



**Response to the Commonwealth  
Government Green Paper on  
CONSUMER CREDIT REFORM - PHASE II**

*National Credit Reform - enhancing confidence and fairness  
in Australia's credit law*

**August 2010**

# Contents

<b>INTRODUCTION</b>	<b>3</b>
<b>RESPONSE TO CHAPTER 5</b>	<b>4</b>
<b>A. Background</b>	<b>5</b>
Overview of for-profit short-term small-amount lending market	5
Alternatives to short-term, small amount lending	11
Government programs	13
<b>B. Current Arrangements</b>	<b>15</b>
Commonwealth, State and Territory regulation	15
Industry self-regulation	16
<b>C. Current Issues</b>	<b>19</b>
<b>D. Reform</b>	<b>21</b>
<b>RESPONSE TO CHAPTER 7</b>	<b>24</b>
<b>B. Enhancements to the hardship variation provisions</b>	<b>25</b>
<b>C. Enhancements to the stay of enforcement provisions</b>	<b>25</b>
<b>RESPONSE TO CHAPTER 8</b>	<b>26</b>
<b>B. Current Arrangements</b>	<b>27</b>
Effect of the National Consumer Credit Protection Reform Package	27
<b>C. Current Issues</b>	<b>27</b>
Avoidance of the Code	27
<b>D. REFORM</b>	<b>28</b>
<b>CONCLUSION</b>	<b>29</b>
<b>APPENDIX: UK OFFICE OF FAIR TRADING HIGH-COST CREDIT REVIEW (Executive Summary)</b>	

# Introduction

This submission is in response to Chapter 5 of the National Credit Reform Green Paper which looks specifically at the regulation of short-term small-amount lending, and parts of chapters 7 and 8 which discuss recent enhancements to consumer credit protection.

## **Cash Converters**

Cash Converters is a well-known growing international brand in Australia and is the industry leader in second-hand goods retailing, pawnbroking and the provision of a range of short term loans.

Australia wide, Cash Converters has 137 outlets and employs more than 2,000 staff. As a public company, listed on both the Australian and London Stock Exchanges, Cash Converters complies with the highest standards of corporate governance and ethical conduct and is an exemplary corporate citizen.

Some ten years ago Cash Converters identified a need in the short-term small-amount loans sector and saw an opportunity to provide, via our franchised network, a service to borrowers that was not available in the mainstream credit market.

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

## **Consumer Credit Reform**

Cash Converters has been a long-term supporter of the development of nationally uniform consumer credit laws. Over many years we have been working with governments at the State and Commonwealth level to assist them in their efforts to reform the short term loan industry.

Phase One reforms afford consumers greater protection while still retaining a valued and viable short term loan industry for the community. Cash Converters believes that responsible lending practices can be realised within this structure.

## **Summary of Response**

In response to the Green Paper Cash Converters hopes to:

- Provide a brief, clear picture of the operation of Cash Converters Personal Finance solutions, in particular the *Cash Advance* product.
- Reflect on the findings and conclusions of –
  - a high-cost credit report recently issued by the UK Office of Fair Trading,
  - consumer research into the credit behaviours of low income users in Australia (research that was commissioned by Cash Converters in January 2008), and
  - *Do you really want to hurt me?: Exploring the costs of fringe lending*, a report on the National Australia Bank Small Loans Pilot (March 2010).
- Comment on whether there is a need for further regulation of the short term loan industry, in particular a [national] annualised interest rate capping regime.
- Outline the case that the underlying costs of the establishment and administration of short term small amount loans is not insignificant, and that annualising the interest, fees and charges of such loans does not provide a fair basis of comparison to other larger, and longer term mainstream products.

**Response to Chapter 5:  
REGULATION OF SHORT-TERM SMALL-  
AMOUNT LENDING**

## A. Background

### *Overview of for-profit short-term small-amount lending market*

Australians are increasingly using a range of consumer credit options to manage their personal finances.

A popular option is the short-term small-amount loan. While the industry sector providing these loans has experienced substantial growth in recent years, the exact size of the industry, and the role short term lending plays in the social and economic life of Australia has not been quantified.

Further, the nature and role of the industry in society is misunderstood and consumers are frequently assumed to be disadvantaged and vulnerable - terminology that feeds very negative views of short term lending.

The reality is that the opposite is true. Recent studies have shown that for users of this form of credit, it is not only valued, but also in some cases used in preference to other forms of credit. Far from being an option of last resort, short term loans are a preferred option and relied upon by a vast number of Australians to help them through unexpected peaks of expenditure and relief from financial stress.

Moves towards regulation of the industry have come as the result of some cases of excessive charges and loan roll-overs, and the perceived need to afford greater protection to consumers.

Cash Converters supports moves by government towards regulation, a position consistently presented over many years. However, the company believes that protecting consumers from the unethical and shady practices of some lenders should not lead to the prohibition of a service that is provided responsibly by many more.

#### **1. Please provide information on the average size and number of short-term, small-amount loans that you offer.**

Cash Converters Personal Finance division operates with two different short-term small-amount loan types:

- Cash Advance loans are loans of less than \$1,000 and are one month in duration.
- Personal Loans are greater than \$1,000 and typically run from between six and 24 months.

Each year, Cash Converters provides more than 625,000 loans across Australia. For the 2009-10 financial year, these transactions amounted to more than \$250million (refer table below).

	<b>Average Loan Value</b>	<b>No. of loans</b>	<b>12-month Turnover</b>
<i>Cash Advance</i>	\$320.67	565,713	\$184,408,951
<i>Personal Loans</i>	\$1161.93	60,842	\$70,694,257
<i>Total</i>		<b>626,555</b>	<b>\$256,947,297</b>

#### **2. Please provide information on the terms of the loans that you offer or that are available in the market.**

Cash Converters Personal Finance Centres help thousands of Australians with short-term financial solutions every week. As a responsible lender, they assess a customer's capacity to repay before offering a financial solution to meet their needs.

Due to differing regulatory structures between states, there are small differences in the terms of the loans offered. There is however little difference between states in the outcomes for consumers.

