SUBMISSION

to the

PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES' INQUIRY

into the

National Consumer Credit Protection Amendment (Enhancements) Bill 2011:

from the

FINANCIERS' ASSOCIATION OF AUSTRALIA / INDUSTRY / SMILES TURNER DELEGATION

"You certainly, in a modern economy can't regulate interest rates"

- Prime Minister Julia Gillard, 4 November 2010, Today Show, Channel 9.

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INTRODUCTION

The Financiers' Association of Australia / Industry / Smiles Turner Delegation (the Delegation), being the representative entity for the largest number of lending and broking companies involved in the short term, small amount finance sector, with some 147 companies, over 180 authorised credit representatives and 2 major service providers associated with these companies, is pleased to provide this submission.

The Delegation includes the oldest peak industry body, with the Financiers' Association of Australia (FAA) having been formed in the early 1930s; three of the 7 major short term, small amount lenders in Australia; an extended range of small, medium and larger lenders and brokers, with business interests Australia wide; a well known compliance advisory and industry research consultancy; and Australia's major software service provider to the sector. The various lenders and brokers undertake either, or both, payday and microlending.

Of the Delegation's core team, two are Directors of the Financiers' Association of Australia and three are Directors of the second peak body, the National Financial Services Federation.

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CHAPTER ONE: The Environment to Keep in Mind

The Delegation notes, from a profile published in the October 2011, CPA "In The Black" Magazine, that Minister Shorten has plans to "*reshape the financial sector*" and introduce "*worthwhile reforms that benefit an entire nation*".

Such plans are laudable but, to avoid socioeconomic disaster in regard to the consumers of short term, small amount loans, their implementation has to be shaped with attention to the realities associated with the short term, small amount lending environment.

Given this concern, the Delegation wishes to bring to the Joint Committee's attention the following facts and issues that provide part of the environment which, it is hoped, the Joint Committee will thoroughly consider when developing its recommendations to the Parliament.

1. The current Bill assumes all short term, small amount lending has the same characteristics, including consumer motivation, consumer needs and lending outcomes.

   The reality is that there are considerable differences within the sector itself.

   Many lenders are keen to stress a significant difference between the payday loan and the micro-loan. The former, with its loan amounts averaging between $285 and $325, for a term of 1 to 6 weeks, the latter with its larger amount loans, often over $1,000 and up to $4,000, and with repayments spread over numerous months - and even 2 or 3 years.

   Many payday lenders do not adopt - and have never adopted - the practices of other and far fewer payday lenders, that have attracted criticism from the consumer advocates in the past. The former apply relatively conservative income tests and limited rollover opportunities, with the result being fewer defaults and/or bad debts. The latter, particularly before the introduction of the current mandatory National Consumer Credit Protection Act 2009 responsible lending regime, on 1 July 2010, were more flexible with their lending criteria.

   The "desperate" and "vulnerable" tend to attempt to borrow smaller payday loans, not micro-loans and, because the consumer profiles are different, it is inappropriate to attempt to regulate both in the same manner, or larger payday loans in the same manner as smaller payday loans.

2. The current Bill assumes all short term, small amount borrowers are "desperate" and "vulnerable". The reality is that some 20% could be "disadvantaged by circumstances", as the Delegation prefers to call them, according to both Consumer Action Law Centre (CALC)'s 2008 research and Smiles Turner's 2006, 2007 and 2010 continuing research.

3. The Delegation accepts that there is a philosophically driven - but not research based - concern to seek greater protection for these people.

   It is very important for the Joint Committee to be aware that the CALC philosophy of blindly advocating a 48% inclusive cap has continued unchanged for several years, but there has not been any research undertaken, by those supporting such a move, as to what has occurred for the "desperate" and "vulnerable" since the implementation of the challenging and highly consumer protective, mandatory Commonwealth responsible lending regime, on 1 July 2010.

4. The current Bill, with its 2 tier cap regime, will make most short term, small amount lending totally uneconomic for the lender.

   Research undertaken by Smiles Turner, following the release of the Exposure Draft of the Bill, revealed none of the payday lenders, or microlenders, with a

loan book providing any mix of loans in the up to $2,500 to $3,000 amount, could financially survive the 3 basic business cost/income burdens of:

- continuing general business costs;
- the extra compliance costs of the Commonwealth regime; and
- a substantial decrease in gross income, determined by the 10%, 2% plus 48% inclusive regime - proposed in the current Bill.

All of the 19 lenders (12 small, 5 medium and 2 large) that were contacted and surveyed, indicated that they could not stay in the short term, small amount sector if the current Bill was introduced without amendment.

Only one lender calculated that they could break even on 48%, when approaching loans of $4,000, for longer periods (note, profit was not involved). Unfortunately, their loan book only includes a small number of those particular loans.

All others, most known to be efficient and experienced lenders, indicated that, on their current lending, they could not break even under either cap -for any of their loans.

5. Any calculation of business sustainability, under a 48% inclusive cap, must recognise that 48% constitutes, at best, a gross income of 92 cents per week, per $100 lent. This must be compared to the costs facing lenders, which include an average of $11 per contract compliance costs for payday lenders and much more for microlenders, an average $7 per credit reference check and a range of staff awards of between $18.50 and $35 per hour. This in the context of major responsible lending and loan administration staff time investment (45-90 minutes per contract) and the fact that business fixed costs, management costs and variable costs, such as advertising, insurance and utilities, have to be recovered somehow.

6. What must also be taken into consideration, by the Joint Committee, is the fact that these are commercial businesses. The meagre profits for those lending amounts more than the above, up to $5,000, for up to 3 years, will discourage continuation in that part of the microlending sector. The traditional payday lenders, through to motor vehicle finance companies, can be expected to exit their sector of the finance industry. These companies will face major encouragement to transfer their activities to non-short term lending and to other industries where profits are commercially sound.

   None of the leading consumer advocates, or the developers of the current Bill, appear to have recognised this - a major exodus of lenders and brokers, followed by credit exclusion for approaching 750,000 people.

7. None have considered the impact on sales of cheaper second-hand vehicles, with car yards going to the wall and the price of vehicle trade-ins tumbling, with serious repercussions for the whole of the motor vehicle retail industry. A similar impact can be expected on pleasure boats and similar relatively large ticket discretionary purchase items.

8. Any mass exodus from the lending sector will provide major problems for the Government. Treasurer Wayne Swan, Families Minister Jenny Macklin and Minister Shorten will have to be involved. At the recent Tax Forum, the Treasurer made it clear that the Government's welfare bill was a concern, stating "*There is not some magic pudding out there that means we can fund every enhancement to our social security system*".

   He would hardly welcome a major new burden - funding the $1.2 billion annual loan book and also finding the money for the necessary lending infrastructure,

staff training and salaries, to replace the commercial short term, small amount lenders.

However, that is what he will face if the current Bill proceeds unchanged and its intention is achieved. The Families Minister may get involved because, throughout the last 10 years of research into the industry and its customers, Smiles Turner has found that borrowers with dependents constitute around 40% of all borrowers, with their borrowing heavily skewed to funding family needs.

9. Comments from the consumer advocates, criticising short term, small amount lending for non-discretionary expenditure by borrowers, impose a middle class perspective, without solution.

   Criticising a system that provides loans for weekly expenditures, such as "*paying bills*", "*shopping*" and "*car repairs*", for generally around 30% of all loans, implying that such loans should be banned, ignores the fact that there is a demand for such loans and avoids any consideration of why such a demand exists, or what the borrowers would do without the availability of such loans.

   Some would claim that it is a primitive attempt at social engineering.

   The consumer advocates also fail to recognise that there is a need "*to make ends meet*" and that the non-commercial sector can also let people down.

   In the recent case study presented by the consumer advocates, involving a young woman in Ballarat who was living in her car, no recognition was given to the fact that the young woman knew all about NILS and LILS, neither scheme was able to help, and the only reason she had accommodation for a time in a motel, was because of a commercial lender's loan.

10. Throughout the 18 months leading up to the presentation of the current Bill to the House of Representatives, a fundamental fiction has bedevilled non-commercial stakeholders' thinking - a view that the non-commercial sector could provide an alternative for all borrowers.

    There are no published statistics to provide any confidence that this sector could entirely replace the commercial sector. For the last several years, considerably less than 1% of all short term, small amount loans have been provided by this non-commercial sector. It is a massive leap to go from 1% to 100%.

    None of the consumer advocates or, it would appear, Minister Shorten, have given any appropriate attention to the lack of resources the non-commercial loan sector will face, even with just 1% extra of total loan demand shifting from the commercial sector.

11. Until the uncertainties of the Commonwealth regime emerged, competition in the sector was increasing exponentially, with significant numbers of new lenders entering the sector each year. The opportunity for the development of a highly competitive, mature market were quickly emerging. Uncertainty and the current Bill have discouraged almost all potential new entrants, thus depriving the sector of an important, ever increasingly competitive edge.

12. The National Consumer Credit Protection Amendment (Enhancements) Bill 2011 (the "current Bill") appears to be primarily directed at Cash Converters and that company's payday lending model. This is unfortunate, because there is a considerable diversity of models operating within the short term, small amount lending sector. It would be appropriate to recognise this diversity in the structure of the Bill.

13. Lenders have always been prepared to publish their interest rate and other charges, however the requirement of consuming advertising space with the publication of a mandatory comparison rate schedule, when mentioning interest rate charges, has made that almost impossible.

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Borrowers find comparison rate schedules confusing and rarely refer to them as part of any decision to borrow. Effective prohibition of publishing interest rates and other charges, denies another important opportunity to encourage transparent price competition.

This is an unintended consequence of a successful consumer advocate campaign, several years ago, to have a comparison rate schedule mandated. Their current campaign, for a totally un-researched, unsubstantiated and unrealistic, philosophically driven 48% inclusive cap, as included in the current Bill, will have the unintended consequence of sentencing the vast majority of consumers to permanent legal credit exclusion.

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CHAPTER TWO: Most Non-Commercial Stakeholders want a Continuing Viable Short Term, Small Amount Sector

It is significant to note that there has been a clear message, from relevant non-commercial stakeholders, that they do not want the short term, small amount lending industry abolished.

1. The Minister has repeatedly stated that he wants a viable industry. Such statements being included in comments made at a major 2011 consumer advocate conference, in his relevant media releases and in both of the meetings he has held with sector representatives (considered in greater detail below).
2. Minister Shorten confirmed his view in the last paragraph of his Second Reading Speech introducing the current Bill into the House, on 21 September this year, when he concluded, "*The bill I am introducing today demonstrates our commitment to stand alongside consumers, <u>but it also puts the importance of the access to credit and the growth and long-term sustainability of financial services businesses at the heart of our vision for the future</u>*".
3. In the Treasury Department's Discussion Papers over the last 12 months, and during meetings with commercial stakeholders, Treasury has repeatedly stated that the aim of the reforms is to further protect the "desperate" and "vulnerable" consumer, while leaving a viable commercial lending sector.
4. At the recent launch of the RMIT University report, "*Caught Short - Exploring the Role of Small Short term Loans in the Lives of Australians*" (August 2011), ACOSS and Financial Counsellor representatives told senior lending sector representatives that they wanted a viable lending sector to remain.
5. The Consumer Action Legal Centre website states that organisation wants the lending sector to earn a "*reasonable profit*", implying recognition of a continuation of the sector.
6. The Good Shepherd submission to Treasury earlier this year, in response to one of Treasury's most recent Discussion Papers, while concerned about "*reasonable administration costs*", recognised the need for a commercial sector to remain and commented on the concern to avoid "*credit exclusion*". This approach was also supported in the Good Shepherd's response to the 2010 Green Paper on credit reforms.
7. Over 750,000 borrowers in 2010, with lenders commonly experiencing annual growth rates in the 15% to 30% compound range and an average of 18.17% (Smiles Turner industry research 2006, 2007, 2010 and industry analysis 2011), clearly indicate that the consumer wants a commercial sector to remain in business.

Without appropriate amendments to the current Bill, all the above people and organisations will have their preference ignored.

