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Submission to the Senate Standing Committees on Economics concerning the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011

Thank you for the opportunity to provide comment on the Bill. My comments relate to small amount credit contracts and the capping provisions in general. If there is further opportunity to provide information, I would be pleased to do so, and can make myself available at the Committees' convenience.

CONTACT DETAILS OF THE WRITER

Name: Robert Legat

SUMMARY OF SUBMISSION

A. Industry is unfairly hamstrung by annualised percentage rates, which are misrepresentative and prejudicial.

B. Government's capping proposal is below the cost of the provision of loans, and will destroy industry.

C. The basis for the proposed general cap, and the existing state caps upon which it is based, come from misrepresentation, deceit and wilful negligence.

D. Industry is needed to service consumer demand, lest public funds are found to satisfy the full need.

E. Aside from the capping implications, the draft provisions will have unintended consequences prejudicial to the interests of consumers.

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6. Consideration of the National Australia Bank report "*Do You Really Want to Hurt Me?: Exploring the Costs of Fringe Lending*"
7. Directory of Annexures.

NB: This document contains only a sample of documents in my possession relating to the matter at hand. For the sake of brevity, I have not been able to attach or reference them all.

1. About the writer, his experience and its relevance

I am an Australian citizen, ordinarily resident in the state of Queensland in the federal electorate of Fadden. I am also a solicitor of the Supreme Court of Queensland, currently practising and holding a Bachelor of Laws qualification from the Queensland University of Technology, with 13 years' post admission experience in the private sector.

I am currently employed as corporate counsel, but am making this submission as a private citizen with a degree of expertise, experience and knowledge in respect of small amount credit contracts. My involvement in the industry goes back almost 15 years, and covers a number of bases. A summary of that experience is:

- From 1993 to 1998 as an articled law clerk, employed by a private legal firm, specifically undertaking work in respect of consumer credit;
- From 1996 to 1997 as a proprietor of a lender conducting business in respect of small amount credit contracts on the Gold Coast, in Queensland;
- From 1997 to present as director, secretary or in-house legal counsel for a number of companies which have conducted and concerned themselves in small amount credit contracts in a number of states;
- From 1998 to 2002 as an employee solicitor in general practice; particularly practising in consumer and commercial lending, and securities;
- From 2002 to 2006 as a representative member of the Microlenders Association of Australia, an unincorporated association to represent the interests of the microlending industry;
- From 2006 to 2008 as the inaugural president of the National Financial Services Federation (Qld) Inc, a state representative body to represent microlenders and payday lenders;
- From 2008 to 2010 as a board member, and inaugural vice chairman, of the National Financial Services Federation Ltd, a federal representative body to represent microlenders and payday lenders. I resigned from my board position under amicable circumstances, and continue to provide ad hoc support when requested; and
- Member, through directorship of a company of the National Financial Services Federation since inception.

During my tenure in representative bodies, I have taken part in numerous presentations to the public, state and federal government both in written format and personal presentation. I have spoken on industry's behalf and taken part in panel discussions at the invitation of organisations such as the Financial Counsellor's Association and Griffith University. Notably, I was a delegate to the Ministerial Council on Consumer Affairs roundtable discussion on consumer credit in April, 2008.

I have been an active and vocal participant in industry advocacy and reform since 2002.

2. Background to the debate

It must first be understood that the Code (both the repealed state versions, and the National Code) has an inbuilt requirement that interest charges must be expressed as an annual percentage rate (sections 17(4), 27 and 28 of the National Code). This requirement means that any consumer credit loan, regardless of term, must express their interest charges on a "per annum" basis. This is known as "annualising" and the rate given is correctly referred to as the "annualised percentage rate" ("APR"). This point is fundamentally integral to all further considerations.

APR creates a problem for any loan that has a term of less than a year, and is the ultimate source of many of the problems facing micro and payday lending. Many people recognise annual percentage rates from, especially, the home loan market. However, the correlation between home loans and micro and payday lending is basically non-existent; it's just that both industries are governed by the one Act and Code. Requiring micro and payday loan rates to be converted to annual figures is akin to looking at an ant under a microscope – it appears huge and scary, but in reality it is small.

The easiest way to demonstrate the ridiculousness of applying an annualised percentage rate to micro and payday loans is by example. Please consider the following:

Applying the Code requirements, a $100 loan for 1 day with a total interest charge of $1 equates to 365% APR. There is something drastically wrong with the mechanism when $1 can equal 365%.

That example simply and succinctly illustrates the insurmountable situation the industry is forced to deal with. When a general lack of knowledge and media sensationalism is added, there is no hope for a lender to establish any credibility. This is through no fault of the lender.

Asking micro and payday lenders to express their charges in an annual format is like making the following requirements:

- All hotels must quote their room rates as a dollar figure per year;
- All taxis must quote their charges per 100 kilometre distance;
- All McDonalds stores must quote their hamburger cost per cow; and
- All car parking garages must quote their charges per annum.

These situations are patently ridiculous. That is exactly the problem with APR in respect to payday and micro lending.

2.1 <u>Dynamics between state and federal legislation</u>

The National Consumer Credit Protection Act, incorporating the National Credit Code, is the legislation that the Bill will amend with respect to credit contracts. The Act and the Code are recent developments following a referral of powers from the states. Prior to this, each state had its own legislation in respect of consumer credit matters. These state acts and codes were mirrored under a national accord, except for certain individual state allowances (such as capping and licensing). Under the referral of powers, these state instruments are now repealed.

The Consumer Credit Code, as it was known in each state, was the pre-cursor to the National Credit Code, and the two instruments are substantively the same (incorporating some amendments that were slated for the state Codes). In comparison, the differences between the state Acts and the federal Act are rather marked.

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The state instruments were enacted in 1996, following extensive deliberations. It was composite legislation that was designed to encompass, and remedy, various state acts that applied to the provision of credit to consumers to create a "uniform" credit landscape (which didn't happen, and was a motivator for the referral of powers to the Commonwealth).

The Code was designed to effectively apply to all instances of consumer credit (with certain specific exemptions), regardless of whether the lender was a bank or a small finance company. Microlending and payday lending were largely unheard of at the time, which is evident from various aspects of the Code and how it relates to these products. For example, the annualising of the percentage for interest rates, discussed above.

2.2 Significant amendments proposed by the Bill in respect of credit contracts revolve around capping the charges that a lender may achieve for the provision of consumer credit. While the states regulated the area, this issue proved to be divisive between lenders and debtor representatives, and even between the states themselves. Indeed, in the referral of power to the Commonwealth, the states with interest rate caps reserved the power to continue them.

It is therefore relevant to consider the history of price regulation of consumer credit by the states in determining the price regulation proposed by the Bill. The old adage "to know where you are going, you must first know where you have been" applies here.

The notion of capping the price of credit has a history in Australia. However, my personal experience only ranges back about 10 years. In any event, enough pertinent particulars relate to this period to enable a comprehensive understanding of the issues involved.

2.3 <u>Initial state caps</u>

In the early 2000s, Victoria, New South Wales and the Australian Capital Territory had implemented caps under the reserved powers of each jurisdiction. The ACT's cap was identical to that of NSW.

2.4 Victoria's cap and NSW's cap were (and are) vastly different to each other in operation – despite any representation made to the contrary. Succinctly, those differences were:

(a) Victoria had a two tier cap in respect of interest – 48% per annum for unsecured contracts and 30% for secured ones. Victoria did not have a cap in respect of fees and charges on consumer credit, but other legislative provisions placed restrictions to ensure there was no overcharging;

(b) Conversely, NSW's cap was 48% per annum inclusive of fees and charges. This was worked out using a complex mathematical formula (discussed at 4G) which resulted in an annualised percentage rate for the charges and interest on the loan, which had to be 48% or under. This cap further evolved in recent years to be more comprehensive in respect of the fees and charges the calculation captures (discussed at2.20 and 2.22).

While both caps relate to a maximum interest rate of 48% per annum, it is the inclusion or exclusion of fees that create the difference. In terms of dollars and cents, it is a marked difference.

2.5 Victoria's cap

Industry viewpoint of the Victorian cap has generally been tolerant. Lenders have been able to maintain profitability by charging a level of fees commensurate with the costs of the provision of the loan. While it is no secret that industry advocates no capping, it has been accepted by industry representatives that the Victorian cap would be acceptable.

2.6 New South Wales' cap

The NSW cap, on the other hand, has always been considered unacceptable and unworkable by industry. In contrast, not surprisingly, most consumer advocates and sympathisers consider the NSW cap both acceptable and workable regardless of the effect on industry. This has created a source of great contention.

2.7 In respect of the general cap proposed by the Bill (proposed sections 32A and 32B), the NSW cap has been adopted.

2.8 When the NSW cap was initially implemented on 1 December, 2001 (by the *Consumer Credit (New South Wales) Special Provisions Amendment (Pay Day Lenders) Regulation 2001)*, there was not the cohesive industry representation that exists today. The microlending and payday lending industries were in their infancy and lacked their current numbers and organisation. Numerous comments were made in both houses of parliament that:

(a) There was insufficient consultation with, or notice to, industry;
(b) The proposed cap made it unviable to conduct business; and
(c) Industry was needed in the marketplace.

2.9 It does not appear that a regulatory impact statement was prepared by the Office of Fair Trading at the time. Nor does it appear that there was any research done into the pricing justification of products in the market.

2.10 It was stated in the Legislative Council, on 20 June, 2001 by New South Wales Senator Richard Jones (Democrat):

"We are rushing into the legislation as a result of headlines about loan sharks."

2.11 I was not a participant in any events leading up to the implementation of the NSW cap, being situated and conducting business in Queensland. Accordingly, any information I have in respect of the implementation of the NSW cap has been obtained through subsequent research.

2.12 In January 2003, I wrote to Fair Trading New South Wales, attempting to open a dialogue for consultation on the matter. This was flatly refused.

2.13 The cap was extended to effectively all lenders in NSW on 1 March, 2006 by then New South Wales Fair Trading Minister, the Honourable Diane Beamer. It should be noted that, in 2001 when the original cap was considered, Ms Beamer made the following statement in parliament[1]:

"Many adjectives have been used to describe payday lenders. They have been called shonky, loan sharks and rip-off merchants. For me, the more appropriate term is thieves."

It has been represented to me that that Ms Beamer and her office were uncommunicative, uncompromising and unhelpful during this period. I hardly find that surprising, given her publicly stated stance.

2.14 Ms Beamer apparently represented that a review of the efficacy of the interest rate cap would be undertaken by New South Wales Fair Trading. Although I have no evidence of this representation, I have evidence that it was not done (please see XXXX).

2.15 The cap was considered for renewal, and passed, in 2007. This was pursuant to the requirements of the *Subordinate Legislation Act.* There is no evidence that a regulatory impact statement was done at this time either.

2.16 Under Freedom of Information searches conducted in late 2007, I obtained a file note made by an officer in Consumer Protection Policy on 3 December, 2007. A copy is attached as Annexure 1 . It states that a review of the cap was indicated by former Minister Beamer, that it had not been conducted and that no date had been determined for one to be done. Further, he was "closing the file". To my knowledge, this review has never been done.

This lack of review is especially disturbing as the New South Wales government was representing that the cap was working well, and that industry had not been "sent out of business". Further, other states, including Queensland, were stating that lenders were operating successfully under the legislative controls. Annexure 2 is an indicative form letter being sent out by Queensland Members in 2008. Page 2 makes the particular statement. I wrote to the Queensland government concerning this, in January 2008, and was not provided with a response.

2.17 I was not a participant in the events concerning the passing of the legislation or consultation in New South Wales. Again, all information I have to hand is anecdotal or obtained through subsequent research.

2.18 Compounding the problems of the NSW cap has been the way in which industry has dealt with the cap, and the perverse way in which that has been treated by cap proponents. From

[1] New South Wales Hansard, Legislative Assembly, 30 May, 2001 (at 13979), Hon. Diane Beamer.

the outset, cap proponents maintained that industry could comply with the cap and remain viable without providing any reasoning or evidence. Industry participants maintain that it was impossible to do so while providing their products, and provided evidence to back this up. The confusing factor has been that despite the implementation of the cap, industry continued to exist. Cap proponents have pointed to lenders' continued existence as evidence that industry is viable under such a cap. However, the truth is vastly different – a fact which leading cap proponents cannot ignore except by wilful negligence.