Product	State	Loan Establishment Fee	Brokerage Fee	Account Keeping Fee	Loan Term	Annual Percentage Rate	Default Fee#
Cash Advance (this is an unsecured product)	QLD, ACT		35% of principal		30 days	24%	\$16.50
	NSW*				1 - 24 months	48%	\$16.50
	TAS	35% of principal			30 days	0%	\$16.50
	VIC	35% of principal			30 days	0%	\$16.50
	WA	35% of principal			30 days	0%	\$16.50
Unsecured Loans (\$1000 - \$2000)	QLD, ACT		35% of principal		6 - 7 months	48%	\$33
	NSW				7 - 24 months	48%	\$33
	TAS	\$350			6 - 7 months	96%	\$33
	VIC	\$385		\$7.50/week	6 - 9 months	48%	\$33
	WA	\$350			6 - 9 months	96%	\$33
Secured Loans (\$2500 - \$5000)	QLD, ACT		35% of principal		12 - 24 months	48%	\$33
	NSW	Not available in NSW					
	TAS	\$450			12 - 24 months	72%	\$33
	VIC	\$450		\$7.50/week	12 - 24 months	30%	\$33
	WA	\$450		\$1/week	12 - 24 months	72%	\$33

\* Deferred establishment fee applied at customer's discretion.

# Default fee includes bank charges for direct debit request default, as well as an element relating to the administration of rescheduling the loan.

**3. Please provide information on the profile of consumers who access these loans (for example, income (including source) and expenses, dependents and other sources of credit used) and the purpose for which this type of credit is sought.**

The following data has been sourced from Cash Converters Personal Finance transactions from the 2009-10 financial year. As part of the assessment and qualification process, income levels and income source must be proven.

- Net income of customers according to loan type.

Net income represents the income of borrowers after tax as shown on proof of income and banking documentation. In much of the independent research on income levels of short-term small-amount borrowers, income levels are quoted in gross terms. Cash Converters only collects net income (after tax) as they need to assess their true capacity to repay.

Net Income (pa after tax)	Cash Advance	Personal Loans
\$0-\$11,999	14.76%	8.93%
\$12,000 - \$23,999	34.19%	34.66%
\$24,000 - \$35,999	26.74%	32.63%
\$36,000 - \$47,999	15.36%	15.52%
\$48,000 - \$59,999	4.96%	4.78%
\$60,000 - \$71,999	1.95%	1.85%
\$72,000 - \$83,999	1.00%	0.82%
\$84,000 +	1.04%	0.82%

- *Cash Advance Customers and Employment/Job Type*

Job Type	% of total
Administration	2.93%
Automotive	0.77%
Baker	0.22%
Building/Construction	6.16%
Butcher	0.18%
Education	0.56%
Farming	0.23%
Government Benefits	46.15%
Hospitality	3.46%
I.T.	0.30%
Manufacturing	3.56%

Job Type	% of total
Mining	0.48%
Nursing	1.73%
Other	11.47%
Processing	1.73%
Public Sector	3.35%
Retail	4.75%
Security	0.57%
Service	4.27%
Student	0.03%
Transport	1.35%
Unknown	5.73%

- *Personal Loan Customers and Employment/Job Type*

Job Type	% of total
Administration	3.90%
Automotive	0.90%
Baker	0.26%
Building/Construction	4.91%
Butcher	0.23%
Education	0.78%
Farming	0.26%
Government Benefits	43.93%
Hospitality	3.63%
I.T.	0.29%
Manufacturing	3.22%

Job Type	% of total
Mining	0.54%
Nursing	2.57%
Other	13.83%
Processing	2.20%
Public Sector	3.13%
Retail	5.04%
Security	0.72%
Service	5.36%
Student	0.01%
Transport	1.93%
Unknown	2.35%

- *Dependents by Loan Type (1 July 2009 to 30 June 2010)*

Data on the number of dependents that Cash Converters customers have is not always collected. However, a sample of the data has been extracted which shows the number of people with zero dependents, and dependent numbers up to six.

	Number of Dependents						
	0	1	2	3	4	5	6
<i>Cash Advance</i>	3,455	714	709	254	102	20	1
<i>Personal Loan</i>	600	136	145	65	29	6	6

**4. Please provide information on the number of loans that customers apply from an individual lender over a 12 month period.**

As per the response to Question 1, Cash Converters provides more than 625,000 loans across Australia each year. However, each Personal Finance Centre takes applications from thousands more customers who are refused a loan based on their capacity to repay. Data on these customer numbers is not retained by Cash Converters.

## 5. Please provide information on the amount of capital lost as a result of defaults.

The following data details the principal lost by loan type in the period 1 July 2009 to 30 June 2010.

	Total Principal Loaned	Total Principal Lost	% of Principal Lost
<i>Cash Advance</i>	\$184,408,951	\$3,828,931	2.08%
<i>Personal Loans</i>	\$70,694,257	\$4,989,598	7.06%
<i>Total</i>	<b>\$255,103,208</b>	<b>\$8,818,529</b>	<b>3.46%</b>

Overall around three per cent of loans default, which Cash Converters believes is a highly commendable figure. This level of default is achieved in a few simple ways:

- *Lending Limits* – Cash Converters does not lend more money than a person can comfortably afford to repay. With *Cash Advance* loans for example, a new customer cannot borrow more than 15 per cent of their net monthly income.
- *Personal Service* – if a customer is experiencing difficulty making ends meet and needs an extension of time on their loan, this can generally be done by the Personal Finance Centre operator. There are no fees or charges that apply to such a change, as long as the request is reasonable.

## 6. Please provide information on why these consumers use this type of credit in preference to other forms of credit.

Until recently, there has been little quantitative evidence concerning the use of short term credit. This situation has changed over the past two years with the release of four reports which have added valuable information and data to the debate.

These reports are useful tools in the development of evidence-based policy making. They are:

- two research papers prepared by Policis, in conjunction with Synovate Australia, (January 2008):
  - *The dynamics of low income credit use* – A research study of low income households in Australia.
  - *The impact of interest rate ceilings* – The evidence from international experience and the implications for regulation and consumer protection in the credit market in Australia;
- *Do you really want to hurt me?: Exploring the costs of fringe lending*, a report on the National Australia Bank Small Loans Pilot (March 2010); and
- a high-cost credit review by the UK Office of Fair Trading (June 2010).

The reasons why people use short term loans are as diverse as the borrowers themselves. The reasons why they use the service in preference to other forms of credit is equally as diverse. However, as cited in the Policis report *The dynamics of low income use in Australia*, part of the explanation lies in the fact that short term credit fits a consumer need.

Users explain that their use of this type of credit is motivated by:

- a need for rapid access to cash;
- the ability to repay over a short term;
- obtaining access to small scale funds which can be difficult to obtain from a bank; or
- minimal process hurdles.

The chart overleaf has been taken from the report and shows the reasons respondents borrowed from a short term lender.