As indicated elsewhere in this submission, the introduction of the current Bill into law, without amendment, will not facilitate a continuing and viable sector, because it will effectively abolish the short term, small amount sector. From no later than 3 months after 1 January 2013 lenders, who are all incorporated, will be forced to close - or risk breaking the law - as the Corporations Act demands that no company trade while insolvent.

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CHAPTER THREE: An Alternative Cap Model

The Delegation is aware that Minister Shorten does not want major restructuring of his current Bill.

However, the Delegation notes that the Regulation Impact Statement identified the "*objectives of the government*" to include:

- "*to assist consumers to have a greater degree of social and financial inclusion...*"

The model proposed by the Delegation in this Chapter achieves this objective. The non-"*vulnerable*" and non-"*desperate*" will have the opportunity to borrow under a 48% cap and establishment/administration fee model. This in contrast to the regime the current Bill would establish, making it financially impossible for lenders to provide loans to most of this group. Lending to a segment of the market at a loss is only commercially possible if there is an opportunity for cross-subsidisation as part of a longer term marketing strategy. As indicated before, this to build consumer loyalty with those borrowers who are expecting to enjoy improved financial circumstances and/or those who will refer other more profitable lending business.

The "*vulnerable*" and "*desperate*" will have the opportunity to borrow under the regulatory circumstances provided by the existing Bill, or enjoy the achievement of the second objective, which is:

- "*to mitigate the particular risks associated with short term credit...*".

This will be achieved by the promotion of the availability of the alternatives, by the lenders. As the RIS explains, more borrowers need to be made aware of these alternatives and the Minister's August media release announced extra funding over the next four years to assist organisations providing these alternatives.

To these objectives must be added the Minister's concern to promote "*access to credit and the growth and long term sustainability of financial services businesses*", as he stated in his conclusion to his Second Reading Speech, when introducing the current Bill into the House. This could be achieved under the Delegation's proposed alternative, while it will definitely not occur under the current Bill.

At a meeting called by Minister Shorten in September, and attended by a broad cross section of the short term, small amount lending sector, a proposal was advanced by Delegation representatives which was supported at the meeting by all sector personnel attending. This proposal satisfied the Minister's concern to avoid a substantial re-structuring of the Bill.

While prepared to be critical in regard to other matters in the earlier part of the meeting, the Minister listened to the proposal without raising critical comment and encouraged the industry representatives to bring it to the attention of the Joint Committee.

The proposal satisfies the key concerns in regard to cost, included at Clause 5.7 in the Explanatory Memorandum:

1. "*The lower the income, the greater the reduction in income that will result from having to meet repayments under a credit contract. (Noting that a significant percentage of borrowers who use these products will have low incomes*)".
2. To "*leave opportunity for the borrower to receive sufficient income to either repay the debt or avoid the immediate need for additional credit...*".
3. To avoid the downside of debtors entering "*into a contract irrespective of the costs being charged*".

The proposal was that, because the bulk of the then Draft, and now current, Bill's content was designed to further protect the "*desperate*" and "*vulnerable*", or "*disadvantaged by circumstances*", therefore:

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(a) some attempt must be made to identify the "*desperate*" and "*vulnerable*"/ "*disadvantaged by circumstances*", rather than wrongly assume all short term, small amount borrowers belonged to such a category;

(b) there should be recognition that many who could be included in such a category were those receiving lower incomes, generally entirely from the lower Centrelink benefits, or lowly paid employment;

(c) a neutral, third-party calculated income figure should be sought as an identifier, rather than one set by the Minister or the lending sector;

(d) there should be an acceptance that such an identification does not mean those above the identifier will automatically be granted a loan, as they (and the "*desperate*" and "*vulnerable*"/ "*disadvantaged by circumstances*") will still continue to have the protection of the National Consumer Protection Act 2009's mandatory responsible lending regime, with all loans granted having to be "*not unsuitable*", according to regulatory criteria.

At the meeting with the Minister it was suggested that a particular Centrelink benefit might be considered, but this has presented some difficulties associated with the different categories of benefit. Similarly, there are a number of concerns in regard to how the Henderson Poverty Index is calculated for different groups of people. Both the benefits and the Index introduce the possible need for multiple threshold measurements.

The recent Tax Forum has offered a one figure solution, with the proposal to increase the minimum taxable income threshold to $21,000 per annum.

The Delegation therefore suggests to the Joint Committee that, in regard to amending the current Bill:

1. the Minister's concern for the "*desperate*" and "*vulnerable*"/ "*disadvantaged by circumstances*" borrower be recognised, with the current Bill, in its entirety, being applied to those "*disadvantaged by circumstances*"; and

2. that the threshold test to identify the "*disadvantaged by circumstances*" borrower, be the current (at the time) ATO minimum taxable income amount. This having the advantage of putting it above both the Henderson Poverty Index single worker and single non-worker poverty line. This recognises the Consumer Action Legal Centre's 2010 "*Pay Day Loans - Helping Hand or Quicksand*" report, which expressed particular concern for the 23.4% of its consumer research respondents who earned below $20,000 per annum, and acknowledges the concerns of Marston and Shevallar in their 2010 Pilot Study, "*The Experience of Using Fringe Lending in Queensland*", where they expressed concern for borrowers who were below "*usually accepted measures of poverty*". In comparison, this is $160 per week in excess of the Newstart allowance for a single person with no dependents and is $20 per week less than is paid, in NSW, under the Workers' Compensation Act 1987;

3. Those borrowers earning above the ATO-set minimum taxable income threshold, to be advantaged by a simple pricing structure of 48% daily reducible interest rate (calculated as proposed in the Bill), plus a competitive market determined and very transparent establishment/ administration fee.

   The latter to be one fee only, repayable in equal amounts over the term of the loan, easily compared as between competing lenders, and to be subject to all the "*unjust*" and "*unconscionable*" provisions currently available in the National Credit Code and the ASIC Act.

Such a model will encourage price competition for the non-"*disadvantaged by circumstances*" borrowers.

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The Delegation is aware that consumer advocates attempt to maintain that borrowers are not conscious of price when they negotiate their loans. This is simply not true. In the November 2010 Smiles Turner Consumer Survey, involving 441 respondents, the following results were obtained:

1. Question - Did you ask about costs, before you made up your mind to take out the loan? Yes - 88.4%
2. In regard to the cost of the loan - 4.3% thought it was "cheap", 60.6% thought it was "fair", 28.5% thought it was "a bit expensive" and 6.4% thought it was "very expensive".
3. In regard to the costs of unascertainable fees - 5.9% thought they were "cheap", 65.8% thought they were "fair", 20.2% thought they were "a bit expensive" and 6.4% thought they were "very expensive".
4. When asked how important the cost of the loan was in their decision to borrow - 6.4% said it was "not important", 64.4% said it was "important" and 23.8% said it was "very important". There was no response to this question by 5.4%.
5. When asked if cost influenced their decision to borrow from the lender they were seeing today, 47.03% said "Yes".
6. The borrowers were asked how many other lenders they were aware of and the responses were:

O lenders	1 lender	2 lenders	3 lenders	4 lenders	5+ lenders
31.3%	19.2%	19.2%	15.9%	3.6%	10.77%

7. When asked how many other lenders they had borrowed from, the responses were:

No other lender	1 other lender	2 lenders	3 lenders	4 lenders	5+ lenders
70.3%	15.7%	10.1%	2.4%	0.9%	0.6%

The above indicates a substantial consumer awareness of costs and competition in a payday and microlending market that, apart from the hiccup caused by Commonwealth regulatory uncertainly this year, is fast reaching a state of maturity where price awareness and intense competition can be expected as the norm, if the necessary changes are made to the current Bill.

A further indication of industry maturation is this group of borrowers' demonstration of financial responsibility and independence, with a growing number of them falling into an emerging category identified by Veda Advantage earlier this year. In that company's recent analysis, a growing number of borrowers were amongst a group who could access credit from mainstream providers, but chose to access from microlenders, recognising actual and perceived superior service levels. An analysis of one lender's consumer base had the percentage in this category as 43%.

We note that the recently released RMIT University "*Caught $hort - Exploring the Role of Small Short Term Loans in the Lives of Australians*" (August 2011) report indicates that the percentage of payday and micro-borrowers who were able to access mainstream finance, amongst its 112 respondents, was 7%. This is a most conservative figure when comparing the consumer base of many of the Delegation's microlender supporters.

COAG Review

It must be remembered that, under the COAG Agreement, the recommended model will attract careful review in two years' time.

Concerning APRs

While the Delegation is of the view that publication of APRs is inappropriate, as they are not considered or appreciated by consumers, publication is regarded as being of value by the consumer advocates. That being the case, the 48% interest and establishment/administration fee amounts could be presented as an APR, as a further opportunity for comparison.

The Delegation reminds the Joint Committee that both the "*disadvantaged by circumstances*" and the non-"*disadvantaged by circumstances*" consumer segments would continue to be protected by the responsible lending regime imposed by the National Consumer Credit Protection Act 2009 and associated regulations. In addition, the consumers "*disadvantaged by circumstances*", will also enjoy the current Bill's consumer protections provisions, thus satisfying the Minister's fundamental concern.

Drafting Changes

To illustrate the relative simplicity of the changes necessary to the current Bill, in order to achieve the introduction of the Delegation's proposal, there are only two basic amendments that need to be made after the inclusion of "small amount credit contract" in the Sections, to direct their applicability.

The first - the addition of subsection 5(1)(g), on page 46 of the current Bill:

"*The debtor/s is/are a recipient of a tax free income no greater than the ATO tax threshold amount, as calculated at the time of entering the contract*".

The second - a section similar to Section 31A (say 31AA), on page 55 of the current Bill, being restrictions on fees and charges for non-small amount credit contracts:

"*(1) A non-small amount credit contract must not impose, or provide for fees and charges, if the fees or charges are not of the following kind:*

- *(a) A fee or charge (a permitted establishment/administration fee) that reflects the credit provider's reasonable costs of determining the application for credit, initial administrative costs and consequent administrative costs of providing the credit under the contract;*
- *(b) A fee or charge that is payable in the event of a default in payment under the contract;*
- *(c) A government fee, charge or duty payable in relation to the contract;*
- *(d) An annual interest rate".*

(2) The amount of a permitted annual interest rate shall not exceed 48%".

CHAPTER FOUR: A Detailed Analysis of the Current Bill

Notwithstanding the previous comments, it may be useful for the Joint Committee to be aware of the Delegation's concerns in regard to the current Bill. The following concerns are presented without reference to the alternate model just discussed.

Changes on Grounds of Hardship - Section 72

"*If a debtor cannot reasonably meet his or her obligations under a credit contract (for a reasonable cause)...*".

There is some argument that describing the condition as simply "*a reasonable cause*" is expanding the circumstances in which hardship can be claimed.

We disagree. The wide range of circumstances have always been covered.

The Delegation's concerns are:

1. that there is an unnecessary requirement to provide two notices in the process;
2. that the offence is one of strict liability. This plus criminal penalties would create most unfair circumstances where a procedural mistake was made, yet negotiation successfully takes place and the mutual agreement arising is implemented.

89A - Effect of Hardship Notices on Enforcement

Section 89A - providing that, before or after issuing a default notice, the credit provider cannot move immediately or continue to enforcement, if the consumer makes a hardship application, or a request for negotiation of a postponement of enforcement proceedings, introduces inequitable disadvantages for the lender.

It is noted that the credit provider cannot start enforcement proceedings within 14 days after receiving this application or request. However, if the credit provider feels that the goods in which they hold security are threatened, repossession during that period is permitted.

Presumably, the 14 days are to ensure consideration of the hardship application or postponement request. Obviously, the consumer could use this at the end of the default period, to gain up to an extra 14 days. This will depend on just when, during the 30 days, the hardship application or postponement of enforcement request is considered. This area gets complicated when the 14 day period includes a further default.

