cousins from Monash University (June 2010)
- **“Review of High Cost Credit”** by Office of Fair Trading in the UK
- **“The impact of interest rate ceilings”**, by Anna Ellison and Robert Forster from Policis (Independent social and economic research group)
- **“Do you really want to hurt me? Exploring the costs of fringe lending.”** Report from the National Australia Bank (March 2010).

In NSW and Queensland annualised caps of 48% p.a., inclusive of fees and charges, have been legislated by the State Governments.

The glaring weakness of this legislation is that it totally ignores the short term nature of the small loans, the vast majority of which are of only one month duration. Regardless of the duration of the loan, the establishment and administration costs are similar.

In this scenario, the complicated formula that calculates interest on a daily reducing basis means that lenders can only apply a charge of less than 4% for a one month loan (48% annualised is less than 4% per month) – a huge loss to the lender since this is gross revenue before any expenses are taken into account!

“The pilot data shows that it is not possible to make a profit and legally operate within the 48% per annum cap for loans of \$1,700 or smaller, for a portfolio of 3000 loans or less, for loan terms of one year or less.”

Page 13, “Do you really want to hurt me? Exploring the costs of fringe lending.” Report from the National Australia Bank (March 2010).

While it is argued that industry survives in these states, the reality is that all short term lenders in these states have in place mechanisms to ensure they receive a return greater than the (less than) 4% per month, which the 48% annualised cap imposes on them.

They resort to these alternative mechanisms, most commonly a brokerage fee, in order to return a profit.

The implication that consumers are better off in QLD and NSW, and are borrowing at much lower effective rates, is just not true. No-one pays less for a *Cash Advance* in QLD or NSW than in other states.

It is worth noting that the majority of States are currently operating without a cap, or have a capping regime which does not include fees and charges (Victoria), and that there is no evidence that consumers in those States have less protection than in QLD or NSW.

In the 2011 financial year, Cash Converters had over 625,000 transactions with only 18 complaints registered with the Credit Ombudsman Service Limited (COSL). Of these, 7 were registered by consumer advocates on behalf of customers testing the validity of our contracts.

Interestingly, there are no more and no fewer complaints going to COSL in the States where there are no caps in place.

Analysis of complaints to State regulatory agencies paints a similar picture. **(see Attachment 1)**

Advocates for capping tend to ignore the consequences of introducing capping regimes that drive providers from the small amount, short term market.

Studies in the UK by the Government and the Competition Commission indicate that the introduction of a rate ceiling is likely to damage vulnerable borrowers and open the door to illegal lending.

“...a rate ceiling would create credit exclusion among the poor and that it would also open the door to unregulated illegal lenders.”

Page 22, “The impact of interest rate ceilings”, by Anna Ellison and Robert Forster from Policis

5.0 Alternative One - 10% + 2% for the “vulnerable” consumer

Minister Shorten claims that he supports a free market except where there has been a market failure. He identifies this failure as applying to those who cannot negotiate because their position is desperate. Unfortunately, basing caps on the loan amount results in an interference in the much wider market comprising all consumers even where there has been no market failure.

Cash Converters submits that it is practical and reasonable to implement a system where the consumer who earns less than a set amount per annum is entitled to enjoy the 10% + 2% cap on fees and charges, but others borrow in a free market.

We regard the only sensible basis on which to define a person to be “vulnerable” is their level of income.

The Government could set the eligibility benchmark by reference to a widely known standard such as the single age pension of \$19,468.80 per annum or some similar standard. This can be updated annually if necessary and adjusted in years to come based on actual experience.

Loans to these consumers will occur below cost but the trade-off will be that the consumers who are better off pay the market rate which effectively subsidises the low income consumer. This is a win-win solution. On the one hand, the Government has genuinely addressed the “vulnerable” consumer’s hardship. On the other hand, industry has a free market to do business with those who do not need the protection of caps.

All consumers will still enjoy the benefit of the Phase One Reforms which can then perform the intended function of regulating the industry towards responsible lending conduct.

6.0 Alternative Two – 20% + 4%

Should the Government wish to proceed with a capping regime, Cash Converters submits that the current proposed caps at 10% establishment fee and 2% monthly fee are demonstrably below cost.

The cost for a Cash Converters Personal Finance Centre to provide the average Cash Advance loan of \$320 for one month is just over \$76.00. **(See Attachment 2 for detailed breakdown in costs)**

Under the 10% + 2% capping proposal, the return on the \$320 loan would be \$38.40.

The 10% + 2% proposed in the Federal legislation would have a tsunami like effect on the micro-financing industry and small amount, short term loans would disappear from the market.

The rationale behind the 10% + 2% is unclear to us and there appears to be no precedent either in Australia, or overseas, for the 10% + 2% capping regime currently proposed.

If the Committee and Federal Parliament supports the Minister in his desire to introduce a national capping regime, we would urge the Committee to amend this proposed capping regime to allow industry to be able to continue offering small amount, short term loans to consumers.

