Chapter 5

Introduction of caps and new regulations for certain kinds of credit contracts

5.1 Schedules 3 and 4 of the Enhancements Bill propose significant modifications to the lending requirements for small amount credit contracts, also known as 'pay-day loans'. These include restrictions on the number of contracts that a borrower may simultaneously hold, and caps on fees and charges.

5.2 The proposed reforms to the short-term lending industry generated substantial comment. The majority of evidence provided through submissions and at the hearing on 24 October 2011 focused on the short-term loan reforms. Evidence presented was on the whole extremely detailed, with individuals and organisations across the spectrum of views presenting in-depth information that included case studies, pro-forma short-term credit contracts, research reports, and projections of business costs.

5.3 This chapter is divided into five parts:

- overview of the proposed reforms (paragraphs 5.4–5.31)
- features of the short-term loan industry (paragraphs 5.32–5.46)
- consumer profile – financial circumstances of short-term loan borrowers (paragraphs 5.47–5.81)
- the case for the short-term loan reforms (paragraphs 5.82–5.134)
- industry concerns with the short-term loan provisions (paragraphs 5.135–5.203)
- other sources of short-term credit contracts (5.204–5.219), and
- committee view (5.219–5.245).

Overview of the proposed reforms

5.4 As noted in chapter one, COAG identified the regulation of short-term lending as a matter requiring consideration under phase two of the consumer credit reforms.[1] Options for a new approach to short-term lending were subsequently outlined in Treasury's 2010 *Green Paper*.[2] Further background to the reforms is provided in the

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1 Council of Australian Governments, Communiqué 2 October 2008, http://www.coag.gov.au/coag_meeting_outcomes/2008-10-02/index.cfm#regulat (accessed 11 October 2011).

2 Treasury, *National Credit Reform: Enhancing confidence and fairness in Australia's credit laws – Green paper,* July 2010, Chapter 5.

Regulation Impact Statement included at chapter 11 of the Explanatory Memorandum for the Enhancements Bill:

> One of the issues identified during the course of Phase One of the National Consumer Credit Protection reforms was the approach to be taken to short term, small amount lending [...]
>
> It was agreed that during Phase Two of the reforms, the need for Commonwealth intervention in relation to the cost of short term lending would be considered. As part of this, an examination would be undertaken of the role of interest rate caps. In the meantime those States and Territories who had interest rate caps would retain them.[3]

5.5 The statement also outlines the policy objectives underlying the reform proposals:

> The objectives of government action are to:
>
> - assist consumers to have a greater degree of social and financial inclusion; and
> - mitigate the particular risks associated with short term credit (and to do so in a way that minimises the risk of avoidance).[4]

5.6 It was apparent that an assumption underlying the measures in Schedules 3 and 4 is the vulnerability of consumers who access short-term loans. As stated in the media release accompanying the Exposure Draft legislation:

> People desperate for a small loan to replace a broken household appliance or to tide them over until their next pay packet will have more protection from inappropriate lending practices...
>
> "For some people, taking out a payday loan might seem like the only answer – but more debt at ridiculously high cost can create more problems than it solves" Mr Shorten said.[5]

5.7 The Second Reading Speech indicates the reforms are intended to balance consumer protection with industry stability:

> ...government strongly believes that short-term loans do have a role in the Australian economy and should be a part of everyday life, but we are also focussed on protecting vulnerable consumers, not terminating the payday

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3 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Chapter 11: Regulation Impact Statement June 2011, paragraphs 11.1 – 11.2.

4 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Chapter 11: Regulation Impact Statement June 2011, paragraphs 11.117.

5 The Hon Bill Shorten MP, Assistant Treasurer, Minister for Financial Services and Superannuation, 'Reforms to payday lending', Media release 123, 25 August 2011.

lending industry. We do believe it is time that the interests of consumers are improved.[6]

5.8 Paragraphs 5.10–5.34 provide an overview of the measures proposed in Schedules 3 and 4.

Schedule 3

5.9 Schedule 3 contains several measures intended to increase protections for borrowers who enter into 'small amount credit contracts'. The measures would commence 1 July 2012.[7]

5.10 ‘Small amount credit contracts’ would be defined as contracts for less than $2,000 over less than two years. However, such a contract would not be a small amount credit contract if it is a continuing contract, a contract provided by an ADI or a contract secured by a mortgage.[8]

5.11 The following measures are proposed:

- requirements to provide web-based disclosure statements
- prohibition on multiple concurrent contracts
- prohibition on refinancing contracts, and
- prohibition on increasing credit under existing contracts.

Web-based disclosure statements

5.12 Credit providers with websites offering access to small amount credit contracts would be required to ensure the website complies with ‘the requirements prescribed by the regulations’.[9] Failure to do so would be an offence carrying a maximum penalty of 50 penalty units and would also attract a civil penalty of 2,000 penalty units.[10]

5.13 Credit providers would also be required to ensure that, if their websites can be used by a consumer to apply for, or make an inquiry about, a small amount credit

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6 The Hon Bill Shorten, Assistant Treasurer, Minister for Financial Services and Superannuation, *House of Representatives Hansard*, 21 September 2011, p. 10952.

7 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, clause 2.

8 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Schedule 3, item 1, subclause 5(1).

9 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Schedule 3, item 3, clause 124A.

10 The value of a penalty unit is established by section 4AA of the Crimes Act 1914. One penalty unit is $110. A civil penalty is an alternative to a criminal offence. The penalty is a fine imposed by a court.

contract, the websites 'complies with the requirements prescribed by the regulations'. Failure to do so would be an offence carrying a maximum penalty of 50 penalty units and would also attract a civil penalty of 2,000 penalty units.[11]

5.14 The Explanatory Memorandum provides detail of the unspecified 'prescribed requirements'. It is intended that the regulations would require the websites to include 'a short high-impact statement disclosing the availability of sources of assistance...and alternative and cheaper sources of credit.'[12]

Prohibition on multiple concurrent contracts and on refinancing contracts

5.15 Credit providers would be prohibited from suggesting, offering, arranging or providing concurrent small amount credit contracts. Were a credit providers to do so, the credit provider would commit two offences both with a maximum penalty of 50 penalty units and would also be subject to two civil penalties of 2,000 penalty units.[13]

5.16 This would have the effect of restricting consumers from entering into more than one small amount credit contract at a time.

5.17 Credit providers would also be prohibited from entering into, or offering, a small amount credit contract where some or all of the contract would be used to refinance an existing small amount credit contract. Were a credit provider to do so, the credit provider would committee an offence with a maximum penalty of 50 penalty units and would also be subject to a civil penalty of 2,000 penalty units.[14] According to the Explanatory Memorandum, the restriction would apply regardless of whether the original small amount credit contract was with the same credit provider.[15]

Prohibition on increasing credit under existing contracts

5.18 Credit providers would also be prohibited from increasing, or suggesting an increase to, the credit limit of existing small amount credit contracts. Were a credit provider to do so, the credit provider would be liable to two offences each with a

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11 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Schedule 3, item 4, clause 133CA.

12 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 4.35.

13 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Schedule 3, item 3, clause 124B; Schedule 3, item 4, clause 133CB.

14 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Schedule 3, item 4, clause 133C.

15 Explanatory Memorandum, Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 4.45.

maximum penalty of 50 penalty units and would also be subject to two civil penalties of 2,000 penalty units.[16]

Remedies available to credit borrowers

5.19 The Enhancements Bill would extend section 180 of the NCCP Act to apply where a credit provider has breached one or more of the above prohibitions.[17] Section 180 of the NCCP Act authorises a court to make orders in relation to 'unlawful credit activities', to prevent the credit provider from profiting from the unlawful activity, or to compensate the borrower for loss, or to prevent or to reduce the loss or damage suffered or likely to be suffered. Such orders may include orders refusing to enforce the terms of the small amount credit contract and orders that the credit provider refund money or return property to the borrower. A court may make orders under section 180 on the application of the borrower or the Australian Securities and Investments Commission (ASIC), where the application is made within six years of the conduct occurring.

Schedule 4

5.20 Schedule 4 would introduce caps on the charges that may be imposed on borrowers under small amount credit contracts, and caps on the costs under certain other credit contracts. The caps would commence on 1 January 2013.[18]

5.21 A 'credit contract' is defined in section 5 of the NCCP Act as 'a contract under which credit is or may be provided'. Credit contracts therefore would include small amount credit contracts. However, it is proposed that the cap would differ between small amount credit contracts and other credit contracts.

Cap on small amount credit contracts

5.22 For small amount credit contracts, the following would be the maximum costs that could be charged:[19]

- an establishment fee not exceeding 10 per cent of the amount of credit the borrower receives
- monthly fees of two per cent of the amount of credit the borrower receives
- any government fees, charges or duties payable in relation to the contract; and

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16 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Schedule 3, item 3, clause 124C; Schedule 3, item 4, clause 133CD.

17 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Schedule 3, item 4.

18 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, clause 2.

19 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Schedule 4, item 12, clause 31A.

- a fee payable in the event of default, not exceeding twice the adjusted credit amount and any enforcement expenses.[20]

5.23 Under the proposal, a small amount credit contract could not include interest charges. Interest charges and fees in excess of the permissible amounts would be void. Monies paid under the void provisions would be a debt due to the borrower.[21]

5.24 A credit provider would commit an offence if entering into, or seeking payment under, a small amount credit contract that breaches the above conditions. The offence would be a strict liability offence with a maximum penalty of 100 penalty units.[22] A person would also commit an offence with a maximum penalty of 50 penalty units if suggesting or assisting a person to enter into a small amount credit contract with a particular credit provider knowing; or being reckless as to whether, the contract contains prohibited fees and charges.[23]

Cap on all other credit contracts – the '48% cap'

5.25 For credit contracts that are not short-term small amount credit contracts, bridging finance contracts or contracts provided by an ADI, it proposed to introduce a cap on the 'annual credit cost rate'. A credit provider would commit an offence, with a maximum penalty of 50 penalty units, if entering into a contract with an annual credit cost rate exceeding 48 per cent. The Enhancements Bill would prescribe a formula for calculating the annual credit cost rate. The formula allows for matters to be prescribed by regulations.[24] The Explanatory Memorandum states that this would allow the Government to address attempts by credit providers to circumvent the cap through charging borrowers additional amounts that do not fit within the definition of 'costs' but none the less result in credit providers receiving more than a 48 per cent return on the credit contract.[25]

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20 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Schedule 4, item 15, clause 39A and clause 39B. 'Adjusted credit amount' is defined at Schedule 4, item 20, as 'the first amount of credit that is, or is to be, provided under the contract but does not include the amount of a permitted establishment fee, or a permitted monthly fee, payable in relation to the contract, and the prohibited credit amount, and any other amount prescribed by the regulations'.

21 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Schedule 4, item 4, clause 23A.

22 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Schedule 4, items 6 and 7.

23 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Schedule 4, item 8, clause 24A.

24 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Schedule 4, item 8, clause 24A.

25 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 5.36.