There is also no recognition of the circumstances where a default notice has been issued and the parties have already agreed to a change in the contractual obligations, recognising hardship - and then the consumer comes back for a second go seeking a postponement. This opportunity for cumulative exploitation, by the dishonest consumer and their unprincipled legal advisers, is of concern.

Section 160B - Words Banned for Brokers - "Independent", "Impartial", or "Unbiased"

Although the Delegation believes this is probably reasonable, the provision focuses on Credit Assistance Providers (brokers) and gives no attention to the words used by unscrupulous credit providers, who achieve an advertising advantage over their more principled and compliant competitors. The next provision addresses some part, but not all, of this concern.

Section 180A - Orders to Remedy Unfair or Dishonest Conduct by Credit Service Providers

It is noted that there is wide ranging flexibility for the court to make orders against the person who provided a "*credit service*", who is determined to have been unfair or dishonest.

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The Delegation regards this provision as one of concern.

We note that this provisions means any person in the provision of credit chain - the referrer, Authorised Credit Representative, Credit Assistance Provider (broker), or Credit Provider's conduct can be the person who provides the "conduct" complained about. Ultimately, the blameless lender will get dragged in.

The Delegation questions the reliability of establishing point (b) - engaging in conduct that was connected with the provision of the service. However, point (c) appears to be a catch-all that makes points (a) and (b) superfluous.

What the Courts will Have to Determine

The Delegation notes that, in determining whether or not the conduct is "*unfair*" or "*dishonest*", the courts can consider the following circumstances:

(a) Whether or not the consumer was at a "*special disadvantage*" in dealing with the credit provider.

(b) Whether or not the consumer was a "*member of a class, whose members were more likely than people who were not members of the class, to be at such a disadvantage*".

(c) The consumer was unable to, or considered themselves unable to, enter a credit contract with any lender, other than the credit provider.

(d) "*the conduct involved a technique that manipulated the consumer or that should not in good conscience have been used*".

(e) The credit provider "*could affect the terms of the contract*".

(f) "*the terms of the transaction ...were less favourable to the consumer than the terms of a comparable transaction*".

The Delegation is particularly concerned with the practical application associated with the above six provisions. There is substantial opportunity to introduce an adverse arbitrary decision that is both unfair to credit providers, and exploits consumer dishonesty against the credit provider. This provides an absolute field day for the Legal Aid and Consumer Credit Legal Centres to blackmail credit providers into giving them what they want for their clients, in order to avoid legal and court costs.

For practical purposes, there must be an opportunity to include some provision in regard to this issue, providing greater certainty for credit providers, in regard to credit contracts. The Delegation asks that there be some curtailment of the breadth of advantage implied in the current provisions. The current Bill's provisions encourage the dishonest consumer, and their often unprincipled legal advisers, to be unethical in their allegations against the lender.

The Delegation is also troubled with the concept of "*class*", which implies separation from the majority and opens opportunities for highly subjective assessment, including adverse characterisation of the individual.

What this will Mean in Practice

Given the taxpayer funded consumer advocates have nothing to lose, the legislative provisions effectively reverse the standard of proof, with the allegation against the credit provider having to be disproved by the credit provider. The consumer only has to assert that they now think the conduct was unfair (let alone dishonest), that one or more of the four criteria existed and applied, and that one or more significantly affected the consumer.

The Delegation notes, with regard to Section 180A(4)(g), the terms of their contract were less favourable than "*the terms of a comparable transaction*" - this is not

necessarily expressed as one the particular consumer, alleging the unfairness or dishonesty, could have obtained elsewhere.

Overall, it may be useful if the details in this subsection of the current Bill were revisited.

The Delegation believes further consideration of the following would be beneficial:

1. The opportunity for the court to declare the offending part of the contract, that emerges from the dishonesty or unfairness, void. The current range of court order options do not specifically include this and this may be a far more equitable solution than those currently contemplated. It is also consistent with other provisions in the National Credit Code.
2. We are not convinced that there has been adequate recognition of the possibility that, although there may have been unfair or dishonest conduct, the contract entered into is, in fact, not disadvantageous to the consumer.
3. There is no consideration of the consumer's potential or actual awareness of the unfairness or dishonesty, at the time the conduct was occurring, and that the consumer had the opportunity to mitigate their disadvantage at that time and during subsequent times.

SCHEDULE 3 - Small Amount Credit Contracts

Sections 124A and 133CA - website content requirements

The Delegation is pleased to note the response to its previous submission to Treasury, suggesting this statement be provided by Government, to ensure content is as the Minister approves.

The content of this statement will now be completely provided by the Government. However, it should include copy, print size and layout. Without such, clarity of Government requirement and dependence on lender/broker research for inclusions, is a challenge.

The Delegation is concerned to note that the provision is simply expressed as "*the licensee must ensure that the website complies with the requirements prescribed by the regulations*".

We regard the penalties of adverse conduct of $5,500, in regard to providing access to website inclusion, as a fairly tough incentive. The provision of prescribing the offence as criminal is excessive. Further, the civil penalty of $220,000, presumably to be levied against a company for not complying, is simply draconian.

The identification of a website as being applicable, to post the proposed statement as being one where a consumer can "*make an enquiry about*" (a loan), is of considerable concern to the Delegation. When does a browser become an enquiry? Is the mere logging on to a website the making of an enquiry? Does there have to be some consumer/viewer action, beyond clicking on to the home page?

Some attempt at a definition of "*make an enquiry*" is strongly recommended in the Bill.

The Delegation notes that "*It is intended that the disclosures will be generic and prescribed... and will have the same content for all licensees*".

That poses a problem. As the provision is applicable to licensees all over Australia, there will need to be generic and functional contact opportunities established, such as 1800 numbers. Further, it will be unwise to assume that all potential consumers will be internet connected and savvy.

As Smiles Turner consumer research conducted in 2006, 2007, 2010 and 2011 has consistently demonstrated, consumers are locality and convenience driven. Out of area contact details will have limited impact.

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Sections 124B and 133CB - prohibition where other small loan exists

As the Committee would appreciate, under this provision it is an offence both to suggest/offer and assist the consumer to apply/enter into the forbidden contract. The loan does not need to actually happen. In these circumstances, the Delegation welcomes the inclusion of the requirement for a "*reasonable belief*", which has been added following recommendations made in response to the Draft Bill.

The Delegation has since taken legal advice, which has determined that "*reckless*" or "*recklessness*" is a form of mens rae that amounts to less than intention, but more than negligence. Such occurring when the offender is aware of the risk of a particular consequence arising from their actions, but nonetheless deciding to continue with that action and take the risk, where it is unreasonable to do so [*R v G* (2004) 1 AC 1034].

Australian courts have also considered recklessness as heedless or careless conduct, where the offender can foresee some probable or possible harmful conduct but, nevertheless, decides to continue with those actions with an indifference to, or a disregard of, the consequences [*R v Nuri* (1990) VR 641]. The High Court has determined that recklessness is something less than intent, but more than mere negligence, as was discussed at the Consultation Group meeting [*R v Crabb* (1985) 156 CLR 464].

The concept of "*reasonable belief*" may imply a similar duty to that of making "*reasonable enquiries*" under Section 117 and similar provisions of the National Consumer Credit Protection Act 2009. This imports the concept of reasonableness being in accordance with community standards [*Bankstown Foundry Pty Ltd v Braistina* (1986) 160 CLR 301]. Where the lender could fairly anticipate something as possible [*Minister administering the Environmental Planning and Assessment Act v San Sebastian Pt Ltd* (1983) 2 NSW R 268].

It is possible that a lender could commit both this offence and an offence under the NCCP Act as a result of the same actions, and face two fines of $220,000.

We regard the provision concerning "*reasonable belief*" as introducing an evidentiary nightmare. Provided a credit provider does not know, and has not been reckless, then another loan is legal under this provision. However, a number of questions then arise:

(a) if the lender does not find out about the other loan, when does this conflict with the "*reasonable enquiries*" associated with the assessment process?

(b) What happens if the consumer lies?

(c) What happens if the lender discovers the first loan <u>after</u> the lender and consumer have entered into the second loan contract?

(d) Does the provision actually create two offences - "*recklessness*" and "*lack of reasonable belief*"?

The Delegation requests that the Joint Committee seek clarification and the avoidance of double jeopardy in this regard.

Sections 124C and 133CD - no increase in credit limits

This provision introduces a government policy clash. The government policy associated with the responsible lending provisions demands that the lender assess the suitability of the consumer for a loan, every 90 days or, at a shorter interval if a larger loan than the initial one associated with the successful 90 day assessment is applied for. Where is the difference with a consumer applying for an increase in their credit limit, with a 90 day assessment being undertaken at the time of this particular application?

The issue is "*unsuitability*", not how the consumer came to apply for extra finance.

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Section 133CC - rollover and refinancing avoidance

It is noted that this Section applies to both rollovers and re-financing, notwithstanding its failure to use the industry acknowledged term "rollover".

The provision inherently contradicts an existing government policy associated with responsible lending (NCCP Act). It must be remembered that the consumer has already been rigorously assessed as to suitability for a loan of a certain size. If the application for the rollover or refinancing is made during the 90 days after the loan was advanced, and involves the consumer in an indebtedness that is no greater than that approved at the commencement of the loan, or there is an opportunity to undertake a fresh and successful 90 day assessment as to suitability, why should the parties be prohibited from re-establishing the level of debt at no more than the original loan, or higher if approved?

There is no issue of debt traps if the borrower has been appropriately assessed under the provisions of the NCCP Act.

This Section is a clear indication of the dominance of consumer advocates' influence, with their passion for change based on poor, or non-existent research and a complete failure to recognise that their thinking was moulded prior to the Commonwealth takeover on the 1st July 2010.

The provision not only introduces a prohibition on the lender rolling over, or refinancing, existing loans advanced by that lender, prior to the rollover or refinancing application, but makes it an offence to offer the same services when the prior loan was entered into with another lender.

The Delegation has major concerns with regard to the creation of the current credit provider's responsibility for the previous activities of a third party lender and the consumer. It is noted that, arguably, the provision has been drafted as an impossible absolute, with no element of mens rae and/or knowledge and/or recklessness recognised. The Delegation would argue that this is unrealistic.

This section also prohibits the borrower refinancing in order to consolidate their indebtedness, which is method of managing finances often suggested and/or facilitated by financial counsellors. It is noted that banning debt consolidation provides a significant issue for 12% of the consumer respondents who wanted such, listed in the August 2011 RMIT University report "*Caught $hort - Exploring the Role of Small Short Term Loans in the Lives of Australians*".

SCHEDULE FOUR - Caps on Costs

Section 31A(1) - permitted establishment fee of 10%

This is similar to the Victorian provision concerning fees and charges, in that it demands that the fee be calculated with reference to "*reasonable costs of determining the application*".

This provision means that there can be no legal possibility of cross-subsidisation towards income in addition to the 2% monthly fee, discussed later in this submission.

We note the concept of "*reasonableness*" is not imposed on calculating the "*initial administrative costs of providing the credit*".

With the fee not changing, except in accordance with the size of the loan, if the microlending sector could survive, "*the permitted establishment fee*" would encourage larger amount and shorter term loans. For example -

1. a one month loan of $200 would attract fees of $24, a one week loan of $200 would attract fees of $24 (the same amount);
2. two $250 loans, for 4 months, would attract $90 in total, a $500 loan for 2 months and another $500 loan for 2 months, would attract $140;

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3. a six month $1,000 loan would attract a gross fee of $220. Six one month loans of $1,000 would attract a gross fee of $720.

The Delegation is intrigued at the justification for this 10%, being offered in the media and the Parliament by the Minister, and in the media by others. They are ignoring the detail of the current Bill that demands that it be *"reasonable"* and reflect actual costs. All are assuming that it is 10%, regardless. That is an indication of the flawed construction that haunts the current Bill.

The reality is that most of the lenders' *"reasonable costs of determining the application"* and *"the initial administrative costs"*, as the Delegation has repeatedly presented during the consultation process, are fairly common. This regardless of the size or length of the loan.