2.19 The simple fact is that lenders in New South Wales found a way to turn a profit by getting around the cap. I have never seen an instance of a lender in NSW (or elsewhere) that was able to turn a profit in payday or micro lending purely under a 48% inclusive cap. The two predominant ways in which lenders remained viable were:

(a) Providing credit by way of promissory notes or similar bills of exchange, which were exempted from the Code at the time (that 'loophole' being closed in late 2007 with an amendment to the Code by the *Consumer Credit (Bill Facilities) Amendment Regulation (No. 1) 2007 (Qld)*); and

(b) By the use of what is known as the 'brokerage' model where an interceding transaction is inserted, between the lender and the consumer, which charges a fee to 'broker' the loan. Through whatever particular mechanism is ultimately used, the profit earned through the brokering transaction makes up for the loss occasioned on the pure interest rate on the loan.

2.20 To my knowledge, there has never been a public acknowledgment by any government authority or cap proponent that the use of the so-called loopholes has been the way in which industry has survived. However, there has been a concerted effort to close those loopholes, first through the amendment referenced in 2.20.1 and secondly by the expansion of NSW's cap as referenced in 2.5. This all but proves my assertion that the NSW government was well aware that industry could not survive purely under their capping model, that they made misleading comments in stating the cap was working and had no basis to make any claim about the cap's effects. In any event, the NSW government did not review the effects of the cap as they promised.

2.21 When NSW expanded the technical terms of their cap in 2010, to include all payments made to anyone in respect of the credit, this was considered a blunt but effective way of removing the 'brokerage' model from the industry. Since then, NSW industry participants have moved to a wide variety of business models, which I do not have direct experience with but have heard about through anecdotal representations. As they were explained to me, most retain a core of lending under the 48% cap but rely on an additional component that does not fall under the law from which to derive some profit and make up for any shortfall occasioned by the cap. To this date, I am unaware of any commercial payday or micro lender that is able to derive a profit purely from lending under the cap.

2.22 Queensland's cap

Queensland implemented an interest rate cap in 2008, adopting the (then) NSW cap of 48% per annum. Queensland had been considering the cap for many years and saw strong representation from both anti-capping industry and pro-capping groups. The media, especially the Courier Mail newspaper, weighed in extensively on the debate; arguably on the side of the pro-capping groups. This is the campaign with which I am most familiar, and have firsthand experience.

2.23 In the couple of years leading up to the cap there were two Fair Trading ministers involved during the time which the cap was most in question; the Honourable Margaret Keech and the Honourable Kerry Shine (also state Attorney-General at the concurrent time). I met with both ministers on a number of occasions.

2.24 As referenced at 2.17 , Queensland members of parliament were already quick to represent that the cap was working in other jurisdictions, particularly NSW. I not only wrote to senior public servants in the Office of Fair Trading, I also wrote to the Ministers and the Premier; highlighted the error in relying on the assertions. No response was received and the practice did not change.

2.25 Of interest, through a Freedom of Information application made to the Queensland Department of Premier and Cabinet in February, 2008, I obtained a copy of a letter to then Minister Keech from then Premier Peter Beattie. This letter, dated 10 April, 2007, and attached as Annexure 3, notes that Premier Beattie was concerned about the "*efficacy of the proposal to introduce an interest rate cap where any interest which exceeds 48% is presumed unreasonable.*" The letter also confirms that an independent working party in Queensland in 2000 and the Victorian Consumer Credit Review in 2006 both recommended against a fixed cap.

2.26 In a meeting with Ms Keech and senior public servants in 2007, I recommended that a regulatory impact statement should be produced before any proposed legislation regarding capping was introduced to parliament because of the background to the New South Wales cap. The Queensland government chose not to do so. They chose to rely on the exemption under the law for bringing in regulations substantially similar to regulations already in effect in another state (i.e., the NSW cap). There was no consideration given to the situation that New South Wales had not only not produced their own statement before they introduced the cap but also that they had not conducted their represented review.

2.27 During the lead up to the introduction of the cap, there were a number of media articles that, in my opinion, unfairly stigmatised industry. It became apparent that pro-cap lobbyists, particularly Legal Aid Queensland, were feeding information to the media. Documentation received during the course of a complaint made to the Australian Press Council included a letter from Ms Loretta Kreet, a solicitor with the Civil Justice Practice (Consumer Protection Unit) of Legal Aid Queensland, to Patrick Lion of the Courier Mail Newspaper; attached as

Annexure 4. Ms Kreet confirms in the letter that Legal Aid had been providing information to the media.

2.28 Ms Kreet is especially prevalent in the pro-capping campaign, and I have had a number of occasions to deal with her. On one such occasion, in my capacity as president of the National Financial Services Federation (Qld) Inc, I had a meeting with her at a George Street coffee shop in Brisbane on February 7, 2007; together with another Legal Aid employee and a representative of our association. At that meeting Ms Kreet made it clear, in no uncertain terms, that she supported the NSW capping model and that she did not consider that the industry was a worthwhile addition to society "at any cost".

2.29 Legal Aid Queensland's further involvement became apparent during the parliamentary speech of then Minister Shine when he introduced the capping legislation to Queensland Parliament on 16 April, 2008. In his speech, Minister Shine stated[2]:

"...we had to consider the facts given to us by groups like Legal Aid Queensland, which told us that last year around 1,000 people sought help from Legal Aid to deal with issues surrounding excessive interest imposed by payday lenders."

2.30 The Minister's statement was rather unfortunate, as I knew that Legal Aid Queensland did not track the number of complaints made against payday lenders. I had already made a Freedom of Information search application to Legal Aid, requesting statistics of the numbers of complaints about industry. I received this information on 22 April, 2008, which is attached as Annexure 5. The information revealed that Legal Aid Queensland did not record their data under specific categories, so they were unable to inform me of the number of people that sought help.

2.31 I followed this up with the Minister's department on 28 April, 2008 where, in a telephone conversation with a public servant, I was informed that the Minister did not receive formal communication from Legal Aid but had "sat down and asked them" about the level of complaints.

2.32 I made a complaint through the Crime and Misconduct Commission on the basis that Legal Aid Queensland could not provide a "fact" to the Minister when they themselves acknowledge that they don't track the information the "fact" is supposedly based on. The CMC referred the matter to Legal Aid to answer, and I was informed (after waiting 8 months for an answer) that the information provided to the Minister was an "*estimate... made in the context of the very substantial experience of the Civil Justice Division of Legal Aid Queensland."* No action was recommended, and the CMC refused to undertake further investigation. In short, Legal Aid Queensland lied to the Minister, causing him to mislead parliament. The difference between a "fact" and an "estimate" can be quite persuasive, especially in terms of whether further investigation is needed.

[2] Queensland Hansard, 16 April, 2008 (at 1041), Hon. Kerry Shine, Minister for Fair Trading and Attorney-General.

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2.33 In summary of the preceding paragraphs, there was a situation where there was:

(a) A stated anti-industry position by a solicitor at Legal Aid Queensland;

(b) Information being fed to the media by that solicitor;

(c) Information being given to a Minister from within the division of Legal Aid, which that solicitor was a part of, that was apparently represented as a fact but was, instead, an estimate; and

(d) The Minister stating, in Queensland Parliament, that Legal Aid had provided him with a "fact" and using it in support of legislation to introduce a cap.

2.34 Summary

When industry is critical of "interest rate caps", it is critical of the situation in New South Wales and Queensland; the cap situation in Victoria has been publicly acknowledged as acceptable to lenders. The caps that have been implemented in New South Wales and Queensland have been on the basis of lies, misinformation and wilful negligence. There has been no investigation of the suitability of the figure of 48%, in any respect, by either state. There has not even been a review, despite promise in New South Wales, of the effect of the cap.

I implore the federal government to do the job these states should have done in the first place.

3. Pricing Control Considerations

3.1 Consideration by New South Wales

3.1.1 We have already seen, in part 2 of this submission, that there is no evidence that any consideration was given by NSW government as to what effect a 48% interest rate cap would have on industry.

3.1.2 There is no evidence that any form of the review of the effects of the cap, as represented by former New South Wales Fair Trading Minister Beemer, has taken place.

3.2 Consideration by Queensland

3.3 On numerous occasions, the Queensland government has been provided with information about the effect of a 48% interest rate cap on industry.

3.4 It must be considered that the figures provided in this section do not factor in the increased costs to business of operating under the National Consumer Credit Protection Act and National Credit Code. The federal regime has added many compulsory cost bases to conducting business, including licensing, external dispute resolution, professional indemnity insurance and ongoing educational requirements. These, together with the compliance costs to create and maintain system in accordance with the law, cost businesses thousands of dollars per annum. Industry must be able to recoup these increased costs; they are too high to absorb.

3.5 In the provision of information to the Queensland government about the effect of the cap, two occasions were notable:

(a) A meeting with then Queensland Fair Trading Minister Kerry Shine, in his electorate office in Toowoomba in 2008, in his capacity as Member for Toowoomba North. I don't recall the date of the meeting. I presented him with financial data for our Toowoomba office which showed that under a 48% interest rate cap our business would change from a projected net profit after tax of $80,000 per annum (before drawings) to a net loss of $85,000 per annum; and

(b) The National Financial Services Federation (Queensland) Inc's submission to Fair Trading Queensland of February, 2008 regarding the capping Bill. While I commend the whole of the submission to Committee's consideration[3], I particularly draw attention to pages 8 and 9 which are attached as Annexure 6. These pages give calculations of what figures can be achieved by industry under a 48% cap, and comparisons to expected profitability percentages for businesses according to accounting standards. These calculations comparisons show that the cap not only makes the industry unprofitable, it is frankly impossible to make it commercially sustainable.

3.6 Despite being afforded with, to date, unrefuted information and calculations, this was all seemingly ignored.

3.7 Consideration in Western Australia

In 2008, the Western Australian government commissioned a study into the profitability of lenders via a report entitled "*Review of the Viability of Interest Rate Caps on Consumer Credit Providers*". The report was commissioned by the Department of Consumer and Employment Protection ("DOCEP") and conducted by a national accountancy firm on their behalf, from data obtained by the Department during lender audits.

3.8 In October, 2008 I made a Freedom of Information application to DOCEP seeking a copy of the report. After negotiation with them, I received a letter on 16 December, 2008 stating that I would be provided with an edited copy of the report, to remove any information that could identify a particular credit provider. A copy of that letter is attached as Annexure 7.

3.9 After much correspondence, due to the information not being provided, I was informed on 22 June, 2009 that I would not be provided with the report, despite my assurances that I didn't want the actual information – I was only interested in the conclusions. Copies of this letter and my email correspondence with the responsible officer are attached as Annexure 8.

[3] http://www.nfsf.org.au/pdfs/news-opinion/PolicyObjectiveSubmissionFinal12_2_08.pdf

3.10 To the best of my knowledge, that report has never been released in any form by DOCEP, despite being the only known study commissioned in Australia into the profitability of the industry. I seriously question why no information has come to light from the report. It is not even apparently mentioned in any literature. The only rational explanation for it being buried is that it dispels the myth that lenders are profiteering through high charges.

3.11 Consideration by Commonwealth Government

In September 2011, a regulation impact statement was issued by the Department of Finance and Deregulation entitled "*The Regulation of Short Term, Small Amount Finance*" (dated June 2011). While the report does not offer any new information to the debate, it does contain at least two important points:

(a) A single comprehensive cap, in the nature of the 48% cap in New South Wales and Queensland, is not recommended; and

(b) In consideration of a tiered capping arrangement, the assumption of allowable charges of $30 per $100 lent is adopted.

4. Technical aspects of the Bill

The Bill contains a number of new mechanisms. The ones I wish to comment on are each dealt with in this section. These mechanisms are:

Part 4A Creation of the small loan contracts ("SLC") classification;

Part 4B A limit on SLC charges to "10% plus 2%";

Part 4C Maximum charges allowable under a SLC;

Part 4D Prohibition against refinancing SLC;

Part 4E Prohibition against increasing credit limit under SLC;

Part 4F Prohibition against lending to a consumer with an existing SLC; and

Part 4G 48% interest rate cap.

4A Creation of the Small Loan Contracts ("SLC") Classification – Subsection 5(1) of the Act

4A.1 A new class of credit contract is created in the Bill, which has not previously existed or, to my knowledge, been publicly contemplated. The hallmarks of this new class, the SLC, as at the date of this document are:

(a) It is not a continuing credit contract;

(b) The lender is not an ADI (authorised deposit-taking institution);

(c) It is not secured by mortgage;

(d) The credit limit is $2,000 or less; and

(e) The term is 2 years or less.