“If an all-inclusive cap were to be introduced, further research to determine an appropriate level would be required,”

“An effective cap would need to take into account payday lenders’ costs and allow them a reasonable level of profit.”

Page 55, “Phase Two of the National Credit Reforms Examining the Regulation of Payday lenders”, by Professor Stephen Corones, Denise McGill and Rebecca Durrant from Queensland University of Technology (March 2011)

The internal and commercially sensitive analysis conducted by Cash Converters demonstrates that the minimum level at which it may manage to continue doing this business in Australia is at a 20% establishment fee and a 4% monthly fee.

On the basis of the Bill as it stands, on a typical \$320 loan for 32 days, this will generate a return of 28% gross revenue being \$89.60. Our current calculated cost for such a loan is \$76.00.

While some further cost cutting will be needed to the Cash Converters business model, the trade-off for legislative certainty is worth the effort.

Cash Converters believe that a 20% + 4% capping regime would equate to 4.25% profit per loan.

To achieve these changes, the Bill can be simply amended to substitute the higher numbers for the lower numbers where they occur.

7.0 Re-financing and multiple loans

The Bill prohibits the re-financing of a borrower by increasing his credit limit, or making him a new loan, where part of the proceeds repay an earlier loan. The Bill also prohibits any lender from making a loan to a consumer where that consumer has an existing loan.

These provisions ignore the Phase One reform requiring compliance with Responsible Lending Obligations (“RLO”).

Whenever a consumer applies for a further loan or an increase in credit or wishes to re-finance a loan so as to access extra cash, the lender has to apply all of the tests required under the RLO. The lender cannot just lend regardless of the overall impact of the extra loan on the consumer’s capacity to repay without hardship to himself or his family. Unless ASIC and the Government regard the whole of Phase One as a waste of time, it must be conceded that RLO renders these prohibitions unnecessary.

What is the downside of leaving these prohibitions in place? Consider these examples :

- (a) Bill has a credit standing with Cash Converters sufficient to allow him to borrow \$1,000 over six months. He only needs \$500 to have his car repaired so he borrows this amount with repayments over three months. As he drives away in a state of excitement, he incurs a speeding fine of \$150. He now cannot borrow the \$150 from anyone until he has repaid the \$500 in spite of the fact that he could have borrowed \$1,000 at the outset.

- (b) Jane has borrowed \$1,000 over six months and has repaid \$500 after three months. She can afford credit of \$1,000 and she would like to borrow an extra \$500 to cover an unexpected bill but she is locked out of any credit choices until the full \$1,000 has been repaid.
- (c) Bill's lender sets up his repayment schedule so that he repays \$290 of his \$300 loan after 1 month and the balance of \$10 by way of 10 monthly payments of \$1. Bill cannot borrow from any other lender until he makes those 10 payments. This would be designed to prevent competitors from lending to Bill.

One consequence of these legislative prohibitions is that consumers will be "trained" to borrow more than they need so that they can forward cover contingencies.

This is the opposite of a desirable outcome. People should be able to borrow what they can afford if that is what they want and the RLO will ensure that they are not lent more than they can afford.

Debt spirals cannot occur under the RLO regime.

8.0 Conclusion

It is recognised by all participants in the discussion on small amount, short term loans that these loans are a critical part of the Australian economy.

Consumer groups consistently highlight isolated cases of "vulnerable" consumers being forced into paying exorbitant interest rates or escalating fees and charges on short term loans. They promote these stories as if they are the norm. The same few stories are endlessly repeated. Under the RLO introduced as part of Phase 1 of the reform process, these situations could not occur.

Every report on 'payday lending' has indicated the need for a viable small amount short term loan industry – neither mainstream banks, non- government agencies or Government have the desire or the will to meet the huge community demand for this form of credit.

The introduction of a 10% + 2% cap will see the disappearance of these loans from the Australian economy as they will not be a viable product for the micro-finance industry.

No Interest Loan Schemes (NILS) and Low Interest Loan Schemes (LILS) are highlighted as saviours of the vulnerable consumer in a credit market devoid of short term credit providers. While these loan schemes play an important role in the community, they do not meet the needs of consumers, nor the demand in this sector. They currently account for less than 2% of the volume of the small amount loan market.

While the reforms needed to protect consumers, in particular vulnerable consumers, are currently being put in place through initiatives introduced during Phase One of the reform process, the issue of maintaining a competitive, viable small loan industry is not being addressed.

“The Green Paper raises some significant concerns about Treasury’s understanding of the for-profit small amount, short term lending industry. High cost does not necessarily equate to unreasonable cost or to predatory lending. The views of industry critics seem to have been taken on board, but those of industry largely ignored.”

Page 14, “Background paper of small amount, short term for-profit lenders in Australia”,
by David Cousins from Monash University

We urge the Committee to seek more information from Cash Converters and independent experts to assist them in their deliberations.