The demanding application and assessment process, to determine *"unsuitability"* (read suitability), the 7 year record keeping requirement that must be provided for in the initial administration of the loan, the highly encouraged credit reference agency checks, and the every increasing AUSTRAC "know your customer" regulatory requirements, all impose costs associated with staff time, documentation, compliance standards and external party payments that are very similar, regardless of whether the loan applied for is $300, $3,000, $30,000, or $3 million, or is for 2 weeks, 2 months, 2 years or 20 years.

The following chart indicates the battle lenders will have, to cover costs, if the current Bill becomes law. It cannot be overemphasised that a model embracing a 10%, 2% fee regime simply cannot work, financially, for <u>any lender</u>.

Amount	Term	Maximum gross income unsecured, establishment fee plus per month %	Maximum gross income secured (48%)
$100	1, 2, 3 or 4 weeks	$10 plus $2 = $12	4 weeks = $2.26
$200	1, 2, 3 or 4 weeks	$20 plus $4 = $24	4 weeks = $4.54
$200	5, 6, 7 or 8 weeks	$20 plus $8 = $28	8 weeks = $15.72
$270	1, 2, 3 or 4 weeks	$27 plus $5.40 = $32.40	4 weeks = $6.13
$325	1, 2, 3 or 4 weeks	$32.50 plus $6.50 = $39	4 weeks = $7.38
$325	5, 6, 7 or 8 weeks	$32.50 plus $6.50 = $45.50	8 weeks = $13.35
$500	1, 2, 3 or 4 weeks	$50 plus $10 = $60	4 weeks = $11.35
$500	5, 6, 7 or 8 weeks	$50 plus $20 = $70	8 weeks = $20.55
$1,000	12 weeks	$100 plus $60 = $160	12 weeks = $59.79
$1,000	24 weeks	$100 plus $120 = $220	24 weeks = $117.06
$1,500	12 weeks	$150 plus $90 = $240	12 weeks = $89.69
$1,500	24 weeks	$150 plus $180 = $330	24 weeks = $175.61
$1,500	36 weeks	$150 plus $270 = $420	36 weeks = $264.48
$2,000	12 weeks	$200 plus $120 = $320	12 weeks = $119.56
$2,000	24 weeks	$200 plus $240 = $440	24 weeks = $234.13
$2,000	36 weeks	$200 plus $360 = $560	36 weeks = $352.62
$2,000	52 weeks	$200 plus $480 = $680	52 weeks = $516.51

The Commonwealth's National Consumer Credit Protection Act 2009 and associated Regulations 2010 and 2011, make no differentiation in the processes demanded of lenders. Only ASIC, in its Regulatory Guidelines, concedes the possibility of less rigorous assessment for smaller loans and smaller lenders. However, ASIC gives

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no concession on the fundamental processes, or the amount of contract and associated documentation involved.

While taking the loan length out of the calculation in the current Bill is realistic - to publicly assume or imply that these costs vary, as a percentage of the amount of the loan, demonstrates one or more of the following:

(a) a fundamental lack of knowledge of the lending process that the Commonwealth has already imposed on the microlending sector;

(b) an attempt to provide some income for lenders under an inappropriate and inaccurate heading;

(c) an underhand attempt to gain acceptance from the microlending sector, while fooling the general public;

(d) a deliberate attempt to deceive the consumer advocates with the detail, knowing their poor numeracy levels; and/or

(e) a deliberate attempt to deceive the borrowers across Australia.

There is no incentive to reduce prices for consumers, given the manner in which the economically unrealistic 10%, one-off fee, was proposed.

1. The wording outlining the structure of the 10% "*permitted establishment fee*" states that it is only for reasonable application costs, plus initial administrative costs. This means that, if those costs are less than 10%, then the lesser amount should be charged.
2. As indicated above, the current Bill thereby provides no opportunity for contribution, from the 10% amount, to costs other than those specified, or for profit, i.e. no cross-subsidisation is recognised.
3. While the current Bill implies an optimism that consumers would be charged less if "*reasonable*" costs in this area did not come to 10%, the Bill thereby provides no incentive for the lender to seek to cut costs in the area of assessment and initial administration.
4. The maximum amount of 10% also indicates that this is the amount the Minister wrongly assesses as the maximum necessary to cover the costs of assessment and initial administration [Section 31A(1)(a)], including:

   (a) credit checks with outside suppliers;

   (b) contribution to legal and compliance professional advice costs;

   (c) payment of software service providers to establish the file;

   (d) the cost of all the contract and associated compliance documentation development and printing; and the like.

The 10% is more easily supported for the larger loans, that attract larger dollar fee amounts. Smiles Turner industry research in November 2010 and April/May 2011, revealed that the assessment requirements incurred at least 45 to 90 minutes of staff time, being paid an average of $23 per hour (junior) to $35 per hour (senior), often involved a credit check, which Smiles Turner September 2011 industry research indicated averaged $7 and the establishment of a loan attracted compliance costs averaging $11 per contract for payday lenders.

That means any contract that does not create an opportunity to attract a permitted establishment fee of at least $35 (with no allowance for general business overheads and advertising), will not be advanced. The impact of this provision, if left unchanged, means that all loans for at least under $300 and generally under $500 (particularly if a senior staff member is involved) will be effectively abolished because of the above costs alone (Smiles Turner industry research April/May 2011).

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Note: The fees and charges referred to are those "*under the contract*", which are "*permitted credit fees and charges*".

Section 31A(3) - 2% "permitted monthly fee"

Given the small income that can be earned under the current Bill provisions, it would be expected that these amounts would, at least in part, if not in whole, be incorporated as the early payout fee in most contracts.

The Delegation notes that enquiries of the Minister's office, and comment by senior Treasury officials at the Consultation Group meeting on 26th August 2011, revealed that this concept, together with the 10% considered above, is not known to exist in any other jurisdiction around the world. The nearest is the regime in South Africa, with its complex mix of maximum amounts and years and permitted fees being based, in part, on a multiple of the official bank rate, nothing like the Australian model being suggested.

It was indicated to the Delegation, by the Minister's office, that caps currently applying in US jurisdictions were considered and that Canadian and European models were not. The Delegation has undertaken extensive research into these US provisions and the results of such impositions.

The Delegation has not been able to identify any support from the US for the current Australian proposals, nor from Canadian, European or UK jurisdictions. Only one US state has a tiered model, cost structures are vastly different and there are continuing reports of failure and unintended consequences, including significant increases in bounced cheques and contracting with interstate and international lenders.

Practicality of the legislation:

The 2% provision is fundamentally impractical and must be considered the gross income source for:

(a) all wages, other than those associated with the time spent assessing the application, or on "*initial administration*";

(b) all costs associated with the assessment of potential consumers, and initial administration costs associated with the majority of applicants who are assessed as "*unsuitable*", under the strict responsible lending guidelines included in the National Consumer Protection Act 2009, i.e. are deemed not suitable to be granted a loan;

(c) all rent, utility, building/contents insurance, cleaning, wages, workers' compensation insurance, wages on costs associated with the conduct of the business, outside the times of application and initial administration;

(d) all wholesale finance costs;

(e) compliance costs, including ASIC fees, EDR membership, staff and responsible manager training;

(f) all bad debts and collection costs;

(g) ASIC's Corporations Law annual report filing fees and the like;

(h) software and internet data costs; and

(i) the only source of contribution to profit.

Given that the 10% amount is supposed to cover establishment and initial administration fees, the following table indicates the gross income to be derived under the current Bill - <u>not net profit</u>.

We emphasise that the amounts listed below, reflecting the current most popular and the average small amount loans, are what is available - in accordance with the rationale included in the current Bill - to cover all the expenses listed above and

provide some net profit to the lender on an unsecured loan to, at least initially, an absolute stranger who has walked in from the street, or telephoned, or emailed with anonymity.

Table - 2% income generation

Amount borrowed	Length of loan	2% income
$275	2 weeks	$5.50
$275	4 weeks	$5.50
$300	2 weeks	$6.00
$300	4 weeks	$6.00
$325	2 weeks	$6.50
$325	4 weeks	$6.50
$350	2 weeks	$7.00
$350	4 weeks	$7.00
$500	2 weeks	$10.00
$500	4 weeks	$10.00
$500	6 weeks	$20.00
$500	8 weeks	$20.00

Even if all other things were considered neutral in their impact, as opposed to negative in the reality, no lender will continue to lend the current average payday loans of $275 and $325 (Smiles Turner 2010-2011 research and Cash Converters' published figures).

Bad debt realities

There is another reason why, all other things being neutral, lenders will move away from offering small amount loans. That is the new and extended number of loans that will now have to be advanced, to recover the losses from one defaulting loan that becomes a bad debt.

Put simply - if you lend $200 for a month, with a gross income (not profit) of (say) $100, one bad debt where the borrower pays nothing back, puts the lender in a position of losing his $200 capital (we will not worry about his costs for this example). With a $100 gross income per $200 loan, the lender then has to lend 2 more such loans to regain his capital.

Under the current Bill the lender loses his $200, but the maximum gross income from such a loan is $24. With a $24 gross income, the lender has to lend 8.33 further loans to recover.

When you add the costs of defaults and bad debts associated with these 8.33 new loans, plus all the assessment and initial administrative costs, plus the later administrative costs and all the other costs of lending listed above - the number of loans the lender has to lend, to recover his lost $200, is much, much greater than 8.33. For a typical $300 payday loan, repaid over a 4 week term, using a 10%, 2% cap, with an optimistic 10% profitability level assumed, it would take 83 fully repaid loans, simply to recover that capital loss and a further 10 loans, to recover the capital, plus the original lost income. This is another indication of the unrealistic attempt to impose a 10%, 2% regime.

Using the same parameters, for any loan amount:

* repaid over 8 weeks and the figures are 71 and 81 respectively;
* repaid over 26 weeks, the figures are 45/55 respectively;
* repaid over 40 weeks, the figures are 35/45 respectively;

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* repaid over 52 weeks, the figures are 29/39 respectively;
* repaid over 78 weeks, the figures are 21/31 respectively; and
* repaid over 104 weeks, the figures are 17/27 respectively.

This factor alone makes the risk of lending under the current Bill prohibitive.

It is unfortunate that the Regulation Impact Statement did not seriously address lender costs. Such would have had to recognise the costs associated with failed loans.

Implementation difficulties

The Delegation notes that the 2% "*is payable on a monthly basis starting on the day the contract is entered into*". That means it is payable in advance. A literal reading of this provision would indicate that the 2% must be paid all in one sum, on that first day of each month of the loan. The lenders' contracts will have to reflect this, with no apportionment over the 2 or more repayments contracted for each month.

This will provide major challenges for loan management software design and implementation. In addition, the amount of extra entries in the contract documentation, to explain a different amount of payment for one only repayment each month, offers a further field of confusion for the consumer.

The Delegation concludes this comment on the 10%, 2% model with this observation - as reported in the Sydney Morning Herald on 24th May 2011 by Chris Zappone, under the headline "Retailers' Mark ups Under Threat from Online" - the Australian Bureau of Statistics reports average product mark ups to be anywhere from a low of 40% to a high of 142%. The average mark up applied to all goods, wholesale or retail, was 65% (flat). There has been no comment from the consumer advocates about this figure.

Distortions of the Current Bill

The Delegation is aware that Treasury attempted to carefully select the 10%, 2%, to minimise distortions in the interface between the small amount credit contract and those coming under the 48% inclusive cap (motivation - mathematics, rather than business reality). The ideal is to have one price point, where it is obviously appropriate for the lender to move from one cap to another. Given the current Bill's inclusion of the $2,000, 2 year criteria, Treasury would hope that intersection between amount and time would assist. Unfortunately, this attempt was not successful, as the contents of the following chart, kindly facilitated by Min-It Software, will reveal.