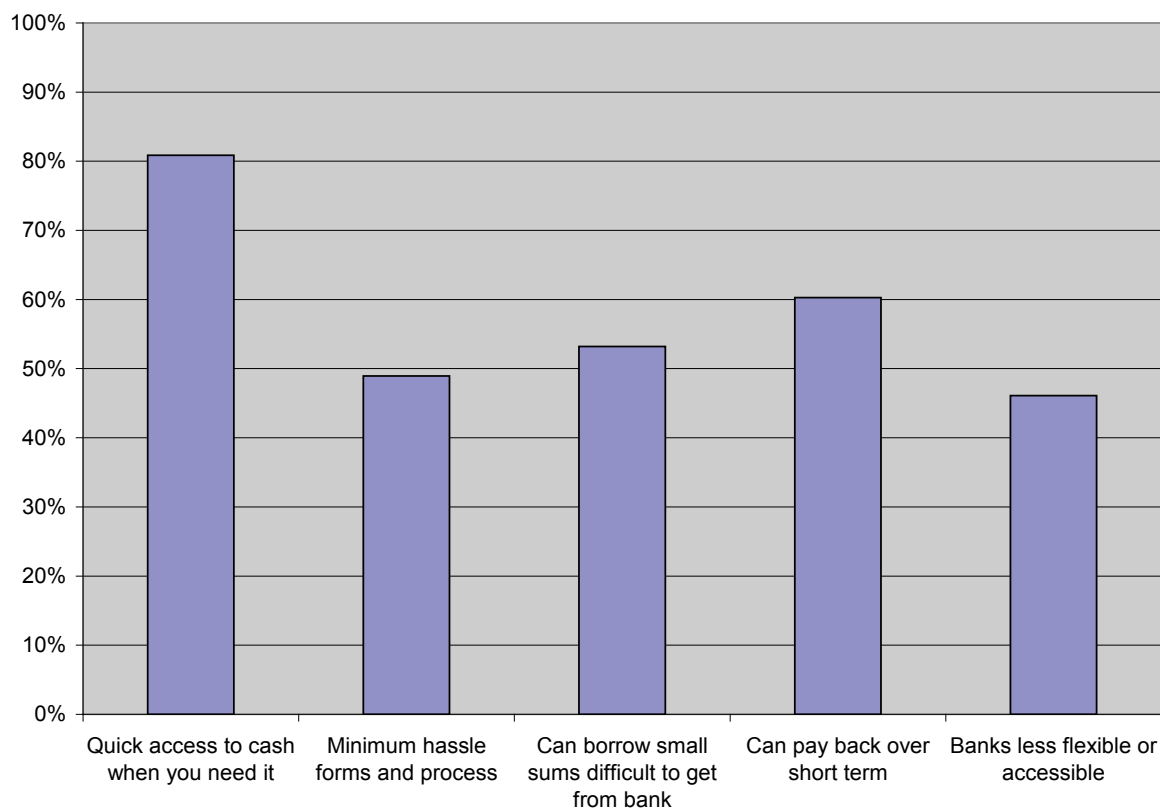


Chart 6.1 - Ready access to small sum cash with minimal process hurdles the key attractions of pay day lending (The dynamics of low income credit use, page 25).

The recent review of high-cost credit by the Office of Fair Trading in the United Kingdom (UK) found that many consumers of short-term small-amount loans in the UK:

- are unaware of the options open to them and advice is limited; and
- tend to focus on how quickly and easily they can access credit and the affordability of the repayments rather than the total cost compared to other products.

The review also found that high cost credit markets:

*work reasonably well in that they serve borrowers not catered for by mainstream suppliers, complaint levels are low, and there is evidence that for some products, lenders do not levy charges on customers who miss payments or make payments late.*

*UK OFT Press Release: OFT Publishes Review of High-Cost Credit (15 June 2010)*

A copy of the executive summary of this review has been attached as an appendix.

**7. What is the average cost to the lender of providing short-term, small-amount loans, (for example, administration costs, profit margins, risk)? Are these costs standard? Are there any factors that are likely to result in significant variation among lenders? Does the interest rate vary to reflect the risk to the lender, particularly in those jurisdictions where there is no interest rate cap?**

The cost to a Cash Converters Personal Finance Centre for providing an average \$320 *Cash Advance* loan is \$76.07 (\$24.60 and \$51.47 as per profit breakdown in Question 8).

Cash Converters does not discriminate between borrowers of short-term small-amount loans, beyond their available income and loan transaction history, which both determine capacity to repay and the amount that

can be borrowed. The terms of the loan and applicable interest, fees and charges are not varied according to the circumstances or characteristics of the individual borrower.

First time customers may borrow up to a maximum of 15 per cent of their net monthly income. This lending limit increases to a maximum of 25 per cent of net monthly income if there is no change in circumstance and after a series of successful loan transactions.

## 8. What is the breakdown of profit on loans, for example, interest, fees and charges?

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

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

### Typical Store Volume

#### Loans

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

#### Income

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

#### Expenses

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

### Typical Expenses (stores overheads)

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

## 9. Please provide information on the size of your loan book/volume of capital.

The following is a statistical summary of these loans types with data sourced from the 2009-10 financial year. The value of loans currently outstanding represents the amount of capital to be repaid on loans whose loan term had not yet been completed at the end of the last financial year.

Statistics	Cash Advance	Personal Loans
<i>Value of loans currently outstanding</i>	\$13,128,946	\$38,767,890
<i>12-month Turnover</i>	\$184,408,951	\$70,694,257

## Alternatives to short-term, small amount lending

### 10. Are there alternatives to high-cost loans in addition to those listed above?

The Policis report *The dynamics of low income credit use* explores the different credit options used by those who have a gross income of less than \$35,000 per annum. Among its many findings, the report shows that far from being credit excluded, those who use short term small amount credit often use this form of credit in conjunction with a host of other options such as credit cards, personal loans from banks, and retail point of sale finance.

Various forms of remote shopping, from the TV, catalogues and online are used by a little over a quarter of credit users with incomes of less than \$35,000 per annum. Retailer sourced credit including store cards is used by one in five credit consumers, with a similar proportion using car finance and personal loans from banks and loan companies.

The following graphs have been taken from the Policis report and show the diversity of credit products used by respondents, and how frequently or recently those products were used.

