Min-it Software

Submission –

Review of the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011

Parliamentary Joint Committee on Corporations and Financial Services.

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Foreword

The author would like to thank the Committee for the short extension of time granted in order to make this submission.

If the Committee would like to discuss any information contained in this submission, please do not hesitate to contact me.

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Background Information

This submission is made by Min-it Software on behalf of our clients. Aside from the software produced in-house, specifically by or for franchised organisations, Min-it Software is the leading internet-based industry software supplier in the Australian market to the micro-lending market.

We were a finalist in the Queensland Consumer Protection Awards 2005 and were awarded a Highly Commended Award in the 2007 Awards. Min-it Software promotes compliance with the Code and other legislation. In order to do this, we have held training conferences open to the entire industry, not just our own clients, since 2006 and have just held this year’s one at the end of last month at the Novotel Twin Waters resort.

Neither the author nor his business partner has any financial interest in any lender.

We welcome this opportunity to assist the Committee in its deliberations regarding the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (“the Bill”) currently before Parliament and hope you find the contents of this submission useful.

Given the author is a member of the FAA/Industry/Smiles Turner Delegation, representing the Financiers Association of Australia (“FAA”), this submission will comment only on certain aspects of the Bill which we feel will add value to the Committee’s deliberations.

The Consultation process

The Committee has been asked to examine and deliberate on a 'consultation process' that gave stakeholders just 11½ days (which included 2 weekends) consideration and to reply. For the record, stakeholders were supplied the documents by email on Thursday, 25 August 2011 at 11.05am for a meeting to be held in Sydney the following morning to discuss the amendments. Submissions closed Monday, 5 September.

As a consequence, it is inevitable that if the Bill is passed 'as is', there will be many unintended consequences. There was simply insufficient time to consider all the outcomes.

The rush to pass this legislation through Parliament is merely so that the Government can meet its promise to the States that legislation would be adopted by a specific date, rather than properly examining and addressing issues raised by the Consumer Groups to see if they hold water. In our opinion, they do not and hence a valid reason for the Committee to deliberate on the proposed legislation.

As a result of the speed imparted on us by Government, we are forced to question the whole process. We fail to comprehend why the Risk Impact Statement dated June 2011 was not published until 2 September and never mentioned to stakeholders prior to Treasury closing the consultation process on 5 September. It was only by chance that this was even seen by the delegation.

Furthermore, as part of the delegation that provided detailed industry costings and modeling to Treasury, we question why much of the research information supplied has not been included. One may make an insinuation that because that data did not fit with the data subsequently published in the RIS, it was deliberately omitted.

Just as occurred back in 2006 when the Hon Margaret Keech, the Attorney-General for Queensland at the time and the Minister responsible for Fair Trading stated that the "concept of an interest rate cap is highly complex, and I am focused on finding an outcome that balances

consumer welfare with the continued financial viability of lenders"[1], a similar message has been voiced by the Assistant Treasurer recently[2].

Although State Ministers and the media have spoken previously about the negative actions of "payday lenders"[3], the actions of Queensland, New South Wales and the Australian Capital Territory when introducing their interest rate capping legislation did not seek to restrict this particular finance segment. Instead of defining payday lending, they chose to enact legislation so wide that any lender, other than an Authorised Deposit –taking Institution ("ADI"), became a payday lender - and thus, by association and insinuation, a 'loan shark'. We are concerned that the Assistant Treasurer is making a somewhat similar mistake in attempting to pass this legislation as presented to the House by defining a payday loan to something that it is not. In doing so, because we believe the industry is still greatly misunderstood by legislators, passing the Bill 'as is" will impact far more than those intended, just as the State legislation did.

On Friday afternoon, just 2 hours before submissions were to close, we received an email with an attachment (see Appendices 1 and 1A) outlining a further amendment to the Bill that is being considered by Treasury and which will be tabled prior to passing. This matter was one of two items removed from the original draft Bill because of concerns. The fact that any of the options being considered will alter some of the modeling for the micro-lending sector is, in our view, totally unsatisfactory. It makes a mockery of due process by introducing such an amendment at this late stage. The only thing that is surprising is we have been given 14 days in which to respond. Many will feel the options and comments further highlight the lack of understanding of the industry by legislators.

This whole "fast track" process does not make for good government, particularly when it is clearly evident the industry's practices are not understood. To industry, it smacks of the same sham

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[1] Keech, M, 2006. "*Discussion paper: Managing the Cost of Credit*" Message from the Minister, p.6. Available online http://www.consumer.qld.gov.au/oft/oftweb nsf/AllDocs/E3B0BF78553C677C4A25721B000C96CB/$File/0467-Consumer%20Credit%20QLD%20Discussion%20Paper.pdf previously viewed November 2006.

[2] Meeting in the Hon Bill Shorten's Electoral Office, Melbourne on 9 September 2011.

[3] For example, refer to the following from the Courier-Mail, 2006 –2007 by Patrick Lion: *"These interest rates sky high*" dated 26 June 2006, *"Poor left to loan sharks*" dated 05 July 2006, *"Feeding frenzy for sharks"* dated 10 July 2006, *"Fair loan rates push - Queensland excuses for inaction shown up by NSW consumer laws*" dated 26 July 2006, *"Squeeze on lenders"* dated 12 November 2006, *"'Payday' rates cap : New laws protect consumers*" dated 27 November 2007, together with others such as *"Mum's 240pc interest scare*" dated 03 August 2007, *"Bungle lets off loan sharks"* dated 13 November 2007, *"Payday rates cap: New laws protect consumers"* dated 27 November 2007 and Department of Justice and Attorney-General Queensland Media Release, 2007. *"Bligh Government to crack down on pay day lenders*" issued 03 December 2007. Available online *http://www.fairtrading.qld.gov.au/OFT/oftweb.nsf/Web+Pages/A489A3150E694AE24A2573A5007E2FF5?OpenDocument* viewed 04 December 2007.

processes used by the States of going through the motions of consultation when there was never any intention to listen. The political decision had already been made long before.

Willful blindness by consumer groups and others is not a valid excuse for creating legislative amendments that may be unnecessary to address the actions of a small number of industry participants in failing to meet their responsible lending and loan suitability obligations.