The Code gives capacity for (d) and (e) to be changed, and additional requirements imposed, by regulation.

4A.2 The commentary to the Bill was missing an explanation as to the rationale for the creation of the SLC class, but it is fairly apparent that this is the determination of the class of contracts that are "pay day" loans.

4A.3 It does not appear that the drafters have intended to capture "micro loans" in SLC provisions as micro loans have traditionally and routinely encapsulated higher credit limits and longer terms than the limits imposed in (c) and (d).

4A.4 From a general industry and government point of view, the term payday loan has been hard to define. What is agreed on, at least from industry's point of view, is that the average payday loan is in the order of $250 for 1 month while the average microloan, in comparison, is $1,000 for 6 months[4].

4A.5 SLC captures both average products, but microloans range up to a principal figure of $5,000[5]. Also, microloans commonly have security in the form of a mortgage, and can be found in the form of a continuing credit contract. My company, when it provided microloans, did both of these things as a rule rather than an exception.

4A.6 It is possible that the rationale for the determination of SLC may be arbitrary, perhaps based on the achievable returns for values. Without further guidance, it is impossible to conclusively say.

4B <u>Limiting SLC charges to "10% plus 2%" – Section 31A of the Code</u>

4B.1 The Bill introduces a new concept for the calculation of charges on SLC, moving away from annualised percentage rates ("APR") which is mandated through the rest of the Code.

4B.2 The basic expression of the maximum charges is:

(a) An establishment fee being 10% of the principal for the loan; plus

(b) A monthly fee being 2% of the principal of the loan.

4B.3 While the amounts are expressed as a maximum, it should be acknowledged that if industry attempts to operate under these figures at all, it will be the minimum as well.

4B.4 Without specific acknowledgment, it would appear that the reason for this mechanism is an understanding by government that the traditional 48% interest rate cap does not allow reasonable returns for loans in the range of SLC. Unfortunately, this mechanism does not either.

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[4] National Financial Services Federation (Qld) Inc. Submission, February, 2008 at page 16.
[5] NFSF (Qld) Submission, February, 2008 at page 7.

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4B.5 The following calculations show what maximum returns are achievable for the average payday loan and microloan (described at 4A.4):

(a) Average payday loan of $250 for 1 month:

- Establishment fee of $25 ($250 x 10%)
- Monthly fee of $5 ($250 x 2%)
- Total gross revenue of $30, over 1 month.

(b) Average microloan of $1,000 for 6 months:

- Establishment fee of $100 ($1,000 x 10%)
- Monthly fees of $120 ($1,000 x 2% x 6)
- Total gross revenue of $220, over 6 months.

4B.6 The context of these charges must be considered in light of the running costs of the businesses involved. Then, added to this, are the mandatory costs of doing business incurred through the licensing process under the Act. On top of that, there is the income tax due on any revenue.

4B.7 The returns are simply too low for business to be feasible. Annexure 9[6], shows a breakdown of average expenses for an office in my company group prepared in April, 2007. It gives an average monthly expenditure of $8,150 and an average amount lent per month of $30,000. These are very real figures, and capable of substantiation. The figures also represent the savings possible within a large group. At the time we had 30 microlending offices in Queensland and were one of the largest groups nationwide.

The expenses do not include the cost of licensing, because they predate them. Factoring them in[7] the monthly expenditure rises to $8,355.

Lending $30,000 per month, at an average loan of $1,000 for 6 months, this gives a gross income of $6,600 per month. Surely it is very easy to see that an income of $6,600 a month does not cover expenses of $8,355, especially when that expense figure is only taking into account the basics. The core, "hard" costs of rent, wages, utilities and licensing, alone, accounts for over $5,500 a month.

4B.8 The "10 plus 2" cap is preferable to the 48% cap (discussed at 4G), but it is still below the cost of running a commercial business. By implementing this cap, government will not only wipe out existing participants, they will make it impossible for any commercial operation to exist in this industry. If this is their aim, it would be much easier to just ban lending in this sector. If, however, it is not their intention to do so (and representations to this effect have

[6] "Expenses versus Interest Rate Cap Comparison", prepared for the Queensland Fair Trading Minister, 23 April 2007.

[7] Annual ASIC licensing fee of $1,000, EDR membership with COSL of $570 (for two representatives and a loan book under $1 million) and professional indemnity insurance of $896.50 (actual quote received 22/9/11). Costs for compliance and mandatory training are not included.

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been made by various sectors of government, including the Minister) then this cap does not achieve that aim.

4C Maximum Charges Under a SLC – Section 39B of the Code

4C.1 It is with a degree of chagrin that I saw the inclusion in the Bill of a method to limit the maximum charges that can be made under a SLC (proposed section 39B). This section states that the maximum amount payable under a SLC must not exceed an amount that is twice the amount of the principal. The reason for the chagrin is that I'm one of the people who proposed this idea, several years ago, and suggested it to government.

4C.2 Originally termed a "total cost of credit" cap, I started championing the idea during my tenure with the National Financial Services Federation (Qld) Inc. The rationale was relatively simple. A predominant concern for government was the threat of "debt spirals" to consumers, and the horror stories in the media of people being charged amounts that were hugely in excess of what they had borrowed. Federation members, myself included, were opposed to these cases and determined to see the lenders who engineered these loans reformed, or out of the industry. Many reputable lenders had already implemented an ad hoc principle of stopping or reducing all charges on a loan if a borrower got themselves into trouble making payments. In many situations, ourselves included, this meant completely freezing all fees and charges for the whole of the loan for its life. A rule of thumb for this, at least in our organisation, was that a borrower should be charged no more in interest than the amount they borrowed. This is exactly the effect of proposed section 39B.

4C.3 The idea of a total cost of credit cap was originally proposed to the Queensland government by the NFSF (Qld) in its submission to the Queensland Minister in December, 2006[8] as an option to meet the Queensland government's policy objectives. It was further reinforced in the NFSF (Qld) submission of January, 2008, in "Element 6 – Protection from 'Debt Spirals'" at page 38, even advocating the exact same amount as contained in the Bill. Added to this, I proposed the idea to anyone who would listen to me on the subject. At the time, no discernible interest was shown in the idea from anyone in government.

4C.4 On its own, the idea is still laudable and I still stand behind it completely. Added to the "10 plus 2" cap, it is completely ineffective and useless – because there will be no commercial lending for the provision to take effect on.

4D Prohibition against refinancing SLC – Sections 124B, 124C and 133CC of the Act, Section 39A of the Code

4D.1 These sections, together, operate to stop what is commonly known as a "rollover"; a situation commonly linked with payday lending. Like many terms used in payday lending, it has provided difficult to conclusively define. Generally, however, it can be considered the situation whereby an existing payday borrower is not able to repay the balance of a loan on its due date. Instead of placing the borrower in default, the lender requires the payment of

[8] "Managing the Cost of Consumer Credit", NFSF (Qld) Inc: http://www.nfsf.org.au/Managing-the-cost-of-consumer-credit-Qld-2006.html at page 44.

the charges component for the loan and refinances the principal into a new loan (i.e., "rolls" the principal over).

4D.2 Rollovers, and even the extent of their prevalence in Australia, has been the subject of intense debate from all sectors. I don't propose to get into that argument here.

4D.3 The proposed sections also capture the instance where a traditional refinance may be done, i.e. a lender is giving a loan to the borrower and part of the proceeds are used to repay an existing loan to a third party lender.

4D.4 Whatever the arguments for or against rollovers, the draft provisions are a very blunt instrument which bans the practice in its entirety; regardless of its motivation or uses.

4D.5 There are a number of situations where banning the ability to refinance is prejudicial against the interests of the borrower. These situations include:

(a) There is no consideration given to a situation where the refinancing loan may be cheaper overall than the refinanced loan, therefore being better for the consumer (accepting, of course, the statements in 4C; this argument is for hypothetical consideration);

(b) The borrower may be in a situation where a refinance is preferable to their circumstances. They may be able to repay the totality of the loan in short order from the due date, and require the refinance to allow them to do so; and

(c) The borrower may not be able to repay the balance on the due date for whatever reason. An inability to refinance the debt places them in breach of the terms of the credit contract and may lead to default charges, debt collection action and possible credit rating implications.

I cannot see where these situations are given any consideration.

4D.6 As well as negatively impacting the borrower, it affects competition within the industry. If there is no ability to encourage borrowers to seek cheaper alternatives to existing credit by lowering charges, there is decreased incentive for lenders to drop their rates. In effect, the government will stop borrowers being able to easily swap between lenders.

4D.7 In recent times, we have heard Treasurer Wayne Swan extensively commenting on just that situation with respect to home loans and how the banks have made it too hard for borrowers to change their home loan provider. In respect of SLC, these provisions don't just make it hard – they make it impossible. I can only imagine the situation if regulations were brought in saying that a person could not refinance their home loan until they had paid it all off. If the legislation says that banks and payday lenders are subject to the same regulatory regime, I say that is a fair comparison.

4D.8 There is no easy answer to the problem of rollovers if, indeed, it is a problem in Australia (which has not been conclusively determined). The proposed provisions go too far in addressing something that may not be the problem it is being made out to be.

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4E Prohibition against increasing credit limit under SLC – Section 133CD of the Act

4E.1 This section determines that once a SLC is set at a particular amount of principal, it cannot be increased. There are no exceptions.

4E.2 When read in conjunction with the provisions discussed in 4D, a situation is created where the borrower and lender are "locked in" to a credit contract until it is repaid in full.

4E.3 If the above are added to the responsible lending obligations already existing in the Act, a potential problem arises. Under the obligations, it is considered that a lender may only provide an amount of credit that is enough to satisfy the borrower's identified needs at the time, not more[9]. It is entirely possible that this amount will be below the level the consumer could afford to service.

For example, a borrower may need $200 for a specific purpose and be able to demonstrate an ability to comfortably service a $500 loan. A prudent lender will only lend $200 to the borrower. If, during the term of the loan, the borrower needs to access a further $300 they are prohibited from doing so by the operation of the sections – despite having demonstrated an ability to be able to service that level of debt.

4E.4 I can foresee that this situation could lead to two distinct situations, both of which will end with the lender being unfairly blamed and suffering a loss of goodwill, because of the constraints of the legislation:

(a) As per the example in 4E.3, the borrower (having already obtained a credit contract) returns to the lender and requests more funds for an emergency expense. The lender is forced to decline the request, despite both parties knowing that the borrower can afford the extra funding. The borrower will then either blame the lender as making excuses or, accepting that legal requirements, still bear ill will to the lender as the deliverer of bad news; or

(b) Taking into account the operation of the sections, and taking (in my opinion) an overly liberal view of the lending obligations, the lender may offer the borrower a loan for $500 when they have only applied for $200. I consider this unsuitable as the borrower will pay fees/interest on $500 despite only needing $200 at that particular point in time. The borrower, not needing that amount and not wanting to pay the increased fees, will possibly perceive the lender's actions as questionable and "shonky".

4E.5 The government's apparent intentions here are to stop a 'backdoor' method of refinancing SLCs, but there is a better way of doing it. If, in initial consultation and taking into account the apparent aims of the Bill, the lender makes a determination of the maximum amount of credit that the borrower can reasonably service then the borrower should be allowed to

[9] This is not conclusively set out in the legislation, to my knowledge. However, the Act requires that the provision of finance must be "not unsuitable" for the purposes of the borrower. "Not unsuitable" is not defined. Taking this into account, and the potential liabilities for breaching the Act (including loss of licence, fines and imprisonment), my opinion is that a conservative approach will be adopted by prudent lenders.

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have a number of principal draw downs up to that figure before any further advances are prohibited.

For example, in the initial determination, the lender determines the borrower can afford a loan of $500. If they only want $200, they should be entitled to further loans totalling $300 while any amount is outstanding under any of them. Once all amounts are repaid in full, a further determination can be made and further credit advanced.

4F Prohibition against lending to a consumer with an existing SLC – Section 133CB of the Act

4F.1 Lenders will be prohibited from providing a SLC to a borrower who already has one.

4F.2 The current credit reporting regime can make it difficult to determine whether a consumer has an existing loan, and whether or not it is a SLC. Ascertainment of the particulars of any loan can depend on a number of factors:

(a) If the primary lender did not conduct a credit search, then the lender must often rely on the representations of the applicant as to the existence of a previous loan because there will be no notation on the person's credit file. It is not a stretch to realise that an applicant desperate for a loan may fail to disclose the previous SLC's existence; and

(b) Even if a search was conducted, and a notation made on their file, current credit reporting does not disclose whether or not the loan was approved (without the lender making an additional disclosure to the credit reporting organisation). This means that either the lender is reliant upon the disclosures of the applicant or they must attempt to make enquiries with the credit providers noted on the report and await their response. This response may never come, as the credit provider is under no compunction to provide the information.