Income generation under the 10%, 2% and 48% cap regimes

Principal	Term (weeks)	Monthly Fee Integer	Mort-gage	10% Fee	Total Monthly Fee(s)	Interest (see Note)	Revenue	Total Payable	Diff in revenue	% Diff Secured/ Unsec'd
100	1	1	N	10.00	2.00	0.00	12.00	112.00		
100	2	1	N	10.00	2.00	0.00	12.00	112.00		
100	4	1	N	10.00	2.00	0.00	12.00	112.00		
250	2	1	N	25.00	5.00	0.00	30.00	280.00		
250	4	1	N	25.00	5.00	0.00	30.00	280.00		
250	6	1	N	25.00	5.00	0.00	30.00	280.00		
250	8	2	N	25.00	10.00	0.00	35.00	285.00		
300	2	1	N	30.00	6.00	0.00	36.00	336.00		
300	4	1	N	30.00	6.00	0.00	36.00	336.00		
300	6	1	N	30.00	6.00	0.00	36.00	336.00		
300	8	2	N	30.00	12.00	0.00	42.00	342.00		
350	2	1	N	35.00	7.00	0.00	42.00	392.00		

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Principal	Term (weeks)	Monthly Fee Integer	Mort-gage	10% Fee	Total Monthly Fee(s)	Interest (see Note)	Revenue	Total Payable	Diff in revenue	% Diff Secured/ Unsec'd
350	4	1	N	35.00	7.00	0.00	42.00	392.00		
350	6	1	N	35.00	7.00	0.00	42.00	392.00		
350	8	2	N	35.00	14.00	0.00	49.00	399.00		
350	10	2	N	35.00	14.00	0.00	49.00	399.00		
500	4	1	N	50.00	10.00	0.00	60.00	560.00		
500	8	2	N	50.00	20.00	0.00	70.00	570.00		
500	12	3	N	50.00	30.00	0.00	80.00	580.00		
500	26	6	N	50.00	60.00	0.00	110.00	610.00		
500	26		Y	0.00	0.00	63.31	63.31	563.31	-46.69	42.45%
500	52	12	N	50.00	120.00	0.00	170.00	670.00		
500	52		Y	0.00	0.00	128.79	128.79	628.79	-41.21	24.24%
750	26	6	N	75.00	90.00	0.00	165.00	915.00		
750	26		Y	0.00	0.00	95.07	95.07	845.07	-69.93	42.38%
750	40	9	N	75.00	135.00	0.00	210.00	960.00		
750	40		Y	0.00	0.00	147.22	147.22	897.22	-62.78	29.90%
750	52	12	N	75.00	180.00	0.00	255.00	1005.00		
750	52		Y	0.00	0.00	193.43	193.43	943.43	-61.57	24.15%
750	78	18	N	75.00	270.00	0.00	345.00	1095.00		
750	78		Y	0.00	0.00	298.28	298.28	1048.28	-46.72	13.54%
750	104	24	N	75.00	360.00	0.00	435.00	1185.00		
750	104		Y	0.00	0.00	409.85	409.85	1159.85	-25.15	5.78%
1000	26	6	N	100.00	120.00	0.00	220.00	1220.00		
1000	26		Y	0.00	0.00	126.8	126.80	1126.80	-93.20	42.36%
1000	40	9	N	100.00	180.00	0.00	280.00	1280.00		
1000	40		Y	0.00	0.00	196.36	196.36	1196.36	-83.64	29.87%
1000	52	12	N	100.00	240.00	0.00	340.00	1340.00		
1000	52		Y	0.00	0.00	258.09	258.09	1258.09	-81.91	24.09%
1000	78	18	N	100.00	360.00	0.00	460.00	1460.00		
1000	78		Y	0.00	0.00	398.27	398.27	1398.27	-61.73	13.42%
1000	104	24	N	100.00	480.00	0.00	580.00	1580.00		
1000	104		Y	0.00	0.00	547.03	547.03	1547.03	-32.97	5.68%
1500	40	9	N	150.00	270.00	0.00	420.00	1920.00		
1500	40		Y	0.00	0.00	294.64	294.64	1794.64	-125.36	29.85%
1500	52	12	N	150.00	360.00	0.00	510.00	2010.00		
1500	52		Y	0.00	0.00	387.24	387.24	1887.24	-122.76	24.07%
1500	78	18	N	150.00	540.00	0.00	690.00	2190.00		
1500	78		Y	0.00	0.00	597.69	597.69	2097.69	-92.31	13.38%
1500	104	24	N	150.00	720.00	0.00	870.00	2370.00		
1500	104		Y	0.00	0.00	820.84	820.84	2320.84	-49.16	5.65%
2000	52	12	N	200.00	480.00	0.00	680.00	2680.00		
2000	52		Y	0.00	0.00	516.51	516.51	2516.51	-163.49	24.04%
2000	78	18	N	200.00	720.00	0.00	920.00	2920.00		
2000	78		Y	0.00	0.00	797.19	797.19	2797.19	-122.81	13.35%
2000	104	24	N	200.00	960.00	0.00	1160.00	3160.00		
2000	104		Y	0.00	0.00	1095.44	1095.44	3095.44	-64.56	5.57%
2500	52	0	N	0.00	0.00	645.76	645.76	3145.76		
2500	52		Y	0.00	0.00	645.76	645.76	3145.76		0
2500	78	0	N	0.00	0.00	996.68	996.68	3496.68		
2500	78		Y	0.00	0.00	996.68	996.68	3496.68		0
2500	104	0	N	0.00	0.00	1369.36	1369.36	3869.36		
2500	104		Y	0.00	0.00	1369.36	1369.36	3869.36		0

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Principal	Term (weeks)	Monthly Fee Integer	Mort-gage	10% Fee	Total Monthly Fee(s)	Interest (see Note)	Revenue	Total Payable	Diff in revenue	% Diff Secured/ Unsec'd
3000	52	0	N	0.00	0.00	774.94	774.94	3774.94		
3000	52		Y	0.00	0.00	774.94	774.94	3774.94		0
3000	78	0	N	0.00	0.00	1196.20	1196.20	4196.20		
3000	78		Y	0.00	0.00	1196.2	1196.20	4196.20		0
3000	104	0	N	0.00	0.00	1643.87	1643.87	4643.87		
3000	104		Y	0.00	0.00	1643.87	1643.87	4643.87		0

Notes:

1. All calculations made as at 1 July 2011, based on a first repayment date of 8.7.11 and all repayments are weekly.
2. If the establishment fee/monthly administration fee rates are changed from 10%, 2%, the distortion is greater for those loans exceeding $2,000.

SECTION 32A - The 48% Inclusive Cap

The Delegation has always recognised that the political challenges associated with the Commonwealth Government completely abandoning the 48% cap concept would require a Ministerial and Committee preparedness to stand up to the nonsense generally pedalled by the consumer advocates.

In addition, the Ministerial and Committee preparedness requires ignoring those who argue that, just because NSW, Queensland, Victoria and the ACT have a cap, however unwise and unsuccessful, then the Commonwealth must have one. This despite Victoria attempting to recognise commercial reality and Tasmania, South Australia, Western Australia and the Northern Territory never adopting a cap, although the first three jurisdictions have considered it.

The choice of the NSW model

The Delegation notes that the current Bill has attempted to embrace the most rigorous cap of all - that applying in NSW. This despite the fact that the NSW Minister, who reintroduced the NSW legislation earlier this year, subsequently told ABC Radio listeners that he thought lenders earned 7 or 8 times what they actually do, under the NSW cap.

It is important for the Joint Committee to understand that the cap in NSW was progressively introduced under the political tenure of several Ministers for Fair Trading, only one of whom ever met with an industry delegation and, then, only after his legislation had passed through the Legislative Assembly.

NSW can also boast ministerial Chiefs of Staff who thought 48% meant $48 income, per $100 lent, per month and a ministerial Policy Adviser who admitted, a week after her Minister's legislation had been passed by the Parliament, that she had not read any industry submission.

In addition, for many years the NSW Office of Fair Trading had a senior policy adviser who was committed to anti-business measures, never visited a lender, nor endorsed a research program, before embarking on designing new anti-short term, small amount sector legislation.

Again we have another government proposal to introduce a 48% cap, that has never been researched by its consumer advocate supporters and was simply the result of an anti-Semitic UK parliamentarian assessing that 50% was usury, as he sat in the backbench of the House of Commons in 1927.

However, he advocated a flat rate 48%, not a nominal daily reducing rate 48%. In other words, if we followed his assessment - the percentage for the cap should at least be 91%.

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It may be useful for the Joint Committee to note the following jurisdictions that have rejected the imposition of a cap, all following extensive research, debate and consideration, over the last 20 years:

- Korea
- Taiwan
- South Africa
- The United Kingdom (rejected 3 times)
- Ireland
- New Zealand
- Tasmania
- Western Australia
- South Australia

In addition, Victoria first introduced a cap in 1941, but has consistently refused to include fees and charges ever since.

The Committee might also be interested in the number of major studies that have rejected any interest rate cap over the last decade, including:

- Queensland Office of Fair Trade Inquiry - Payday Lending in South East Queensland, 1999-2000
- UK Department of Trade and Industry, 2004/6
- UK Competition Commission, 2006
- Victorian Credit Review Report, 2006
- Federal Reserve Bank of New York Staff Reports, No. 273, Donald P. Morgan, 2007
- New Zealand Minister of Consumer Affairs, 2007
- UK Department of Industrial Relations, 2008
- Queensland University of Technology, 2011.

Lender Costs Realities

The Joint Committee is invited to compare the following information, in regard to the costs faced by lenders, with the gross income amounts listed in the above two charts. As will be observed, in most circumstances, the gross income generated does not even cover staff costs.

Staff Member	Rate per hour (net of on-costs)
Junior Clerk	$13.50 - $17.50
Loans Officer	$20.20 - $24.55
Outlet Manager	$23.00 - $28.50
Approvals Officer	$28.00 - $35.00
Underwriting Manager	$47.00
Senior Manager/Owner	$34.00 - $55.00
Compliance Manager	$67.00
Director	$75.00

(Smiles Turner May 2011 Supplementary Lender Research)

Given that loans will take a minimum of 1½ hours for application, documentation preparation, explanations to consumers and general management throughout the term, if you are lending up to $1,500 for 2 weeks, up to $800 for 4 weeks, up to $500 for 8 weeks, or up to $350 for 12 weeks, under a 48% inclusive interest cap regime, you will not even cover the lowest paid Junior Clerk's personal wages (excluding on-costs).

It is interesting to note that this wage is the equivalent of the hourly rate of a 16 year old working at McDonalds.

Smiles Turner's April 2011 Research provided the following information concerning other unavoidable costs:

1. 28 lenders, with 80-odd lending outlets, reported between 0-10% of their loans were never repaid, with an average of 4.3%.
2. In regard to the cost of compliance, faced by those same lenders - the payday lenders reported a range of between $5-18 per loan, with an average of $11. The microlenders reported a range of between $10-160 per loan, with an average of $60.70 and a number of the microlending outlets reported compliance costs in excess of $100 per loan.

In addition to the above costs, the lenders face the wholesale cost of money, normal business running costs including management salaries, utility costs, business rentals, generally on relatively expensive High Streets and premises and staff insurance, plus substantial computer and software costs. In addition, because they deal with money and armed robberies have occurred, most retail lending outlets have invested substantially in premises, staff and operational security facilities, some as much as $63,000 just for one outlet.

Job Losses

The details indicating failure to cover costs, listed above, will contribute to the loss of 2,500 full time equivalent positions and affect some 3,500 people, with payday, microlenders and brokers across Australia exiting the sector.

Already, one of the Delegation's bigger lenders has had key staff resigning, to seek employment security before the avalanche of retrenchments and one of the Delegation's smaller supporters has decided to quit the sector, given his investors have indicated a termination of their long term commitment due to the uncertainty.

Mass closures are expected to commence in the third quarter of next year, with the exit concluded within approximately 3 months of the commencement of the current Bills' caps on 1 January 2013 - unless the Joint Committee successfully recommends the essential amendments to the current Bill.

Section 32B - Calculation of Annual Cost Rate

The Delegation is aware that the methodology used by NSW has been adopted. A number of attempts have been made by the Delegation to question the nature and application of such a formula, because it is <u>fundamentally flawed</u>.