Recalling the parody of 'Sir Humphrey Appleby' in the BBC program "Yes, Minister" and its sequel, "Yes, Prime Minister", in which he was always advising his Minister, the Honourable Jim Hacker to "never hold an enquiry unless you know the outcome in advance," it is imperative that the Committee addresses the injustices the Bill contains and make the appropriate recommendations to the Minister that they be changed before being passed. Rubber stamping the Bill 'as is' will inevitably lead to further loss of confidence within the sector, increase uncertainty and likely lead to lenders looking for accommodations they can use to stay viable should they decide to remain in the industry. If this were to occur, in our view, it will be very undesirable and sends the wrong signals to the industry. Lenders should be able to make a living no differently to that of any other business without resorting to having to use legitimate loopholes and Parliament's laws should not be used for price cutting without having regard to costs.

Should adverse decisions be made, there will inevitably be some fall out. This will be discussed in greater detail as part of the unintended consequences we wish to bring to your attention.

Market segmentation

From the outset, it is important the Committee understands that suppliers of credit fall into four fairly distinct segments:

- Banks and other large financial institutions
- Other lenders (including micro-lenders)
- Payday lenders
- Pawnbrokers

This delineation approximately represents the types and terms of the loan products generally offered, so as one comes down the list, the length of the loan gets shorter and the amount lent reduces, often considerably.

These are basic facts yet, from our experience, the industry has consistently failed to educate bureaucrats at both State and now Federal level of the market segments. It is our belief this lack of comprehension or, what may be more appropriately regarded as an unwillingness to accommodate the facts due to a lack of fit of [perceived] Government intention, has long been the cause of much of the industry's issues with credit regulators, both previously and currently.

There is a huge difference in attitude between the different types of lenders reflecting the risks associated with lending within each sector. By failing to recognise the different segments, regulators have tried to adopt a one-size-fits-all approach, consistent with what was previously in the State-based Consumer Credit Code ("UCCC") and which morphed into the National Credit Code ("the Code") with the passing of the National Consumer Credit Protection Act 2009 ("the Act").

It is worth repeating the comment we made in a Green Paper response to Government "that the only difference between a bank and a loan shark is the size of the client base over which its costs can be spread."[4] That is why, as a rough approximation and coming down the list, excluding pawnbrokers, the interest rates payable on the various products offered by each of the sectors generally increases with the risk level. These facts are inescapable.

As a generalisation, most payday lenders will now lend anywhere from $50 through to $800 for a term of anywhere from a day through to 12 weeks with some lending even as much as $1500. The vast majority of these loans are for terms of 4 to 8 weeks maximum with weekly or fortnightly repayments, in line with how the borrower is paid. On our system, the average 'payday' loan amount lent, repayable over a 4 or 6 week period, is around $300. This will be covered in further detail later in the submission.

In contrast, many micro-lenders will lend between $500 through to $3,000 over terms ranging from 26 through to 104 weeks. There are a number of lenders that will extend these limits, increasing the amount lent out to $5,000 or even $10,000, depending on client requirements. Some of our larger clients that lend to consumers compete directly with banks and credit card issuers, providing loans up to $20,000 and more on terms up to 5 years or more, consistent with those providing motor vehicle finance.

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[4] Joint Min-it Software/ FAA Submission, August 2010, p15. *Green Paper: National Credit Reform - Enhancing confidence and fairness in Australia's credit law*

Min-it Software has less than a handful of what we would define as pure payday lenders using our system. We have not actively sought out clients in this sector and the vast majority are micro-lenders with shop fronts, motor vehicle financiers and non-regulated (i.e., business loan) lenders. That said, some of our clients will offer, where responsible lending obligations can be met, what we regard as a 'payday' loan in order to meet the client's loan suitability requirement as one product offering amongst their available range.

The need for a precise and accurate definition of a payday loan

We maintain there is a real need to define exactly what constitutes a payday loan because this is the area where the consumer groups have consistently claimed there is a problem.

In the US, a payday loan is generally defined as a short term loan used to cover expenses until the next payday. The principal and any fees must be repaid in full from the borrower's next pay cheque.

In Australia, since 1995, it has generally meant a short term loan of less than 62 days duration. This was because many 'payday' lenders used the then-applicable exemption under the UCCC to avoid compliance. Even when this exemption was removed (although Consumer Groups would call it fixing a loophole), the industry's participants still provided their short term loans using the old definition. The difference was their contracts and documents now had to be UCCC compliant.

Many lenders here limited their 'payday' loan offering to small(er) amounts but since the arrival, from 2000 onwards, of a number of overseas payday lending companies, many operating totally over the Internet, the amount of money lent has seen a marked increase. Whereas many local lenders were reluctant to lend no more than $200 or so initially, we know of some lenders that will now lend up to $1200 and still require a single repayment on the next payday in full. In our view, few borrowers would be able to meet this imposition.

There is also a system issue relevant here and this will be covered later in this submission but generally, requiring consumers to make full repayment in a single repayment is often totally out of the question for most. In fact, we would go so far as to say the lender would probably breach their responsible lending obligations if they did. However, there are sufficient teeth in the existing Act

for the Australian Securities and Investment Commission (“ASIC”) to enforce this without the need for further legislation.

In our view, the definition proposed by Treasury and included in the Bill unfortunately bears no resemblance to industry reality. Defining a payday loan as an unsecured loan under $2,000 and of a term less than 2 years cuts across both loan market segments and will create lending distortions.

In our view, a payday loan should be defined as less than $500 with a maximum term of no more than 12 weeks. Smaller loans outside these parameters should be regarded as micro-loans rather than payday loans and outside of the proposed capping mechanism.

Existing responsible lending obligations and loan suitability ignored

We will not suggest that there is, nor has been, no issue with loans taken out by a small number of borrowers but this can be also apply to any product. It is important that this is also put into context. Some – and we stress ‘some’ - consumers have issues with telecommunication contracts, power supply contracts, insurance policies to name but a few but not one consumer group has suggested these companies be closed down as the they have done for the micro-lending and payday lending businesses. We question why the same amount of determination has not been applied when there are far more complaints and the answer would seem to lie in the fact that most of these businesses are small and not large corporates; being smaller makes for an easier target.