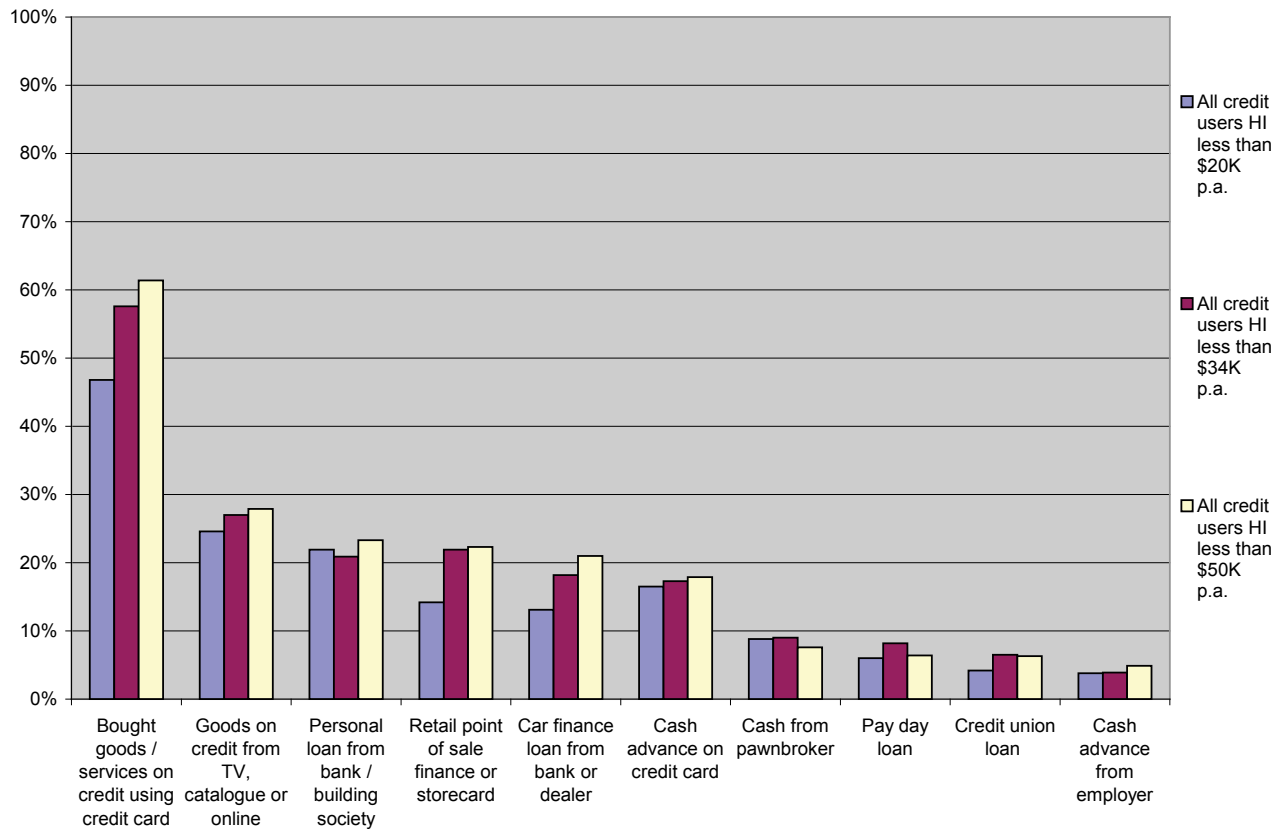


Chart 10.1 - Low income borrowers use a diverse mix of credit products to meet a variety of credit needs with non standard lending a small part of the overall mix.

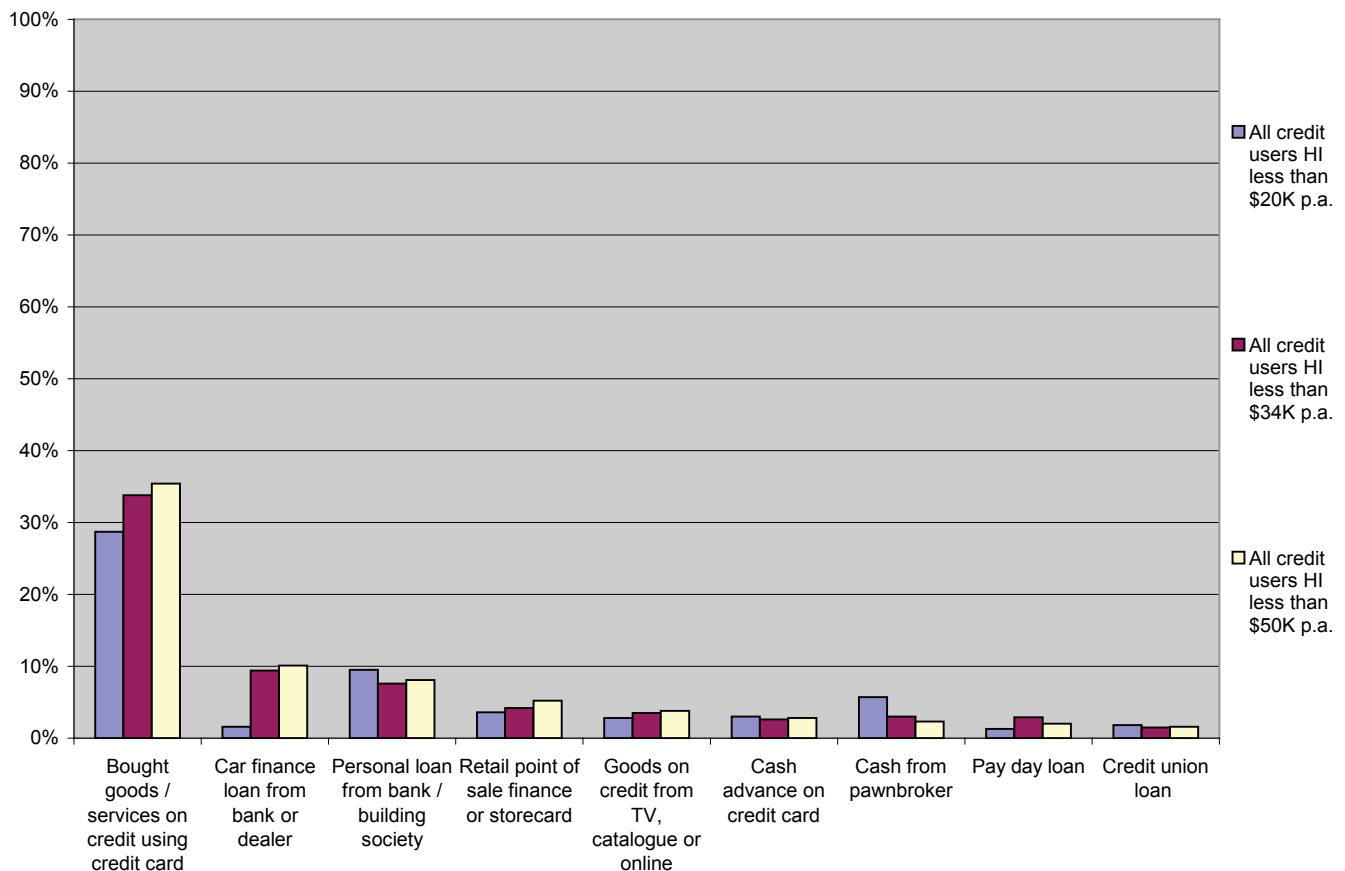


Chart 10.2 - Revolving credit on credit cards used more frequently and recently than payday lending or pawn even among lowest income ranges.