This is provided for in Section 32B(1) and (2) and is calculated "*as a nominal rate per annum, together with the compounding frequency, using the* (provided) *formula...*".

This is the very flawed formula that Haydn Cooper, from Min-It Software, has attempted to draw to Treasury and every States' attention, over the last 20 months. It is the formula championed by NSW in Section 7 of that State's Credit (Commonwealth Powers) Act 2010. The ACT, Queensland and Victoria all have identical formulae in their Commonwealth Powers' legislation. Further:

* The "*credit cost amount*" for the 48% loans includes most of the characteristics one or other of the States have included.

* The Bill also refers to an "*annual cost rate*", which is the amount calculated by this section (Section 20).

However, at the Consultation Group meeting on 26th August, a senior Treasury official indicated that the Delegation's concerns had been considered by Treasury experts and, while there may be some issues, it was a formula the industry was familiar with and, consequently, it was being adopted.

Notwithstanding the fundamental adoption, the Delegation notes one difference between the NSW and the Commonwealth formulae - the Commonwealth formula imports uncertainty by providing an opportunity to recognise Section 32B(3)(c), which allows for amounts to be included in the cost amount, prescribed by regulation.

After 11 years of State and Territory regulatory uncertainty, it is unfortunate that there are elements of the Commonwealth regime which import continuing uncertainty.

Inherent Challenges

The following may provide problems with the employment of this formula:

(a) R1 implies repayments of equal value. If that is the case, it must be remembered that there are frequent occasions when the last payment under a contract is different to the preceding repayments.

(b) J, in providing for circumstances where the contract does not have a constant repayment interval, by allowing the credit provider to select an interval, runs the risk of generating a value outside the prescribed tolerance amount in Section 32B(5).

We note the possibility of "*distortion*" is acknowledged in the "*Commentary - Caps on Credit Contracts*" paper, issued by Treasury some weeks ago.

Impracticality of the Legislative Provisions

The Delegation notes that the cap provisions are described as being "*an annual cost rate*" rather than "*an annual interest rate*", which is used in the NSW and Qld legislation.

The annual cost rate formula is <u>different</u> from the Comparison Rate in that the definition of C_j is defined as being:

"*the credit cost amount (if any) for the credit contract that is payable by the debtor at time **j** in addition to the repayments* R_j",

Whereas, under the Comparison Rate formula, it is

"*the fee or charge (if any) payable by the debtor at time **j** in addition to the repayments* R_j*, being a credit fee or charge (other than a government fee, charge or duty) that is ascertainable when the comparison rate is disclosed (whether or not the credit fee or charge is payable if the credit is not provided*".

Whilst the definitions of j and t are worded slightly differently, they have the same meaning.

The effect of this would likely mean that all existing calculators would have to be modified, or reassembled to cope with the change, as no existing software will be able to calculate it. It may even mean having to use two calculators, one to calculate the actual repayment using a nominal interest rate and another to ensure it remains within the annual cost rate. It is not possible to use a nominal rate, as occurs now, on any lender's ability to legitimately comply with the NSW capping regime. For many credit providers, given the complexity that it entails, it may mean changing systems.

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The formula in the current Bill creates distortion where there are irregular payment amounts and dates and suggests redefining ***j*** to be a multiple of days. Whilst this is achievable for those that can calculate it (it cannot be calculated using Microsoft Excel®), being based on the Comparison rate formula, it would encompass the same inherent distortions that one produces.

The definition of "*credit cost amount*" is a new term, defined in Section 32B(3) and this is the sum of the following amounts if they are ascertainable:

(a) "*the amount of credit fees and charges payable in relation to the contract;*

(b) *the amount of a fee or charge payable by the debtor (whether or not payable under the contract) to:*

   i. *any person (whether or not associated with the credit provider) for an introduction to the credit provider; or*

   ii. *any person (whether or not associated with the credit provider) for any service if the person has been introduced to the debtor by the credit provider; or*

   iii. *the credit provider for any service relating to the provision of credit, other than a service referred to in subparagraph (ii);*

(c) *any other amount prescribed by the regulations*".

Although similar to the redefinition of credit fees and charges in the NSW Credit legislation, it differs from it in two respects:

1. the formula now excludes all government fees and charges, making it closer to the Comparison Rate formula; and
2. the wording further extends the NSW provision of the definition of credit fees and charges, to include all fees and charges payable by the debtor to anyone for an introduction to the credit provider, or for any service if the person has been introduced to the debtor by the credit provider, even if they are not associated with the credit provider.

Unintended Consequences

The Delegation has identified four unintended consequences that will emerge:

1. Any default fees or charges would have to be regarded as principal and any actual expenses incurred in the exercise of the defaults would therefore be totally unrecoverable by the credit provider.
2. The recovery of costs expended by the credit provider, prior to the contract being executed, such as a REVS or security interest certificate, will also be cause for concern. Most contracts contain a provision for the credit provider to recover from the borrower any fees or charges they may expend, prior to execution. If the debtor does not actually take up the credit, for whatever reason, A_j will always be "0.00" and, as the requirement is not to exceed 48% at any time, where there is no credit being provided this would make it impossible for any lender to recover such costs. Even if the borrower were to pre-pay such costs, the wording would mean the credit provider breaches Section 32A(2) if any amount pre-paid is not refunded in full.
3. As "*government fees and charges*" are not defined, there is confusion as to whether a fee payable to a third party for a government certificate, in connection with the credit contract, is included or excluded. Typical examples here are REVS or V-Check certificates, but it will also encompass security interests under PPSR. This is because that third party will also have made some element of profit for supplying the certificate, yet the credit provider is not permitted to make any profit for supplying exactly the same certificate.

4. The formula also provides the ability to be further modified under Regulation. Again, we have the introduction of regulatory uncertainty.

Section 32A(4)(a) - Exemptions

The Delegation notes that, if the credit provider is an ADI, it is exempt from the 48% cap regime.

During 20 months of consultation, no explanation has ever been offered as to why ADIs should be treated differently.

Section 204(1) - the First Amount of Credit

The Delegation notes that a new addition to Section 204(1), being the definitions section of the Code, is included in the current Bill. It is "*the first amount of credit*", minus permitted establishment fee, minus permitted monthly fee, minus any prohibited credit amount, minus anything else that may be included in the regulations, from time to time.

The first payment of 2% at the signing of the contract, in accordance with the provision "*payable on a monthly basis starting on the day the contract is entered into*" is highly likely going to be included in the borrowed amount. The 10% establishment/initial administration fee is highly likely to be included in the contract credit amount. As the Joint Committee would also appreciate, this is due to the consumer applying for a loan because he is short of money and it is likely that he will need the lender to cover these two fees on the first day of the loan.

It is accepted that this 2% for the first month, thereafter will be paid back periodically, along with a contribution to repaying the principal, from the consumer's own resources.

Free Loan Portion for Consumers

The problem with deducting the first 2% payment and the 10% payment from the amount advanced, and then calculating the fees to be paid as a reward to the lender for the credit provision, is that the methodology provides an inbuilt subsidy to the consumer. While he has to repay that money as it is part of the loan principal, he pays nothing for it. It is a free loan.

That means the lender cannot calculate a gross income of 10%, plus 2% per month, on the money advanced. The meagre total involved must be reduced by that amount attributable to the money provided, to cover the 10% and the first 2% fees.

In addition, when the lender approaches calculating his net profit, he must deduct the cost to provide the portion of the loan that is available for free to the consumer. This will be some part of his business costs appropriately apportioned, plus the 10% and 2% per month of that portion of the credit provided that cannot attract those fees, being his opportunity cost. That money has been tied up giving a free loan to the first consumer to cover costs, and is not then available to lend to a second consumer, who would be paying the 10% and 2% on that money (or a similarly adjusted down amount).

If the borrower provides his own 10% and first 2% fees, on the signing of the contract, then the calculation is simple.

The Delegation expects some software programming challenges and some complexity in explaining all this in the contract documentation.

As the definition in Schedule 4, Topic 20 is written - if the consumer borrows an amount and this does not include an amount for an establishment fee and to cover the monthly fee, and/or the first 2% monthly fee, it still has to be deducted. That is - even if paid separately by the consumer, without any of the amount borrowed being used to pay any part of the fee/s.

SCHEDULE 5 - Consumer Leases

Section 175H - being the requirement of an End of Lease Statement.

The Delegation recommends that the regulations foreshadowed in Section 175H(1) should also provide, as an option for the lessee, to extend the lease rather than just a requirement to return the goods. If the goods are to be returned, in addition to the prescription of a return date, the Regulations should also require the statement to include a time and the place for return of the goods.

Section 179A(2) - in regard to the provision in subsection (2)(b), to the effect that the lessee has no right to own the goods if the lease is terminated - the Joint Committee is asked to note that legal advice the Delegation has received supports the proposition that a contractual option allowing the lessee to make an offer for the goods is essentially granting a right - but not an obligation - to purchase. However, it is recognised that this option adds some value to the lease. There is an argument, supported by a number of the Delegation's legal advisers, that the inclusion of the option demands that the lease be treated as if the option was granted from the start.

In the alternative, the Delegation recognises that an option is the equivalent of an unascertainable fee and should not colour the nature of the lease until it is exercised.

On this basis, the Delegation has come to the opinion that a contract containing such an option should not invalidate the lease, as it is clear the intent is to allow return or purchase. It is only where the choice is to purchase that the arrangement should become subject to Section 9 of the Code.

Section 179M(1) - requiring the lessee to provide details of the location under a lease, within 7 days of the request being received.

The Delegation is concerned with the challenges of getting Courts to enforce such a provision. It would be useful if the section was strengthened, to allow for a Contempt of Court order to be granted, if the previous Disclosure Order is disobeyed by the lessee.

It appears that any enforcement action must be taken by ASIC, given there is no obvious ability for the lessor to take the lessee to Court. In light of the previous reluctance by the States to enforce a similar provision under the former Consumer Credit Codes, it might be useful if the section was also amended to allow the lessor to take the lessee to Court.

Division 9 - concerning increasing credit provider's responsibility in linked credit circumstances.

The Delegation interprets this provision to mean any supplier's misrepresentations, in linked leases and tied consumer leases, are to be treated as if they were either the supplier or the lessor's statement and the lessee can chase the lessor, rather than the supplier, when the goods do not match their description.

The Delegation's concern is that this provision is inequitable. It is unrealistic to expect a credit provider to have the opportunity for sufficient management and control over a retailer, or control over the quality of manufacture of the product that retailer is selling.

The Delegation supports the general thrust of the new legislation, which equates loans with leases. However, Credit Providers that provide both loans and leases face a significant test of establishing suitability/unsuitability, particularly as most lease applications are made at the point of sale.

If a retailer is encouraged to concentrate on one method of finance over another (lease over loan, or reverse), via a bonus or commission structure, the credit

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provider has no real way of establishing whether or not the loan or lease requested is more suitable than the other for the consumer's needs.

The Delegation suggests that a clear conflict of interest arises that leaves the credit provider at risk to claims, after the event, that the contract/lease was not suitable. This may emerge as an important issue, as a result of the new regulatory provisions concerning tied leases.

It is the Delegations' view that there needs to be a high degree of certainty established and, with a salesperson in a unique and influential position when dealing with the consumer, we do not believe this is possible unless the point of sale company and staff are also made accountable under the NCCP Act.

Section 151 - Obligations to Assess Unsuitability (Promising Eligibility without Assessment)

The Delegation notes this Section provides that you cannot promise eligibility for a loan or a lease, without the need for an "unsuitability" assessment. While this is understandable, given the focus on assessment in the NCCP Act, the Delegation suggests splitting this section into a credit contract and a lease component and inclusion of this lease provision in Schedule 5, so that all provisions concerning consumer leases are in the one area of the Bill.

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CHAPTER FIVE: The Lending Sector's Response to Consumer Advocate Claims

We have frequently been advised to be prepared to respond to the claims put forward by the consumer advocates and it is hoped that the following assists the Joint Committee in its understanding of the commercial sector's position.