Responsible lending obligations and ensuring loan suitability requirements are met by all consumers, introduced as of 01 July 2010, however, have gone a long way to alleviate the financial difficulty some may have previously gotten into. The consumer groups claim these statutory requirements are not being met by the industry yet have offered little in the way of proof. Furthermore, as the industry has not heard anything about these organisations, we suggest they have done little to persuade ASIC to review individual lenders’ practices where they believe these obligations and requirements have not been met. If they are genuine in their claims, there is no need to attack every lender but only those that are failing to be compliant. Unfortunately, as before, there are just a few that are tarnishing the reputation of the many good lenders in the industry.

In our experience, the vast majority of micro-lenders have never had an issue with assisting consumers meet their financial obligations. It is important to remember this is largely their own money they are lending and so they want it back with some element of profit. For this reason, our clients and some of the other micro-lenders that do not use the Min-it Lending System will reduce a borrower's payments, and in our clients' case, hold interest and payments as well if that is what it takes to assist the consumer recover from their difficulties. From experience, this is far more than the ADI's will do for their clients.

Many of our own clients complain about the number of payday loans some consumers have at any one time and find they cannot payout and consolidate some of these loans because as fast as they do, the client returns for yet another payday loan and exacerbates the situation. Note, again, we have said 'some' as this does not apply to all borrowers. If all lenders were undertaking proper checks and meeting their responsible lending requirements, we believe many of those getting into financial difficulty would not do so.

That is not to say more cannot be done, however. ASIC already has the ability and resources available to police this and it should take action where there is evidence that the lender has not met or suspects it has not met its responsible lending obligations or loan suitability requirements. For example, one of our clients approached a competitor recently and ascertained they will lend up to 50% of net after-tax income. After advising it was $500 a week and so the maximum borrowing would be $250, our client was advised the total cost of the loan would be $403.80 repayable in one single payment on the next payday. This sum was made up as follows:

Principal Repayment		250.00
Fees payable:		
Credit card		10.00
ATM Fee		7.00
Monthly card fee		7.50
Brokerage fee		107.23
Interest		8.24
Consumer Protection Insurance		13.38
	Total $	**403.80**

Some points to note:

1. The card fee is the fee payable to supply a credit card and is required in order to draw the funds supplied via an ATM;
2. The ATM fee is the fee payable to load the card with funds initially;
3. The Monthly Card fee is a fee payable monthly and continues to apply even after the loan is paid back. The borrower must cancel it for it not to be levied;
4. The Consumer Protection Insurance appears to be compulsory although it should not be. Consumers need to request a copy of the policy and it takes 14 days to supply, a period in which the consumer will have been required to make full repayment of the total owing via one single payment.
5. The interest calculation appears to be for a 15 day period, even though the loan was to be for just 7 days.

The important thing to remember here is the borrower only gets $500 net per week. On that basis, in our opinion, this must fail responsible lending obligations because the consumer, having repaid the loan, is only left with $96.20. The consumer is left with insufficient funds on which to survive. We also question the loan suitability of having to repay the loan in one repayment but this is largely because it would appear this lender's lending system cannot cope with multiple repayments. From our own knowledge, the total revenue payable is well above what most other payday competitors charge, even in, as is the case here, a State where there is an all-inclusive interest rate cap.

This type of lending and fees and charges are, thankfully, not universal but it is this type of payday lending **and no other** that is the cause of the industry's suffering. We, and our clients, do agree ASIC needs to act where this occurs. It doesn't need all-encompassing further legislative changes, such as those proposed, applying to all lenders to do it. Legislators should recognise there are bad eggs in any industry but it doesn't mean one must take a sledgehammer to crack every nut, regardless of size. The Australian finance industry is already amongst, if not, the world's most regulated.

We are unaware of any micro-lender that does not leave borrowers with sufficient disposable income, based on the assessment the lender must do, after taking into account the loan repayment. To further protect the consumer, unlike other systems, our system will also not allow any lender to reduce the repayment amount to a sum below that of the interest component,

where one is applicable, without altering other parameters such as the interest rate or term. This ensures whatever amount is paid by the consumer will enable the loan to be paid out.
In our view, responsible lending and loan suitability requirements should be the key issue, not attempts to control prices artificially at unrealistic rates by anti-industry consumer agitators.

Manipulating statistics – the academic and Consumer Group approach

Despite any substantial evidence to suggest otherwise, consumer groups, aided by pro-consumer academics, convinced State bureaucrats and Ministers in NSW over 6 years ago that interest rate caps were the way to stop the desperate and vulnerable from getting into debt spirals. The Australian Capital Territory followed soon afterwards but it took another 2 years for Queensland to introduce its capping regulations.

One would realistically assume that if the problem were or is as bad as alleged, there would be a huge number of complaints about the industry. Yet, even when Queensland introduced its cap, the number of complaints against the industry didn't even rate a mention in the top ten complaint categories according to its Office of Fair Trading for the previous year.

In 2008[5], we submitted that according "to the Minister himself, the top 10 complaint categories to the Department in 2007[6] were:

Complaint category	Percentage of total complaints
1. Household electrical and appliances	18%
2. Motor vehicle dealing	8%
3. Furniture	7%
4. Computers	6%
5. Motor vehicle repair and maintenance	6%
6. Motor vehicle parts and accessories	5%
7. Personal services	5%
8. Real estate property management	5%
9. Household trade services	5%

[5] Ministerial Media Statements, 03/02/2008. Available online: http://www.cabinet.qld.gov.au/MMS/StatementDisplaySingle.aspx?id=56341 viewed 04/02/2008.
6 Ibid 5

10. Mobile phones	4%
TOTAL	**69%**

As we stated in our submission[7], “[a]s the total number of complaints made amounted to 12, 561[8], this means the maximum number of complaints that could have been made last year in regard to consumer lending had to be less than 4% or 502. Based on our own data for loans raised in 2007 and allowing for at least an equivalent amount of loans being created each by City Finance, Cash Converters and all other lenders who either are not a franchisee of the latter two companies or who do not use our system, these comprising predominantly of what we regard as ‘payday lenders’, we believe a rough estimate of lending by the so-called fringe or alternative lending sector in Queensland alone is 9,200 loans per month. This equates to some 110,400 per annum. Even if 500 complaints were received, a figure we do not believe has been, this equates to an absolute maximum figure of just 0.453% of all new loan transactions. If 100 complaints had been received, this figure would drop to 0.09%. We believe the true number of complaints made in respect of alternative lenders will be much less than even this number. Even at its maximum, this figure is hardly reflective of the widespread consumer detriment being claimed as occurring. One would expect to find far greater numbers given the amount of attention being devoted to the industry by the Department.”