5.26 The Explanatory Memorandum states that the formula is derived from the New South Wales model, modified to address avoidance practices that have arisen in response to the cap. As outlined in the Explanatory Memorandum, consumer credit legislation in the Australian Capital Territory, New South Wales and Queensland applies a 48 per cent cap that includes interest, fees and charges. Victoria reportedly applies a 48 per cent cap, although this does not apply to fees and charges. Caps are not in place in the Northern Territory, South Australia, Tasmania or Western Australia.[26]

Consultation on further amendments

5.27 Treasury released for consultation a late amendment, subsection 32A(2), to the Bill on 14 September 2011, after the Bill had been introduced in the House of Representatives. The amendment was sent to members of Treasury's Credit Consultation Group, with a short time frame to respond. Treasury stated that the amendment was originally included in the Exposure Draft of the Bill.

5.28 The provision in question is subsection 32A(2):

> 32A Credit provider must not enter into a credit contract if the annual cost rate exceeds 48%
>
> (1) A credit provider must not enter into a credit contract (other than a small amount credit contract) if the annual cost rate of the contract exceeds 48%. Criminal penalty: 50 penalty units.
>
> (2) A person must not be a credit provider under a credit contract (other than a small amount credit contract) if the annual cost rate of the contract exceeds 48% at any time. Criminal penalty: 50 penalty units.[27]

5.29 The purpose as argued by Treasury is to:

> [A]ddress potential techniques for avoiding the annual cost rate, including:
>
> - the imposition, under the credit contract, of relatively high contingent fees that were in practice usually payable (particularly a deferred establishment fee);
> - varying the interest rate or increasing fees and charges to exceed the 48% cap once the credit contract has been entered into; and
> - the use of continuing credit contracts where costs were imposed in a way that differed from the assumptions specified in relation to this class of contracts.[28]

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26 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Table: 'Comparison of key features of new law and current law', p. 62.

27 Treasury Discussion Paper: *Maximum Annual Cost Rate* (The secretariat has not received an official copy of this discussion paper. A copy is available at NFSF, *Supplementary Submission 22A*, Appendix 2, p. 13).

5.30 Treasury goes on to explain that:

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

5.31 Treasury then canvasses four options in relation to implementation of the amendment. These options are not considered in this report.

Features of the short-term loan industry

5.32 The committee understands that the short-term loan industry in Australia commenced in the late 1990s, in response to ADIs withdrawing from the short-term, small amount loans market.[29] The Queensland University of Technology's March 2011 report into the industry commented on the lack of statistical evidence regarding industry size. However, the report notes industry estimates that there are 'approximately 500 000 active clients' and 'around 400 lenders nationwide.'[30] Data forwarded by the National Financial Services Federation also provided an indication of the size of the short-term lending industry. The committee was advised that the Federation 'represents almost 300 ASIC licensed, small amount, short-term credit providers who arrange more than $800 million of loans to over 500 000 consumers each year.'[31]

5.33 Evidence before the committee indicated that the industry is comprised of lenders across the spectrum from small business operators to publicly listed companies with substantial market share. As noted in the Queensland University of Technology's report, the largest providers of short-term loans in Australia are

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28 Treasury Discussion Paper: *Maximum Annual Cost Rate* (The secretariat has not received an official copy of this discussion paper. A copy is available at NFSF, *Supplementary Submission 22A*, Appendix 2, p. 13).

29 Cash Converters, *Submission* 27, p. 3; Ms Catriona Lowe, Co-Chief Executive Officer, Consumer Action Law Centre and Mr Gerard Brody, Director Policy and Campaigns, Consumer Action Law Centre, *Committee Hansard*, 24 October 2011, p. 38.

30 Cash Converters, *Submission 27*, Attachment 3; Professor Stephen Corones et al, *Phase two of the national credit reforms examining the regulation of payday lenders*, March 2011, Queensland University of Technology, p. 7.

31 National Financial Services Federation, *Submission 22*, p. 1.

Cash Converters, Cash Stop and The Cash Store.[32] The committee heard that Cash Converters issues in excess of 625 000 short-term loans per year, with the total value of loans exceeding $250 million.[33] The committee was also informed that the provider 'will lend a new customer a maximum of 10 per cent of net income.'[34] While not providing details of loan volume, The Cash Store informed the committee that it operates 82 branches Australia-wide.[35] Both companies are publicly listed.[36]

5.34 The committee also heard evidence of the turnover of short-term loan providers with smaller market share. Money 3, also a publicly listed company, advised that it provides a mixture of secured and unsecured loans that range from $100 to $20 000 over a maximum 36 month period, for 25 000 consumers. For the 2010-11 financial year the provider reportedly earned a net profit of $2.4 million.[37] Can Do Credit Pty Ltd stated that it provides approximately 600 loans per year to 600 customers. Self-identifying as a 'micro-lender', the provider reported that the loans are, on average, for '$1000 for a period of 52 weeks'.[38] The committee also heard evidence from several small businesses, including Action Cash, Fundco, Action Finance and Moneyplus. Action Cash, a franchise of 'nine "Mum and Dad" small business owners', reportedly provides loans to 3000 consumers.[39] Moneyplus reported issuing loans of $100 to $6000 with lending periods over one to two years. For the 2010-11 financial year, Moneyplus reportedly issued loans to 25 000 consumers. Moneyplus self-identified as a 'family business'.[40]

Emerging market – web-based providers of credit

5.35 Evidence before the committee also indicated that there is a growing web-based segment of the short-term loan industry. Web-based providers that contributed to the inquiry included First Stop Money, Dollars Direct and the Cash Doctors. First Stop Money advised that the company, founded in 2009, conducted 300 000 loan transactions in the past 12 months. The committee was informed that First Stop Money caps the repayments owed to 'a maximum...of 200% of principal lent including

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32 Cash Converters, *Submission 27*, Attachment 3, Professor Stephen Corones et al, *Phase two of the national credit reforms examining the regulation of payday lenders*, March 2011, Queensland University of Technology, p. 7.

33 Cash Converters, *Submission 27*, p. 3. P. 58.

34 Mr Ian Day, General Manager, Cash Converters International, *Proof Committee Hansard*, 24 October 2011, p.

35 The Cash Store, *Submission 42*, p. 2.

36 Cash Converters, *Submission 27*, p. 3; The Cash Store, *Submission 42*, p. 2.

37 Money 3, *Submission 7*, p. 1; 8.

38 Can Do Credit Pty Ltd, *Submission 15*, p. 1.

39 Action Cash, *Submission 36*, p. 1.

40 Moneyplus, *Submission 12*, p. 2.

any default fees and charges'.[41] The committee was also informed that First Stop Money:

> ...will cap our instalment amount at a maximum of 30 per cent of their income, minus all their other fixed outgoings—other loans, rent, mortgage, bills. When we are working it out we will take into account the instalment amount, which obviously includes fees and charges.[42]

5.36 The committee was further advised that, having assessed the applicant's financial circumstances, First Stop Money refuses nine out of every ten applications,[43] and limits the availability of loan refinancing:

> ...we have restricted refinancing unless over 50% of the principal has been repaid and we have for some time now provided a cooling off period for all loans.[44]

5.37 Mr Daniel Shteyn, Managing Director, Dollars Direct, advised that the multi–national online provider has issued approximately 50 000 short-term loans to consumers in the Australian market, with the average loan ranging between $280 to $450.[45] Similar to First Stop Money, Mr Shteyn advised that the credit provider screens applicants according to an income assessment:

> Our issue rate, as we define it which is the number of people we issue a loan to as a proportion of the people who apply, probably ranges between one out of six to one out of three—in other words, somewhere between 15 per cent and 33 per cent. The reason I am unable to be more specific is that we simply do not consider people who are not employed, but they still apply. We do not even see them, given the fact that we are purely online and we have filters set up. Those people who make it are already employed and out of those we probably fund one out of three. The proportion is essentially half, to account for the fact that many people who are not employed still apply.[46]

5.38 Cash Doctors provided the following overview of the company's approach to short-term loans:

> To date, Cash Doctors has provided more than 155,000 cash advances under its continuing credit facility to some 23,000 customers. We offer advances of between $100 to $600 for a maximum period of 45 days with no roll-overs permitted. Repayments are typically over 1-3 pay cycles. The

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41 First Stop Money, *Submission 17*, p. 3.

42 Ms Lucy Auchincloss, Commercial Director, First Stop Money, *Committee Hansard*, 24 October 2011, p. 54.

43 Ms Lucy Auchincloss, First Stop Money, *Committee Hansard*, 24 October 2011, p. 55.

44 First Stop Money, additional information received 25 October 2011, p. 1.

45 Mr Daniel Shteyn, Managing Director, Dollars Direct, *Committee Hansard*, 24 October 2011, p. 61.

46 Mr Daniel Shteyn, Dollars Direct, *Committee Hansard*, 24 October 2011, p. 60.

> average advance is $421 over a period of 21 days. We only offer loans to fully PAYG employed customers, and as such, only 17% of total applications are approved.[47]

5.39 The committee was informed that the following lending philosophy underlies the low application acceptance rate:

> Cash Doctors is a growing national brand in Australia and is the industry leader in responsible online small-amount short-term lending. In 2005, the founders, Greg Ellis and Sean Teahan, identified a need in the small-amount short-term lending sector and saw an opportunity to provide a responsible, transparent service to the Australian working community that was neither available in the mainstream credit market nor the incumbent fringe/short-term lending and pawn broking market[...]
>
> The low approval rate is the result of an extremely rigorous selection and approval process, which includes prudent credit checks and other responsible lending checks, accompanied by technically sophisticated data-driven underwriting measures to carefully assess capacity to repay and maximise the chance of customer repayment and satisfaction.[48]

5.40 Mr Gregory Ellis, Co-Chief Executive Officer, Cash Doctors, and Mr Sean Teahan, Co-Chief Executive Officer, Cash Doctors, further explained that the lending criteria is designed to promote appropriate lending and prudent business practice:

> **Mr Ellis:** We are a little bit different, because we have a very rigorous data driven underwriting method at the outset, approving just 17 per cent of applicants. Eighty-three per cent repay fully on time. We write off just two to three per cent of principle. Importantly, if someone does go overdue they can only be overdue for a further 45 days. We have a different fee structure. We have carefully tweaked it so that we make a loss on anybody who goes overdue, so the organisation has incentive to lend correctly at the outset. Obviously, we want positive and happy experiences. That is when we can make money.
>
> **Mr Teahan:** We only make money when people pay on time. That is probably different from other options that customers would have if you compare it to a credit card. If everybody paid their credit card on time, the credit card companies would not make any money. We only make money when they pay on time. That is why customers use us. Our customers are employed, financially literate, earn $40,000 per annum net and 65 per cent have a credit history. They choose to use us because they trust us to give them this product. They will receive their money now when they need it

47 Cash Doctors, *Submission 33*, p. 2.

48 Cash Doctors, *Submission 33*, p. 2.

> and they will pay it off in a few weeks. Then they can move on and forget about it.[49]

Small amount short-term loans or micro-finance?