Some of the issues have been raised above, but we include them in the chart for the sake of completeness.

Consumer Advocates	Delegation's Response
Consumers borrow for "weekly" (basic living expenses) items purchase	The purpose of the loan cannot be controlled by the credit provider. The NCCP Act & Regulations mandates responsible lending, not the actual purpose of the loan.
CALC determines basic living expenses as including 20% car repairs/registration, 21% utilities, 18% food and other essentials, 11% rent.	Smiles Turner research indicates somewhat different percentages for reasons to borrow, with "paying bills", "shopping" and car repairs and registration frequently adding up to approximately 30% of the total reasons given for borrowing. However, if consumers need to borrow to cover these items, why shouldn't they be allowed to do so? Problem - where else do they go? They can't all go to the non-commercial alternatives, as these alternatives' criteria preclude them.
One repayment loans are bad	The key issue is disposable income after repayment. If prohibiting such loans was to be considered, is there a danger that you increase the amount of debt outstanding for longer, plus encourage people to take longer or larger loans than they need or want?
Anti-back to back, or repeat loans	Why force consumers to go to a different lender, who has no history with the consumer?
Prohibition of 2 parallel loans	Why a total exclusion? There is no evidence that 2 or 3 concurrent loans are necessarily a problem, provided responsible lending obligations are satisfied. This fails to recognise changing consumer circumstances and forces entry into larger loans "just in case". It is impossible to adequately and comprehensively control, when consumers can go to a second lender for their second loan. There is no current comprehensive register of small amount loans, to assist the second lender - as is available in some overseas jurisdictions.
Quoting APR critical	This is not an issue for the industry, but is confusing and useless for consumers. Consumers want dollar amount costs, not interest rate costs. Interest rates do not effectively indicate the costs of any small amount loan.
Need strong enforcement	The legitimate industry agrees. Loss to non-compliant competitors is distressing and most inappropriate.
Use of Direct Debit Deposits bad	Tell that to the banks, with their collection of home and other mortgage payments, the insurance companies with their collection of premiums, real estate agents with their collection of rents, retailers such as Myers and Grace Bros with their credit accounts, utilities and telcos with their universal adoption of such payment processes, and many other businesses who insist their customers pay in this way. Consumer advocates ignore the positive change in behaviour this imposes on some previously irresponsible consumers, the fact that it reduces default fees, it can be cancelled at

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	the whim of the consumer and, for most lenders, it is not a condition of providing a loan, as they will accept other methods of paying.
48% is essential	It began in 1927 as a whim on the part of an anti-Semitic UK MP, who wanted a figure under his concept of usury. His idea was a flat rate, not daily reducing balance, which equates to approximately 27% flat - just 56.25% of the original intended amount. None of the consumer advocate groups have ever done any research into the 48% amount, including any quantitative investigation as to lender costs. They just assume a lender can make a profit lending small amounts, generally without security, at 48%. They refuse to visit any of the lending outlets to see what goes on, or to recognise cost analyses provided by the Delegation and others. With no business experience or training, with no employment of actuaries or accountants, their simplistic answer is – 'just adjust your business model so that you can make a profit'.
All borrowers are "desperate" and "vulnerable"	The population they look to, before arriving at that conclusion, are the small minority of borrowers who go to them for help. Some are in genuine need, but many are looking for any excuse to avoid repaying. They do not see the 95.4% who repay their loans without a default, or the 99% plus, who never see a need to contact them.
Responsible lending is not enough	When does the consumer take some responsibility for their own actions? They have to be over 18, they can vote, they can marry and have children, they can enter into contracts which they know bind them legally. Why do they have to be treated like idiots?
The lenders must lend at a loss	What other commercial venture is expected to trade at a loss? Why don't they petition the Government for higher Centrelink benefits, rather than attempting to make legal, compliant, commercial small amount lenders conduct a supplementary service to the benefits provided by Centrelink? Is the Government going to provide these lenders with the same tax and other benefits that charitable organisations receive? The consumer advocates are attempting to coerce lenders into breaching the Corporations Act, requiring them to continue trading while insolvent.
The consumers must not be denied the opportunity to borrow	Unfortunately, what consumer advocates are proposing will deny the majority of micro-borrowers the opportunity to borrow, because the consumer advocates simply refuse to understand that businesses must cover costs and generate at least some profit, to justify business continuation. In the business world, if you are not making a profit, you get out of the business.
Payday lenders should not lend to the "desperate" and "vulnerable"	There is no apparent evidence of this concern being transformed into action, to obtain adequate resources for the supposed alternatives. There isn't any recognition that it does not make any business sense to lend to someone who you don't believe has the capacity to repay. The term often used is "throwing good money after bad".

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To reduce the number of loans should be an objective.	Why not suggest a level at which all loans should be banned. The response to the industry, when a suggestion of this nature is made, is that you cannot have a group excluded from credit and you cannot have a rigid rule. You cannot tell people they aren't allowed to borrow, which is the only way that the number of loans can be reduced. Are those borrowers just supposed to forget about finding the money they need? They are attempting to place all responsibility on the lenders, with none on the consumer advocates to actually make some hard decisions.
NSW caps work	This is simply not true. No one is lending in NSW, using the conditions under the current NSW legislation. As the Regulation Impact Statement noted avoidance, by exploiting loopholes, has been encouraged by the stupidity of this legislation.
Our research shows	The "research" undertaken by and for the consumer advocates has been totally inadequate and extrapolations from this research have been disingenuous. The procedures and processes adopted have been almost universally inadequate, by professional research standards, and many samples used have been grossly undersized and incredibly biased in their selection, with results then presented as being applicable to the whole consumer population. Further, only one research project has been attempted in recent years, mixing poor 2008 and 2009 "qualitative" and "quantitative" investigations to produce a 2010 report, prior to the Commonwealth takeover, and then attempt to apply it for the post-Commonwealth takeover period.
US circumstances are comparable	This is also not true. US payday loans are generally for only one pay period, are guaranteed by a post-dated cheque and are lent in circumstances where considerably lower lending costs are involved.
Canadian circumstances are comparable	This is also not true. Canadian lenders face far lower costs.
European circumstances deserve consideration	State owned alternatives often exist, costs are lower and significant criminal lending alternatives are able to flourish.
Wish to restrict availability of loans	This fails to acknowledge: • the outcome in Victoria, in the 1990s, when pawnbroking was effectively abolished; • the existence of bikie gangs in SA and QLD, with national connections, who have already shown an interest in payday lending; and • the Lebanese and Vietnamese/Australian gangs, with their experience of lending in casinos in NSW.
The use of figures "showing" 40 to 49% of short term borrowers having incomes of under $24,000, and 50 to	This is cited looking only at one lender and assuming that lender's lending policies are those common to the whole microlending sector. They are not. The percentages are not necessarily reflected in the loan books of other companies.

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74% having incomes of less than $36,000 per annum	
Payday loans are not for unexpected expenses	This has been substantially disproved by Smiles Turner research.
Homeless seek payday loans	Responsible lending criteria, plus the business reality of not giving money away, makes it unlikely for a lender to ever lend to someone who does not have a permanent address.
Drug users borrow payday loans	A South Australian MPs' allegation that 8% of borrowers are drug users, has never been substantiated by any other research.
The greater of 2 weeks, or one pay period between repeat loans	There has been no research undertaken to support this approach as having achieved anything.
Reduction in the harm caused by short term loans	There has not been any credible research and/or greater clarification of the concept and amount of "harm" (as opposed to relating one-off anecdotes). No alternative solution has been provided, except to pretend that the existing non-commercial loan sources will be able to cope.
Want APR quoted so consumers can compare with other products	There has been no research undertaken, by consumer advocates, to counter the Smiles Turner research that shows consumers do not use APRs for product comparison.
DDRs encourage repeat loans and debt spiral	No research has ever been attempted to explore such an alleged link.
One off stories must be the norm	No research has ever been undertaken to support their, often poorly researched, one-off stories.
DDRs impinge on capacity to repay	No research has ever been undertaken to support this alleged connection.
Garnishee orders inappropriate	The court recognises that the consumer owes.
Employment deduction authorities inappropriate	This is always done with the consumer's consent. In the majority of cases they have the opportunity to pay via an alternative method.
Ineffective state caps bad	There is no recognition that they are totally unrealistic, because they fail to consider the actual costs of lending.
Greater enforcement will encourage lenders to settle	This is the current blackmail approach frequently adopted, regardless of the legitimacy of the consumer's case. This is using a taxpayer funded facility to force a lender to spend more than the loan amount outstanding, just to defend itself.
CALC want an ASIC regulatory guide for what lenders' reasonable costs are	This assumes uniform cost conditions apply which, as with all industries, is totally unrealistic. Further, they have failed to undertake their own research in the area and have rejected all cost information that has been provided.
Little incentive for the borrower to 'dob in' the lender	This is not necessary, given ASIC's comprehensive investigation powers and the mandatory existence of IDR and EDR processes. This also ignores the possibility that borrowers may be happy with the service provided and not see any need to do so.

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Borrowers do not see any other option	Smiles Turner research, plus recent Veda Advantage analysis, indicates at least 25% do have other options. Substantial answer provided in proposed legislation, for some with internet access seeking loans.
Payday borrowers usually have a low income, experiencing hardship	The latter is contrary to mandatory responsible lending criteria.
Seeing more clients who cannot afford to repay	Probably, given the exponential growth of microlending. This is also due to second tier economic conditions. Further, the influence of biased media reports, where borrowers read/see how a "borrower" was "saved" from having to repay a loan to "loan sharks", cannot be overlooked.
Payday lenders feed the myth that people on low incomes can't manage their finances, while the S&L products offered by the Brotherhood of St Lawrence, with the ANZ, disprove this myth.	There has been no industry research that has revealed any significant difference in defaults, according to the different income segments serviced by the industry. Note, this Brotherhood of St Lawrence statement conflicts with CALC statements, that low income people should not be given loans because they can't manage their finances. Proposed reforms will penalise the many, while attempting to assist the few.
CALC 2010 Report quoted research results indicating most payday borrowers had recently used other forms of credit	This is not consistent with Smiles Turner research and is based on one internet survey, which introduces a methodological bias.
Use of payday loans to pay off credit cards and/or mortgages	Highly likely the consumer lied about the purpose for their borrowing. There is also an element of debt control, where a borrower is wishing to consolidate their debts in order to be more able to afford repayments.
Financial counsellors see many people impacted by payday loans	Possibly, but no statistics have ever been provided to substantiate this claim and there has never been any information provided as to what other finance elements could have been involved.
Low income earners' meagre resources are siphoned off by high cost loans	Resources 'siphoned off' have to meet responsible lending criteria.
High cost of payday loans leaves clients paying off the interest but never the capital	Either a question of reporting to ASIC, or consumer deception. Fundamentally, lenders require their capital to be repaid, because the longer the loan term, the higher the bad debt risk. This is more of a problem with credit cards.
Borrowers are unaware of terms and costs/hidden costs	The mandated documentary regime makes that virtually impossible, as has been substantiated by Smiles Turner research.

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ACOSS - financial exclusion is a barrier to people on low incomes	This problem will be much larger with the introduction of the proposed legislation.
Each wants the onus back on lenders to adhere to legal and/or ethical responsibility re. inappropriate loans for utility bills and gambling	When are the borrowers going to take some responsibility for their actions? Why are lenders expected to be financial counsellors and act like supervisors?
Wesley Uniting Care, Adelaide, supports the current proposals to ease the pressure on borrowers, thereby easing the pressure on services dealing with the borrowers	If the legislation passes unaltered, there will be more pressure on borrowers, who will have nowhere to go and even more pressure on community services, who will have to bail them out.
Clients who use these loans are frequently unable to escape the debt trap, with lenders targeting the most vulnerable consumers.	Why would a lender target someone who couldn't pay them back? It is totally unrealistic to expect lenders to just give money away, which would be the outcome of such a foolish business concept.
Payday lending is accessed as a last resort	Yes. But where will the people go if the industry is effectively abolished by the current proposed legislation?