This could potentially make it difficult and time consuming for a lender to determine an application.

4F.3 Although the section stipulates that the lender must know of, or be reckless as to, the existence of a prior SLC, a transgression could lead to stiff penalties and it becomes too late once it occurs.

4F.4 It is expected that a reform of the credit reporting scheme will eventuate, but the ultimate timing and effect of this remains to be seen.

4G 48% Interest Rate Cap –Sections 32A and 32B of the Code

4G.1 The proposed general cap under the Code (i.e., for non SLC) is 48% APR, in relatively the same form as that which currently exists in New South Wales. It is a comprehensive cap including all costs for the provision of credit except government fees, and even some outside amounts (discussed below).

4G.2 The formula at the core of the cap is the same formula as used in the New South Wales and the Queensland caps. The formula is $i = n \times r \times 100\%$, where r is the solution to:

$$\sum_{j=0}^{t} \frac{A_j}{(1+r)^j} = \sum_{j=0}^{t} \frac{R_j + C_j}{(1+r)^j}$$

4G.3 The mechanism of the formula is to convert all amounts payable for the credit contract, over and above the principal, into a single annualised percentage rate. Then, according to the terms of the cap, that annualised percentage rate must be less than 48% lest the contract breach the Code.

4G.4 The formula is complex, to say the least. It must also be calculated exactly to ensure compliance with the law. To do so, lenders have had to engage the services on an actuary; which my company did. They provided me with a software program that would calculate the rate from inserted data. To this date, I do not understand the mathematical operation of the formula and there are not many who can say that they do.

4G.5 The actuarial firm who provided the software to me is the same firm that provided advice on the formula to the NFSF (Qld). When they provided the advice, they made a number of comments concerning the formula being unsuitable or misleading, (which included comments about comparison rates, which uses the same formula):

(a) “*The magnitude of the APR may be well over 48% for small short term loans on reasonable contract terms*”;

(b) “*The size of the APR or Comparison Rate may mislead customers*”; and

(c) “*The APR and Comparison Rate are not always good indicators of the cost of credit*”.

Attached Annexure 10 is a copy of the pages of the advice from the firm which shows their reasoning.

Quite frankly, the formula is unsuitable for the use to which it is put here.

4G.6 The formula itself aside, the requirement for the solution to be under 48% makes the provision of small loans uneconomical. Taking the average microloan of $1,000 for 6 months (referred to in 4A.4 and 4B.5), the formula allows for a maximum interest charge of around $126.33. I say “around” because the exact start date and term of the loan changes the amount of the calculations. Because the average microloan often involves security being taken, it would not be classified as a SLC. I will not be considering the ethics of taking security in this submission.

4G.7 Discussion in 4B that the rates of return for SLCs of this amount are uneconomical is doubly relevant here. If $220 return on a loan is insufficient to meet costs, then there is no possible way that $126.33 is going to fare any better.

4G.8 The situation is even more dire for payday lending. Discussion in 4B showed that the “10 plus 2” cap allows the average payday loan to achieve $30 revenue. Under the 48% cap, the average payday loan of $250 for 1 month achieves a maximum return of $5.77.

4G.9 As an aside, the proffered “10 plus 2” cap appears scary when the returns are turned into the APR format. Using my actuarial program, here’s the comparison (calculated on 12 October, 2011):

Product	Term	“10 plus 2”	APR
$250 payday loan	1 month	$30	244.85%
$1,000 microloan	6 months	$220	80.1%

Any pro-capping group that accepts the “10 plus 2” cap without renouncing their favour for the 48% cap is either misguided in the extreme or fully realises that they have intended to send industry out of business.

4G.10 The implementation of the 48% interest rate cap in Queensland was the impetus for my group of companies to cease the provision of consumer credit under the Consumer Credit Code in Queensland. We changed business models to one that was not within the regulatory extent of the Code.

4G.11 In March 2010, the National Australia Bank and the Small Loans Pilot Advisory Group published a report entitled *“Do You Really Want to Hurt Me?: Exploring the Costs of Fringe Lending”* which was the culmination of a pilot study into “fringe” lending where the bank backed a commercial entity to go out and provide loans to determine the actual breakeven point for this type of loan. This report is important, and it is discussed in part 6 of this submission.

4G.12 The Regulation Impact Statement “*Regulation of Short Term, Small Amount Finance*” of June 2011, released by the Federal Department of Finance and Deregulation in September 2011, considers various options available to government. One considered option is the introduction of a cap such as sections 32A and 32B of the Bill will implement. A number of problems are identified with such a mechanism and it is not recommended for implementation.

4G.13 There has been no research undertaken by any group other than industry, to my knowledge, into the practical effects and outcomes of the 48% interest rate cap.

4G.14 There has been no satisfactory response given from any government department or pro-cap group as to the reasonableness of the rates of return achievable under the 48% cap. Indeed, the standard answer from pro-capping groups has been either “find a way to make do with that amount” or “we know you can’t survive, we don’t want you to”. Government has never provided a substantive comment to my knowledge.

4G.15 Many groups and reports, notably the June 2011 RIS, have labelled the comprehensive 48% interest rate cap a “blunt instrument”. I go further than that: it’s a ten ton weight dropped on the head of industry from a great height. There is no hope of complying with it and remaining in the business of providing small principal, short term credit.

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5. Consumer protection and Industry Preservation – not inconsistent

5.1 For years, the payday and microlending industry has been the subject of claims that they are nothing but predators and "loan sharks". Two things, predominantly, has allowed this take place:

(a) Bad operators, or "cowboys"; and

(b) Annualised percentage rates.

5.2 Just like any industry, payday and microlending has suffered due to operators doing "the wrong thing". A casual look at the history of media articles about the industry are peppered with references to these lenders; the $500 payday loan that becomes "thousands", the lender who continues to lend to the borrower after being begged not to and the lender who threatens to take all the possessions of a pensioner who fails to pay their loan.
This industry is not alone in suffering at the hands of operators who do the wrong thing. It's not hard for the average person to think of instances where they have seen reports of shonky builders, negligent doctors, corrupt cops and so on. Yet, overall, these groups don't suffer from an unduly negative perception.

However, in the case of payday and micro lenders, the actions of the few have led to the judgment against every one. And this is despite the best efforts of industry as a whole, for example through the actions of the National Financial Services Federation and the Financiers Association of Australia, to campaign for the reforms necessary to get rid of the bad operators. The evidence of this campaign is captured in the range of public submissions made by these groups, and others, over the years at state and federal level.

5.3 The overarching problem that industry suffers from is the requirement to express charges in the form of an annualised percentage rate, and the mechanism by which that figure is derived. I've already explained, in part 2 of this submission, how a total charge of $1 can become 365% under the mechanism. A percentage rate is not a measure of cost in credit, until it is related back to a principal figure and a time frame.

Unfortunately, the average person is not aware of this and will automatically compare one interest rate to another on commensurate terms, without taking into account the amounts and time frames to which the rate relates. It is truly like trying to compare apples and oranges, and industry is hamstrung through the Code requirement to express costs using this method. The negative view industry suffers from must be recognised for the artificial, incorrect view that it is.

5.4 From there, the simple fact of the need for the service provided by industry must be acknowledged. There is no such thing as creating demand by making supply possible. All that supply can do is cause a demand to be realised that may not have previously been apparent. It's an unfortunate fact that many people are finding themselves in a situation where they are living beyond their immediate means. On one end this shows as the means to achieve the "Australian dream" of owning your own home slipping out of reach of many average Australians. On the other end, it's being behind in the rent, or unable to pay the car registration on time.

5.5 Financial exclusion at the lower end of the lending spectrum, where payday and micro loans exist, can cause real, immediate issues to people. This could include:

(a) Being overdrawn on a bank account, and incurring a fee;

(b) Not being able to pay the registration on the car and having to choose between driving illegally or going without a mode of transport;

(c) Simply losing their mode of transport through an inability to pay for repairs;

(d) Not being able to obtain housing because of the lack of a rental bond; or

(e) Losing their current accommodation because of a temporary inability to pay rent.

These are just examples of real potential outcomes when people are not able to access small amounts of finance, quickly.

5.6 An option must exist for consumers to be able to cope with these expenses if they are not able to finance them themselves. That money either has to come publicly or privately. I doubt that the government, in general, is willing to fund all the money needed to do this. The only other option is private concerns, either commercial or charitable. Charity, unfortunately, will never practically be able to supply sufficient funding to cope with demand. Plus, for either government or charity, their processing times are generally unfeasible. Most payday and micro lenders can offer same day access to funds.

That just leaves commercial lenders, and government must allow them to achieve a commercial return – otherwise they will exit the industry. The provisions of the Bill WILL cause that to happen.

5.7 Payday and micro lenders have been labelled as a problem to society. This is simply not true. In a perfect society where everyone had enough money, they would not exist. That does not mean that they are negative or bad, it just means that they're a symptom of a flaw in society. If no one committed crimes, we wouldn't need police. Yet, you don't see anyone saying that we should get rid of them.

As with any malady, simply removing a symptom will do nothing to address what is wrong. All it does is increase the stress and discomfort of the patient. Removing industry from society will do exactly that. Taking lenders away will not stop people needing access to funds; it will only remove what is perhaps the only viable option for a specific sector of the community.

6. <u>Consideration of the National Australia Bank report "*Do You Really Want to Hurt Me?: Exploring the Costs of Fringe Lending*"</u>

In March 2010, the National Australia Bank and the Small Loans Pilot Advisory Group published a report entitled "*Do You Really Want to Hurt Me?: Exploring the Costs of Fringe Lending"* which was the culmination of a pilot study into "fringe" lending where the bank teamed up with a commercial entity to go out and provide loans to determine the actual breakeven point for this type of loan. The report was backed by an advisory group made up of:

- Australian Financial Counselling and Credit Reform Association;
- Brotherhood of St Laurence;
- CHOICE;
- Consumer Action Law Centre;
- Consumer Affairs Victoria;
- Foresters Community Finance;
- Good Shepherd Youth & Family Service;
- Griffith University;
- NSW Office of Fair Trading;
- Queensland Department of Justice and Attorney-General (which incorporated the Office of Fair Trading in Queensland at the time); and
- RMIT University.

This list reads like a shopping list of pro-capping groups. This should give an indication that there is little to no chance that the information contained in the report could be accused of being biased towards industry. If anything, the opposite is true.

The pilot set out to provide loans in the range of $1,000 to $5,000, and ended up with an average loan of $2,900. It acknowledged, in various places, that this is nowhere near the range comprising payday lending. It is also only barely within the range of microlending (which has an average loan of $1,000). These points, however, are not the information I wish to direct the committee to.

The important part of the report is contained on pages 11 to 14, which are attached as Annexure 11. Perhaps the most telling data is on page 14 under the heading "Scenario 4 – What is the lowest possible loan size?" This section provides:

(a) Calculations were made to look at the smallest average loan that could be written to stay under a 48% APR cap, over a year and with a profit margin of 20 cents in the dollar. This margin is not expressed as gross or net;

(b) A $100 million loan portfolio is needed to support an average loan of $605 (or over 165,000 loans at a time) ;

(c) A $50 million loan portfolio is needed to support an average loan of $635 (or over 78,000 loans at a time);

(d) A $20 million loan portfolio is needed to support an average loan of $735 (or over 27,000 loans at a time); and

(e) An $8.8 million loan portfolio is needed to support an average loan of $1,700 (or over 5,000 loans at a time).

No mention is made of how the costs of administering the actual number of loans are factored in to the figures. It must be further acknowledged that these figures do not factor in the costs of the federal licensing regime, which only serves to increase the cost base for the provision of loans.

To give an indication of actual figures, across the twenty or so separate companies in our business group there was an estimated, average loan portfolio per company of $300,000 at any one time, with an average loan of $1,000. This amount was constrained by such things as level of demand, availability of funds (all funds being internally sourced) and suitability of applicants.

$300,000 is a long way short of the NAB's projected breakeven point.

While it's a shame that the figures did not include calculations against the average payday loan of $250 or the average microloan of $1,000, the figures are very telling. When they are considered in light of the backing by pro-capping proponents, it is extremely disturbing that there is still support for a 48% APR cap.

