

Redfern Legal Centre



The General Manager
Retail Investor Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: creditenhancementsbill@treasury.gov.au

7 September 2011

Dear Sir/Madam

Please find attached our policy submission: *Payday Lending and Credit Law Reforms*, which we submit in response to Treasury's invitation to comment on the exposure draft of the *National Consumer Credit Protection Amendment (Enhancements) Bill 2011* (the Bill).

We would welcome the opportunity to further discuss our submission with you should you wish to do so.

Yours faithfully,

Redfern Legal Centre

Joanna Shulman
Chief Executive Officer

Redfern Legal Centre



SUBMISSION:

Payday Lending and Credit Law Reforms

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1. Introduction: Redfern Legal Centre

Redfern Legal Centre (RLC) is an independent, non-profit, community-based legal organisation with a prominent profile in the Redfern area.

RLC has a particular focus on human rights and social justice. Our specialist areas of work are domestic violence, tenancy, credit and debt, employment, discrimination and complaints about police and other governmental agencies. By working collaboratively with key partners, RLC specialist lawyers and advocates provide free advice, conduct case work, deliver community legal education and write publications and submissions. RLC works towards reforming our legal system for the benefit of the community.

2. RLC's work in Credit & Debt

RLC identifies economic rights as important in the attainment of a just society. RLC has long recognised that, without the ability to exercise their economic rights, people are unable to maintain other rights. Economic rights are essential to effective and productive participation in society, including keeping families together, safe housing, jobs, and freedom. For this reason, RLC has continued to emphasise casework delivery to people in relation to banking, credit and debt problems. RLC provides specialist credit and debt face-to-face and telephone advice services.

RLC also provides a support service to financial counsellors in NSW, whereby financial counsellors are able to call or email our credit and debt solicitors to obtain legal information and assistance as they need it.

3. RLC's views in summary

RLC welcomes the opportunity to comment on the Bill. It is important to recognise the role that payday-lending plays in indebtedness amongst socioeconomically disadvantaged individuals. Payday lending can seem like a suitable solution to credit and debt problems for low income and desperately indebted individuals. However, because of the high cost of such loans, payday lending often worsens indebtedness to the point where it becomes extremely unlikely that the individual will ever be able to repay the debt.

It is our position that a prohibition on charging fees and charges (than those specified) and on the refinancing of small amount contracts would assist consumers to better understand the cost of the loan, and to avoid becoming entrapped in a debt spiral through the refinancing of one credit contract to repay another. This is an all too common problem in the payday loans market, and one that consumers are often unable to escape without extreme hardship.

In addition, we welcome improved regulation of payday lenders' websites. Payday lenders use their websites both to advertise and to accept applications for credit. In our view, the advertising content of many payday lenders' websites is cause for concern. Payday loans are presented as a quick, easy solution to cash flow problems for consumers, who are

lured into making an application by the promise of easy money. Such advertising messages have the potential to be inaccurate and misleading to consumers. The proposal to require a short, high-impact statement disclosing available credit and debt advice/assistance services and loan alternatives would go some way towards assisting consumers to understand the real risks (and the high cost) of payday loans.

In addition to regulation of website content, we would like to see a similar requirement to inform consumers of their options with regard to small amount credit contracts imposed on television, radio and print media advertising, as many consumers find out about payday loans through sources other than the internet (particularly vulnerable groups such as the elderly, people with disabilities and people from culturally and linguistically diverse backgrounds).

Further, it is our position that the proposed amendment to introduce Australia's first national cap on the annual cost rate is an important step forward in maintaining and expanding the NSW cap, which has long been an important protection for credit consumers in NSW.

We acknowledge that the payday lending market is characterised by certain features that make small amount loans more expensive, including the high risk of default and the high administrative costs of short-term loans. However, there should be a limit on the amount of fees and costs that can be charged under small amount credit contracts, to protect vulnerable consumers. It is important to recognise the role that payday-lending plays in indebtedness amongst socioeconomically disadvantaged individuals.

Where the risk of lending is so high that a consumer loan cannot be granted without charging an interest rate that breaches the 48% cap, we submit that such a loan is irresponsible and predatory, and should not be permissible.

4. RLC's comments on specific issues

Clients of the payday loan industry

There are primarily two reasons why people enter the payday loan market:

1. The amount of money required by the individual is too small for the mainstream lender market.
 - Most mainstream lenders do not grant personal loans for amounts less than \$4,000 or \$5,000. If an individual is unwilling to seek a personal loan of a higher amount from a mainstream lender, the payday loan market may seem like their best option to access a smaller amount of credit.
2. Inability to obtain credit from mainstream lenders.
 - Often, the main reason individuals seek to borrow money from a payday lender is because they are unable to obtain credit in the mainstream market due to their poor financial situation. In other words, mainstream lenders consider them to be a bad risk, due to the low likelihood that they will be able to afford their repayments. Individuals who fall into this category have few options in terms of accessing credit, and as a result are more vulnerable to the risks associated with payday lending.