## 11. What are the main obstacles to consumers accessing alternatives to short-term small-amount loans?

Consumers on low incomes can often access a host of short term lending alternatives, and hardship provisions depending on the reasons why the cash is needed and their credit history. For example, if a person needs household goods, and they have no adverse credit history, there is usually a suite of store-based finance alternatives available. If payment for a government utility is due with no cash available, a government scheme or payment deferral may be available. However, it should be noted that these are options determined by specific need and do not allow for discretionary use of funds, a service that Cash Converters can provide.

In its 2009-10 Budget, the Commonwealth Government allocated \$50million over two years to help build the financial capacity of those on very low incomes. Some of these funds were channelled into no interest and low interest loan schemes.

This initiative is well intentioned and the Government is to be congratulated for its support. However, the funds are limited. Total funding of \$50million over two years equates to only 10 per cent of Cash Converters total volume over the same period.

Cash Converters also identified other potential obstacles to accessing short term lending alternatives as:

- The alternatives to mainstream lending are few in number and restricted in choice.
- Compared with a network of stores such as Cash Converters, government hardship assistance programs and other short term lending alternatives are not as readily available both in terms of accessibility and urgency.

- A perceived lack of knowledge and awareness of the range of schemes available to assist consumers in retaining their financial independence.
- No interest and low interest loan scheme alternatives have restrictive qualifying criteria thereby rendering many borrowers ineligible.

## **12. What are the main costs and risks associated with use of these alternatives?**

Due to the limited number of no interest and low interest loan schemes, and their limited available funds, these programs would be over-stretched by heavy demand, and their strict eligibility criteria may deter many consumers from applying in the first instance.

One of the advantages of Cash Converters short term loan products is their ability to assess an application, and if successful, provide funds in a short time period. In many cases this quick turnaround time has allowed its customers to meet bill deadlines without incurring further penalties. As detailed in question six, more than 80 per cent of borrowers cite quick access to cash as the primary reason why they use short-term small-amount lenders. Many alternative lending programs don't have quick turnaround times, thereby potentially harming the welfare of those applicants in acute financial need.

Finally, but perhaps equally importantly, Cash Converters customers have indicated that the discretion and convenience of its short term lending service enables them to retain their financial independence in a dignified manner.

### ***Government programs***

## **13. Are borrowers aware of the availability of Utility Financial Assistance Programs? What proportion of short-term small-amount loans are used to pay utility bills?**

Information concerning this query has not been collected by Cash Converters in any form. The quantitative surveys undertaken in the past also have not collected information for this question. Anecdotally however Cash Converters can state that most users of its services have good awareness of available government financial assistance programs.

## **14. What proportion of users of short-term, small-amount loans are benefit recipients? Are these users aware of the availability of advances on income support payments? What are income support recipients using the advance payments for?**

Approximately 45 per cent of Cash Converters loan recipients are in receipt of some form of government benefit (refer to consumer data on page five). They are however unable to borrow beyond the determined loan capacity in accordance with Cash Converters lending policies, which strictly govern borrowing limits.

A *Cash Advance* loan allows a borrower taking out their first loan to borrow no more than 15 per cent of their net monthly income.

If a person successfully completes the first transaction, and shows a capacity to repay, they are able to progress to borrow 20 per cent of their net monthly income with a ceiling of 25 per cent.

With respect to the awareness of advances on income support payments, as mentioned above, anecdotally Cash Converters can state that most benefit recipients are aware of such financial assistance programs that may be available to them.

## **15. Do users of short-term, small-amount loans know of and use budgeting/debt management services?**

Cash Converters does not collect information on what budgeting or debt management services are used by short term loan users, however they do have ASIC *Understanding Money* booklets widely available in its stores across Australia.

In addition, Cash Converters are currently developing online budgeting tools for customers and others Internet users who may find such tools useful. This is part of an ongoing program of Cash Converters initiatives aimed at assisting those who require short term financial assistance. The new tools will be available on the Cash Converters website in the coming months.

## B. Current Arrangements

### *Commonwealth, State and Territory regulation*

The focus of some State Governments has been on regulation through price control of small amount, short term loans. Outside of price control mechanisms, Western Australia has a licensing regime in place, and Victoria has a registration regime in place with capping on interest rates only.

There is little difference between States in price control approaches, with the exception of New South Wales which recently changed its legislation to include all third party fees and charges under its 48 per cent annualised cap. It should be noted that this inclusion was against the spirit of the COAG agreement to transfer legislative powers to the Commonwealth without imposing further changes to existing credit laws.

As a national operator, Cash Converters has experienced the different regulatory regimes of each State and Territory over the past eight years. Western Australia is the only State that has introduced substantial regulatory reform without a price control mechanism, instead imposing a licensing requirement for short term lenders.

Cash Converters believes this licensing requirement has imposed substantial and verifiable reform based on lender conduct and was a welcome inclusion in Phase One of the National Consumer Credit Reform process.

Price control measures do not take account of the fact that there are substantial establishment and administration costs associated with short-term small-amount loans that are ignored and distorted by an annualised percentage rate.

#### **16. How effective have interest rates caps been at restricting the cost of credit to borrowers?**

To date, the interest rate caps that have been put in place in various forms around the country by State Governments have had little effect in changing the charges payable of a short term loan.

This is primarily due to measures that have been taken by lenders to operate lending models that fit the state's regulations on interest rate caps. These measures include the application of an establishment fee when taking out a loan.

It is worth noting that this mechanism is critical to the business as the short term loan product could not be offered without fees that truly reflect the cost of loan establishment and administration. There is no evidence of concern about this mechanism from consumers; consumer concern and stress increase when access is denied.

#### **17. How do the different regulatory approaches among the jurisdictions affect the short-term small-amount lending market including the availability of credit, the terms on which it is offered and the number of credit providers?**

Differing approaches to regulation amongst the states have lead to duplication of resources and the imposition of significant costs for businesses such as Cash Converters. This sort of duplication and ensuing operational and legal complexity requires additional resources in the following areas:

- legal drafting and compliance;
- information software and technology requirements;
- government and network communications requirements;
- store compliance auditing;
- state-based training requirements;

- store-based training requirements; and
- communications and marketing regulatory compliance.

With regard to the number of lenders or the availability of credit, from a competitive standpoint, Cash Converters does not collect this sort of market-based information and in the absence of a reporting function for the industry, this data is difficult to obtain.

Compliance with the *National Consumer Credit Protection Act 2009* has involved considerable expense in meeting license requirements. It would be disappointing if consistency across all jurisdictions was not achieved and industry benefits outlined by government, such as improved efficiencies, were not delivered.