5.41 As noted above, evidence before the committee indicated that the total amount lent under a short-term loan can substantially vary. It was put to the committee that there is a distinction between 'pay-day lenders' and 'micro-lenders'. Super Nexus Pty Ltd argued that loans for a maximum of $1500 at 12 weeks fall within the category of a small amount short-term loans. It was submitted that loans of $500 to $3000 for 26 to 104 weeks are more appropriately termed 'micro-loans'. It appeared that the micro-lending category could cover a broad range of credit contracts, with Super Nexus Pty Ltd arguing that micro-lenders can 'compete directly with banks...providing loans up to $20 000 and more on terms up to 5 years or more.'[50]

5.42 It was also put to the committee that the cost of micro-finance is less than that of small amount short-term loans:

> Micro loans are generally recognised as $300 to $2000 for terms of 25 to 52 weeks. Loan repayments start at $24. There is a massive difference in the impact of the repayment compared to a payday loan repayment.[51]

5.43 While noting the categories and cost variations, the committee understands that Schedules 3 and 4 would apply to loans classified as small amount short-term loans as well as to micro-finance not provided by an ADI. Therefore, the report has taken into account the full spectrum of the credit contracts covered by Schedule 3 and 4. As noted above, the report uses the terms 'short-term loan' to refer to credit contracts that would be affected by the measures in Schedules 3 and 4.

Repeat lending

5.44 Industry data appeared to support claims that there is a high proportion of repeat borrowing among consumers who access short-term loans. As noted, industry estimates that there are 500 000 consumers entering into a short-term loan credit contracts per year. Estimates received of total loans issued per year included:

- Cash Converters: over 650 000[52]
- First Stop Finance: over 300 000[53]
- Dollars Direct: approximately 50 000[54]

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49 Mr Gregory Ellis, Co-Chief Executive Officer, Cash Doctors; Mr Sean Teahan, Co-Chief Executive Officer, Cash Doctors, *Committee Hansard*, 24 October 2011, p. 21.

50 Super Nexus Pty Ltd, *Submission 24*, p. 8).

51 Mrs L Pozzebon, *Submission 30*, p. 2.

52 Cash Converters, *Submission 27*, p. 2.

53 First Stop Money, *Submission 17*, p. 3.

- Can Do Credit Pty Ltd: approximately 50 per month, therefore 600 per year, and[55]
- Action Finance: approximately 400.[56]

5.45 It is noted that estimates of total loans were provided by only one of the three major lenders, and that estimates of five lenders is a minute proportion of the approximately 400 credit providers operating in the Australian market. None the less, on the basis of the figures provided it is clear that repeat borrowing is required to generate the rate of loans that are apparently issued per year. On the basis of this information it would appear that either industry significantly underestimates the number of consumers accessing short-term loans per year or there is extensive and substantial repeat borrowing by consumers.

5.46 One lender provided details of the level of repeat borrowing by their customers. Mr Daniel Shteyn from Dollars Direct informed the committee that 'our customers generally take approximately four-point-something loans annually.'[57] Further, the Financiers' Association of Australia advised that 28 per cent of short-term, small amount credit contracts 'are dependent, in part....on some form of rollover or refinancing opportunity.'[58]

Consumer profile – financial circumstances of short-term loan borrowers

5.47 The Regulation Impact Statement (the statement) accompanying the Explanatory Memorandum contains an assessment of the predominant financial background of consumers who access short-term loans. The statement submits that the consumers typically have a high degree of financial exclusion:

> The majority of consumers accessing short term credit have low incomes, with possibly up to 25% of borrowers having incomes below the Henderson Poverty Line ($401 a week for a single working person as at March 2010).
>
> Borrowers largely have no access to other forms of credit (with some surveys finding that this is the situation of over 70% of borrowers) [....]
>
> There is an element of self-selection in that consumers who are price sensitive are more likely to be deterred from using short term loans and

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54 Mr Daniel Shteyn, Dollars Direct, *Committee Hansard*, 24 October 2011, p. 61.

55 Can Do Credit Pty Ltd, *Submission 15*, p. 1.

56 Action Finance, *Submission 36*, p. 1.

57 Mr Daniel Shteyn, Dollars Direct, *Committee Hansard*, 24 October 2011, p. 61.

58 Mr Phillip Smiles, Consultant, Financiers Association of Australia, *Committee Hansard*, 24 October 2011, p. 18.

> seeking alternatives; that is, the more vulnerable the consumer the more likely they are to use short-term loans.[59]

5.48 The statement also suggests that short-term loans are sought to cover basic expenses rather than discretionary spending:

> The most common uses of the funds advanced under short-term loans are to meet living expenses, such as bills (including utilities), food, rent, and car repairs and registration. There is minimal or negligible use of short term loans for discretionary spending purposes.
>
> The combination of low incomes and the use of loan proceeds to meet basic expenses can result in significant levels of repeat borrowing.[60]

Research data

5.49 Research before the committee provided similar assessments of the financial profile of short-term loan borrowers. However, as will be noted, the extent to which the research took account of web-based lending was unclear. The committee noted two recent research papers, one released in 2011 by RMIT and the University of Queensland, the other in 2010 commissioned by the Consumer Action Law Centre. Also noted was the National Australia Bank's report into its 2010 Small Loans Pilot.

5.50 As detailed at paragraphs 5.63 – 5.82, key research findings include the following.

- A high proportion of borrowers are low income earners, including Centrelink recipients. However, there is an increasing number of middle income earners accessing the short-term loan market.
- Consumers on Centrelink benefits are likely to enter into loans for smaller amounts than consumers not receiving Centrelink benefits.
- The data casts doubt on whether consumers understand the total costs of the loan.
- Consumers access short-term loans as a mid-point between government services and finance provided by ADIs.

Caught Short – interim report by RMIT/University of Queensland

5.51 Released in August 2011, the interim report for a joint RMIT/University of Queensland study provides the most up-to-date analysis of the circumstances of

59 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Chapter 11: Regulation Impact Statement June 2011, paragraph 11.3.

60 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Chapter 11: Regulation Impact Statement June 2011, paragraph 11.3.

consumers accessing the short-term loan industry.[61] As part of the study, 160 interviews were conducted across Queensland, Victoria and New South Wales; 112 with consumers 'who had borrowed between $50 and $1500 from non-bank lenders for short periods of time.'[62] The following methodology was applied to source participants:

> A range of methods were used to source borrowers willing to be involved in the project. Approximately 4,000 cards were distributed, supplemented by emailing electronic versions of the card to payday lending outlets, financial counselling agencies, Neighbourhood Houses and other community organisations. A $50 honorarium was offered to prospective interviewees in Victoria. NSW and Queensland borrowers received $40.[63]

5.52 The report further explained:

> Lenders interviewed for the study thought that a distorted picture of the ‘average’ customer would emerge unless the study directly sourced most participants from payday outlets. A majority (54 per cent) of people interviewed found out about the study from cards displayed in payday outlets or from talking to a researcher situated in an outlet. The rest saw a card or heard about the project from financial counsellors (20 per cent), via word of mouth (10 per cent), newspaper advertising (8 per cent), other community organisations (6 per cent) and the source for three participants is unknown.[64]

5.53 It is not clear whether interviewees included persons who obtained short-term loans from web-based credit providers.

5.54 The researchers concluded that 'poverty pervades the lives of most borrowers interviewed.' The study indicates that users of short-term loans are commonly unemployed, receive Government assistance, have low rates of home ownership and are likely to be in their 30s or 40s. Of the 112 borrowers interviewed, 78 per cent received Centrelink benefits, less than 25 per cent were in paid employment, and 75 per cent lived in rental accommodation. Only nine persons interviewed owned their

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61 Marcus Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians*, *Interim Report*, August 2011, RMIT University.

62 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians*, *Interim Report*, p. 6.

63 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians*, *Interim Report*, p. 7.

64 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians*, *Interim Report*, p. 10.

own homes, and eight were homeless.[65] Of the 112 borrowers interviewed, only seven had credit cards and 68 had poor credit history.[66]

5.55 There did not appear to be substantial difference in the number of persons receiving Centrelink benefits among the interviewees sourced from short-term loan outlets and those who heard of the research through other sources. 78 per cent of borrowers sourced from short-term loan outlets received Centrelink benefits compared to 83 per cent from community/financial counselling agencies.[67]

5.56 The research indicates that the short-term loan industry has a disproportionately high client base of Disability Support Pensioners. The report notes that while approximately 18 per cent of Centrelink recipients receive the Disability Support Pension, 37 percent of interviewees receiving Centrelink benefits were Disability Support Pensioners. Similarly, Newstart recipients were overrepresented, with 30 per cent of the Centrelink recipients interviewed receiving the allowance compared with 11 per cent of the general population receiving Centrelink benefits. Of the 87 participants receiving Centrelink benefits, 61 per cent were women.[68]

5.57 The research evidence suggests that persons receiving Centrelink payments predominantly seek smaller amount loans. Those receiving Centrelink benefits borrowed on average $300 or less per loan. For those not receiving Government assistance, loans typically exceeded $300.[69]

5.58 The study shows that the primary reason for seeking a short-term loan is to cover regular expenses such as food, bills and petrol.[70] Of the regular expenses cited as reasons to obtain a short-term loan, the third most common reason was 'to pay back another loan.'[71]

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65 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians, Interim Report*, p. 8.

66 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians, Interim Report*, p. 13.

67 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians, Interim Report*, p. 10.

68 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians, Interim Report*, p. 9.

69 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians, Interim Report*, p. 11.

70 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians, Interim Report*, p. 14.

71 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians, Interim Report*, p. 15.

5.59 Borrowers reported being 'caught in a vicious cycle' and having limited financial options outside short-term loans.[72] The study also indicates that short-term loans are rarely entered into on a one-off basis. Only 10 per cent of borrowers had entered into one loan. In contrast, over 50 per cent had entered into at least 10, with some borrowers reporting that they had entered into over 50 short-term loans.[73] The majority of borrowers owed monies under one or more short-term loans for substantial periods of time.[74]

5.60 The report provides the following overview of the data relating to repeat borrowing:

> Four themes provide a more complex understanding of a participant's borrowing practices: one-off, cycling, spiralling or parallel loans. Forty two per cent of borrowers reported taking out one or more one-off loans separated by periods of time. Forty four per cent of people discussed a practice of cycling – how they had immediately taken out a new loan once the previous loan had been paid out. Twenty three per cent became involved in the spiralling process of refinancing the balance of a partially paid-out loan to start a new loan, and a quarter of respondents described how they took out two or more parallel loans from the same or different lenders simultaneously.[75]

5.61 The research also indicates that there is a higher probability that borrowers receiving Centrelink benefits will enter into multiple loans.[76]

5.62 The report noted that the costs attached to short-term loans are not commonly understood by consumers. Only 48 of the 112 consumers interviewed commented on the terms of the loan, and, of these, half did not adequately understand the conditions attached to the loan.[77]

5.63 The findings also provide indicative support for the proposition that consumers with limited options outside short-term loans are supportive of the short-term loan industry. Support for the industry was higher among frequent borrowers, that is, those who had had at least 10 short-term loans, and consumers with loans less

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72 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians, Interim Report*, pp 4 – 5.

73 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives if Australians, Interim report*, p. 11.

74 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians, Interim Report*, p. 18.

75 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians, Interim Report*, p. 17.

76 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians, Interim Report*, Figure 11: 'Borrowing practices by recipient of Centrelink payment', p. 17.