“Whilst we are not saying that there aren’t rogue lenders operating in Queensland or elsewhere, the Office of Fair Trading’s own statistics clearly show, however, that it is unjustly misdirecting its attention at a legislative and policy level to an industry sector where there really isn’t a big problem. The Office of Fair Trading’s own statistics should be suggesting where its efforts need to be focused.”

The same situation continues today, and COSL, for example, has reported a very low number of complaints were referred to it.

The consumer groups have consistently used extremely small numbers of case studies to argue they are the tip of the iceberg[9]. Even the RMIT in its latest research, “Caught $hort”[10], uses the

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7 Min-it Software, 15 February 2008. *Submission: Interest Rate Capping Measures for Fringe Lenders - Consumer Credit Code Amendment Bill 2008 and Consumer Credit (Queensland) Special Provisions Regulation 2008*, p.5

8 Ibid 6

9 For example, refer to those listed on pages 11 – 12 of the RIS (Australian Government, June 2011. *The Regulation of Short Term, Small Amount Finance: Regulation Impact Statement* available online http://ris finance.gov.au/files/2011/09/RIS-Short-term-small-amount-finance.pdf viewed 04 September 2011.

data from just 112 people, all of whom were paid for their responses. Victorian respondents were paid $50 whilst NSW and Queensland ones were paid $40 [11]. As a result of its findings, the RMIT has chosen to laud figures like:

- More women (59 per cent) than men (41 per cent) take out payday loans.
- Most people talked about borrowing amounts less than $300 (54 per cent), followed by $301 to $500 loans (21 per cent).
- People in their 30s (32 per cent) and 40s (24 per cent) were more likely to borrow small, short-term loans than individuals in the 20s (19 per cent), 50s (13 per cent) or those over 60 years of age (12 per cent).
- Over half the respondents had taken out more than 10 loans since they had started borrowing from this sector, with many saying they had taken out more than 50 loans.(But no mention over what period this is)
- When asked why they first took out a loan, the most commonly cited reasons (food, 'had no money', bills and rent) were to meet regular, weekly-type needs and expenses.
- Few people (7 per cent) had a credit card and over 60 per cent mentioned they had a poor credit rating.
- Ninety nine respondents had often strongly-held opinions about what needs to happen to help people on low incomes. The most common views were:

  Increase Centrelink payments and pensions (43 per cent of respondents)

  Increased government support for education, training or finding a job (27 per cent)

  Centrelink payments be made weekly rather than fortnightly

  Centrelink advances be more flexible to reflect respondents' borrowing practices with small-loan, short-term lenders (23 per cent). Many proposed that smaller amounts (down to $50) be available through Centrelink with short repayment schedules of two to four fortnights.

but these figures are representative only of the 112 they did engage with, not other 3,888 plus potential respondents mentioned at the very beginning of the report on page 7 that didn't reply. It does not take a mathematical genius to know 32% of 112 is a far lower number than 32% of 4000, leading to distorted views. The vast silent majority who didn't need the inducement to reply

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[10] RMIT University, 2011. "Caught $hort: Exploring the role of small, short-term loans in the lives of Australians", Interim Report. Available Online: http://www nab.com.au/wps/wcm/connect/c0f59d80486ac8f4851595fa033d4942/CaughtShortInterimReportSeptember2011.pdf?MOD=AJPERES&CACHEID=c0f59d80486ac8f4851595fa033d4942 viewed 24 September 2011.

[11] Ibid 9

weren't interested. If someone has to be paid for their reply, we submit this is or, at the very least, could be interpreted as, clear evidence of bias.

It must be remembered that the Consumer Groups only see people who have already got themselves into some degree of financial difficulty and yes, some of their issues may have been exacerbated by a loan or number of loans that they then couldn't repay. On this basis, if almost all have or have had a payday loan or loans, then their argument is the common denominator - the payday loans - must have been the cause of their problems. This is simplistic nonsense.

We would submit this is no different to asking any group of doctors or nurses that work in Emergency Response over a weekend whether they believe cars should be banned. Without doubt, almost all will, because all they see is the carnage and destruction caused by motor vehicle accidents. They are so immersed in their own perceptions of reality that they cannot see the wider picture. This conditioning is a known medical fact and is a form of untreated post-traumatic stress disorder commonly suffered by those engaged in stressful emergency work.

The use of research in policy making

We have previously stated "[t]he use of case studies, even if validly highlighting certain adverse commercial practices, is no better than the reliance placed on small-scale research studies such as that of Griffith University upon which the Department has relied heavily, even though it was advised not to. Small-scale research invariably limits the scope and range of what is either reviewed or researched. The same biases are brought equally to the fore in each and call into question whether the research or use of the case study is ethical and has integrity. Shills notes "[t]he ethical values affected by contemporary social research are vague and difficult to formulate precisely. They refer mainly to human dignity, the autonomy of individual judgment and action, and the maintenance of privacy."[12] The consumer agencies have no ethical bounds in using such material; they rely on situational ethics to justify their cause. "

"Citing Walt & Gilson, Almeida & Bascolo[13] state that "the underlying assumption of many is that both research and policy-making are logical, rational processes where researchers ask the right

[12] Shills, E.A., 1959, p.117. "*Social inquiry and the autonomy of the individual*", in Lerner, D (ed), "*The Human Meaning of the Social Sciences*", Meridian Books, New York.