CHAPTER SIX: THE OTHER SIDE OF THE STORY - 12 Case Studies

The Delegation is aware that consumer advocates have a preference for presenting one-off anecdotes featuring a consumer that, allegedly, has been disadvantaged by one or more lenders.

While Delegation members are always most distressed to hear of any consumer being mistreated by other lenders in the industry, nevertheless they are very conscious of the fact that the consumer advocates' pattern of failure to verify the truth of the individual stories, has been consistent.

In June 2011, one consumer advocate organisation released a document which included 12 "*case studies*". While it was noted that, on page 6 of the document, there appeared the statement "*the cases cited herein do not claim to be representative or of a statistically significant number*" and it was later learnt that at least two of the studies were successfully challenged as fictitious by the alleged relevant lenders, the organisation involved still widely circulated the document as having veracity and has included it on its website.

With such apparent interest in "case studies" and anecdotal "evidence", the Delegation resolved to use the same approach and collect the same number of case studies from lenders around the country. Following the request, coordinators Smiles Turner were inundated and decided to use the first 12 that were received, to establish neutrality in selection for participation.

To conclude this submission, we provide "the other side of the story" for the Joint Committee's consideration.

LENDER NO. 1

Lender's state:	NSW
Company size:	Large
Number of complaints involving consumers, referred to COSL, since 1 July 2010:	1 (not from a consumer). This was resolved in 2 minutes by negotiation.
Number of complaints referred, decided in the lender's favour:	No COSL determination required/involved.
Percentage of total loan applicants since 1 July 2010, who have attempted to materially misrepresent their financial circumstances	10% +
Percentage of total loan applicants who have presented forged or altered documents, or attempted to avoid providing certain documents:	Significant numbers

Worst case 1 July 2010 - 30 June 2011:

The consumer negotiated a loan to pay medical bills.

Three days later he came back and admitted he had not been honest about his financial circumstances and that he could not meet his repayments as negotiated.

He admitted this in writing and the lender negotiated a manageable repayment plan of $20 per week.

The consumer was very grateful.

For some time, the new repayments were being met.

Without warning, the consumer then went to the Consumer Action Legal Centre.

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To avoid costly lawyer's bills and waste of management time, the lender wrote off the loan.

The end result was that the consumer walked away without paying the full principal, or anything towards interest or fees.

LENDER NO. 2

Lender's state:	Vic
Company size:	Small
Number of complaints involving consumers, referred to COSL, since 1 July 2010:	0
Number of complaints referred, decided in the lender's favour:	N/A
Percentage of total loan applicants since 1 July 2010, who have attempted to materially misrepresent their financial circumstances	5%
Percentage of total loan applicants who have presented forged or altered documents, or attempted to avoid providing certain documents:	0%

Worst case 1 July 2010 to 30 June 2011:

A young unmarried woman with a child, and one on the way, asked for a loan to purchase items for the children (beds, cot, walker, etc.).

After the lender arranged the loan, it was discovered that the woman had at least two other bank accounts. This meant the lender had no way of knowing the consumers' real financial situation, with regard to other loans.

When her account started to default, she immediately stopped answering the phone, or hung up on the lender's staff.

Within a month, she had moved to Tasmania.

LENDER NO. 3

Lender's state:	Qld
Company size:	Large
Number of complaints involving consumers, referred to COSL, since 1 July 2010:	18
Number of complaints referred, decided in the lender's favour:	16 (2 decisions pending, but the lender is expecting another favourable outcome)
Percentage of total loan applicants since 1 July 2010, who have attempted to materially misrepresent their financial circumstances	5%
Percentage of total loan applicants who have presented forged or altered documents, or attempted to avoid providing certain documents:	1.5%

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Worst case 1 July 2010 to 30 June 2011:

The consumer denied ever signing for a loan or contacting the lender. Never made a repayment. The lender has a voice recording of the consumer consenting to the loan and third party witnesses to the consumer signing the documentation, but didn't both pursuing the consumer, due to the associated costs and low value of the loan.

LENDER NO. 4

Lender's state:	SA
Company size:	Small
Number of complaints involving consumers, referred to COSL, since 1 July 2010:	0
Number of complaints referred, decided in the lender's favour:	N/A
Percentage of total loan applicants since 1 July 2010, who have attempted to materially misrepresent their financial circumstances	30%
Percentage of total loan applicants who have presented forged or altered documents, or attempted to avoid providing certain documents:	15%

Worst case 1 July 2010 to 30 June 2011:

The lender had a middle aged couple come into the branch with the lady in a wheelchair, which the husband was pushing.

The lady was crying that they were about to be evicted, as they had not made the rent payments because of her medical expenses.

The lender lent a small amount of money to both the husband and wife.

By the time the lender went to direct debit their account for their first payment, the couple had cancelled the authorisation.

A short while later a staff member spotted the couple at a local shopping centre, fit and apparently healthy, no wheelchair and shopping!

LENDER NO. 5

Lender's state:	WA
Company size:	Small
Number of complaints involving consumers, referred to COSL, since 1 July 2010:	0
Number of complaints referred, decided in the lender's favour:	N/A
Percentage of total loan applicants since 1 July 2010, who have attempted to materially misrepresent their financial circumstances	5%
Percentage of total loan applicants who have presented forged or altered documents, or attempted to avoid providing certain documents:	5%

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Worst case 1 July 2010 to 30 June 2011

May 2011 - New client application

- Home buyer, said she only had a mortgage, an M/U loan and credit card.
- On investigation, it was found she had 27 consumer credit enquiries in the last 12 months, she had 4 other loans that she hadn't declared and 1 court writ.

LENDER NO. 6

Lender's state:	WA
Company size:	Small
Number of complaints involving consumers, referred to COSL, since 1 July 2010:	0
Number of complaints referred, decided in the lender's favour:	N/A
Percentage of total loan applicants since 1 July 2010, who have attempted to materially misrepresent their financial circumstances	95%
Percentage of total loan applicants who have presented forged or altered documents, or attempted to avoid providing certain documents:	25% avoid

Worst case 1 July 2010 to 30 June 2011

Consumer came in wanting to borrow $1,000 (unsecured) for Christmas presents for her family. She said she had debts and was "sick of it all".

A Veda search revealed the consumer had 10 defaults, 2 court writs, 7 court actions and owed in excess of $1 million.

She then admitted she intended to file for bankruptcy the following week.

She couldn't understand why that she was being declined for unsuitability reasons.

She said "It's only a thousand dollars!"

LENDER NO. 7

Lender's state:	NSW
Company size:	Small
Number of complaints involving consumers, referred to COSL, since 1 July 2010:	0
Number of complaints referred, decided in the lender's favour:	N/A
Percentage of total loan applicants since 1 July 2010, who have attempted to materially misrepresent their financial circumstances	10%
Percentage of total loan applicants who have presented forged or altered documents, or attempted to avoid providing certain documents:	10%

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Worst case 1 July 2010 to 30 June 2011

Couple seeking a loan, "ripping off" Centrelink. On single parent benefit, but living with someone - one child each, still living together after "splitting up", to get higher Centrelink benefits.

LENDER NO. 8

Lender's state:	Qld
Company size:	Medium
Number of complaints involving consumers, referred to COSL, since 1 July 2010:	1
Number of complaints referred, decided in the lender's favour:	0
Percentage of total loan applicants since 1 July 2010, who have attempted to materially misrepresent their financial circumstances	2%
Percentage of total loan applicants who have presented forged or altered documents, or attempted to avoid providing certain documents:	1%

Worst case 1 July 2010 to 30 June 2011

Consumer borrow $1,000 and immediately entered into a Part 9, without making a single repayment.

LENDER NO. 9

Lender's state:	Vic
Company size:	Small
Number of complaints involving consumers, referred to COSL, since 1 July 2010:	0
Number of complaints referred, decided in the lender's favour:	0
Percentage of total loan applicants since 1 July 2010, who have attempted to materially misrepresent their financial circumstances	60% (or seriously understate their financial commitments)
Percentage of total loan applicants who have presented forged or altered documents, or attempted to avoid providing certain documents:	5%

Worst case 1 July 2010 to 30 June 2011

A couple, one a nurse and the other a postman, borrowed a larger amount, then made between 4-5 payments (out of a possible 39), left their jobs and disappeared. It was discovered they had set up bogus contacts, which appeared legitimate at the time.

Their intention was to "sting" the lender.

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LENDER NO. 10

Lender's state:	Qld
Company size:	Small
Number of complaints involving consumers, referred to COSL, since 1 July 2010:	0
Number of complaints referred, decided in the lender's favour:	0
Percentage of total loan applicants since 1 July 2010, who have attempted to materially misrepresent their financial circumstances	8%
Percentage of total loan applicants who have presented forged or altered documents, or attempted to avoid providing certain documents:	0%

Worst case 1 July 2010 to 30 June 2011

A reliable consumer, with a secure job, who had never missed a payment before, requested a $2,000 bond loan. This was granted.

Then her direct debit payments bounced because she'd closed her bank account.

On investigation, it was found she'd quit her job after getting the loan and had gone overseas.

LENDER NO. 11

Lender's state:	Vic
Company size:	Small
Number of complaints involving consumers, referred to COSL, since 1 July 2010:	0
Number of complaints referred, decided in the lender's favour:	0
Percentage of total loan applicants since 1 July 2010, who have attempted to materially misrepresent their financial circumstances	5%
Percentage of total loan applicants who have presented forged or altered documents, or attempted to avoid providing certain documents:	5%

Worst case 1 July 2010 to 30 June 2011

A consumer claimed that someone had stolen her identity and had used it to take out a loan with the lender three days earlier.

The lender questioned the consumer as to how it was the "identity thief" knew all her personal details and how the consumer had managed to retrieve all of her credit cards and licence so quickly.

It was pointed out to her that the handwriting on the loan application and the signature appeared to be hers and, when questioned as to how she had learned that the loan had been taken out, when there were thousands of businesses where the cards could have been used, the consumer had no explanation.

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LENDER NO. 12

Lender's state:	Vic
Company size:	Medium
Number of complaints involving consumers, referred to COSL, since 1 July 2010:	1
Number of complaints referred, decided in the lender's favour:	1
Percentage of total loan applicants since 1 July 2010, who have attempted to materially misrepresent their financial circumstances	10%
Percentage of total loan applicants who have presented forged or altered documents, or attempted to avoid providing certain documents:	Internal procedures block this

Worst case 1 July 2010 to 30 June 2011

The consumer approached COSL, claiming that the lender's fees and charges were excessive and that he had not been made fully aware of them before signing the contract. He believed the should not have to pay the loan back in full, if at all.

The consumer had not approached the lender first, would not speak or write to the lender and requested COSL to represent him.

On investigation, it was found that three weeks into his first loan's 12 month term, he had requested and been refused an additional amount.

It was also found that the consumer had previously worked in the credit industry and, after taking out a loan with another lending group and defaulting on that loan, he had threatened to complain to the Credit Ombudsman Service that their fees were too high and they hadn't fully disclosed them to him.

Unfortunately, that earlier lender discharged the loan, rather than argue, which encouraged him to try the same tactic, not only with the current lender, but with another who also fought back.

The current lender has a policy of having the consumer initial every fee and charge in the contract once they have been explained to them.

COSL found in favour of the lender and, after some negotiation, the consumer went on to pay out the loan.

CONCLUSION

There should be no expectation that lenders will continue in the industry sector, while losing money on every short term, small amount loan they advance, if the current Bill proceeds unamended.

Any reliance on the RIS, or wishful thinking of others that sufficient lenders will stay in the sector after 1 January 2013, would be most unwise.

The Delegation thanks the Joint Committee and its staff for their consideration of this submission and hopes that the Committee will see fit to recommend appropriate changes to the current Bill, to ensure a continuation of the availability of short term, small amount credit for consumers - and the existence of fairly and realistically regulated lenders, after 1 January 2013.

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