77 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians, Interim Report*, p. 13.

than $300.[78] The report also noted the comments of one participant that the short-term loan industry responds to a 'gap' that would otherwise exist in the consumer credit market:

> I think, like in a perfect world it would be great if they didn't exist because then people would have enough money – there wouldn't be that desperation. I mean as long as there's that desperation and people aren't earning enough to support themselves, there's always going to be those people that are going to prey on that need. So, it's like a necessary evil...I think that they are filling a gap that the welfare state isn't providing for. (Partnered student in her 20s receiving Austudy)[79]

Payday loans: Helping hand or quicksand? – Report by Zac Gillam and the Consumer Action Law Centre

5.64 The September 2010 report by Zac Gillam and the Consumer Action Law Centre paints a similar picture of the circumstances of the average short-term loan consumer.[80] The report explains that the following methodology was applied to gather evidence regarding the experience of consumers accessing payday loans.

- An online survey of 448 persons who had entered into a 'high-cost short term loan', that is, a loan for under $2000 taken out for no more than eight weeks from a registered institution. The survey was conducted in May 2008.
- A 'small scale qualitative study' that combined group discussions, in-depth interviews and extended home interviews. The study aimed to 'identify the sociological and psychological drivers of payday lending and the impact on borrowers.' The study was conducted in October and November 2009.
- 11 case studies provided in September 2009 from financial counsellors.
- Desktop research that included a literature review.[81]

5.65 It is not clear the extent to which the report considered consumers who accessed short-term loans through web-based providers.

5.66 Of the consumers who participated in the research the majority (55 per cent) were women; a high proportion of whom were single parents.[82] 60 per cent of

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78 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians, Interim Report*, p. 19.

79 Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians, Interim Report*, p. 19.

80 Zac Gillam and the Consumer Action Law Centre, *Payday loans: Helping hand or quick sand? Examining the growth of high-cost short-term lending in Australian, 2002 -2010*, September 2010, http://www.consumeraction.org.au/downloads/PayDayLendingReport-FINAL.pdf (accessed 1 November 2011).

81 Gillam et al, *Payday loans: Helping hand or quicksand?*, pp 36–39.

82 Gillam et al, *Payday loans: Helping hand or quicksand?*, pp 45, 49.

respondents were aged between 26–45 years.[83] While not providing data on the proportion of participants who received Centrelink benefits, the research corroborates the view that consumers who access loans are predominantly lower income earners. Of the borrowers interviewed, 23.4 per cent were at or below the Henderson Poverty Line[84], 50 per cent earned less than $40 000 per annum, and 72.7 per cent received below average weekly earnings. However, 14.5 per cent earned more than $60 000 per annum, leading the researchers to conclude:

> The data suggests high-cost short term loan providers no longer serve strictly marginal income earners, although low and marginal income earners clearly remain the overwhelming consumer base.[85]

5.67 The primary reason for the participants to seek a payday loan was to 'meet basic needs'. Of the borrowers interviewed, 22.1 per cent sought a short-term, small amount credit contract to meet the costs of car repairs or registration, 21 per cent to pay bills, 17.6 per cent for living expenses such as groceries, 10.7 per cent for rent payments, and six per cent to repay debts.[86] On this point, the report concluded:

> Consumers do not generally take out high-cost short term loans for discretionary purposes but instead borrow when they are struggling to cope and have insufficient purchasing power to maintain a basic living standard.[87]

5.68 The average cost to consumers of a $300 short-term loan was $100. However, the report also found that consumers have a limited understanding of the nature of short-term lending and therefore substantially underestimate the overall costs. The report concluded:

> A striking feature of the high-cost short term lending industry is the degree of ignorance amongst consumer regarding interest rates charged by lenders [...] it seems clear borrowers know how much they are borrowing but not how much they are paying.[88]

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83 Gillam et al, *Payday loans: Helping hand or quicksand?*, p. 47.

84 The Henderson Poverty Line was defined in 1973 by the Commonwealth Commission of Inquiry into Poverty as $62.70 per week for a family of two adults and two dependent children. As of the June Quarter 2011, the Henderson Poverty Line is defined as $838.59 per week for a family comprising two adults, one of whom is working, and two dependent children. This figures is decreased to $754.15 where an adult is not employed (University of Melbourne, *Poverty Lines: Australia*, http://melbourneinstitute.com/miaesr/publications/indicators/poverty-lines-australia.html (accessed 15 November 2011)).

85 Gillam et al, *Payday loans: Helping hand or quicksand?*, p. 53.

86 Gillam et al, *Payday loans: Helping hand or quicksand?*, pp 58–60.

87 Gillam et al, *Payday loans: Helping hand or quicksand?*, p. 60.

88 Gillam et al, *Payday loans: Helping hand or quicksand?*, p. 60.

National Australia Bank – Small Loans Pilot

5.69 Data regarding consumers accessing small amount loans was also derived from the report on the National Australia Bank's (NAB) Fast Money small loans pilot. The pilot, which commenced in May 2008, provided $1000 to $5000 loans for 12 month terms. Applications were made via telephone or the internet.[89] The pilot 'explored the feasibility of providing fair and affordable small loans in an alternative credit environment to those who are not able to access mainstream loan products.'[90]

5.70 The 2010 report into the pilot scheme notes that the consumers 'were not low income and did not fit the stereotypical profile of a payday lender client'. The consumers earned an average of $859 per fortnight, and only 19 per cent received Centrelink benefits. However, financial exclusion seemed to be a key reason why consumers sought credit under the pilot. Thirty eight per cent of consumers had declared bankruptcy or otherwise defaulted on credit contracts. As the report noted, '[m]any were financially excluded from mainstream loan operations due to defaults on their credit record.'[91]

Industry views

5.71 Evidence received from industry seemed to concur with a number, but not all, of the research findings.

Consumer profile

5.72 There appeared to be a notable divergence in the client profiles of credit providers. Of the store-front operators, only three indicated providing short-term loans to persons who receive Centrelink benefits. Cash Converters advised that 'over 40 per cent of our customers are on welfare payments.'[92] Moneyplus advised that the provider does 'not lend to consumers receiving Government benefits as their sole source of income.'[93] Money 3 noted that at least 60 per cent of its customers are employed, and advised that the credit provider has a diverse client base:

> Money3 customers are drawn from most walks of life. Doctors, bankers, painters, boiler makers, sales people, ministers, lawyers, dentists, tradesmen, labourers and even the local court registrar are represented.[94]

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89 National Australia Bank, *Do you really want to hurt me? Exploring the costs of fringe lending – a report on the NAB Small Loans Pilot*, March 2010, p. 6.

90 National Australia Bank, *Do you really want to hurt me? Exploring the costs of fringe lending – a report on the NAB Small Loans Pilot*, p. 6.

91 National Australia Bank, *Do you really want to hurt me? Exploring the costs of fringe lending – a report on the NAB Small Loans Pilot*, p. 4.

92 Mr Ian Day, Cash Converters International, *Committee Hansard*, 24 October 2011, p. 58.

93 Moneyplus, *Submission 12*, p. 2.

94 Money 3, *Submission 7*, p. 2.

5.73 Money Centre stated that 'prospective customers must be employed and earn a minimum of $450 nett per week.'[95] Fundco advised that the provider applies an income threshold, stating that '[o]ur current policy is that we do not lend to any consumer with a gross weekly income of less than $400.'[96]

5.74 In contrast, it was apparent that the web-based sector is tailored to middle income earners, with lending criteria specifically excluding Centrelink recipients. Mr Daniel Shteyn, representing Dollars Direct, advised:

> Before talking about the bill itself, I first want to share a few facts about our customer base, which includes many thousands of satisfied Australian consumers. Just to dispel a few myths, we do not prey on the desperate and vulnerable, nor are we simply a lender of last resort. On the contrary, our customers are all employed and have bank accounts. On average, our customers are in their mid-30s and earn over $40,000 gross per annum. One out of every two customers has a dependant and approximately one out of three owns their own home. Our customers tell us that they are extremely satisfied with the quality of our customer service, which they say is as good or better as that provided by mainstream financial institutions. Our record with COSL supports this as we have not had any cases which have been adjudicated through EDR during the whole time we have been a member.[97]

5.75 Cash Doctors provided a similar overview of its client base:

> We are here to represent our clients, who are a growing demographic of financially literate, credit averse and tech savvy people, so they are accustomed to transacting on the internet and on their mobile phones. They are fully employed and their net salary on average is $40,000 per annum.[98]

5.76 First Stop Money noted it has a similar client base:

> We also only lend to people who are employed full time. We do not lend through Centrelink. We do not lend to people who would potentially turn financially vulnerable.[99]

5.77 The view that web-based providers have a predominantly 'middle class' client base was shared by St Luke's Anglicare. However, this was attributed to difficulties which lower income earners may have in accessing internet based services:

> ...the fasted growing sector of pay day lending is on-line, which means many low income households will not have access to this. Consequently the

95 Money Centre, *Submission 1*, p. 2.

96 Fundco, *Submission 35*, p. 3.

97 Mr Daniel Shteyn, Dollars Direct, *Committee Hansard*, 24 October 2011, p. 59.

98 Mr Gregory Ellis, Cash Doctors, *Committee Hansard*, 24 October 2011, p. 16.

99 Ms Lucy Auchincloss, First Stop Money, *Committee Hansard*, 24 October 2011, p. 52.

> growth in this sector is targeted at people who borrow to buy discretionary purchases, the fasted growing pay day lending group[100]

An alternative source of finance

5.78 Evidence before the committee indicated that there is a need for alternative sources of finance. Similar to the borrower's comment noted at paragraph 5.69 and the findings of the NAB study, industry submitted that short-term lenders fill the gap between government services and finance provided by ADIs. Reasons put forward for accessing this alternative source of finance appeared to differ according to the financial circumstances of the provider's client-base.

5.79 In relation to low income earners, Money 3 submitted that a short-term loan can assist a vulnerable consumer to rebuild their financial security, arguing that 'we do not sell money. We sell self-esteem.'[101] Action Cash stated:

> The capacity of your local LILS and NILS' schemes, to lend more than they are currently lending: nabs' latest $34 million offering through their community banking scheme are only able to approve lending to 6% of total applicants. That is a lot of unsatisfied clients screaming for second chance finance if they have in the last 5 years, a small blemish on their credit file or are discriminated against because they don't have any assets or savings. Who will save these people – We'll SAVE them! (your short term credit lender).[102]

5.80 The view that short-term lenders address the shortfall in the finances of lower income earners was also noted by 'consumer advocates'. St Luke's Anglicare commented that '[l]enders feel they are providing an important social service.'[103] While not commenting on the merits of short-term loans, St Luke's Anglicare noted that additional finance is of critical importance to persons dependent on Centrelink benefits:

> The inadequacy of Centrelink incomes for some household types, particularly those reliant on Newstart and Parenting payment, can be illustrated by the percentage of income required for a variety of households to buy the food they need to eat well. The purchase of basics such as food is a common reason for borrowing from payday lenders. Compounded by other increasing cost of living pressures, Centrelink recipients are increasingly vulnerable to sourcing financial resources through short term loans as a common coping strategy.[104]

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100 St Luke's Anglicare, *Submission 45*, p. 4.