[13] Almeida, C & Bascolo, E., 2006, p.S11. "*Use of research results in policy decision-making, formulation, and implementation: a review of the literature.*" Available online http://www.scielo.br/pdf/csp/v22s0/02.pdf viewed09/02/2008

questions, plan and conduct their studies rigorously, and circulate their results appropriately, and that decision-makers read research reports, understand the results and their implications, and act to correct their course in the direction indicated. Even admitting to a specific rationality in each of these processes, the real world is not so linear." These authors argue that there are a number of influences such as Ideological Problems and Media Interference that affect research being used as expected by decision-makers. Ideological Problems are those "that constrain political rhetoric and the formulation of reform agendas, in addition to a lack of political "will" or an inability to formulate and implement more integrated, interactive policies"[14] whilst Media Interference is that " which can both confuse the issue by publicizing results inappropriately and exploit divergences rather than clarifying them"[15]. "

"Almeida & Bascolo go on to cite Bardach who "states that policy analysis theory proposes that evidence is information that affects existing beliefs by important persons about significant features of the problem under study and how it might be solved or mitigated."[16] Unfortunately, Griffith University has collected little actual evidence; it mainly reviewed some overseas studies and literature. Noting that the Office of Fair Trading not only financially supports but directs what research is undertaken at Griffith, there is little if any autonomy and one may draw a presumption that its research to date is no more unbiased than that applying to any other paid research. "

"We note that none of the research done by Griffith University appears to have cited any counter-argument in its research such as that done by the Personal Finance Research Centre at Bristol University. Professor Kempson of the Personal Finance Research Centre at Bristol University states

> "superficially [an absolute interest rate cap] is a very attractive idea. However, our research with people on low incomes suggests that it is premature while they have such poor access to low-cost credit and could well have an adverse effect on the people it would be intended to benefit. It would, undoubtedly, lead to a displacement of costs (with more additional charges) so that they would not have to be included in the APR quoted by lenders. This would result in a serious lack of transparency for people who need it most."[17] "

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[14] Ibid 13, p.S12.
[15] Ibid 13, p.S12
[16] Ibid 13, p. S12
[17] Kempson, E., 2006. House of Commons Treasury Committee enquiry into "Financial inclusion: credit, savings, advice and insurance", pp17-18. Available online http://www.publications.parliament.uk/pa/cm200506/cmselect/cmtreasy/848/848i.pdf viewed 14/02/2008

Interest rate caps – do they currently work as claimed?

The Consumer Group claims that the all-inclusive interest rate caps work in those States that have them simply aren't true. If they were, no one would be in business. The Consumer Groups claim they work is simply to dupe politicians into believing they do so that an all-inclusive style of interest rate cap can be applied that they know will close the industry down. This is their sole goal in pushing for this type of cap. They have no awareness of, nor indeed any regard for, the costs incurred by lenders, despite having stated they do want a viable industry. Their one desire is to see the industry closed down, under the misguided presumption the banks will come in and save the day. We will cover this in more detail under the heading "Unintended Consequences".

Cash Converters have said their average Payday Advance ("PDA") loan is now $325.00[18]. In those states that have an all-inclusive interest rate cap at present, the maximum revenue it could earn by staying completely within the legislation is $7.38 where the loan is repaid over a 4 week term. This would amount to a 2.27% mark up.

We have pointed out to Treasury that Chris Zappone quoted statistics from the Australian Bureau of Statistics in May 2011 that showed what the average mark-up by type are[19]. These are reproduced below:

Product average mark-up by type

Product Type	**Average mark-up**
Clothes and shoes	142%
Other manufactured products	97%
Electrical and electronic goods	85%
Furniture	76%
Books newspapers and magazines	52%
Fresh food	47%

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[18] Donkin, R., The West Australian, 23 August 2011. "*Cashies lifts profit on higher payday lending*". Available online http://au.news.yahoo.com/thewest/a/-/newshome/10093563/cashies-lifts-profit-on-higher-payday-lending viewed 02 September 2011.

[19] Zappone, C, The Age.com.au, 24 May 2011. "Retailers' mark-ups under threat from online". Available online http://www.theage.com.au/business/retailers-markups-under-threat-from-online-20110524-1f1g7.html viewed 26 May 2011.

DVDs and music	40%
All goods wholesale or retail markup	65%

Source: Australia Bureau of Statistics data, The Australia Institute

If the average retail or wholesale mark-up across Australia is 65%, how can any small business expect to say viable with an all-inclusive 48% capped interest rate? The answer, of course, is they can't. Even at a straight 48% all-inclusive interest rate they can't, because 48% daily reducing is approximately 26% flat. This is well below any of the mark-ups listed in the table.

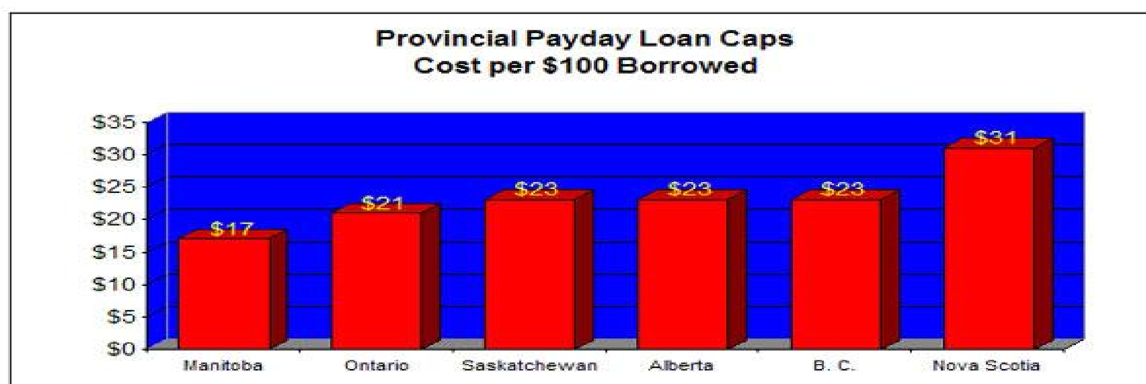
Lending system issues

In a verbal discussion with Treasury at an industry group meeting, we pointed out that some of the issues faced by lenders are system related. As this point has not been mentioned in the Explanatory Notes, we will provide the Committee with our reasons for stating this.