Individuals falling into the second category are already vulnerable due to their financial disadvantage and perceived need for urgent funds. Such vulnerability is often compounded by other factors such as mental illness, disability, age, financial illiteracy or poor English skills. These features can be contributing factors to the reason why these

individuals are unable to access credit in the mainstream market. Consequently, clients of the payday lending industry are particularly vulnerable to exploitation and predatory conduct.

The payday loan industry

Many people who enter into short-term, small amount credit contracts (or payday loans), are people on low incomes who are unable to afford to repay their loans even at the time of entering into the contract, and are susceptible to unscrupulous or irresponsible practices of some payday lenders. Such practices can include: credit contracts that do not provide for the due date for payment to coincide with the borrower's payday, providing access to further finance in order to meet repayment obligations, and "rolling over" one payday loan into another. These practices lead to further indebtedness on the part of the borrower and make it unlikely that the borrower will be able to repay their debt.

As stated above, we acknowledge that clients of the payday loan industry are often higher risk, and that as a result, payday loans come at a higher cost than mainstream loans. However, it is important to remember the high social cost of severe indebtedness, and the impact that it has on the lives and families of the debtors. Accordingly, in our view it is essential to regulate the payday lending market to prevent vulnerable consumers from entering into credit arrangements that they are unlikely to ever repay.

We are aware of arguments made by representatives of the payday loan industry that small amount credit contracts are expensive to grant, and that without the payday loan industry, individuals with poor credit records would be excluded from the consumer credit market and unable to access any form of credit. In response to this argument, we state that obtaining further credit is not the answer to credit and debt problems, and that accessing further credit at a high cost simply worsens the problem of indebtedness for the individual. Further, many customers of the payday loan industry are not made aware of NILS or other alternatives to seeking a payday loan. Greater awareness of their options would lead to better financial decisions.

Prohibitions on certain fees and charges and refinancing

We strongly support the introduction of prohibitions on small amount credit providers charging fees and charges other than those specified as permitted and other than at the maximum rates set out.

In addition, we strongly support the introduction of prohibitions on suggesting re-financing or re-financing small amount credit contracts, including suggesting or financing increases on a credit limit where the credit provider knows or recklessly disregards whether or not the consumer has an existing payday loan. The practice of constant credit limit increases and/or re-financing creates or worsens the debt spiral for many consumers to the point that they are unable to ever get out of debt, or have to take extreme measures to do so. Such practices place the consumer in a worse financial position than they were in before they entered into the initial payday loan.

By way of illustration, we provide the following case study of a client of Redfern Legal Centre.

Case Study: Bill

Bill is a person with a mental illness, who receives a Disability Support Pension. He also worked casually part time in a job where he required the use of his vehicle in the course of his employment. Facing a short-term cash flow problem he approached a

payday lender and entered into a small amount credit contract. Unable to repay that loan, Bill borrowed further money from the same payday lender to pay out his loan. From that time on Bill was trapped in an ongoing cycle of repeated re-financing to pay out his previous loan with the payday lender. After repeated cycles, Bill was so indebted that the payday lender refused to advance him any further money. Unable to re-finance or pay the loan, Bill defaulted under his loan. The payday lender demanded repayment.

In order to repay them, Bill pawned his vehicle and paid out his payday loan. During the time that his vehicle was being held as security by the pawnbroker, Bill was without his vehicle and not able to earn any income from his part time employment as a driver. When the time came to make a repayment, Bill was unable do so and subsequently lost his vehicle to the pawnbroker. In doing so, Bill lost his ability to be able to engage in his casual employment and so lost both his ongoing source of additional income and the sense of pride he had in being able to work.

Payday lender website content and advertising

Furthermore, we support the proposed regulations to require payday lenders to include the prescribed high impact statement on their websites. Such a requirement would assist in ensuring that vulnerable consumers are better informed about the risks of and alternatives to payday loans before they apply.