**18. In those jurisdictions with a cap, how have lenders responded (for example, have they exited the market, revised prices, changed business structures or resorted to avoidance techniques)?**

In order to retain the viability of its product in NSW, Cash Converters currently are providing short-term small-amount loans over a two year period at an interest rate of less than 48 per cent per annum. Should the borrower elect to repay the loan earlier, they can do so and a deferred establishment fee is applicable.

However, it must be noted that any loan paid off over the two year period at 48 per cent per annum results in a loss to Cash Converters. The only way that this service will be viable, bearing in mind that it is less than a month old, is if a large proportion of borrowers elect to repay early and incur a deferred establishment fee.

In Queensland, many lenders including Cash Converters use brokerage fees as a means to recover the cost of providing loans. Brokerage fees can be legally added to a contract without being included within the cap calculation.

Victorian regulations call for an interest rate cap (exclusive of fees and charges). Cash Converters stores in Victoria charge a flat fee on the loan and do not apply an interest rate charge.

The lending mechanisms which Cash Converters have put in place comply with the Credit Code legislation in the States of Victoria, New South Wales and Queensland and with Commonwealth Government legislation.

Cash Converters does not have specific data relating to changed business structures, revised prices, levels of avoidance or whether businesses have exited the market.

**19. Is there evidence of an increase in avoidance or unlawful lending in jurisdictions that have introduced a cap?**

Cash Converters is aware there are a wide variety of methods used by lenders to circumvent caps on interest, fees and charges.

Cash Converters does not collect information about these methods. However, by way of example, we are aware of lenders who use post-dated cheques to provide short term loans, and others where loans are provided against diamonds purchased by the customer.

***Industry self-regulation***

An industry body representing short term small amount lenders is critically important to provide a credible partner for Government to work on reform of the industry.

The National Financial Services Federation (NFSF) is a strong and responsible voice that shares the Government's goal of affording greater protection to consumers while retaining a viable service for the community. Since its inception, the NFSF has represented its members to present an alternative view on the debate by acknowledging community need for the service and supporting practical regulation.



## 20. What proportion of borrowers make use of available internal dispute resolution processes? How effective are they in resolving disputes?

The total Personal Finance transaction volume for Cash Converters for the 2009-10 financial year was 626,555.

The total number of complaints made to the Cash Converters Internal Dispute Resolution system for the same period was 95. These complaints are from across all sectors of Cash Converters business including pawnbroking and only seven of the 95 complaints were referred to External Dispute Resolution (EDR).

The total number of written or other complaints made to state fair trading bodies concerning a Cash Converters Personal Finance product was 15 (refer page 17 of this submission).

	Totals	% of complaints to transactions
<i>Total Personal Finance Transaction Volume</i>	626,555	
<i>Internal Dispute Resolution (IDR) complaints</i>	96	0.015%
<i>State Fair Trading complaints</i>	28	0.0004%

### Internal Dispute Resolution

Cash Converters has had a structured Internal Dispute Resolution (IDR) process in place for some time. The process was recently reviewed and amended in accordance with *Australia Securities and Investments Commission (ASIC)* and *Commonwealth Ombudsmen Service Limited (COSL)* requirements and standards.

The IDR process is a fair and effective system, largely because Cash Converters closely monitors the conduct of its stores with a host of built-in safeguards in its lending procedures to ensure compliance with lending policies.

Stores and their staff are trained to deal with any complaints at the store counter, however if the need has arisen, the Internal Dispute Resolution process has been offered as a means to deal with customer complaints. Specific data relating to this process is listed below.

- The number of disputes that progressed to the Cash Converters Internal Dispute Resolution system in the last 12 months.
  - From July '09 to end of June'10, the total number of complaints to support centre was 95.
- The number of these disputes that have been escalated to court action, EDR or other.
  - Seven complaints that were referred to the IDR process were escalated further and referred to the EDR scheme.
- The number of disputes that have been referred to EDR and resolved.
  - Of the seven complaints that were escalated to the EDR scheme, six have been resolved and one remains outstanding. The seven disputes relate to the following - two complaints concerning pawnbroking, two relating to Cash Advance loans, two relating to *Veda* credit rating listing of customers and one in relation to a Personal Loan.

### Fair Trading Complaints

Of particular note is the lack of complaints to State consumer affairs organisations about Cash Converters short- term loan products when compared with the 625,000 loans provided during the same time period.

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

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

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

## C. Current Issues

**Cash Converters has long proposed a closer examination of the issues surrounding the capping of short-term small-amount loans. There is ample international evidence to suggest that capping is not the solution that it is widely feted to be, and instead will harm the very people it seeks to protect.**

The recent review of high-cost credit by the Office of Fair Trading in the United Kingdom considered the case for price controls for pawnbroking, payday loans, home credit and rent-to-buy credit and concluded that:

*they will not address the problems identified in the high-cost credit sector, which stem from both limited supply options and consumers' lack of ability to drive competition.*

*UK OFT Press Release: OFT Publishes Review of High-Cost Credit (15 June 2010)*

The report also found that:

- The markets for high cost loans worked reasonably well in that they meet a demand and fill the gap not served by mainstream lenders, and there has been little complaint.
- The lack of competition encouraged higher prices because consumers don't seek comparison; and suppliers are limited.

The debate in Australia about how best to protect the interests of consumers who use short-term small-amount credit has often focussed on price control mechanisms, such as an annualised cap of 48 per cent per annum (inclusive of all fees and charges).

Caps on the interest, fees and charges payable on short-term small-amount loans are unworkable, in particular for loans of less than 12 months in duration, and such an outcome will harm the very people they intend to protect.

For a Cash Converters *Cash Advance* loan of one month, this 48 per cent per annum cap represents a maximum return of less than 4 per cent - around \$12 for an average \$320 loan. In a fully inclusive capped environment, this sort of return falls short of covering costs, let alone generate a profit, thereby removing this sort of product as an option for those who use it.

Even the National Australia Bank in their report *Do you really want to hurt me? Exploring the costs of fringe lending - A report on the NAB Small Loans Pilot* states:

*“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.”*

*Do you really want to hurt me?; Exploring the costs of fringe lending – A report on the NAB Small Loans Pilot (March 2010, Section 2, p.13)*

The NAB report also points out that costs increase for loans of a shorter term.

### 21. What will be the impact of licensing and responsible lending obligations on short-term, small-amount lending?

The Western Australian market has long had a licensing regime in place for short term lenders - a pragmatic approach that seeks to remedy conduct issues with specific lenders as opposed to casting a blanket across the entire industry.

Cash Converters welcomes the national adoption of a licensing and responsible lending regime which formed part of the National Consumer Credit Reform. However, this sort of regulation has created a great deal of work and has placed significant pressure on our internal resources.