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7. DIRECTORY OF ANNEXURES

No.	Title	Section Reference	Number of pages
1	File Note – New South Wales Office of Fair Trading regarding review of the cap, 3 December, 2007	2.17	1
2	Form letter from Queensland elected representatives concerning the cap "working" in New South Wales, 9 January, 2008	2.17	2
3	Letter from Premier Beattie to Minister Keech, 10 April, 2007	2.26	2
4	Letter from Legal Aid Queensland's Loretta Kreet to Courier Mail journalist Patrick Lion, 14 December, 2006	2.28	4
5	Letter from Legal Aid Queensland, under Freedom of Information, concerning complaint statistics, 22 April, 2008	2.31	3
6	Excerpt from National Financial Services Federation (Qld) Inc submission to Queensland government, February, 2008	3.5b	2
7	Letter from Department of Consumer and Employment Protection, Western Australia regarding Freedom of Information application, 16 December, 2008	3.8	2
8	Letter and email from Department of Consumer and Employment Protection, Western Australia regarding Freedom of Information denial, 22 June to 20 July, 2009	3.9	2
9	Expenses versus Interest Rate Cap Comparison document, 23 April, 2007	4B.7	3
10	Excerpt from actuarial advice concerning the interest rate cap formula, 20 December, 2007	4G.5	3
11	Excerpt from National Australia Bank report "*Do You Really Want to Hurt Me? Exploring the Costs of Fringe Lending*", March 2010	6	4

ANNEXURE 1

File Note – New South Wales Office of Fair Trading regarding review of the cap, 3 December, 2007

Number of pages: 1

07/012377

File Note – 3December 2007

- As indicated in the Commissioner's Invitation to Comment, this review was conducted in accordance with the requirements under the Subordinate Legislation Act 1989 and is not the review of the cap as indicated by former Minister Beamer.

- The Invitation to Comment informed stakeholders that the submissions received as part of this current review will be considered at the time the cap is reviewed.

- File closed pending the commencement of the cap review at a date yet to be determined.

Consumer Protection Policy
3 December 2007.

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ANNEXURE 2

Form letter from Queensland elected representatives concerning the cap "working" in New South Wales, 9 January, 2008

Number of pages: 2

Lillian van Litsenburg MP
Member for Redcliffe

9 January 2008

Dear Mr. Johns

Thank you for your letter of Wednesday, December 05, 2007 about short term, small amount loans. I understand that you are concerned about some of the decisions made by the Queensland State Government.

Your concern is that changes outlined by the Queensland State Government might have unforeseen detriment to consumers in this electorate. However, recent figures released by the Reserve Bank of Australia show Australian households are holding historically high levels of debt. At the same time, the costs of many basic living expenses such as rent and petrol, are also increasing. Against this background, many Queensland households are at risk of financial stress. Often those most at risk resort to high cost loans because they are unable to obtain credit from mainstream lenders such as banks and credit unions.

Borrowers who use high cost lenders are predominantly low-income, disadvantaged or vulnerable consumers. Many have poor credit histories, are already in financial difficulty and have been excluded from the mainstream market. These consumers often seek credit in urgent or desperate circumstances and can be vulnerable to exploitation.

The consumer detriment flowing from high cost loans can be serious. Problems include serious financial hardship including inability to meet other bills and household expenses; forced sale of assets; a depleted capacity to save; debt spirals or debt traps; an increased likelihood of default on loan repayments; bankruptcy; stress and other health and social costs including family breakdown and suicide caused by financial stress. High cost loans also have broader social impacts including an increased strain on the community and welfare services, and reduced consumer confidence.

The Queensland Government has adopted a three-stage process to help low-income and vulnerable consumers with short term, high cost loans. Stage 1 involves reducing the cost of short term finance; this is done by introducing the regulated environment which exists under the uniform *Consumer Credit Code* (the Code).

As part of stage 2, the Government, along with all other States and Territories, is considering further changes to the Code to provide better protection for borrowers. A draft Bill and Regulation which incorporate these amendments was recently released for national consultation. Stage 3 involves determining whether an interest rate cap should be introduced in Queensland to prevent potentially exploitative lending practices.

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Victoria, New South Wales and the Australian Capital Territory have interest rate caps to control the cost of consumer credit. Lenders are operating successfully under the legislative controls in those jurisdictions. The South Australian Government has also decided that a cap should be introduced.

While the fringe lending industry in Queensland has grown dramatically in recent years, competition has failed to lower the price of credit to acceptable levels. Cabinet has approved a course of action that includes capping interest rates, fees and charges to ensure all consumers are protected, particularly vulnerable and marginalised consumers without the capacity or financial means to dispute the "reasonableness" of a loan before the Courts.

An interest rate cap provides automatic relief to consumers and is easily enforced. It also sends a clear message to lenders about what is legitimate lending practice, and provides consistency and certainty for both consumers and industry.

The Bligh Government is committed to ensuring that the three-stage process outlined above is implemented in its entirety. In light of this, our meeting which was arranged for the 17th of January 2008 is no longer necessary and would be a misuse of your time.

Thank you for bringing your concern to my attention.

Yours sincerely,

Lillian van Litsenburg
Member for Redcliffe

Ref LvL:KW

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ANNEXURE 3

Letter from Premier Beattie to Minister Keech, 10 April, 2007

Number of pages: 2

112459

posted & finalised
11/4/07
~~TK~~
CC
CM

For reply please quote: TN112459/CM33/LJP

1 0 APR 2007

The Honourable Margaret Keech MP
Minister for Tourism, Fair Trading, Wine
Industry Development and Women
GPO Box 1141
BRISBANE QLD 4001

Dear Margaret

I am writing in relation to the proposed Cabinet submission, *Managing the Cost of Consumer Credit in Queensland*.

I note that the submission, which was advance lodged in the week of 26 March 2007 for Cabinet consideration on 16 April 2007, follows previous Cabinet consideration of this issue on 23 October 2006, when Cabinet noted the release of a discussion paper on options to manage the cost of consumer credit and that a further submission would be brought back to Cabinet on the preferred options for responding to this issue.

I am concerned that it would be premature to bring this submission to Cabinet for consideration on 16 April 2007, as the financial implications of implementing the proposals outlined in the submission have not yet been fully considered by the Cabinet Budget Review Committee (CBRC). A budget submission seeking resources to support the proposals has been lodged as part of the 2007-08 budget process and CBRC's decision is pending.

More importantly, however, I am concerned about the efficacy of the proposal to introduce an interest rate cap where any interest which exceeds 48% is presumed unreasonable.

As the submission notes, the issue of a legislative interest rate cap has been considered both in Queensland by the independent working party established in 2000 and more recently by the Victorian Consumer Credit Review in 2006, with both reviews recommending against a fixed cap. The Victorian Government position in response to the report is that a fixed cap is a blunt instrument incapable of safeguarding all consumers, risks excluding some legitimate products from the market and would propel consumers away from regulated credit.

N:\policy_com\lp_com\[Contact Agencies]\OFT\POLICY DEVELOPMENT AND COORDINATION\ADVICE\Fair Trading\Consumer Credit\Interest Rate Caps\Prem to Keech re interest rate cap sub 3-4-07.doc

I am concerned that the current submission does not provide sufficient exploration of how these flaws might not be similarly present with a presumptive cap. In addition, the submission does not incorporate a consideration of the impact of proposed amendments to the Consumer Credit Code which have been approved by Cabinet and are currently being developed which will strengthen sections 70 and 71 in relation to unconscionability in loan contracts.

I would be grateful if you would ask your department to work closely with my department in revising the submission to address the concerns outlined above, prior to re-lodging the submission for Cabinet consideration. As a minimum, the submission should not proceed prior to a CBRC decision on your submission for additional funding to support implementation of the proposals.

Yours sincerely

SIGNED BY
PREMIER

PETER BEATTIE MP
PREMIER AND MINISTER FOR TRADE

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ANNEXURE 4

Letter from Legal Aid Queensland's Loretta Kreet to Courier Mail journalist Patrick Lion, 14 December, 2006

Number of pages: 4

Legal Aid
QUEENSLAND

Our Ref: LK :
Date: 14 December 2006

Contact: Loretta Kreet
Telephone: (07) 3238 3015
Facsimile: (07) 3238 3400
E-mail: lkreet@legalaid.qld.gov.au

FACSIMILE TRANSMISSION

DATE: 14 December 2006 **TIME:** 1:30 PM

TO: Courier Mail **FAX NO:**

ATTENTION: Patrick Lion

FROM: Loretta Kreet

SUBJECT: Australian Press Council

NO OF PAGES (including this page): 4

PRIVACY AND CONFIDENTIALITY NOTICE

The information contained in this facsimile is intended for the named recipients only. It may contain privileged and confidential information and if you are not an intended recipient, you must not copy, distribute or take any action in reliance on it. If you have received this facsimile in error, please notify us immediately and return the original to the sender by mail.

MESSAGE:

Hope this is what you wanted

Loretta

IF YOU HAVE ANY TROUBLE WITH THIS TRANSMISSION PLEASE TELEPHONE Loretta Kreet on (07) 3238 3015

44 Herschel Street
BRISBANE QLD 4000

Telephone: 1300 65 11 88
www.legalaid.qld.gov.au
ABN: 69 082 423 824

GPO Box 2449
BRISBANE QLD 4001
DX 150 BRISBANE DOWNTOWN

Your Ref:
Our Ref: APC
Date: 14 December 2006

Contact: Loretta Kreet
Facsimile: (07) 3238 3400

Australian Press Council

Dear Sir/Madam

Press Council complaint re interest rates of up to 1600%

I'm writing to provide you with additional information about the interest rates charged by non-mainstream lenders in Queensland. I believe information we provided to the media, particularly to The Courier-Mail, regarding our clients' experiences with very high interest rates has formed the basis of a complaint to the Press Council.

I am a solicitor with Legal Aid Queensland's Civil Justice Practice (consumer protection unit), which specialises in consumer injustices including disputes with credit providers and insurers. The unit provides advice and represents Queenslanders affected by high cost loans and suffering under the burden of unfair loans. Our unit gives advice to 600 Queenslanders every year.

In the last five years, we have noticed an increase in lenders charging interest above 48%per annum.. In our submission to the Department of Treasury's Consumer Protection Penalties Review in 2005, we submitted an unidentified list of lenders charging rates above 48% in Queensland.[1]

The following list shows the interest rates our clients (borrowers who have sought advice from the our consumer protection unit[2]) have been charged by fringe lenders:

Company	Percentage rate
Company A	240%
Company B	468% (1600%)
Company C	120%
Company D	67.2%
Company E	120% (240%)
Company F	240%
Company G	520% (1000%)
Company H	168%
Company I	300%
Company J	216%
Company K	240%
Company L	66.41%
Company M	60.8%
Company N	120%
Company O	240%

We recognise that we do not have evidence that all loans provided by these lenders will be at the listed rates, but in each case the interest rate (not including fees and charges) for the specific loan we have reviewed is as listed.

Company B is the lender referred to in the media as having charged a consumer an interest rate of more than 1600%. On the face of their contracts, the company disclosed its interest rate at 468%. However, the contract either required the amount borrowed to be repaid within two days or over approximately six weeks. If the contract was repaid within two days, the borrower was charged a week's interest (at 9% per week) rather than interest for two days. The *Consumer Credit Code 1996* requires interest rate calculations to be based on daily, rather than weekly, rates. If the proposed loan was paid after two days, the interest rate was 1642%

We have enclosed a copy of a sample calculation changing the amount borrowed and the interest payment in the same proportion and the date of the loan. This shows the effective interest rate calculated on a daily basis, in line with the Consumer Credit Code's standards, was 1642%.

We would prefer not to identify this company because the contract in question is currently the subject of litigation before the court.

You may be interested to know that at a seminar held on 7 December 2006 at the Queensland Law Society regarding high interest loans and the need for regulation (presented by the Centre for Credit and Consumer Law at Griffith University), one of the speakers stated that when fees and charges were taken into account, one loan they had seen was over 3000%. We note that a number of industry representatives, including a representative from a company who manufactures software for the fringe lending industry, were present at the seminar. Not one industry member challenged this calculation, despite numerous opportunities for questions.

In our view, the fringe credit industry exploits financially vulnerable Queenslanders. We applaud the actions by all media (and in particular the Courier-Mail) in highlighting the detriment caused by the lack of an interest rate cap in Queensland.