Currently, the websites of payday lenders present payday loans as an easy, fast, low-risk and reasonably priced solution to the consumer's credit and debt problems. The websites may contain highly suggestive statements, intended to encourage the consumer to think about how they could spend such quick and easy money. For example, Unicredit's website¹ suggests that a loan may be taken out for a holiday. Other lenders are currently advertising that an applicant's first cash advance can arrive in as little as 15 minutes, at a fee of 1 cent, even if the applicant has bad credit.²

By way of illustration, an examination of current website advertising by two of the main payday lenders operating in NSW and who both advertise and accept online applications has been undertaken and are provided below:

Cash Doctors

Cash Doctors (www.cashdoctors.com.au) advertise their loans as being "*the solution to the consumer's credit and debt problem.*" They advertise that their "*costs are crystal clear - We always tell you upfront the exact cost of your short-term loan. No surprises. No catches. No hidden fees.*" They advise the consumer that "*Unlike a credit card, we won't make you borrow more than you need, putting you into long-term debt. We also won't let loans spiral out of control for months like other short-term lenders. Borrow what you need. Repay when you get paid. We're your short-term solution, not your long-term problem.*" Further, "*There's no long-term debt. Just instant cash relief.*" "*It's easy. Get cash and get on with your life.*" "*Get the cash you need now and pay later at a low cost.*"

Such claims are accompanied by testimonials of satisfied customers all attesting to how it is an easy, cost effective solution to a credit and debt problem.

¹ <http://www.unicredit.com.au/loans/personal.html>, as at 7 September 2011

² <http://australiacashloan.com/>, as at 7 September 2011

Cash Stop

Similarly, Cash Stop (www.cashstop.com.au) advertise on their website that they are “*The ONLY Stop for your Quick Cash needs!*” They advertise extensively on television using smiling actors waving cash, who sing “*Cash Stop ... put money in your pocket.*” Cash Stop presents itself as the “*modern solution to credit problems*”. The television advertising directs consumers to their website or branches to make an application with “*real people*” for “*fast cash*” because “*Using Cash Stop is fast, confidential, reliable – and could be the answer to your immediate cash problem.*” On the website they advise consumers that “*A pay day loan is money that you borrow from us until pay day and then repay with a small fee added on top, after the boss pays you.*” Its “*quick and easy*” and gets quicker and easier after the first time as “*Once you have had a pay day loan and repaid it on time, getting another pay day loan is even easier... just log in and verify your existing details and apply – no need to fill in the whole form ever again.*”

In our view, the above description of the payday lending experience differs greatly from the reality of borrowing money from a payday lender. Many consumers of payday loan products end up in long-term debt, or make repayments to the loan at a high cost. We support the proposed measures to regulate website advertising of payday loans, as it would provide a more realistic and balanced perspective for consumers to assist them to make informed decisions.

It is important to remember that at the time of borrowing, few consumers consider the risk of not repaying their loan, particularly when the consumer is in desperate need of cash. The statements extracted above from payday lenders’ websites, describing payday loans as “quick”, “easy” and low risk, do little to alert consumers to the potential problems ahead, and in our view have the potential to mislead and deceive consumers.

High impact disclosure statement to be made available on websites

We support the requirements to include on websites a short high-impact statement disclosing details of advice and counseling services and information about alternatives to payday loans, however we note that the precise content of such a statement has not yet been made available for comment. We note that such a statement should be made in plain English, and should contain a link to where more information can be found. We would like to see a link made available to the information in accessible formats for non-English speakers and people with disabilities.

In addition to the proposed regulation of payday lenders’ websites, we submit that the regulations should apply to other forms of media advertising, such as print, radio and television. This is particularly so because many of the more vulnerable clients of the payday loan industry may not access the internet at all.

Annual Cost Rate Cap

Finally, we strongly support the proposed amendments to introduce Australia’s first national cap on the annual cost rate of a credit contract. We consider that the proposed measures are an important step forward in both maintaining and expanding this important protection for credit consumers in Australia.

Where the risk of lending is so high that a consumer loan cannot be granted without charging an interest rate that breaches the 48% cap, we submit that such a loan is irresponsible and predatory, and should not be permissible.

4. RLC's responses to the Questions for Stakeholders

Schedule 4 - Caps on credit contracts

1. Transitional period

Given that the 48% cap is already effective in NSW, we submit that in NSW there should be no transitional period in relation to the provisions that are already applicable in NSW. However, in other states and territories, a transitional period may be appropriate, and also in NSW insofar as the proposed amendments introduce new regulation in NSW.

We consider that 6 months would be a sufficient period of time before the provisions in the new legislation came into effect.

2. Disclosure requirements in section 17 of the Code

In our view, it is not necessary to amend section 17 of the Code. This is because the drafting of the section requires certain information to be disclosed only in relation to certain types of contracts. Where the disclosure requirement is not relevant, the section does not require disclosure. As a result, the amendments proposed in the Bill will only be affected by section 17 of the Code insofar as they are applicable.

3. Rate of permitted fees

We consider that the rates of permitted credit fees and charges with respect to the permitted establishment fee and permitted monthly fee as outlined for small amount credit contracts are reasonable. Further, the setting out of the permitted maximum fees and charges is much better tailored to the way that small amount credit contracts operate for their consumer base. In addition, it makes it easier for the consumer to work out what the legal limitations are in relation to fees and charges, and to determine whether their credit provider is abiding by them.