101 Mr Robert Bryant, Chief Executive Officer, Money 3, *Committee Hansard*, 24 October 2011, p. 24.

102 Action Cash, *Submission 32*, p. 2.

103 St Luke's Anglicare, *Submission 45*, p. 4.

104 St Luke's Anglicare, *Submission 45*, p. 7.

5.81 However, providers with a client-base predominantly comprised of middle income earners put forward other reasons for consumers accessing their credit services. Views are reflected in Cash Doctor's statement that:

> [a]bout 65 per cent of our clients have a perfect credit history, so they are free to choose from among any financial products in the mainstream industry. They choose Cash Doctors because they do not necessarily want to be locked into a long-term commitment or to have more credit than they need.[105]

The case for the short-term loan reforms

5.82 As noted at paragraphs 5.5-5.7, the key motivation for the short-term loan reforms is to protect vulnerable consumers. The Regulation Impact Statement commented that the reforms are necessary to address financial vulnerability:

> The higher the costs charged the greater the impact on a consumer's income, default rates and level of social inclusion. This means that the most financially vulnerable consumers are paying high costs relative to their income when using short term, non-productive forms of finance, resulting in financial harm through an inability to accumulate savings or personal wealth, and a risk of continuing dependency on these products.[106]

5.83 Similar views were expressed by 'consumer advocates'. It was argued that the reforms are essential to:

- rectify the increased indebtedness and financial vulnerability that can result from the high-cost of short-term loans, and
- strengthen consumer protections across jurisdictional boundaries, through applying national cost caps designed to foil avoidance practices.

High-cost finance

5.84 As noted above, it appeared that difficulties with accessing finance from mainstream lenders are a primary reason for accessing short-term loans. The financial disenfranchisement of short-term loan consumers was also noted in the Regulation Impact Statement. The statement claimed that, as part of the consultations on the *Green Paper* reforms, industry provided the following insights into the financial circumstances of its clients:

> In its submission Cash Stop quotes research undertaken by Smiles Turner for the NFSF of 3408 consumers across Australia. Cash Stop states that the research demonstrated that a large proportion of consumers reported that

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105 Mr Gregory Ellis, Cash Doctors, *Committee Hansard*, 24 October 2011, p. 16.

106 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Chapter 11: Regulation Impact Statement June 2011, paragraph 11.4.

> they had no access to other forms of credit — 71.6 per cent (QLD), 72.1 per cent (SA), 76.7 per cent (NSW); 81.6 per cent WA.
>
> The submission by the Financiers Association of Australia and Minit-Software to the Green Paper lists poor credit history as one of the reasons consumers access short term loans.
>
> Cash Converters report that three in 10 of their clients cannot get credit from other types of lenders.[107]

5.85 Evidence presented to the committee suggested that due to financial exclusion the financially vulnerable seek finance from non-ADI lenders; finance that is typically at a higher cost than 'mainstream' lending. St Luke's Anglicare summarised the situation as follows:

> Payday lending is undoubtedly the most expensive form of credit. There is a real question mark over whether these loans alleviate financial hardship or in fact exacerbate it.[108]

Examples of costs attached to short-term loans

5.86 The committee was provided with evidence of costs calculated according to an annual percentage rate (APR). The March 2011 report into the short-term lending industry by the Queensland University of Technology noted research findings that:

> ...the typical payday loan was in the range of $100 to $500 for a period of two to four weeks, involving a flat fee of $20 to $35 lent, rather than an interest rate. As a result, the situation can arise where the annual percentage rate (APR) for a two week loan can range from 390% to more than 1000% for more money borrowed for only a few days.[109]

5.87 National Legal Aid noted, with disapproval, instances of interest rates of 100 to 1500 per cent.[110] Further details were provided at the hearing:

> Payday lending diverts income. It goes in one hand and straight back out by way of high repayment costs, where there is little or no ability to reduce the balance owing. Who amongst us here could afford a credit card with a 240 per cent interest rate? And yet, without a community norm, that is the very

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107 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Chapter 11: Regulation Impact Statement June 2011, paragraph 11.29.

108 St Luke's Anglicare, *Submission 45*, p. 6.

109 Cash Converters, *Submission 27*, Attachment 3, Professor Stephen Corones et al, *Phase two of the national credit reforms examining the regulation of payday lenders*, March 2011, Queensland University of Technology, pp 8 – 9.

110 National Legal Aid, *Submission 19*, p. 2.

> rate that Legal Aid clients in Ipswich were frequently paying before the state cap was implemented in 2008.[111]

5.88 Similarly, the Consumer Action Law Centre submitted that short-term loans 'are extremely expensive', and advised the committee:

> [t]hese loans typically attract effective annual percentage interest rates (APR) of 400 per cent (and can be over 1000 per cent). Moreover, repayments create a very large burden for borrowers on low income, particularly due to the short term nature of many of the loans.[112]

5.89 Industry representatives disputed the accuracy and appropriateness of representing costs with reference to the APR. The view put forward by the National Financial Services Federation appeared to be indicative of the short-term loan industry's position:

> Annual Percentage Rates are not a useful guide on the cost of small amount, short-term loans.
>
> Small Amount Credit Contracts typically run for between a couple of weeks and several months so an APR is misleading.
>
> No consumer would take out a loan if they are quoted an APR of 365% or 626%.
>
> However, if they are told the dollar cost, they can then make an informed decision, as they do.[113]

5.90 This argument notwithstanding, the committee also received estimates of costs as a percentage of a consumer's income and in dollar terms. The Regulation Impact Statement asserted:

> There are significant variations in the level of costs charged by short-term lenders. The impact on low income borrowers (defined as those with an annual income of $24,000) of loans of between $300 and $1,000 over terms of 1 week to 1 year can be summarised as follows:
>
> - The cost of a single loan can be between 2.59 and 50.05% of their income during the period of the loan.
> - The cost of two consecutive loans (where it is assumed the borrower uses 25% of the proceeds of the second loan to repay the first loan) can reduce the borrower's income by between 9.55 and 77.13%, during the period of the two loans.[114]

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111 Ms Catherine Uhr, Senior Solicitor, Legal Aid Queensland, representing National Legal Aid, *Committee Hansard*, 24 October 2011, p. 43.

112 Consumer Action Law Centre, *Submission 20*, p. 2.

113 National Financial Services Federation, *Submission 22*, p. 20.

114 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Chapter 11: Regulation Impact Statement June 2011, paragraph 11.3.

5.91 The Consumer Action Law Centre held a similar view, providing two scenarios to demonstrate the high cost of the loan as a proportion of a consumer's income:

> For example, assume a typical short term credit scenario where the borrower earns $24,000 per annum after tax (that is, $923 per fortnight), borrows $300 over a term of 28 days, and is required to repay a total of $405. In this scenario, fortnightly repayments would be $202.50 per fortnight, which is 22 per cent of this borrower's income.
>
> Alternatively, assume the borrower's income was the maximum, single adult rate of Disability Support Payment (this is also not uncommon, as discussed below) which equates to an income of $748.80 per fortnight. Assuming all other factors in the scenario above remain the same, repayments for this person would be 27 per cent of income.
>
> In both scenarios, repaying the loan creates what is without doubt an enormous burden for a low income borrower whose entire income is likely to be required to meet necessary living expenses.[115]

5.92 Commenting on the proposed 48 per cent cap on certain credit contracts, the RMIT and the University of Queensland estimated that a 48 per cent annualised cap would result in a cost to the borrower of $0.92 for a $50 short-term loan taken out for a two-week period. The RMIT and the University of Queensland contrasted this with an estimate of what consumers are currently paying for the same loan. According to the researchers, borrowers would currently pay between $15 to $17.50.[116]

5.93 Data provided by industry indicated that the terms on which credit is offered, and therefore the costs to borrowers, can differ between credit providers. Evidence presented to the committee indicated that consumers can be charged:

- $35 per $100, which would result in a fee of $112 for a $320 loan calculated as $320 x 0.35[117]
- $403.80 for a $250 loan comprising repayment of the principal, $10.00 credit card fee, $7.00 ATM fee, $7.50 monthly card fee, $107.23 brokerage fee, $8.24 interest and $13.38 consumer protection insurance,[118] and
- $110.84 for a $320 loan.[119]

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115 Consumer Action Law Centre, *Submission 20*, p. 4.

116 Marcus Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians*, *Interim Report*, August 2011, RMIT University, p. 23.

117 Cash Converters, *Submission 27*, p. 13; Super Nexus Pty Ltd, *Submission 24*, p. 2.

118 Min-it Software / Financial Association of Australia, *Submission 34*, p. 11.

119 Super Nexus Pty Ltd, *Submission 24*, p. 2.

Consumer awareness of costs

5.94 Reflecting research findings, submissions noted that there is limited understanding among consumers of the total costs of short-term loans. The Indigenous Money Mentor Network commented:

> Many aboriginal people I deal with don't understand the interest rates or fees charged by Payday lenders. In fact when I sit down and show them on paper the full cost of the money borrowed, they are 'shamed and frustrated', thinking these people were there to help them. Instead, they feel they were tricked![120]

5.95 Similarly, Sydney commented that consumers often fail to understand the cost of the loan, and argued that greater disclosure is needed:

> Our concerns are the hardship levels that are created from the interest rates. They trap people into a cycle of financial exclusion, and there is no option or alternative given to clients when they go in to payday lenders. We find that they prey on the most vulnerable—people with mental health issues, poor English skills or low levels of financial literacy. We would just like to see, perhaps, a clearer display and disclosure of the actual costs involved with these loans so that people understand, and we would like there to be alternatives provided to them such as microfinance and financial counselling.[121]

5.96 While acknowledging factors that may legitimately increase credit providers' costs, Redfern Legal Centre argued that the level of costs were unsustainable for lower-income earners:

> 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 fees and the 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.[122]

5.97 Similarly, the Consumer Action Law Centre reported:

> In most cases, the high cost, short-term loans are required because individuals have insufficient cash to meet their essential, daily needs (such as utilities, car expenses, food and rent). They are already in financial difficulty. The loan is repaid via direct debit from their bank account at the same time their wages or benefits are credited into the account. Having such a significant amount deducted from their next pay usually leads a borrower

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120 Indigenous Money Mentor Network, *Submission 5*, p. 1.

121 Ms Felicia Andersen, Community Care Sustainable Living Coordinator, Anglicare Sydney, *Committee Hansard*, 24 October 2011, pp 67–68.