In addition, store resources have been required to ensure that the new procedures are implemented correctly. However, Cash Converters acknowledge the value of the reform to further ensure the safety of our customers and the efficacy of the short term small amount lending industry.

## **22. Is there evidence of a need for further Government intervention to address specific issues with high-cost lending?**

Cash Converters recommends a range of relatively simple measures that could be considered to address issues relating to the use of short-term small-amount loans, the conduct of lenders in the market and the welfare of users, including the following:

### **Enforcement**

- *Ensuring proper oversight of the industry, and enforcing conduct penalties.*

Prior to the introduction of licensing and registration [as part of Phase 1], the number of lenders and their conduct could not be accurately determined. The industry was largely left to grow and operate with little oversight from Government or an industry representative body.

Licensing and registration, coupled with the enforcement capacity provided to ASIC, allows government to have direct intervention in the industry, oversee its operation, assess its role in society based on real data and prosecute specific instances of unconscionable conduct on the part of rogue lenders.

### **Education**

- *Focus on programs to assist those with specific financial capability issues.*

Some consumers who use the services of short-term small-amount lenders have specific issues relating to their financial capability. ASIC already has available a very useful document *Understanding Money* that is available for distribution. There may be an opportunity to ensure that all short-term small-amount lenders have stock of these brochures available for in-store distribution.

### **Communication**

- *Better communication about social welfare nets for those with issues relating to the payment of Government related bills (for example utilities), and partnerships between industry and welfare organisations.*

Many who may be borrowing money to pay for utility bills where a deferred payment option is available, may simply benefit from having this service communicated to them. The short-term lending industry may be a valuable partner to government in communicating the services available and referring consumers in need to these services.

### **Self-Regulation**

- *Empower the NFSF to enforce further conduct obligation measure for its members.*

An empowered industry body has much to lose by retaining some of the very lenders whose conduct has been questioned as part of this credit review. It is in the interests of the consumer to have a strong NFSF that has an open line of communication to Government.

### **Information**

- *Centralised database – Comprehensive Credit Reporting*

To keep track of the conduct of short term lenders, Cash Converters proposes that all loan transactional data be uploaded to a centrally held database, much as Cash Converters recommended doing, and which has now become law with respect to the trade of second-hand goods and pawnbroking loans. Although there may be privacy issues emanating from this opportunity, it is a serious opportunity for direct transaction data to be available.

## D. Reform

### 23. Which option(s) do you consider would be effective at addressing the concerns associated with high-cost credit?

There are differences between States in their application of interest rate capping, however as already discussed the provision of short-term credit has continued in all jurisdictions.

Taking into consideration the resources that the credit industry has committed to compliance, Cash Converters would prefer the Commonwealth to adopt Option One, that is, to maintain the status quo and not impose further regulation.

This would allow a period of transition and bedding down, and a complete understanding of the changed environment and its effect on consumers.

This should not diminish the objective of achieving credit reform that is nationally consistent.

Of the alternative reforms proposed in the Green Paper, Cash Converters would be open to discuss and consider concepts for increased consumer protection such as:

- Option Three: Warnings on high-cost products
- Option Four: Prohibition of roll-overs
- Option Five: Restrictions on fees and charges.

Regarding option two, the implementation of a national interest rate cap, Cash Converters remain opposed to such a price control mechanism.

By annualising the rates of short-term small-amount loans, pro-capping bodies and individuals have a convenient way to present their arguments on unconscionable costs. However, what is ignored is that annualising interest rates, fees and charges on these products is not truly representative of the relative costs that apply.

In simple terms, a 48 per cent cap on a one month loan equates to a maximum return of 4 per cent.

- 4 per cent of an average \$320 *Cash Advance* transaction equates to a little more than \$12.
- \$12 does not cover the costs of providing the loan (already shown to be more than \$70).
- Government and not-for-profit organisations could not cover the gap left if this product were removed from the market.

Arguments offered in favour of an annualised cap in the Green Paper are as follows:

- *Failure to implement a national cap would result in a loss of protection for consumers in jurisdictions with a cap.*

The behaviour of short-term lenders in Western Australia, a jurisdiction without a capping regime but with strict licensing, has proven adequate protection can be afforded to consumers without a national rate cap.

- *The presence of a cap makes it easier to seek remedies as proof of breach of a cap is relatively easy (that is, it is not necessary to prove that the interest rate is unconscionable).*

As there is a clear and undeniable consumer need for short-term small-amount loan products, most lenders currently circumvent the caps using legal measures because they can't cover costs let alone make a profit. As short-term small-amount loans are not able to be provided within the cap, avoidance techniques will continue leaving the consumer less safe.

- *Disclosure of costs is not sufficient protection for vulnerable, desperate consumers who will take up credit irrespective of the cost.*

It is clear there is a need for short term credit in the community.

Conduct provisions applied to lenders, and social welfare nets provided to those in need, are better ways to manage consumers who are truly desperate and vulnerable. The majority of Cash Converters customers cannot be classified as desperate and vulnerable and therefore it would be unnecessary to remove a credit product that is so widely used.

Evidence from the UK OFT high-cost credit review shows that consumers of payday loans have a high understanding of the obligations of this type of credit (see chart below).

Question	Payday Loan	Pawn Broking	Home Credit
If you take out this loan today, how much will you get?	95%	94%	96%
If you take out this loan today, by when do you have to pay it back completely?	N/A	85%	82%
What is the APR on this loan?	84%	82%	81%
If you take out this loan, what is the total amount you will have to pay back?	84%	89%	87%
If you take out this loan, how often will you have to make repayments?	66%	60%	85%
If you take out this loan, how many repayments will you have to make in total?	82%	65%	87%
If you take out this loan, how many repayments will you have to pay in total as interest charges?	86%	84%	83%
If you take out this loan, what is the average interest cost per week?	66%	58%	64%
<b>MEAN UNDERSTANDING SCORE</b>	<b>81%</b>	<b>77%</b>	<b>83%</b>

*Chart 23.1 - Correct response rates for eight questions examining loan understanding (UK OFT Final Report, 2010, p. 22)*

- *Competition is not an effective price control mechanism in this market. Annualised interest rates in excess of 1000 per cent have been seen in jurisdictions without an interest rate cap.*

Annualised interest rates of 1000 per cent are present in markets with an interest rate cap. This form of abuse can be addressed through a variety of other regulatory measures.

#### **24. Are there other mechanisms which should be considered?**

Cash Converters recommends that the current approach to regulation be allowed time to take effect in the industry and for the community before other regulatory measures are considered.