9.0 Additional Information and Resources

In preparation of this submission we have only focused on a couple of issues which we think are paramount to the survival of this industry.

There may be other issues of interest to the Committee.

Cash Converters are happy to provide any information that the Committee believes will assist them in their deliberations and the Managing Director, Peter Cumins, and General Manager, Ian Day will be available to answer questions or clarify issues for the Committee.

Should the Committee want to speak to someone in the industry who is in regular contact with consumers, Cash Converters are also happy to arrange for one of their Franchisees to be questioned by the Committee.

There are a number of well respected, well qualified independent academics who have been involved in recent reports on the issue of payday lending. The Committee may wish to seek input from these non-aligned stakeholders. These might include: Professor Stephen Corones from Queensland University of Technology, Prof David Cousins from Monash University, and Marcus Banks from RMIT.

Please also find attached to this submission copies of a number of the reports mentioned in the body of this submission, and the Cash Converters submission *“Response to the Commonwealth Governments Green Paper on Consumer Credit Reform - Phase Two”*. This paper contains a detailed analysis of Cash Converters operation and our response to many of the issues raised during this reform process.

Attachment 1

Fair Trading Complaints

There have been very few complaints to State consumer affairs organisations about Cash Converters short-term loan products when compared with the 625,000 loans provided during the same time period.

In 2010 Cash Converters contacted all State and Territory departments responsible for fair trading and requested data on the number of complaints made about the business. The table below is a summary of these responses for the period 1 July 2009 to 30 June 2010.

State	No. of complaints on short term loans	Findings
Victoria	13*	13 complaints, 8 of these complaints were escalated to dispute resolution. Of the 8 complaints: <ul style="list-style-type: none"> • 4 were resolved • 3 were unable to be resolved, and • 1 lapsed.
South Australia	0	8 complaints were received by the SA Office of Consumer and Business Affairs. Of these: <ul style="list-style-type: none"> • 1 related to a pawnbroking Loan and was resolved; • 6 related to faulty second hand goods purchased from stores and all were resolved; and • 1 related to alleged price fixing and was referred to the Australian Competition and Consumer Commission (ACCC).
Western Australia	1	13 written complaints were received by the Department of Commerce. Of these: <ul style="list-style-type: none"> • 11 were with regard to the sale of goods • 1 related to a store's activities in relation to <i>The Credit Administration Act (1984)</i> • 1 related to a financial loan.
New South Wales	1	Fair Trading New South Wales received 8 complaints on the operation of Cash Converters stores. Of these: <ul style="list-style-type: none"> ▪ 7 of these complaints related to faulty goods. ▪ 1 complaint was in relation to short term lending.
Queensland, Tasmania, ACT, Northern Territory	N/A	At the time of writing this report, Cash Converters had not received a response from these states

* Information was not available as to whether these 13 complaints were all related to personal finance transactions or if this includes complaints concerning other areas of Cash Converters business such as pawnbroking.

Attachment 2

The breakdown of profit on loans

The cost to a Cash Converters Personal Finance Centre for providing an average \$320 *Cash Advance* loan is \$76.07.

The following example shows the calculation of average return on investment from a \$320 Cash Converters *Cash Advance* loan.

Return on Investment	Income	\$112.00
<i>Based on the charge of</i>	Less administration, processing and IT costs	\$24.60
<i>\$35 per \$100 borrowed</i>	Less expenses (store overheads as listed below)	\$51.47
	Profit	\$35.93

Typical Store Volume

Loans

- \$110,000 loaned each month
- Average *Cash Advance* loan is \$320
- 350 *Cash Advance* transactions per month ($\$110,000 \div \$320 = 350$) or 4200 annually

Income

- Gross income from \$320 loan = \$112 (\$35 per \$100, i.e. $\$320 \times 0.35$)

Expenses

- Annual overheads for a Cash Converters store estimated at \$216,200
- Average cost per transaction equates to \$51.47 ($\$216,200 \div 4200$)

Typical Expenses (stores overheads)

Rent/outgoings allocation	\$25,000	
Wages	\$70,000	• Rental for an average store with average space allocation for Personal Finance Centre
Postage & Stationery	\$1,700	
Uniforms	\$1,500	
Tele/Broadband	\$6,300	• Note – no allowance has been made for the cost of Advertising at a local level.
Electricity	\$1,500	
Insurance	\$1,500	
Workers comp	\$2,000	• Staff assumptions, one full time staff [approx \$40,000 per annum] and two casual/part time staff.
Super	\$6,300	
Security costs	\$4,800	
Advertising	\$48,000	
Bad debt (at 3 per cent)	\$39,600	• Bad Debt at 3 per cent or \$3,300 per month x 12 = \$39,600 annually.
Collection fees	\$5,000	
Cleaning	\$2,000	
Staff amenities	\$1,000	
Total	\$216,200	