122 Redfern Legal Centre, *Submission 18*, Attachment 1, p. 5.

> to needing another loan within a short period of time to supplement their reduced income.[123]

5.98 The Centre further argued that '[a]ccess to harmful financial products does not amount to financial inclusion.'[124] Fair Finance Australia took a similar view, submitting that:

> Our experience would indicate that any loan made for the purpose of payment of daily consumption or bills cannot by definition fit within the responsible lending framework. This is because it is usually the case that individuals do not have enough income to survive day to day and are clearly in poverty. Any form of loan that has to be repaid will in effect reduce their future income and is thus increasing their poverty levels. This can be seen as just a short term fix to their financial problems.[125]

5.99 National Legal Aid submitted that a consumer's financial vulnerability can be increased where the short-term loan is secured against the consumer's property. The committee was provided with case examples of security attached to short-term loans, which included the following:

123 Consumer Action Law Centre, *Supplementary Submission 20a*, p. 2.

124 Consumer Action Law Centre, *Submission 20*, p. 7.

125 Fair Finance Australia, *Submission 51*, p. 1.

Table 5. 1 – Case examples of security taken for short-term loans[126]

Amount borrowed	Year loan contract signed	Length of loan	Asset over which security taken
$2189.13	2007	12 months	Car
$3300.00	2007	Unknown	Car, house
$2198.52	2008	36 weeks	Car
$7306.00	2008	46 fortnights	Dining suite, queen-sized bed, single bed, stereo, sofa bed, microwave, 34cm TV, DVD player, lounge suite, laptop
$1000.00	2009	30 weeks	Car x 2
$1700.00	2009	29 weeks	Car, house
$1958.40	2009	52 weeks	Car
$3968.00	2009	31 weeks	Car
$1400.00	2010	17 fortnights	Car

Support for the proposed caps on the costs of credit contracts

5.100 The committee gauged strong support among consumer advocates for the introduction of caps on costs and the formula for calculating costs.[127] Anglicare Victoria argued:

> From our client experiences, the main destructive nature of uncapped short term lending appears as two-fold; both the high cost of credit and the overcommitment of borrowers through multiple or 'rollover' loans can cause crippling effects. The proposed amendments seek to address exactly this, and Anglicare Victoria wholeheartedly welcomes the new obligations placed on such credit providers.[128]

5.101 Commenting on the effect of the Queensland cap, National Legal Aid reported a 'diminution of clients coming for assistance after the state cap was introduced'.[129] National Legal Aid argued that a clearly defined, national costs cap would be an appropriate and effective means of ensuring consumer protection:

> We need something where it is a 'tick and flick', where there is a definite rule where you are in breach of the cap so therefore you cannot claim the interest.[130]

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126 National Legal Aid, answer to question on notice, 24 October 2011 (received 4 November 2011).

127 For example, Consumer Credit Legal Centre (NSW) Inc, *Submission 47*, p. 2; Financial Counselling Australia, *Submission 49*, p. 2.

128 Anglicare Victoria, *Submission 39*, p. 5.

129 Ms Catherine Uhr, National Legal Aid, *Committee Hansard*, 24 October 2011, p. 43.

130 Ms Catherine Uhr, National Legal Aid, *Committee Hansard*, 24 October 2011, p. 44.

5.102 The Financial and Consumer Rights Council Inc stated:

> We view the proposals as an improvement on the current regulatory landscape in Victoria, where the soft 48% cap has proven largely ineffectual.[131]

5.103 Redfern Legal Centre further submitted that loans with costs above a 48 per cent cap are contrary to prudent market practice:

> 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.[132]

5.104 In relation to the proposed 10 per cent cap on establishment fees for small amount loans, the Consumer Action Law Centre rejected the view that consumers could be protected were the caps to increase:

> If the establishment fee is increased to 20 per cent of the amount borrowed (keeping the monthly rate the same), this will be equivalent to an annual percentage rate of 264% for a one month loan. If it is increased to 25 per cent, this will be the equivalent to an annual percentage rate of 324% on a one month loan. If the establishment fee is increased to 30 per cent, this will be the equivalent to an annual percentage rate of 384%[...]
>
> Leaving annual percentage rates aside, a 20 per cent, 25 per cent, or 30 per cent establishment fee would allow a lender to obtain a return of $66, $81, or $96 on a one month loan of $300. A fortnightly repayment on such a loan would be between 22.5% and 24% of a single pensioner's fortnightly income. A product that takes such a large proportion of a low-income earner's regular income is designed to require them to come back to obtain another loan.[133]

5.105 In relation to a proposal to increase the cap for small amount loans, the Consumer Action Law Centre further stated:

> We do not doubt that there are costs involved in issuing a loan, and we also acknowledge that the RIS suggested a return of "approximately $20-30 per $100 is required to generate a reasonable return" on loans under around $300 (though costs would be lower on larger loans). However, we would oppose a cap at the levels suggested by the NFSF, for two main reasons.
>
> The first is that the cap suggested by the NFSF would allow lenders to charge very close to what they are charging now—for example, Cash Converters' fee for their 'Cash Advance' product is $35 per $100 loaned. Given the lack of price competition currently in this market, we do not accept that the NFSF's proposed cap would bring fees down to a competitive level.

131 Financial and Consumer Rights Council Inc, *Submission 28*, Attachment 1, page 1.

132 Redfern Legal Centre, *Submission 18*, Attachment 1, p. 5.

133 Consumer Action Law Centre, *Supplementary Submission 20a*, pp 1–2.

> The second is that (even if the NFSF's suggestion represented a competitive price) increasing the cap to allow continued provision of very short term versions of these loans would be to profoundly miss the point of this reform. The reason the proposed cap will protect consumers is that it will make the shortest term loans less viable, encouraging lenders to offer longer term loans. As discussed above, the short terms of these loans are one of the key reasons they are so harmful. The object of any cap should be move the market away from the shortest term loans.[134]

5.106 However, both Good Shepherd Youth and Family Services and Financial Counselling Australia noted their preference for the 48 per cent cap to apply to all short-term loans including those that would be defined as small amount credit contracts. Good Shepherd Youth and Family Services stated:

> Given an all inclusive cost rate cap of 48 per cent has been tested previously and has already been in place in other states, we believe this may be sufficient for loans both under and over $2,000.[135]

5.107 Financial Counselling Australia noted:

> Our sector has long advocated for an all inclusive interest rate cap of 48% (including fees and charges) along the lines of that already in place in Queensland, New South Wales and the ACT. This Bill does not go this far, instead proposing a two-tier structure. While this is not our preferred position, we support the legislation as a reasonable compromise.[136]

Support for the formula for calculating costs under the caps

5.108 There appeared to be general approval for including in the cost capping formula a regulation-making power to address potential avoidance practices. The committee received evidence from consumer advocates of examples that verified the assertion in the Explanatory Memorandum and Regulation Impact Statement that lenders had adopted tactics to generate income that falls outside of the cap formula under state and territory consumer credit legislation.

5.109 Financial Counselling Australia provided the following example of avoidance techniques:

> Mr O on a Widows Pension, borrowed $1000, $200 went to pay out her first loan. She had to borrow $900 to buy a money management DVD. She already had the money management DVD from her first visit.[137]

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134 Consumer Action Law Centre, *Submission 20*, p. 7.

135 Good Shepherd Youth and Family Services, *Submission 23*, p. 6.

136 Financial Counselling Australia, *Submission 49*, p. 2.

137 Financial Counselling Australia, *Submission 49*, Attachment 1, Financial Counselling Australia, *What financial Counsellors say about payday lending*, October 2011, p. 10.

5.110 A similar case was provided by the Consumer Credit Legal Centre (NSW) Inc:

> Our client wanted to borrow $1000. In order to do so she was required to —borrow a DVD set on money management for which an extra $400 was added to the contract. She was then charged 48% on $1400 instead of $1000. When our client wanted to borrow more money at a later date, she was forced to —borrow the same DVD set at a further cost of $400.[138]

5.111 It was also put the committee that the formula must address brokerage fees. The Consumer Action Law Centre submitted that the cap should 'prohibit fees incurred with third parties (such as introducers, brokers or processors) whether associated with the credit provider or not).'[139]

Debt spirals – support for the proposed restrictions on multiple concurrent small credit contracts, refinancing and increased credit limits

5.112 Rather than alleviate financial pressures, it was argued that short-term loans can increase financial hardship for the consumer. Financial Counselling Australia submitted that:

> The overwhelming experience of financial counsellors is that payday loans are harmful and leaves the majority of consumers worse off. As a general principle, more credit, particularly at such high cost, is not the answer to financial difficulty.[140]

5.113 Drawing on a survey of over 300 financial counsellors, Financial Counselling Australia reported that it was the view of the financial counsellors interviewed that access to short-term finance did not improve the consumer's financial situation:

> The majority of financial counsellors (269 or 79%) said that payday lending "never" improved their client's financial situation. No financial counsellor said that payday lending either "often" or "always" improved their client's financial situation.[141]

5.114 The committee was informed that financial difficulty linked to short-term borrowing is a significant proportion of consumer advocates' work. Drawing on the findings of a survey, conducted in September and October 2011 of financial counsellors across Australia, Financial Counselling Australia estimated that in a

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138 Consumer Credit Legal Centre (NSW) Inc, *Submission 47*, p. 3.

139 Consumer Action Law Centre, *Submission 20*, p. 1.

140 Financial Counselling Australia, *Submission 49*, p. 1.

141 Financial Counselling Australia, *Submission 49*, Attachment 1, Financial Counselling Australia, *What financial Counsellors say about payday lending*, p. 8.

12 month period the 341 financial counsellors surveyed saw approximately 2777 clients with short-term loans.[142]

5.115 Good Shepherd Youth and Family Services reported that approximately 30 per cent of their financial counselling clients have payday loans. However, it was noted that this figure could be higher as 'many clients do not mention their payday loans as they are ashamed to admit they have them'.[143]

5.116 Anglicare Victoria and Anglicare Sydney also provided data concerning the proportion of clients seeking assistance for matters connected with short-term lending. Anglicare Victoria advised:

> We see about 10½-thousand people throughout our financial counsellors ... As we indicated in our submission, 72½ per cent of the cases relate to client debt problems and 50 per cent of that 72½ per cent are from creditor harassment or creditors, most of those being payday lenders.[144]

5.117 Anglicare Sydney also provided the following data, noting the figure may be a conservative estimate due to client under-reporting:

> This figure is off the top of my head but I would say at least 1,000 to 1,500 of those would present with payday lender issues. It is a question of whether, through services like Emergency Relief, people will actually disclose those issues to you, because quite often they can be quite embarrassed that they have those problems.[145]

5.118 It was argued that the high cost of credit, combined with refinancing, can lead to 'debt spirals'. Redfern Legal Centre provided the following description of the short-term loan borrowing cycle:

> Many people who enter into short-term, small amount credit contracts...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 of 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

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142 Financial Counselling Australia, *Submission 49*, Attachment 1, Financial Counselling Australia, *What financial Counsellors say about payday lending*, October 2011, p. 6.

143 Good Shepherd Youth and Family Services, answer to question on notice (24 October 2011) received 2 November 2011.

144 Mr Paul McDonald, Chief Executive Officer, Anglicare Victoria, *Committee Hansard*, 24 October 2011, p. 67.

145 Ms Felicia Andersen, Community Care Sustainable Living Coordinator, Anglicare Sydney, *Committee Hansard*, 24 October 2011, p. 69.