Yours sincerely,

Loretta Kreet
Solicitor
Civil Justice Practice (Consumer Protection Unit)
Legal Aid Queensland

---

[1] LAQ Submission to the "Civil Penalties Review 2005"
[2] Some of the disclosed interest rates are incorrectly calculated and the rates in parenthesis are the approximate effective interest rates.

Example loan

Loan commencement date: 11/04/2006
Interest Rate: 1642.5% per annum

NOTE:- All payment amounts are based on the loan contract
This table assumes that the due date of payments is followed as per the loan contract

Day no.	Date	Opening Balance	Payment Amount	Receipt Number	Fees or charges	Description of fee or charge	Calculated Balance	Daily Interest on balance	Closing Balance
1	11/04/2006	$750.00					$750.00	$0.00	$750.00
2	13/04/2006	$750.00					$750.00	$67.50	$817.50
3									
4									
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6									
7									
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ANNEXURE 5

Letter from Legal Aid Queensland, under Freedom of Information, concerning complaint statistics, 22 April, 2008

Number of pages: 3

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Legal Aid
QUEENSLAND

Our Ref: [redacted]FOI:1466
Date: 22 April 2008

Telephone: (07) 3238 3477
Facsimile [redacted] (07) 3238 3340
E-mail: [redacted]

Registered post
Mr Robert A C Legat
PO Box 1443
NERANG QLD 4211

Dear Mr Legat

Freedom of Information

I refer to your request, under the *Freedom of Information Act 1992* (the FOI Act), for access to documents, namely:

> "Statistical numbers, year by year, of all complaints made to Legal Aid Queensland about
> - micro lending;
> - payday lending; and
> - fringe credit,
>
> in Queensland."

FOI decision

I have identified a report, produced from our LAQ office database, in response to your request.

You have been granted full access to the enclosed copy of this report (page 1), listing all legal advices given state-wide by Legal Aid Queensland from 1 July 2004 to 22 April 2008.

Legal Aid Queensland does not record data under specific categories of micro lending, payday lending or fringe credit.

Any legal advice given for micro lending, payday lending or fringe credit matters would be recorded in the categories listed in our report.

Your review rights

If you are dissatisfied with the decision, you can apply for an internal review of the decision. An internal review application must be in writing (detailing your grounds for appealing) and lodged within 28 days of receipt of this decision. Enclosed is a form you can use to request a review.

If you are still dissatisfied after a review, you may appeal to the Information Commissioner. You should do this within 28 days of receiving the decision from your request for an internal review.

If you have any questions, please call me

Yours sincerely

FOI Decision Maker
Legal Aid Queensland

Enc. Form – Application for review of decision
Freedom of Information document

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Matter type	Interview date between 1/7/2004 and 30/6/2005 Number of advices	Interview date between 1/7/2005 and 30/6/2006 Number of advices	Interview date between 1/7/2006 and 30/6/2007 Number of advices	Interview date between 1/7/2007 and 22/4/2008 Number of advices
Banking	73	47	68	46
Bankruptcy - Civil	93	91	118	117
Consumer - Sale of goods	697	642	662	618
Debt	1,782	1,657	1,603	1,304
Hire purchase	47	27	45	45
Money lending	180	151	165	195
Other - Civil	840	791	864	701
Other administrative law	395	311	422	344
Other contracts	813	649	764	763
Other property claims	433	419	401	313
Real property - Mortgage	18	44	40	63
Trade practices			1	1

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ANNEXURE 6

Excerpt from National Financial Services Federation (Qld) Inc submission to Queensland government, February, 2008

Number of pages: 2

included to reduce the balance of the loan to zero at the end of the term. From this we see that the total amount of interest changes greatly.

Table 1.2

Amount of Loan	Term in Months	Repayment per Week (at 48% p.a.)	Total Repayments	Total $ payable in Interest at 48% p.a.
$100	1	$25.56	$102.23	$2.23
$250	1	$63.90	$255.57	$5.57
$500	3	$40.92	$531.87	$31.87
$750	3	$61.38	$797.80	$47.80
$1,000	6	$43.33	$1,126.33	$126.33
$1,500	6	$64.99	$1,689.51	$189.51
$2,000	6	$86.65	$2,252.69	$252.69
$2,500	9	$76.35	$2,977.20	$477.20
$3,000	9	$91.61	$3,572.72	$572.72

Table 1.2 shows us that on an interest reducing balance (created by the repayments), the return on each loan becomes almost half of that shown in Table 1.1.

Further to showing the dollar figure return per loan, we can take that information and show the gross rates of return to the lender for each loan when calculated under the proposed cap. Table 1.3 shows this in detail.

Table 1.3

Amount of Loan (A)	Realised Amount from Table 1.2 (B)	Dollars earned per $100 invested (C) – (B/A)*100	Percentage return on investment per annum – C/Term*12 months
$100	$2.23	$2.23	26.76% p.a.
$250	$5.57	$2.23	26.76% p.a.
$500	$31.87	$6.37	25.48% p.a.
$750	$47.80	$6.37	25.48% p.a.
$1,000	$126.33	$12.63	25.26% p.a.
$1,500	$189.51	$12.63	25.26% p.a.
$2,000	$252.69	$12.63	25.26% p.a.
$2,500	$477.20	$19.09	25.45% p.a.
$3,000	$572.72	$19.09	25.45% p.a.

From Table 1.3, we find that the gross return on investment for loans $3,000 and under is in the range of 25.45% to 26.76% gross profit annually.

We compare this level of return to other businesses that operate under similar circumstances. Payday and micro lending are retail service businesses. They operate in a retail environment, providing their products to ultimate end users and predominantly dealing with the general public. They are service providers in the aspect of the service being the use of funds for a period of time.

For this exercise, we consulted *"CCH Benchmarking Classic for Accountants"*, published by CCH Australia, 2005. This extensive document, widely used by accountants when looking at the levels of profitability for businesses, considers data from many different industries. Part of the information derived from the document is a guide to the average net profit percentages that businesses should realise before payment of principals' takings. It is against these benchmarks that businesses measure themselves to determine economy of operation. Table 1.4 shows these benchmarks:

Table 1.4

Business	**Net Profit Percentage Before Payments to Principals**
Architect	28.08%
Consulting Engineer	32.77%
Consulting Surveyor	31.18%
Financial Planner	40.41%
Insurance Broker	38.31%
Legal Practice	36.68%

Table 1.4 shows a range of net profits from 28 to 40%, with an average of 34.57%. In other words, **net** profit should be in the low to mid 30% range. **Gross** profit for payday and micro lenders under the impending cap will be in the mid 20% range (meaning there is no net profit).

Clearly, the government's impending cap will make both payday and micro lending unprofitable, placing their ability to earn far below accepted accounting benchmarks.

Of course, making a reasonable return on the investment of money by a business supposes two factors:

1. That there is a component of effort for return; and
2. That there is a component of risk for return.

Effort for Return

The Consumer Credit Code is a prescriptive document for lenders in terms of how a compliant credit contract must be framed and executed. There are a number of hoops that a lender must "jump through" to ensure that they have created an enforceable contractual arrangement and conducted themselves in

ANNEXURE 7

Letter from Department of Consumer and Employment Protection, Western Australia regarding Freedom of Information application, 16 December, 2008

Number of pages: 2

Department of Consumer
and Employment Protection
Government of Western Australia
Consumer Protection

Our Ref: CP02271/2008

16 December 2008

Enquiries: [redacted]

Mr Robert Legat
National Financial Services Federation
PO Box 1443
NERANG QLD 4211

Dear Mr Legat

FREEDOM OF INFORMATION APPLICATION

I refer to your Freedom of Information application received on 21 October 2008 and the subsequent discussion between yourself and Ms Maree Barry on 3 December 2008. During that discussion, you indicated that you are seeking the broad conclusions and trends identified as part of the review of the viability of interest rate caps on consumer credit providers. You also indicated that you do not wish to obtain copies of specific lender information or earlier documentation such as the Request for Quote documentation and correspondence.

The decision maker, [redacted] has determined that an edited copy of the final report 'Review of the Viability of Interest Rate Caps on Consumer Credit Providers' can be provided in response to your application. The report has been edited to remove any information which may lead to the identification of a particular credit provider

To date, costs of $45 have been incurred on a $30 per hour basis. Photocopying costs of $10 (50 pages at $0.20 per page) will also apply. Once these costs have been paid, a copy of the report will be forwarded to you. An excerpt from the *Freedom of Information Regulations 1993* detailing the charges is attached for your information.

Forrest Centre 219 St Georges Terrace Perth Western Australia 6000 Locked Bag 14 Cloisters Square Perth WA 6850
Telephone Administration (08) 9282 0777 Call Centre 1300 304 054 Facsimile (08) 9282 0850
Email: online@docep.wa.gov.au Internet: www.docep.wa.gov.au

Department of **Consumer and Employment Protection**
Government of **Western Australia**

If you wish to contest the decision, you have the right to apply to the Department of Consumer and Employment Protection for an internal review. Applications for review must be in writing and be lodged within 30 days of receipt of the decision and must identify which part of the decision you wish to have reviewed. Details of the review process are set out in the attached notes.

Yours sincerely

Project Officer
Finance and Valuation Industries Branch

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ANNEXURE 8

Letter and email from Department of Consumer and Employment Protection, Western Australia regarding Freedom of Information denial, 22 June to 20 July, 2009

Number of pages: 2

Government of **Western Australia**
Department of **Commerce**

Consumer Protection

Our Ref: CP02271/2009

22 June 2009

Mr Robert Legat
National Financial Services Federation
PO Box 1443
NERANG QLD 4211

Dear Mr Legat

FREEDOM OF INFORMATION APPLICATION

I refer to the Freedom of Information application made by you on 21 October 2008, and the notice of decision issued to you on 16 December 2008 stating that an edited copy of the report 'Review of the Viability of Interest Rate Caps on Consumer Credit Providers' would be provided to you in response to your application. The report contained an analysis of data collected from short term lenders in Western Australia.

The decision to provide you with an edited copy of the report was based on initial legal advice received by the Department of Commerce (the Department). However, since the notice of decision was issued, new information has come to light regarding the processes by which data was collected from the short term lenders.

Further legal advice obtained in regard to this issue confirms that the Department has a legal obligation to hold the data received from the short term lenders in confidence. Therefore, in accordance with clause 8(1) of Schedule 1 of the *Freedom of Information Act 1992*, the Department cannot disclose this information and is therefore unable to provide you with a copy of the report.

I understand that a cheque for $85.00, made out to Fast Access Finance (Cairns) Pty Ltd, was issued on 16 June 2009 and has been sent to you. This is a refund of the $30.00 application fee and the $55.00 paid for photocopying and time spent by the Department in dealing with your application.

Enclosed is an information sheet regarding your rights of appeal, should you be aggrieved by the Department's decision to refuse access to the report. An application for internal review must be lodged within 30 days of the date of this letter. You also have the option of applying for an external review by the Information Commissioner. An application of this nature must be lodged within 60 days of the date of this letter.

Yours sincerely

A/Manager
Finance and Valuation Industries Branch

Rob Legat

From:
To: "Rob Legat" >
Cc: @commerce.wa.gov.au>
Sent: Monday, 20 July 2009 12:18 PM
Subject: RE: Freedom of Information

Hi Rob

I refer to your email of 23 June 2009.

Legal advice obtained by the Department of Commerce confirms that the report cannot be released in any form, even if all identifying particulars have been removed. The reason for this relates to the processes by which data used in the report was collected from short term lenders. Please refer to the letter dated 22 June 2009 for further information.

Regards

From: Rob Legat
Sent: Tuesday, 23 June 2009 8:48 AM
To: Felicity Smith
Subject: Re: Freedom of Information

Hi

Has consideration been given to my request, ages ago, that all identifying particulars be taken out of the document before provision? In essence, our main interest is in the conclusions drawn.

Regards,
Rob

> ----- Original Message -----
>
> **Sent:** Monday, June 22, 2009 2:30 PM
> **Subject:** Freedom of Information
>
> Hi Rob
>
> Please refer to the attached letter. The original is being sent in today's mail.
>
> As of today, I have started a new position. However, I am retaining responsibility for this FOI application and will be available to deal with any further issues that arise. I
>
> Regards
>
> Felicity
>
> This email is from the Department of Commerce and any information or attachments to it may be confidential.
> If you are not the intended recipient, please reply mail to the sender informing them of the error and delete all copies from your computer system, including attachments and your reply email. As the information is confidenti you must not disclose, copy or use it in any manner.