Payday lenders typically use software derived or modeled on US- or Canadian-based systems where the amount payable is a simple ad valorem percentage of the principal calculated at an amount per $100 lent. It is not an interest rate per se, though many of the Canadian payday lending interest rate cap legislations describe it as such. The table below shows the various rates[20]:

Canadian Jurisdictional Comparisons

Maximum total cost of borrowing for payday loan agreements



Source: Ontario Ministry of Consumer Affairs

[20] Ministry of Consumer Services, Ontario, 2011. *Ministry News: Cost of Payday Loans Capped*. Available online http://www.sse.gov.on.ca/mcs/en/Pages/News_15Dec2009.aspx viewed 012 October 2011.

Using such a rate, however, one cannot calculate interest in accordance with the requirement of s.28 of the Code.

These systems all work on typical US pay cycles (being fortnightly or monthly), so most have a single repayment due at the borrower's next payday, a maximum of either 15 or 31 days. The amount due will generally be a whole dollar rounded amount and calculated using rates between \$20 to \$25 per 15 days or between \$35 or \$50 per 31 days. These systems generally have no ability to extend the loan or create a number of repayments.

Cash Converters used, and continues to use but only in those states where there is no current State-based interest rate cap, a \$35 fee per 4 weeks or per multiple of 4 weeks. Loans are generally calculated over the 4 week period but if the repayment is too high, the loan will be repaid over a longer period. Whilst this increases the fee payable, the repayment amount will decrease. As an example, a \$300 loan for 4 weeks will be repaid at \$101.25 per week. The revenue (not profit) received will be \$105.00. If this same loan is taken over 8 weeks, the revenue received will be \$210.00 but the repayment will drop to \$63.75 per week.

On our system, we have made it so that all 'payday' loans are capped at a maximum of 12 weeks. The lender cannot exceed this term. If they need to reduce the repayment amount to accommodate what the borrower can afford to repay, then they must create the loan as a standard principal and interest bearing loan over a longer period.

Prior to the introduction of interest rate caps, our clients used two types of 'payday' loan contracts, one along identical lines to that of Cash Converters but with the ability to override the fee amount payable. This enabled a client to offer a reduced fee when compared to that of competitors for, say, a 6 week term, or even to simply reduce the fee lower than that of competitors. Whilst some clients used the same fee rate as Cash Converters, many others reduced it as a way of competing.

Alternatively, they could use an interest bearing loan contract and whilst some of the rates may sound horrendous, a nominal 925% interest rate applied on a \$100 loan over 4 weeks equates to the same amount of gross revenue as does applying a single \$35.00 fee. Consumer Groups, however, would prefer to quote the Comparison Rate as generally, this rate is higher. On the interest bearing loan, when repayments are paid weekly, the Comparison Rate is 688.485% or

688.0877% for the fee based loan due to the slight differences in actual repayments on the due dates. However you look at it and using whatever calculation method you wish, the lender still receives just $35.00 in gross revenue.

By comparison, in those States where an all-inclusive 48% interest rate cap applies, this same loan of $100 for 4 weeks using a nominal interest rate of 48% would enable the lender to earn a maximum revenue amount of just $2.26.

Unintended consequences

The decision by Government not to propose an allowable fee, such as an establishment fee, in addition to interest capped at a maximum rate of 48% for all non-payday loans will create a number of unintended consequences.

For example, the motor vehicle financiers that use our system generally have relatively large loan books. Anecdotal evidence suggests that at least 70% of the used car market for cars over 8 years old is met from the micro-lending sector with the balance being funded either by unsecured personal loans or on credit cards. This is because some of the main financiers such as Toyota Finance, GE Money, Esanda, etc. will not lend on vehicles exceeding 8 years old. In fact, many lenders will only lend on terms that take the age of the car up to the 8 year mark. As the car gets older, the risk and interest rate increases.

Even though none of them actually charge anywhere near 48% interest right now, three of our largest car financiers have said they will consider withdrawing from the market if they have to effectively survive on a maximum 48% interest rate because they consider the risk exceeds the return on investment. Many of these lenders do so via brokers who are paid for their services by the consumer. We know of one private, publicly listed company, not one of our clients, that has said to us privately that they would have to exit the market should this Bill be enacted "as is".

If this were to occur on a widespread basis, and no finance could be secured for their subsequent purchase, there could well be a domino effect felt through the motor vehicle industry. As cars older than 8 years essentially become all but worthless, depreciation would increase on all vehicles and it would immediately reduce the value of the entire fleet on Australian roads. As younger cars fetched less as a trade-in, this would impact on the upward distribution channel so that it would cost more to trade into a new vehicle. If the differential required were to become so

great that it would cause buyers to think twice, new car sales will slump and result in the layoff of more workers in the already hard-hit automotive industry.

For those other micro-lenders that decide to remain in the industry rather than exiting it, they will inevitably become more risk-adverse and cherry pick potential borrowers even more than they do now. This will lead to financial exclusion for many. Depending on the definition of payday loan eventually selected, if the term is too long or the amount too high as we suggest it is, as proposed, the restriction on repeat borrowing will not enable micro-lenders to assist the many good clients they have now. This may lead to further financial exclusion and force more consumers to seek out other means of finding the money they see as needed. This may see some retailers or service industry suppliers attempting to enter the black credit market by offering services which are tantamount to providing credit but attempting to avoid the licence requirements. Industry will certainly seek ASIC's assistance should this occur.

Depending on the ultimate outcome of the rate to be applied to payday loans and the actual definition enacted, without any establishment or other such fee being applied, even if capped as the delegation proposed, a funneling of the amount lent may quickly be established depending on the thresholds chosen. This could cause many to be financially excluded because of failure to meet loan suitability requirements.

Given the overseas experience with credit cards, should one of the banks, such as the

NAB, which has funded nearly all the major research work in recent years, decide to introduce a high interest rate, low value limit credit card, the detriment seen now by consumer groups will be a small drop in the ocean. It will also see general credit card rates rise to offset the losses incurred. Given the NAB's own findings from its Money Fast project[21], we believe it could only do so, though, by using the ADI exemption proposed. We will discuss this separately in the next section.