> borrower and make it unlikely that the borrower will be able to repay their debt.[146]

5.119 Similarly, the Indigenous Money Mentor Network commented:

> I am seeing firsthand the financial hardship payday loans often bring. I have clients who take out small loans to pay bills which quickly grow as a result of defaulting on their payments, hefty penalties for insufficient funds and letter writing to the offending person. Studies have shown that people who take out these short small loans focus on the dollar amounts without any understanding of the annual effective interest rates, fees or charges.
>
> The people that present to me, often have more than one loan from a Payday lender, leaving little money for food and the basic needs of their children. This then creates a situation where families are required to attend welfare agencies for electricity/gas vouchers, food or other assistance. This in turn drains the resources of the charity as they support people over the long term.[147]

5.120 National Legal Aid provided a case example of subsequent loans being used as a means to finance the initial loan:

> Mr H suffers from a mental illness and is on a disability pension working limited hours. Mr H took out his first payday loan to assist him to pay for basic living expenses. Unable to meet these expenses he approached the neighbouring payday lender and was granted a second payday loan which he used to pay the first payday loan. By the time he sought legal advice, Mr H had 3 payday loans, the second and third were being used to pay for the earlier payday loans.[148]

5.121 Accordingly, it appeared that the restrictions on multiple concurrent loans, refinancing and increased credit limits were supported by consumer advocates. As Redfern Legal Centre commented:

> It is our position that a prohibition on charging fees and charges ([other] than those specified) and on the refinancing of small amount credit contracts would assist consumers to better understand the cost of the loan, and to avoid becoming entrapped in a dept spiral through the refinancing of one credit contract to repay another. This is an all too common problem in the payday loan market, and one that consumers are often unable to escape without extreme hardship.[149]

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146 Redfern Legal Centre, *Submission 18*, Attachment 1, p. 6.

147 Indigenous Money Mentor Network, *Submission 5*, p. 1.

148 National Legal Aid, *Submission 19*, p. 3.

149 Redfern Legal Centre, *Submission 18*, Attachment 1, p. 4.

Support for the proposed cap on default charges for small credit contracts

5.122 The proposed cap on the fee payable in the event of default on a small amount credit contract appeared to have general support.[150] Treasury provided the following explanation of the proposed cap:

> The bill draws a distinction between default charges, which are essentially charges for the loss of use of the money due to it being not paid on time, and enforcement expenses, which are the actual costs of chasing down the debt—for example, debt collectors or court actions. The first set of costs for not paying the money on time have been capped under the total cap of 200 per cent. Enforcement expenses are regulated already under the NCCP Act and must be reasonable.[151]

5.123 Anglicare Victoria argued that the proposed limit on the maximum that can be charged in the event of default will assist the financially vulnerable to avoid debt traps:

> Anglicare Victoria views this provision as most important in restricting exploitative practices by some small credit providers. The current concern is for those consumers who access a small credit amount and default in payment, requiring them to refinance the original amount plus the interest and or fees. This can quickly spiral out of control and lead to additional debt. The current provision provides much needed protection from this scenario.[152]

5.124 It appeared that the default cap has some support from within the short-term lending industry. Fundco advised that 'we welcome this approach as we believe it will protect consumers against spiralling debt.'[153] First Stop Money commented 'we already cap the total repayment including default fees at the proposed 200% of principal.'[154] Similarly, Money 3 argued:

> The best part of this legislation that has come in—and we actually urged that it happen—is that we cap all fees at the amount of principal advanced. So, if someone were to borrow $200, under this legislation—and please do not touch that—it is capped at 100 per cent of the loan. If a person borrows $50, the most they can ever pay back, with fees charged for defaulting, is $50. If it is a $200 loan, the most that can ever be paid back is $200 plus $200[...]

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150 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Schedule 4, item 15, clause 39B.

151 Mr Christian Mikula, Manager, Consumer Credit Unit, Retail Investor Division, Treasury, *Committee Hansard*, 24 October 2011, p. 75. The committee considers that this would limit the repayment amount to the principal lent plus an additional amount not exceeding the principal.

152 Anglicare Victoria, *Submission 39*, p. 5.

153 Fundco, *Submission 35*, p. 3.

154 First Stop Money, additional information, received 25 October 2011, p. 1.

> That will resolve many of those concerns that we have. We have taken over a number of companies, and some of the practices are disgraceful. A $500 loan becomes a $2½ thousand loan with the default et cetera...It is captured in this bill. Do not lose it. For people [who] have not worked out the way you want, cap the total amount that can be charged at 100 per cent of the loan amount.[155]

5.125 It appeared that Moneyplus supported a more limited application of the proposed cap on default fees. Moneyplus submitted that the Enhancements Bill should be amended to limit repayments owed under credit contracts for less than $500 over less than 6 months to 'twice the credit amount; including loan amount and all fees, including default fees'.[156]

5.126 However, Money 3 questioned whether the proposed default fee cap was sufficiently comprehensive to cover all potential misconduct:

> They will get the repayment in a week or a fortnight and then charge an obscene default fee that is not captured under the bill. The only people who will go will be the credible and transparent businesses. I see that as missing that as a major flaw [sic].[157]

5.127 The National Financial Services Federation advocated for the introduction of an additional measure to address default fees where loans are 'sold or passed on':

> A requirement that if a Small Amount Contract is sold or passed to an external debt collection firm, etc, those subsequent parties are also bound by the 'twice adjusted credit amount' debt spiral control.[158]

5.128 The Federation argued that without this additional measure the legislation contains a 'hole', and implied that as currently drafted the Enhancements Bill would allow third parties to charge in excess of the cap on fees in the event of default.[159]

5.129 The Financiers' Association of Australia disagreed with Treasury's assessment that clause 39B would not apply to enforcement fees, arguing that the clause would have the effect that '[a]ny 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.'[160]

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155 Mr Robert Bryant, Chief Executive Officer, Money 3, *Committee Hansard*, 24 October 2011, p. 26.

156 Moneyplus, *Submission 12*, p. 3.

157 Mr Robert Bryant, Money 3, *Committee Hansard*, 24 October 2011, p. 22.

158 National Financial Services Federation, *Submission 22*, p. 12.

159 National Financial Services Federation, *Submission 22*, p. 12.

160 Financiers' Association of Australia, *Submission 40*, p. 28.

Concerns with the use of direct debit facilities

5.130 Although the Enhancements Bill does not contain proposals relating to the use of direct debit facilities, the committee's attention was drawn to concerns with the practice of credit providers promoting the use of direct debit for loan repayments. As St Luke's Anglicare stated:

> Lenders use direct debit for payments meaning they have the first call on the borrower's income before other essentials are covered.
>
> Lenders charge a penalty fee if the direct debit is not completed and this is often compounded by the banks also charging a dishonour fee. Often borrowers are not aware that they can cancel the direct debit without permission of the lender to avoid the default. Any administrative errors on the part of lenders can consequently be disastrous for borrowers.[161]

5.131 Financial Counselling Australia provided the following case example of the difficulties that can be caused by the use of direct debit repayments:

> Client neglected their living expenses eg utilities, rent etc in order to pay these debts, because they are direct debited. In many cases they become so overwhelmed by their financial difficulties, they try to consolidate with another payday lender compounding their situation. They end up with default banking fees etc.[162]

5.132 The Consumer Action Law Centre also noted concerns with the use of direct debits:

> Today we have brought along a copy of a bank statement of one of our clients, which we would like to hand up to you. It demonstrates an experience which is not uncommon for borrowers. This client had debts to two providers at any one time over many, many months, and they are demonstrated by the highlighted marks on the statements. You can see that payments were directly debited to these providers on the same day that his Centrelink pension was credited. In most fortnights he was left with only $150 to live on after those repayments had been deducted and his account was at a very marginal balance, often in debit. Because this was insufficient, further loans were advanced very easily due to his ongoing relationship with the lender. There is no doubt that the short-term loans were contributing significantly to his very precarious financial situation and robbing him of essential daily living finances.[163]

5.133 It was put to the committee that the following measure is needed:

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161 St Luke's Anglicare, *Submission 45*, p. 6.

162 Financial Counselling Australia, *Submission 49*, Attachment 1, Financial Counselling Australia, *What financial Counsellors say about payday lending*, October 2011, p. 6.

163 Ms Catriona Lowe, Co-Chief Executive Officer, Consumer Action Law Centre, *Committee Hansard*, 24 October 2011, p. 34.

> ...prohibit lenders requiring the signing of a direct debit authority and/or introduce a requirement for lenders to offer a range of repayment mechanisms—not just direct debits. This recognises that payday loans are commonly repaid by direct debits which remove payments from the debtor's account as soon as payment is deposited. Where a borrower has insufficient income to both repay debt and buy essentials, direct debit authorities ensure the debt is prioritised leaving them unable to pay for rent, groceries and utilities. This ensures that lenders wear little risk of losing their money on even the most irresponsible loans. In turn, this removes financial incentives to loan responsibly and actually creates incentives for irresponsible lending by encouraging repeat borrowing.[164]

5.134 These concerns did not, however, reflect the view of the short-term loan industry. In response to the concerns with the use of direct debit, the Financiers' Association of Australia commented:

> 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 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.[165]

Industry concerns with the short-term loan provisions

5.135 Industry representatives raised several concerns with the proposed measures. Notably, representatives:

- questioned the need for phase two reform to short-term lending, arguing that the responsible lending obligations are effectively regulating industry practice
- advocated for the measures in Schedules 3 and 4 to be extended to apply to ADIs
- argued that the proposed restriction on refinancing, multiple concurrent contracts and increasing existing credit limits will disadvantage, rather than assist, vulnerable consumers, and
- challenged the Government's conclusion that the industry can remain viable under the caps proposed.

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164 Consumer Action Law Centre, *Submission 20*, p. 13.

165 Financiers' Association of Australia, *Submission 40*, pp 32–33.

Responsible Lending Obligations (RLO)

5.136 It was put to the committee that the Responsible Lending Obligation (RLO) requirements implemented as part of the phase one reforms are sufficient to regulate industry lending practice.[166] Can Do Credit Pty Ltd praised the merits of the phase one reforms and responsible lending:

> Credit Providers are not angels either. However, the Responsible Lending laws have gone a long way to ensuring more Credit Providers are doing the right thing.[167]

5.137 Cash Converters argued that under the RLOs consumers' borrowing capacity is currently adequately assessed to ensure that they are able to properly service their debts.[168] Mr Peter Cumins, Managing Director, Cash Converters, provided further comment:

> Again, under the responsible lending obligations you are required to reassess every application. It is not a question of people just coming in and you giving them another $200. We have to get the bank statements and have to assess the application again on its merit. If you are in the business of lending money unsecured, why would you lend somebody some money if you knew right at the beginning that they could not afford to repay it? It would be a pretty dumb business practice. All of our processes are about identifying how much income a person has available to meet repayments. A customer may come in and ask to borrow $800 but leaves borrowing $200 because that is all they can afford to repay. There is no point from a business proposition to lend more than they can afford to repay.[169]

5.138 The National Financial Services Federation also submitted that the RLOs provide sufficient protection to consumers, quoting the argument of Professor Corones, from the Queensland University of Technology, that:

> [t]he more preferable regulatory response appears to lie in the adoption of the responsible lending regulations, together with the associated licensing, conduct and disclosure obligations, to prevent credit being extended to those who cannot afford to repay it.[170]

5.139 Industry representatives were also concerned with the timing of the introduction of the Enhancements Bill, arguing that the legislation is premature as the reforms introduced under phase one have not been properly 'embedded', and hence

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166 Cash Converters, *Submission 27,* pp 5–6; First Stop Money, *Submission 17*, p. 1; Min-it Software, *Submission 34*, p. 10.