ANNEXURE 9

Expenses versus Interest Rate Cap Comparison document, 23 April, 2007

Number of pages: 3

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Expenses versus Interest Rate Cap Comparison
23 April, 2007
Prepared for the National Financial Services Federation (Qld) Inc
By Fast Access Finance for the Minister of Fair Trading, Queensland

Our monthly expenses:

Fast Access Finance monthly expenditure:

Rent:	$1,400
Advertising:	$2,050
Postage and Stationery:	$200
Employee:	$3,700
Debt collection:	$600
Utilities:	$200
Total:	$8,150

This does not include equipment, documents, taxation or profit.

Average amount lent by a Fast Access Finance office per month: $30,000.

What happens currently?

Under our current lending rates of 240%, the total amount of interest payable under the $30,000 in lending is $19,869. See attached forecast for a $1,000 loan at 20% a month (which is our average loan amount).

Taking 30% for tax leaves $13,908.30.

This leaves a figure of $5,758.30 available to fund growth, profit, equipment, bad debts and so on.

What happens under a 48% cap?

Under a 48% per annum cap, the total amount of interest payable under that $30,000 in lending is $3,628.80. See attached forecast for a $1,000 loan at 4% a month.

Just given the figures quoted above, that a per month loss of $4,521.20.

Loan Forecast Report

Name of Borrower :			
Date of Loan :	23/4/2007	Loan Amount :	$1000
Date of First payment :	30/4/2007	Interest Rate :	20% Per Month 240% Per Annum
Repayment Cycle :	WEEKLY	Minimum Repayment :	$65

Date	Notes	Debit	Credit	Balance
23/04/2007	Loan Drawdown	1000.00		1000.00
30/04/2007	Loan Repayment		65.00	935.00
30/04/2007	Interest	52.90		987.90
07/05/2007	Loan Repayment		65.00	922.90
14/05/2007	Loan Repayment		65.00	857.90
21/05/2007	Loan Repayment		65.00	792.90
28/05/2007	Loan Repayment		65.00	727.90
31/05/2007	Interest	173.26		901.16
04/06/2007	Loan Repayment		65.00	836.16
11/06/2007	Loan Repayment		65.00	771.16
18/06/2007	Loan Repayment		65.00	706.16
25/06/2007	Loan Repayment		65.00	641.16
30/06/2007	Interest	151.63		792.79
02/07/2007	Loan Repayment		65.00	727.79
09/07/2007	Loan Repayment		65.00	662.79
16/07/2007	Loan Repayment		65.00	597.79
23/07/2007	Loan Repayment		65.00	532.79
30/07/2007	Loan Repayment		65.00	467.79
31/07/2007	Interest	125.01		592.80
06/08/2007	Loan Repayment		65 00	527.80
13/08/2007	Loan Repayment		65 00	462.80
20/08/2007	Loan Repayment		65.00	397.80
27/08/2007	Loan Repayment		65.00	332.80
31/08/2007	Interest	92.56		425.36
03/09/2007	Loan Repayment		65.00	360.36
10/09/2007	Loan Repayment		65.00	295.36
17/09/2007	Loan Repayment		65.00	230.36
24/09/2007	Loan Repayment		65.00	165.36
30/09/2007	Interest	54.74		220.10
01/10/2007	Loan Repayment		65.00	155.10
08/10/2007	Loan Repayment		65.00	90.10
15/10/2007	Loan Repayment		65.00	25.10
22/10/2007	Interest	12.21		37.30
22/10/2007	Final Repayment		37.30	0.00

Total Interest Paid : $662.30
Number Of Repayments : 26
Total Amount Repaid : $1662.30

Loan Forecast Report

Name of Borrower :

Date of Loan : 23/4/2007

Loan Amount : $1000

Date of First payment : 30/4/2007

Interest Rate : 4% Per Month
48% Per Annum

Repayment Cycle : WEEKLY

Minimum Repayment : $45

Date	Notes	Debit	Credit	Balance
23/04/2007	Loan Drawdown	1000.00		1000.00
30/04/2007	Loan Repayment		45.00	955.00
30/04/2007	Interest	10.61		965.61
07/05/2007	Loan Repayment		45.00	920.61
14/05/2007	Loan Repayment		45.00	875.61
21/05/2007	Loan Repayment		45.00	830.61
28/05/2007	Loan Repayment		45.00	785.61
31/05/2007	Interest	35.26		820.86
04/06/2007	Loan Repayment		45.00	775.86
11/06/2007	Loan Repayment		45.00	730.86
18/06/2007	Loan Repayment		45.00	685.86
25/06/2007	Loan Repayment		45.00	640.86
30/06/2007	Interest	28.87		669.74
02/07/2007	Loan Repayment		45.00	624.74
09/07/2007	Loan Repayment		45.00	579.74
16/07/2007	Loan Repayment		45.00	534.74
23/07/2007	Loan Repayment		45.00	489.74
30/07/2007	Loan Repayment		45.00	444.74
31/07/2007	Interest	22.14		466.88
06/08/2007	Loan Repayment		45.00	421.88
13/08/2007	Loan Repayment		45.00	376.88
20/08/2007	Loan Repayment		45.00	331.88
27/08/2007	Loan Repayment		45.00	286.88
31/08/2007	Interest	15.08		301.96
03/09/2007	Loan Repayment		45.00	256.96
10/09/2007	Loan Repayment		45.00	211.96
17/09/2007	Loan Repayment		45.00	166.96
24/09/2007	Loan Repayment		45.00	121.96
30/09/2007	Interest	7.88		129.84
01/10/2007	Loan Repayment		45.00	84.84
08/10/2007	Loan Repayment		45.00	39.84
15/10/2007	Interest	1.13		40.96
15/10/2007	Final Repayment		40.96	0.00

Total Interest Paid : $120.96
Number Of Repayments : 25
Total Amount Repaid : $1120.96

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ANNEXURE 10

Excerpt from actuarial advice concerning the interest rate cap formula, 20 December, 2007

Number of pages: 3

6.2 *Circumstances where the formula is not so useful*

However, there are some important instances where the APR/Comparison Rate may produce undesirable results, or be misleading to consumers:

<u>*Example 1:*</u> *The magnitude of the APR may be well over 48% for small short term loans on reasonable contract terms.*

Under proposed regulations, the APR may be limited to 48% pa (i.e. the Maximum Annual Percentage Rate).

In many instances, particularly for short loan terms and/or small amounts, it may be very difficult to offer loans on reasonable, profitable terms which also keep the APR below 48% pa.

To illustrate this, in the table below, we have considered a few more examples, and calculated the APR's for them:

Loan Amount	Establishment Fee	Interest Rate (pa)	Term of loan (weeks)	Weekly repayments	Total amount repaid ($)	APR (pa)
$100	$20	10%	6	$20.13	$120.78	296.09%
$500	$100	10%	20	$30.60	$612.00	104.74%
$1,000	$200	10%	26	$47.34	$1,230.84	83.69%
$2,000	$300	10%	39	$61.25	$2,388.75	47.94%

The examples above assume the establishment fee is charged at commencement of the loan, and no other fees or charges are payable.

Of the examples, only the loan for $2,000 is (just) within the proposed limit on the APR. Therefore the loans with terms equivalent to the first 3 examples in the table above may not be permitted under the proposed regulations.

If any other fees or charges were introduced to the loan contract, or the interest rate was increased, the APR would increase further.

To fully appreciate the impact of fees and charges on the APR for loans of short duration and small amounts, consider the following examples. The loan examples below all charge a zero (0%) rate of interest. All fees are charged at commencement of the loan and the loan is repaid in a single instalment at the end of the loan term.

Loan Amount ($)	Upfront Fees ($)	Term	APR
100	20	1 week	1,044%
100	0.91	1 week	48%
500	4.59	1 week	48%
500	20.00	1 month	48%

As shown above, charging a $20 fee on a $100 loan to be repaid in 1 week's time will result in an APR of 1,044%, far in excess of the proposed cap. Such a fee would seem reasonable given the costs to the lender for documentation, credit checks, and processing etc, associated with a loan. Yet the cap on the APR of 48% would prevent such loans from being offered.

In fact, for the APR of such a loan to remain within the 48% limit, the maximum fee chargeable would only be 91 cents, and the lender would need to provide the loan interest free!

It is hard to imagine that 91 cents would be sufficient to cover the costs of providing such a loan.

For a loan of $500, repaid by a single payment in 1 week, with no interest charged, the maximum fee possible would be $4.59. For a loan of $500, repaid by a single payment in 1 month, with no interest charged, the maximum fee possible would be $20.00. Such loans are also unlikely to cover the costs of the lender.

<u>*Example 2:*</u> *The size of the APR or Comparison Rate may mislead consumers*

For short-term loans of small amounts, the calculated APR/Comparison Rate may appear very high. This is may be because reasonable administration charges relating to such a loan can represent a significant proportion of the amount borrowed. So even if the interest rate imposed is quite low (or even zero), once the other charges are included, the APR/Comparison Rate is high.

While a high disclosed APR/Comparison Rate is theoretically correct, many consumers won't have an intuitive understanding of what it means. For example, a loan of $100 with an interest rate of 10% pa and an establishment fee of $20 repaid by 6 equal weekly instalments has an APR/Comparison Rate of nearly 300% pa. Yet apart from repaying the principal, the borrower only pays back an additional $20 (the establishment fee) plus interest of just 78 cents (ie. total repayments of $120.78).

In this example, an APR/Comparison Rate of 300% p.a. may appear quite unreasonable to consumers, and lead to concern that the terms of the loan are unfair. The consumer is unlikely to understand how an interest rate of 10% pa plus a $20 fee leads to such a high APR/Comparison Rate. In this case, disclosing the APR/Comparison Rate to a consumer is unlikely to improve their understanding of the "true" cost of credit.

However, a consumer provided with the total amount of the repayments (in this example, $120.78) is likely to have a much clearer intuitive understanding of the loan they are agreeing to. That is, they are borrowing $100 and must repay, in total, $120.78.

<u>*Example 3:*</u> *The APR and Comparison Rate are not always good indicators of the cost of credit*

The logic of applying a cap on the APR and the use of the Comparison Rate assumes that the result of the calculation formula provides a good measure of the cost credit. Whilst this may be true in some instances, it is not always true – for example where a consumer is interested in the total dollar cost of their commitments.

Suppose we are told that the APR/Comparison Rate of a loan is 48% p.a. What information does this give us?

Assume a consumer borrows $100 at the start of the year, to be repaid within 1 year. What total dollar amount must be repaid?

Intuitively a typical consumer would think that the answer is $148. However, this is often not the case. If there is only one repayment under the loan, at the end of the year, then the total dollar repayment *is* $148. However, if repayments under the loan are weekly, the total dollar cost over the year would be materially lower, at around $126. For fortnightly or monthly repayments, the total dollar cost would be between $148 and $126.

The APR does not always represent the true cost of a loan, as consumers may perceive it. For two loans with the same APR, the dollar cost of credit can vary materially from what is expected by consumers. This may distort competition in the marketplace.

Also note that the Comparison Rate formula excludes government fees and charges, and hence may tend to understate the true cost of credit.

<u>*Example 4:*</u> *The APR/Comparison Rate formula does not account for the likelihood of cash flows actually occurring*

The formula treats the repayment cash flows as if they were certain to occur. The result of this is that both high risk loans (where repayment is less certain) and low risk loans (where repayment is more certain) will produce the same APR/Comparison Rate.

The practical implication of this is that the 48% cap will be much more onerous on providers of high risk loans, where they have very legitimate reasons to charge higher rates of interest on their loans relative to low risk loans.

From the consumer's perspective, two loans with the same APR/Comparison Rate may actually include very different financial commitments, because the of the nature of the security required by the lender. That is, the APR/Comparison Rate also takes no account of the risks for the borrower.

<u>*Example 5:*</u> *The APR/Comparison Rate formula does not account for non-cash-flow aspects of a loan*

The calculation formula ignores other aspects of loans, such as whether it is secured or unsecured, has fee-free banking, low cost transactions, fee-free refinancing, no early repayment fees, deferment periods or other flexible repayment arrangements.

These aspects will make the APR/Comparison Rate less useful in comparing the attractiveness of differing loans. The disclosed rates may even mislead consumers if warnings mandated by the legislation are ignored, or not fully appreciated.

<u>*Example 6:*</u> *The APR/Comparison Rate formula excludes fees and charges that are not ascertainable*

The calculation formula for both the APR and Comparison Rate excludes fees and charges that are not ascertainable at the time of calculation (for example, a charge that is payable only on the occurrence of an event which may or may not happen). The imposition of a limit on the APR may therefore have the perverse effect of encouraging loan providers to increase such charges.