Should some of our clients and other lenders exit the industry, there is the potential for many redundancies. We would estimate it could be as high as 2000, depending on what might occur. It is already difficult to get suitable staff with the right attitude and knowledge and whilst some may

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[21] National Australia Bank, 2010. *Do they really want to hurt me? Exploring the costs of fringe lending - a report on the NAB Small Loans Pilot*. Available online http://www nab.com.au/wps/wcm/connect/9f8b888046d2f552af2bbfa676247d67/NAB-Small-Loans-Pilot-Report.pdf?MOD=AJPERES&CACHEID=9f8b888046d2f552af2bbfa676247d67 viewed 04 October 2011.

obtain employment elsewhere, it will be at the cost of another's position. We have a small number of clients currently considering whether or not to stay in the industry and their decision will ultimately be made on what is enacted by this Bill. Should they decide to go, although it will impact on us immediately, we would encourage them to go and close down almost immediately rather than wait until 01 January 2013 so that they could extract the best possible price for their loanbook from potential purchasers. Leaving it until the commencement date will inevitably see fire sale prices offered and possibly accepted.

Finally, we are aware consumer groups have already played down, as have politicians, bikie and other gangs entering the market. This should not be dismissed. I have been advised of three very unsavoury individuals with gang connections already operating now, two operating on the Gold Coast and one in South Australia. I have been informed one borrower is so terrified, he has fled the country twice after being badly beaten up and threatened. He has had ribs, both arms and one leg broken after being taken out into the bush. He cannot work due to his injuries and his family has been forced to move and live elsewhere. He is not contacting them, for fear of retribution and is far too afraid to go to the Police.

Level playing field imperative

The Bill as presented allows an exemption from all of the capping mechanisms. We oppose this totally as it sends the wrong message. All lenders must have an Australian Credit Licence and there should be no exemptions from compliance available to big business.

There is already a distortion in the Act that protects ADI's when compared to any other lender. As we said in an earlier response to Government[22], "[a]s the Minister states he wants to promote uniformity and deter widespread consumer detriment, then the Government must apply the same standards to all credit providers without exception or favour. The Minister should not become personally involved in any decision to prosecute or not as the case may be or apply any punitive measure against any credit provider. "

[22] Min-it Software/ Financiers Association of Australia, 11 December 2009. *Joint Submission Draft National Consumer Credit Protection Regulations 2010, Draft National Consumer Credit Protection (Transitional and Consequential Provisions) Regulations 2010 and other legislative amendments pertaining to the National Consumer Credit Protection Act 2009,* p.9

"There is no arguable case for exempting the ADI's if the Government wants to be seen to be promoting transparency for the industry. One type of organisation should not be treated differently to another merely because of size and the fact that it subject to other regulation; every business in Australia can claim the same since they are subject to both Federal and State laws."

"In retaining the provision that allows only the Minister to decide whether or not a prosecution will occur for an ADI is effectively creating the ability for corruption to occur or be perceived to occur. To be blunt, there is enough evidence to show the top end of town are not adverse to providing "financial sweeteners" dressed up as donations to political parties in return for "favours"[23]. We suggest it would be a brave Minister indeed that effectively stopped a bank from trading yet the legislation makes it clear the Government is not adverse to any other [non-ADI] credit provider or credit assistance provider business from being stopped from trading [by ASIC]. There should be no differential; if the ADI has or could have committed an offence that would stop it lending, then so be it."

Under the old Consumer Credit Code, it was those areas where exemptions applied that caused the most detriment. There was ample evidence that the banks and ADI's have been the main cause of consumer detriment[24]. Despite the fact that many would have us believe they really are responsible, there are still current examples of poor lending practices still occurring[25]. Apart from bridging finance where, for a small loan amount, we acknowledge there may be an issue, there is no commercial practicality whatsoever for an exemption. The bridging finance issue can easily be accommodated by the inclusion of a clause granting exemption where the loan, or any extension of such a loan, is secured by a mortgage over real property for a term of less than 12 months.

We wish to make it plain that if this Bill is passed without amendment, it sends the clear message that the Government believes it perfectly acceptable for the people of Australia to be ripped off by

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[23] Australian Protectionist Party, 2008. "*Political donations from corporations are a recipe for corruption*" Available online http://www.protectionist net/?p=126 viewed 21/05/2009

[24] See for example, Janet Albrechtsen Blog, The Australian, 06/05/2009. "*Having a lend of us - Comments*". Available online http://blogs.theaustralian news.com.au/janetalbrechtsen/index.php/theaustralian/comments/nightmare_for_business/#commentsmore viewed 08/05/2009, Martin North, Fujitsu on Broker News, 05/03/2009. *Fujitsu: Australian banks ripping off customers* Available online http://www.brokernews.com.au/people/fujitsu-australian-banks-ripping-off-customers/1330/34044 viewed 20/05/2009 and I Hate Bank$.com.au, Available online http://www.ihatebanks.com.au/ viewed 21/05/2009

[25] For example, AAP article, Sydney Morning Herald, 16 September 2011. Banks rip off elderly, lobby group claims. Available online http://news.smh.com.au/breaking-news-national/banks-rip-off-elderly-lobby-group-claims-20110916-1kdi4.html viewed 19 September 2011 and Gardner, N, Sunday Telegraph, 02 January 2011. *The secret bank home loan rip-off, Available online http://www.dailytelegraph.com.au/property/the-secret-bank-home-loan-rip-off/story-e6freztr-1225980068997 viewed 03 January 2011*

banks and other ADI's with impunity because their clients can afford to be. It is a fallacy that detriment only occurs amongst the poor and every Australian has a right to be statutorily protected.

We reject the arguments put forward by these institutions that they need to be exempted because it will add cost. Why should it cost only those that are not an ADI? The cost of compliance is proportionate to each lender's client base, so the non-ADI lenders already face a far higher cost of compliance per customer that will have to be passed on than that applying to the ADI's. The exemption should not be a tool to force out non-ADI lenders from the market by inflicting massive compliance costs.

The exemption should be seen for exactly what it is: an anti-competitive request by the top end of town for regulatory assistance to further strangle the market and protect their market power.

Furthermore, as the charities such as Good Shepherd and others that use NILS and LILS have funding supplied by ADI's, it gives those ADI's the ability to charge more than what would or could be applied by non-ADI lenders. This would be a totally hypocritical and farcical scenario. We urge the Committee recommend this provision be removed totally.

Compliance costs

For my business partner and I, as we have it as part of our contract with our clients that we will supply a compliant system, we will have to meet all the compliance costs, just as we have done to date. The problem for us is if some of our clients decide to leave the industry, we face meeting increased costs over a diminishing customer base. Whilst some may see us having a captive market, we do not try to capitalise on this.