There is great confidence that the new measures, in particular those relating to licensing and registration, Responsible Lending and mandatory membership of an EDR will have positive outcomes for consumers whilst retaining the viability of the industry.

The level of complaint and objective data on consumer behaviour across the spectrum of users should be the measures that dictate the need for further intervention as opposed to a subjective debate about consumer welfare.

**Response to Chapter 7:  
ENHANCEMENTS TO THE NATIONAL  
CONSUMER CREDIT PROTECTION  
REGIME**



## **B. Enhancements to the hardship variation provisions**

This chapter relates to parts of the credit market that are beyond that serviced by the short term small amount lending industry.

However, Cash Converters and other lenders in this industry help many individuals who are experiencing hardship as a result of difficulties with mainstream lenders.

The current hardship provision thresholds of \$500,000 are more than adequate for Cash Converters business.

For Cash Converters borrowers, the current status quo is sufficient and allows flexibility for both lender and consumer.

## **C. Enhancements to the stay of enforcement provisions**

If it is legislated that a request for a “stay” implies certain actions from a lender, then the possibility of credit providers trying to circumvent requests for “stays” is more likely to result in defaults being sent quicker for small amount loans.

**Response to Chapter 8:  
COVERAGE OF CREDIT UNDER THE  
*NATIONAL CONSUMER CREDIT  
PROTECTION ACT 2009* AND AVOIDANCE  
PRACTICES**

## B. Current Arrangements

### *Effect of the National Consumer Credit Protection Reform Package*

1. Does the introduction of licensing and responsible lending requirements to persons who provide or arrange regulated credit increase the incentives to avoid the Code?

Licensing and responsible lending introduces a workable regulatory framework for any person who provides regulated credit to act responsibly.

## C. Current Issues

### *Avoidance of the Code*

2. What current practices are being used to provide credit without the transaction being regulated by the Code?

Cash Converters has implemented alternative means to continue to meet the needs of consumers in Queensland and New South Wales. Both of these alternatives are compliant with State and Commonwealth legislation, including the National Consumer Credit Code.

Cash Converters customers enter into a consumer contract which is legally compliant and provides the customer with all the protection that the National Consumer Credit Code offers.

In Queensland Cash Converters loan applications are prepared, vetted and approved by a broker who then introduces customers to the lender for a fee. In NSW, after their loan is approved, Cash Converters customers can elect to allow their loans to run the full two year term or elect to pay the loan out early, reduce total interest costs, and pay a deferred establishment fee.

These practices are not employed to avoid any legislative intent to provide consumers protection. They are necessary to allow the true costs of establishment and administration of short term loans to be recovered and make an acceptable profit.

The reason short term credit is high cost is because the lender doesn't have the opportunity to recover fixed establishment costs over the length of the loan as is the case with traditional finance products, which generally run over several years.

3. How widespread are these practices?

Cash Converters does not hold information about the practices being adopted by other lenders in the short term loan industry.

4. Are these practices being targeted at particular classes of consumers, and what are the consequences for consumers?

As Cash Converters consumer data indicates, the income range and reasons for using short-term loans varies greatly among its customers. The marketing of its short-term loan products is not aimed at any particular class of consumers.

5. What are the consequences for lenders and brokers who are complying with the Credit Act?

Compliance with the *National Consumer Credit Protection Act 2009* has added additional administrative processes to Cash Converters business both at the store level and at the corporate level.

## D. Reform

Chapter 8 of the Green Paper presents four options to implement further reform that will improve coverage of credit under the *National Consumer Credit Protection Act 2009* and (perceived) avoidance techniques.

Effective 1 July 2010, all lenders are required to be licenced, a provision of Phase One of the national consumer credit reforms. However, these new regulatory measures have only been operational for one month. Therefore, of the four options, Cash Converters would advocate for option one; no further Commonwealth intervention.

Of the remaining three options for reform presented, Cash Converters has the following responses.

- *Broaden the definition of regulated credit*

Lenders are currently adjusting their business practices and suite of short-term loan products to ensure compliance with the reforms implemented under Phase One. Further amendments at this time may cloud the desired outcomes for more effective regulation.

- *Respond to individual practices*

If further reform is determined to be required, Cash Converters would welcome a case by case approach. The fact is there is a range of products currently available in the short term lending market that serve the needs of a wide variety of individuals and circumstances. Price control mechanisms such as interest rate caps seek simple remedies to complex problems. One size does not fit all.

As detailed in the UK OFT report:

*There are a number of different high cost credit products available at different prices with different costs based on the product characteristics and target consumers. Imposing prices controls would be difficult in these markets, as detailed investigations of the pricing and profits of suppliers would be needed at a product-by-product level.*

*UK OFT Review of High-Cost Credit Final Report (2010, p. 10)*

- *Adopt other measures*

As previously stated, Cash Converters feels the status quo should be maintained.

Cash Converters recommends that the current approach to regulation be allowed time to take effect in the industry and for the community before other regulatory measures are considered.

## Conclusion

Cash Converters has been, and remains, very supportive of the development of a national consumer credit protection regime.

While pleased with the reforms introduced under Phase One, there was disappointment that the issue of interest rate caps was not addressed, and Cash Converters are hopeful this issue will be quickly resolved during Phase Two.

Price control mechanisms, in particular the use of an annualised interest rate (inclusive of fees and charges), has been a major concern to the short-term loan industry in recent years.

It is clear from discussions that Cash Converters have had with departmental and elected officials in some States that there is also little understanding of the impact the introduction of an annualised capping regime has on the capacity of a company to offer a short-term loan product.

The UK OFT high cost credit report argues that if price control mechanisms are introduced the supplier will, in order to protect the business, restrict the type of product they offer and reduce their consumer base. A high price control could see them exit the market.

*“We have concluded that introducing price controls would not be an appropriate solution to the particular concerns that we have identified in these high-cost credit markets.”*

*UK OFT Review of High-Cost Credit Final Report (2010, p. 9)*

Further, as previously outlined in this submission, the small loans pilot project by the National Australia Bank found 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.”*

*Do you really want to hurt me?; Exploring the costs of fringe lending – A report on the NAB Small Loans Pilot (March 2010, Section 2, p.13)*

These actions impact on consumers who already have limited options and who may require the money for urgent non-discretionary expenditure.

Price control is also complex, expensive and difficult to administer.

In considering further consumer credit reform, Cash Converters would like the Commonwealth Government to remain aware that short term lending is:

- **widely used** - There is clearly a need for short term lending among consumers. This is evidenced by the 625,000 loans that Cash Converters alone administers annually in Australia.
- **highly valued** - Relative to this substantially high number of loans, the number of consumer complaints is negligible.
- **unique** – in that it meets a need in the community that could not be met to the same volume by mainstream lenders, Government or community-based organisations.