ANNEXURE 11

Excerpt from National Australia Bank report "*Do You Really Want to Hurt Me? Exploring the Costs of Fringe Lending*", March 2010

Number of pages: 4

Section one:
the fringe lending landscape cont

Interest rates – it's complicated

In addition to the general data gathered about loan demographics and loan costs and revenues outlined in this report, insights were gained into difficulties in understanding and clearly communicating the structure and comparability of interest rates.

NAB, Money Fast and the Small Loan Pilot Advisory Group discussed at length how to express the "break-even" pilot interest rate.

It's a sensitive issue made more complex by the facts that:

- interest rates in the fringe credit environment are typically higher than those offered by mainstream credit providers; and
- there are Australian legal requirements to express interest rates as comparative or Average Annual Percentage Rates.

When we launched the pilot, we used the following example to illustrate the pilot's Money Fast interest rate:

Total repayments on a 12 month $1,000 loan = $1,159.50, ie $159.50 is the interest component. This means, in this example, if a borrower is lent $1,000 to be repaid in 12 months they will pay an interest component of 15.95% if expressed as a percentage of the original $1,000 loan amount. This however, is not how interest rates are expected to be expressed by Australian regulations.

Australian regulation requires that loan interest rates must be expressed as an Annual Percentage Rate or APR. The Consumer Credit Code defines annual percentage rate in s25(1) as a "rate specified in the contract as an annual percentage rate", stipulating in S26 (1) that a credit provider can't charge interest in excess of the amount determined by applying the daily percentage rate to the unpaid daily balances.

As a result of this definition, the major difference between a flat rate and the APR, is that the APR allows for the reduction in the principle of the loan (ie the daily balance should be lower if the client has started making regular repayments) over the course of the loan. The flat rate is an upfront calculation of the total amount lent. In the above example, with a flat rate of 15.95%, the APR is equivalent to 28.25%.

Early discussions around the interest rate show that there is a challenge in clearly and simply articulating the interest rate in order to communicate the real cost of a loan. In effect, the **APR** does not appear to be a transparent way to inform the customer of what they will be paying back. Money Fast has confirmed that their process ensures that all customers are aware of the cost of the money they are borrowing and the repayments that they are required to make – for example, "for every dollar you borrow you will pay back this much".

Section two: economics

A primary objective of the Small Loans Pilot was to determine the break-even interest rate for $1,000 to $5,000 loans offered to the typical customer in this market. This section of the report outlines these findings.

Readers are also encouraged to look at the four interim reports on the economics of the pilot. These can be found at **www.nab.com.au/smallloanspilot**

How the economics were determined

To determine the breakeven interest rate to apply to the pilot, an 18 month forecast of Money Fast's cash flows was completed in early 2008. This required a number of assumptions:

- Money Fast's operating costs for the period the pilot was to run;
- The level of additional revenue expected from fees charged to the loans (for example overcharging fees), and
- The anticipated default rate on loans written during the pilot.

The annual operating costs for Money Fast were estimated at $730,000. At the time Money Fast estimated that this would be amortised over 3000 loans, which lead to an administration cost per loan of about $243.

As a part of the Small Loans Pilot it was expected that approximately 370 loans would be written with the $1 million in capital provided, however, Money Fast forecast annual operating costs were spread over other anticipated Money Fast business (to take it to 3000 loans).

Additional fee revenue was estimated at $64.75 per loan. Loan defaults (defined as 180 days past due) were estimated at 5%.

To ensure the pilot approximated what happens in the fringe lending market, cost of funds, or the cost to NAB of lending money to Money Fast, was set at 7.30% for the period of the pilot. This revenue – which approximated $53,000 by the end of the pilot – was used to fund research into the pilot and to cover any additional costs associated with tracking and operating the pilot (for example audit fees). The money did not return to NAB.

No upfront fees are charged to Money Fast customers so these did not form part of the forecast.

A key determinant of the breakeven interest rate is the make-up of the loan portfolio, in particular the number of smaller loans, which would then affect the average loan size of the portfolio. The smaller the (average) loan the greater the proportion of fixed administration costs that need to be recouped through the interest rate, and so the higher the interest rate that needs to apply to the portfolio.

The forecast average sized loan in the Money Fast portfolio was $2,900.

After forecasting the cash flows a breakeven APR of 28.25% was calculated for the pilot. This is equivalent to a flat rate of 15.95%, or $15.95 of every $100 lent.

In order to get the interest rate forecasts as close as possible to breakeven, calculations resulted in a small positive cash balance, recorded as a small profit margin for Money Fast of 1.55%.

Full details of the forecast costs and revenues against actual costs and revenues can be found in Table (i) on page 16.

Actual costs and revenues

Over the period of the NAB Small Loans Pilot (from June 2008 to September 2009) the total amount lent over the pilot period was $1.73m and a total of 510 loans were written.

Results of the pilot were as follows:

- The average size of loans written was $3,397, larger than the forecast size of $2,900.
- Fee revenue per loan was $110.25 against a forecast of $64.75.
- Loan defaults were 4.16% against a forecast of 5%.
- An administration cost of $321 per loan was larger than the forecast cost of $243.

The first three actual outcomes listed above have the individual effect of lowering the breakeven interest rate, while the last outcome has the effect of increasing the breakeven interest rate.

Table (i) on page 16 illustrates a breakdown of these loans and cash flows associated.

With 15 months of actual cash flows in place the pilot data confirmed a break-even APR of 26.5% (a flat interest rate of 14.9%) applied to the portfolio of loans written by Money Fast compared to a forecast APR of 28.25% (flat rate 15.95%).

It should be noted that this outcome still relies on 12 months of forecast data as some loans in the portfolio will continue to be paid off over the following 12 months. Where forecast figures are relied upon, the actual outcomes for the pilot are used, for example loan defaults of 4.16%.

Section two:
economics cont

Using the pilot outcomes to examine the economics of small loans

The value of actual cost and revenue data obtained during the small loans pilot lies not so much in looking back at the Money Fast portfolio but in using the information to look more closely at the economics of lending in the fringe sector.

Scenario 1 – reducing the average loan size

Loan size is a key economic driver of lending small amounts of credit in this market – if loan size decreases, each loan in the portfolio will attract a higher proportion of fixed costs.

If we apply the cost and revenue information from the pilot to the forecast portfolio of loans at the commencement of the pilot (where the average loan size was $2,900), we are able to explore what happens to the APR when the loan size changes.

The assumptions behind this scenario are that 3000 loans are written in a year and are paid back over 12 months. All other cost and revenue data is from the actual outcomes from the pilot.

In a portfolio of 3000 loans with an average loan size of around $2,900 and repayments over 12 months, the data shows an APR of 32.84% (flat interest rate of 18.7%) is required to breakeven.

If a modest profit margin of 20 cents in the dollar is added an APR of 39% (flat rate of 22.1%) would need to be charged to customers. This is on the basis that all loans have no up-front fees.

This modelling allows a direct comparison with the forecast made at the beginning of the pilot. The forecast breakeven interest rate was an APR of 28.25% (flat rate of 15.95%) compared with an actual APR of 32.84% (flat rate of 18.7%) using data arising out of the pilot.

The impact of the makeup of any lending portfolio in the fringe lending market is highlighted here – the higher the average loan size the lower the breakeven interest rate. For example a reduction of the average loan size from about $3,400 to $2,900 increases the breakeven APR from 26.5% to 32.8%.

Using the data we can also estimate the lowest average loan size for a portfolio of 3000 loans that has an APR below the 48% per annum cap that operates in some States. The data shows that to be at a (breakeven) rate of 48% per annum, the average loan size can only decrease to $1,700.

This is an important finding of the pilot as it has implications of lending that occurs below an average size of $1,700 over a period of a year.

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.

It should also be noted that if a loan period is less than 12 months, the APR will also increase. All of the above scenarios will see increased APRs if loans are made for less than 12 months.

Scenario 2 – increasing the loan portfolio

The pilot was limited to a $1 million recurrent capital pool (equating to a total of $1.73 million), which equated to 510 loans being written over 15 months. As noted, the pilot assumed that the fixed cost from loan administration would be averaged over a portfolio of 3000 loans.

Another way of looking at the pilot results is to calculate the minimum capital required to meet these fixed costs and sustainably run a lending program.

Like loan size, loan volume also influences the break-even interest rate. The greater the volume of loans, the more the fixed costs can be spread across the loan portfolio - effectively decreasing the breakeven APR.

Using our model, we asked what would be the minimum amount of capital required to operate a lending program under the APR cap of 48% per annum.

The results show that the minimum capital required to run a loan portfolio where the average loan size is $2,900 and is paid back over 12 months is $5.2 million.

This allows about 1780 loans per year and would see customers charged an APR of 48% (assuming a modest profit to the lender of 20 cents in the dollar).

Data from the pilot can also be used to look at the impact a much larger portfolio has on the required APR.

Assuming an average loan size of $2,900 with a 20 cent in the dollar profit margin, the following outcomes are possible:

- At a $100 portfolio – where $100 million of loans are written per year, an APR of 12.15% is possible.
- At a $50 million portfolio, an APR of 14.10% is possible.
- At a $20 million portfolio, an APR of 20.24% is possible.
- At a $8.8 million portfolio (ie 3000 loans per annum) an APR of 39% is possible.
- At a $5.2 million portfolio, as discussed above, an APR of 48% is possible.

Scenario 3 - What is the lowest possible APR?

The modelling also allows us to look at the case highlighted in “loan size scenario section” with a portfolio with an average loan size of $1,700 and with a 20 cent in the dollar profit margin. What is the lowest possible APR?

- At a $100 million portfolio – where $100 million of $1,700 loans are written per year, an APR of 17.27% is possible.
- At a $50 million portfolio, an APR of 21.11% is possible.

Section two: economics cont

- At a $20 million portfolio, an APR of 27.14% is possible.
- At a $8.8 million portfolio (ie 3000 loans per annum) an APR of 48% is possible.
- At a $5.2 million portfolio, as discussed above, an APR of 54.16% is required.

Scenario 4 - What is the lowest possible loan size?

Finally the modelling allows us to look at the smallest average loan that is possible to be written and stay under the 48% cap, and paid back over a year, with a profit margin of 20 cents in the dollar:

- At a $100 million portfolio – where $100 million of loans are written per year, the smallest average size loan possible is $605 at an APR of 48% (note that this lender would need to lend over 165,000 loans in a year).
- At a $50 million portfolio, the smallest average size loan possible is $635.
- At a $20 million portfolio, the smallest average size loan possible is $735.
- At a $8.8 million or 3000 loan portfolio the smallest average size loan possible is $1,700 as discussed earlier.

This analysis shows how mainstream lenders are able to keep their interest rates low by lending at a considerable volume. Volume lending is, however, often at the expense of higher risk customers who don't fit the simplified criteria needed to run such programs.

The analysis also shows that large fringe lenders, say with portfolios between $20 million and $100 million, are capable of delivering interest rates well below the 48% cap where the average loan size is around $1,000.

It also confirms that even large fringe lenders with portfolios of between $20 million and $100 million cannot lend small amounts of money, say less than $700 over a year and remain under the cap.

Conclusions from modelling

The APR that applies to a loan is a balance between average loan size, the size of a lending portfolio and loan term. This much was known before the small loans pilot.

The pilot can, however, speak to some specific outcomes. For example, the modelling suggests that you cannot lend below an APR of 48% for a loan portfolio of less than $5 million and an average loan size of $2,900 or less for a loan term of one year.

The modelling also suggests that for a reasonable sized loan portfolio of approximately 3000 loans at an average loan size of $2,900 - an APR within the range of around 30% to 35% is required to generate a modest profit of 20 cents in the dollar. This requires a capital pool of around $8.8 million and may be considered an average lender in this space.

Although considerably higher than mainstream bank lending, this would be considered a low cost lending model in the fringe lending sector and is below government regulated interest rate caps of 48% that operates in some States.

The modelling shows the need to investigate further the provision of loans with less than an average size of $700. Even large lenders (with portfolios greater than $20 million) would struggle to deliver such loans under the 48% per annum cap. This would be further exacerbated if the lending period was shorter than a year.

This is a particularly important finding as it brings into sharp focus first the ability of lenders to meet legislative requirements when lending small amounts of money, and second, the ability of customers to be protected under such loans where they will be paying interest in excess of regulated levels.