Appendix 1

-------- Original Message --------
Subject:RE: Update - Enhancements Bill [SEC=UNCLASSIFIED]
Date: Fri, 14 Oct 2011 15:11:41 +1100
From: Sutcliffe, Ward
To: Named recipients
CC: Named recipients

To: Stakeholders

The Exposure Draft of the *National Consumer Credit Protection Amendment (Enhancements) Bill 2011* included a prohibition in relation providing credit where the annual cost rate exceeds 48% at any time. The purpose of the prohibition was to address potential techniques for avoiding the annual cost rate.

That provision was not included in the Bill when it was introduced into the House of Representatives. It was considered that further consultation was desirable to consider whether the prohibition introduced practical difficulties where the annual cost rate was imposed over the life of the contract.

The attached paper seeks views on the implementation of the proposed Subsection 32A (2). Can you please provide your comments on the options proposed in the paper by Friday 28 October.

Regards

Ward Sutcliffe

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Appendix 1A

Discussion Paper: Maximum Annual Cost Rate

Introduction

The Exposure Draft of the *National Consumer Credit Protection Amendment (Enhancements) Bill 2011* included a prohibition in relation to a person being a credit provider under a credit contract where the annual cost rate exceeds 48% at any time. The provision was in subsection 32A(2):

32A Credit provider must not enter into a credit contract if the annual cost rate exceeds 48%

(1) A credit provider must not enter into a credit contract (other than a small amount credit contract) if the annual cost rate of the contract exceeds 48%.

Criminal penalty: 50 penalty units.

(2) A person must not be a credit provider under a credit contract (other than a small amount credit contract) if the annual cost rate of the contract exceeds 48% at any time.

Criminal penalty: 50 penalty units.

The purpose of subsection 32A(2) was to address potential techniques for avoiding the annual cost rate, including:

- the imposition, under the credit contract, of relatively high contingent fees that were in practice usually payable (particularly a deferred establishment fee);
- varying the interest rate or increasing fees and charges to exceed the 48% cap once the credit contract has been entered into; and
- the use of continuing credit contracts where costs were imposed in a way that differed from the assumptions specified in relation to this class of contracts.

Subsection 32A(2) was not included in the Bill when it was introduced into the House of Representatives. It was considered that further consultation was desirable to consider whether the prohibition introduced practical difficulties where the annual cost rate was imposed over the life of the contract.

While the same formula was used to calculate the annual cost rate for subsections 32A(1) and (2), subsection 32A(2) would in practice operate differently from subsection 32A(1):

- Subsection 32A(1) only included non-contingent fees that were known to be payable at the time the contract was entered into.
- Subsection 32A(2) includes contingent fees that became payable under the contract (for example, fees for providing statements or deferred establishment fees where the liability arises after the contract was entered into).

The primary concern was whether subsection 32A(2) would, in practice, require credit providers to check whether or not they exceeded the annual cost rate each time they charged a contingent fee or varied the interest rate.

Having considered the matter further Treasury's view is that:

- The formula used to calculate the annual cost rate averages the cost of the term of the contract, and therefore the impact of a new fee or charge will not usually be significant in itself.
- The formula allows a credit provider to determine the maximum amount they can charge before the contract is entered into, and therefore to ascertain a relative buffer of additional costs that they can charge.
- The impact of an individual fee or charge will be significant where the fee is relatively large compared to the amount of credit being provided (particularly therefore where the credit provider is arranging a credit contract for a relatively small amount).

Option 1 – retain existing provision
The existing provision could be retained. The effect of this would be that the annual cost rate could not be exceeded, capping the amount of contingent fees that could be charged, irrespective of the type of those fees.
It would not be necessary for most credit providers to check whether they exceeded the annual cost rate every time they charged a contingent fee or increased the annual percentage rate, as for most credit providers the total amount payable would be substantially below the annual cost rate.
This approach:

- would be simple to apply, as it would not require credit providers to operate two different formulas;
- would address current avoidance techniques; and
- would create the risk that some credit providers who charge significant contingent fees could exceed the annual cost rate

Option 2 – retain existing provision but apply a modified version of the formula
The existing provision could be retained, but the formula could apply in a modified way, by distinguishing between fees that relate to the cost of credit and those that relate to costs incurred by the credit provider for services. The prohibition in respect of the annual cost rate could not be exceeded would only apply in respect of fees that relate to the cost of credit. For example, under this approach, deferred establishment or early termination fees would be included in the annual cost rate, but charges for providing statements of account would not.
This approach:

- would depend on whether the distinction between fees and charges that relate to the cost of credit and all other fees and charges can be determined or defined with precision (with the risk that it may encourage artificial changes in fees, so that fees could be charged that are not covered by the definition developed to describe fees that relate to the cost of credit);
- would address current avoidance techniques; and
- would address the risk that some credit providers who charge significant contingent fees that do not relate to the cost of credit could exceed the annual cost rate inadvertently.

Option 3 – change the obligation so that it is an obligation not to have charged more than 48% by the time the contract is discharged.
The operation of the provision would be changed, so that it would only be an offence if the annual cost rate was exceeded when the contract was discharged – so that the credit provider would either have to reduce the final payment by the debtor or refund the difference.
This approach would still need to address the issue raised in Options 1 and 2, as to whether the definition of fees and charges for the purpose of calculating the annual cost rate included all fees and charges or only those that relate to the cost of credit.
This approach:

- would only require credit providers to determine whether the total amount charged exceeds the annual cost rate at the end of the contract;
- would address current avoidance techniques; and
- would create the risk of avoidance through contracts providing that the contract is not discharged even where the debtor has made all payments due under the contract.

Option 4 – application of the provision to continuing credit contracts

The application of the annual cost rate to continuing credit contracts creates different issues. The ongoing nature of these contracts and the uncertainty as to how consumers will use the credit provided or the timing and amount of repayments makes its application more complex.

Views are sought on whether the formula could still apply to determine the annual cost rate on the basis of the fees and interest charged under the contract, including whether a distinction can be made between fees and charges that relate to the cost of credit and all other fees and charges.