However, we consider that the inclusion in s31A(1)(c) of a fee or charge that is payable in the event of a payment default under the contract (without a percentage cap similar to those in sub-sections 31A(1)(a) and (b) being applied), may operate to the detriment of consumers. Irrespective of the fact that sub-section 39B (1) operates to cap the maximum amount that may be recovered at no more than twice the adjusted credit amount, the effect of s31A(1)(c) is that in the event of a initial default it would be possible for the credit provider to immediately seek to recover fees or charges that would greatly increase the total amount due by the consumer under the contract.

4. Annual cost rate applicable to life of loan

We consider the proposed introduction of the cap in subsection 32A(2) to be a positive reform in the area of consumer protection.

However, we are concerned that in effect this measure could prove to be confusing for consumers, who may find it difficult to know whether or not they have in fact been charged more than the permissible annual cost rate. Whilst RLC strongly supports the introduction of this subsection, we suggest that ASIC might make a calculator or tool available on its website to enable consumers and credit and debt advice and assistance services to check that credit providers are complying with the requirement throughout the term of the contract.

In addition, we encourage ASIC to instigate a program of "spot checking" of credit providers in order to ensure compliance.

5. Total amount on default charges

In effect, default charges are capped by specifying that the total amount (including permitted establishment and monthly fees) that can be recovered under a contract on default is 200% of the credit received by the consumer. Whilst it is our view that having a cap such as this is an important consumer protection that will ensure that the overall cost to some of the most vulnerable consumers is kept down, there are issues to be addressed in the operation of this section.

As noted above, irrespective of the fact that sub-section 39B (1) operates to cap the maximum amount that may be recovered at no more than twice the adjusted credit amount, the effect of this is that in the event of a initial default it would be possible for the credit provider to immediately seek to recover fees or charges that would increase the amount payable by the consumer under the contract. We would welcome a cap on the amount that can be charged in the event of a default.

6. Penalty for providing credit assistance in breach of the caps

We consider that the penalties are an important part of the proposed new legislation. It is our view that consumers should be entitled to be reimbursed for the difference between the amounts that would have been paid had the caps been correctly applied, and the amounts actually paid. The consumer should be able to recover this amount from the credit provider, irrespective of whether the breach was caused by the credit provider or a third party, such as a broker. Where the broker is responsible for the breach, the credit provider would have recourse against the broker, however the credit provider must remain responsible for ensuring that credit contracts comply with the regulations.

In addition, enabling ASIC to seek penalties in respect of systemic non-compliance is a valuable deterrent to credit providers.

7. The definition of small amount credit contract, and continuing credit contracts

We consider the definition of a small amount credit contract to be adequate. We do however consider that the limit of \$2,000 is too low and suggest that the limit should be increased (perhaps to \$4,000 or \$5,000), to prevent lenders from lending more money in order to circumvent the new regulations.

We consider that making continuing credit contracts (such as credit cards) only subject to the 48% cap to be reasonable.

8. Exemption for bridging finance

Given that bridging finance loans are taken out in highly specialised situations, and are not loans that would particularly target vulnerable people such as our client base, we do not have any strong objections to an exemption from the 48% cap for bridging finance. We support the inclusion of a clear and tight definition of 'bridging finance contract' such as that included in the commentary, as we consider this essential to ensure that consumers are protected from this exemption being misused by credit providers.

9. Exemption for ADIs

We do not support a general exemption from the 48% cap for credit provided specifically by ADIs. We do not see any justification for excluding ADIs from having to comply with the same consumer protection regulatory requirements as other credit providers.

10. Exemption for temporary credit facilities

We do not support an exemption from the 48% cap for a 'temporary credit facility'. Should it be decided that an exemption is warranted for this type of credit, we support the

inclusion of a clear and tight definition of 'temporary credit facility' such as that included in the Credit (Commonwealth Powers) Act 2010 (NSW), at Sch 3, s 5(5), where it is defined to "include, but is not limited to, an overdraft facility and a short term extension of the total amount of credit available under an existing credit contract", as we consider this essential to ensure that consumers are protected from this exemption being misused by credit providers.

Schedule 5 – Small amount credit contracts

1. Transitional period

We consider that 12 months would be an appropriate period of time to allow before the provisions in the new legislation came into effect.

2. Transitional issues

To ensure that credit providers are aware of the changes, we strongly support the roll out of education programs regarding the changes to be implemented. These programs should include educational seminars, fact sheets and advices as to where more information can be obtained. In addition, we support a consumer focused community awareness program to ensure that consumers are aware of the changes to their rights. In addition, ASIC should be pro-active in spot-checking during the transitional period.