167 Can Do Credit, *Submission 15*, p. 2.

168 Cash Converters, *Submission 27*, p. 9.

169 Mr Peter Cumins, Managing Director, Cash Converters, *Committee Hansard*, 24 October 2011, p. 53.

170 Quoted in National Financial Services Federation, *Submission 22*, p. 4.

their effectiveness not sufficiently monitored and evaluated. First Stop Money submitted:

> First Stop Money believes it is unfortunate that the impact of the introduction of responsible lending obligations has not been given the time to make significant impact nor has any review of its impact been released.[171]

5.140 Money Centre argued that '[t]he legislation is vast overkill; ASIC now has sufficient power to ensure responsible lending.'[172] The National Financial Services Federation further noted Professor Corones' conclusion that:

> ...there appears to be no evidence that the general protections in the NCCP and the ASIC Act and the remedies they make available to payday borrowers are inadequate. On the contrary, we believe they are comprehensive and sufficient.[173]

5.141 Concerns with the timing of the introduction of the proposed short-term loan reforms were also raised by the Australian Finance Conference, which commented:

> The AFC is concerned that...regulatory options, other than a cap inclusive of fees and charges, that have been implemented under the NCCL Phase 1 reforms (eg licensing, mandatory membership of an external dispute resolution scheme, responsible lending obligations) have not been given a chance to take effect and be tested for areas of failure as a pre-cursor to inclusion of these amendments in the Bill.[174]

5.142 It was also put to the committee that the phase one reforms have already imposed a substantial financial burden on the industry; the phase two reforms would make obsolete those of phase one and render these as an 'expensive waste of time'.[175]

5.143 However, the committee is aware that the Regulation Impact Statement disputes that the RLOs have resulted in significant changes to industry practice:

> First, the responsible lending obligations require the credit provider or lessor to assess whether or not the consumer can afford the repayments under the contract without substantial hardship, and do not directly impact on the cost of credit. Credit providers and lessors therefore cannot set the repayments at a level the consumer cannot afford to repay. In some situations, this may result in the consumer having to meet lower repayments

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171 First Stop Money, *Submission 17*, p. 1.

172 Money Centre, *Submission 1*, p. 3.

173 Prof Stephen Corones, *Phase Two of the National Credit Reforms Examining the Regulation of Payday Lenders*, (March 2011) http://www.ljrc.law.qut.edu.au/files/PhaseIICreditReforms-regulationofPaydayLending.pdf, p. 56.

174 Australian Finance Conference, *Submission 29*, p. 2.

175 Cash Converters, *Submission 27*, p. 6; National Financial Services Federation, *Submission 22*, p. 6.

> than would otherwise be the case. However, this would apply on an individual basis, and does not provide a comprehensive response in the same way that an upfront limitation on costs would.
>
> It is noted that the introduction of the responsible lending requirements could be expected to have the greatest impact on very short-term loans with a single high repayment. However, there do not appear to have been any significant changes to practices in this area.
>
> Secondly, the responsible lending obligations require each contract to be considered in isolation. In the case of repeat borrowings this will mean that it is not possible to consider the cumulative effect of a series of contracts with the same lender.
>
> Finally, there are practical limitations in establishing whether or not a consumer can afford the repayments under short-term contracts. For these consumers, it depends on being able to precisely establish what their living expenses are, and this can be difficult in practice.[176]

5.144 The committee was informed of an ASIC review of the impact of the responsible lending requirements on the lending practices of short-term lenders.[177] Broadly, the committee understands the review found that lenders are predominantly aware of the obligations. However, the review did identify instances where lenders were at risk of non-compliance with the RLOs.

Application of proposed consumer contract measures to ADIs

5.145 The short-term lending industry noted with concern that the measures in Schedules 3 and 4 are not intended to apply to ADIs. The National Financial Services Federation commented that the exclusion of ADIs from the proposed new lending requirements was 'unfair and anti-competitive':

> All Australian Credit Licence holders operate under the same rules. The law must apply equally to all licensed credit providers. Non-bank lenders provide similar, if not the same products, to ADI's. Creates an unfair market place and possible anti-competitive issues.[178]

5.146 It was further argued that extending the Schedules to apply to ADIs would afford 'consumers with protection regardless of the type of credit providers being used.'[179]

5.147 The short-term lending industry's position was not supported by ADI representatives. The ABA argued:

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176 *Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, Chapter 11: Regulation Impact Statement June 2011, paragraphs 11.108–11.111.

177 FAA/Industry/Smiles Turner Delegation, *Supplementary Submission*, pp 4, 8.

178 National Financial Services Federation, *Submission 22*, p. 13; p. 14.

179 National Financial Services Federation, *Submission 22*, p. 13; p. 14.

> There is the clear policy intention for this Bill to apply to only what are collectively described as payday lenders. The Government has identified market failures by this group of credit providers that it proposes to address by this legislation. It follows that the proposed regulation should not be extended to ADIs.[180]

5.148 The Australian Finance Conference also supported the exemption for ADIs, arguing that the exemption should go further:

> In particular, we submit continuation and expansion of the current exemption for ADIs to also encompass regulated credit provided by registered financial corporations (RFCs) as defined under the *Financial Sector (Collection of Data) Act 2001*. The policy basis for inclusion of the exemption for ADIs would equally be applicable for RFCs. Further we submit the exemption should be of general application for credit products offered by these entities because of the broad-application of the interest cap calculation proposed and consequence broad potential for unintended consequences and application to a range of products offered by AFC members (including credit card products).
>
> We also acknowledge and support the proposed inclusion of an exemption for bridging finance on the lines as proposed. The concerns expressed for AFC members involved in bridging finance were incorporated in the submission to the NSW Government on interest rate caps referred to earlier...These concerns remain valid and the AFC recommends inclusion of the proposed exemption for providers of bridging finance to address those concerns.[181]

Restrictions on refinancing and multiple concurrent contracts

5.149 Industry representatives were unanimous in their concern the proposed restrictions on concurrent contracts. During the hearing, Mr Phillip Smiles, Consultant, Financiers' Association of Australia argued that:

> 28 per cent of the short-term, small-amount, payday lenders will go under the other provisions of the legislation. The focus has been on the interest and cost cap. The reality is that, before we get to 1 January 2013, we have 1 July 2012 and, I repeat, at least 28 per cent of the payday lenders will go because at least that number are dependent, in part—whether good or bad; but this is an economic fact—on some form of rollover or refinancing opportunity.[182]

5.150 Cash Converters and First Stop Money both argued that limiting the number of loans permissible will unfairly restrict consumers' financial capacity, irrespective of

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180 Australian Bankers' Association, *Submission 43*, p. 16.

181 Australian Finance Conference, *Supplementary Submission 29a*, p. 11.

182 Mr Phillip Smiles, Consultant, Financiers' Association of Australia, *Committee Hansard*, 24 October 2011, p. 18.

their personal circumstances and ability to service the loans.[183] In their submission First Stop Money put to the committee that:

> By providing such a restriction, consumers are excluded from accessing credit, irrespective of their personal circumstances. This directly conflicts with the Bill's purpose and the responsible lending requirements of the existing NCCP Act that decisions should be based upon the consumer's personal circumstances.
>
> A consumer who is more than capable of affording the repayments on two or three small amount credit contracts is therefore prevented from accessing credit which may help them out of short term financial distress thereby snowballing into long term hardship.[184]

5.151 Cash Converters agreed with First Stop Money, and reiterated its view that limiting concurrent contracts is unnecessary due to current restrictions under the RLOs:

> These provisions ignore the Phase One reform requiring compliance with Responsible Lending Obligations ("RLO").
>
> Whenever a consumer applies for a further loan or an increase in credit or wishes to re-finance a loan so as to access extra cash, the lender has to apply all of the tests required under the RLO. The lender cannot just lend regardless of the overall impact of the extra loan on the consumer's capacity to repay without hardship to himself or his family. Unless ASIC and the Government regard the whole of Phase One as a waste of time, it must be conceded that RLO renders these prohibitions unnecessary.[185]

5.152 Fast Access Finance also argued that the restriction would be in conflict with the responsible lending obligations:

> If the above are added to the responsible lending obligations already existing in the Act, a potential problem arises. Under the obligations, it is considered that a lender may only provide an amount of credit that is enough to satisfy the borrower's identified needs at the time, not more. It is entirely possible that this amount will be below the level the consumer could afford to service.
>
> For example, a borrower may need $200 for a specific purpose and be able to demonstrate an ability to comfortably service a $500 loan. A prudent lender will only lend $200 to the borrower. If, during the term of the loan, the borrower needs to access a further $300 they are prohibited from doing so by the operation of the sections – despite having demonstrated an ability to be able to service that level of debt.[186]

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183 Cash Converters, *Submission 27*, pp 9–10.

184 First Stop Money, *Submission 17*, p. 9.

185 Cash Converters, *Submission 27*, pp 9–10

186 Fast Access Finance, *Submission 13*, p. 17.

5.153 Mr Paul Baril, Committee Member, Financiers' Association of Australia, argued that the restriction will reduce consumer choice and competition within the industry:

> If I go to Cash Stop and my disposable income is $2,000 and I borrow $300 – and we do it over three or four payments – and then something breaks down or my car breaks down, I cannot go to another lender and get another loan until that loan is paid off. It also reduces competition because the customer will be stuck to stay with the same lender to do the loan.[187]

5.154 Both First Stop Money and Cash Converters foreshadowed that restrictions on refinancing and multiple concurrent contracts will compel consumers to borrow higher amounts to 'cover forward contingencies'.[188] The committee was advised of industry's view that this may weaken, rather than improve, a vulnerable consumer's financial position. Moneyplus supported the proposition that requiring consumers to take larger loans over longer periods will lead to a greater incidence of default and higher indebtedness.[189] The Financiers' Association of Australia advised that under this approach to lending '[e]very three months you would double your default rate.'[190]

5.155 It was also put to the committee that the proposed restrictions on multiple concurrent contracts are impractical, and therefore inappropriate, for lenders. First Stop Money argued that the lenders' obligation to establish a consumer's current loan obligations is 'impossible'. It noted that its ability to ascertain these details is reliant upon consumer disclosure, which they regarded as problematic.[191] First Stop Money noted with concern that the obligations may potentially unfairly penalise credit providers for customer dishonesty.[192] In this regard, Action Cash advised:

> The difficulty we find in making enquiries in regard to previous loans is because of the negative credit reporting regulations...because if a client is desperate they will **not** always be truthful...The proportion of consumers that lie is about 3%.[193]

5.156 Similarly, Can Do Credit Pty Ltd submitted:

> While we do our best to ascertain what other loans a consumer has, it would be greatly beneficial if Credit Providers had to register a loan to a

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187 Mr Paul Baril, Committee Member, Financiers' Association of Australia, *Committee Hansard*, 24 October 2011, p. 20.

188 Cash Converters, *Submission 27*, p. 6. See also First Stop Money, *Submission 17*, p. 9.

189 Mr David Prosser, Chief Executive Officer, Moneyplus, *Committee Hansard*, 24 October 2011, p. 28.

190 Mr Phillip Smiles, Consultant, Financiers' Association of Australia, *Committee Hansard*, 24 October 2011, p. 28.

191 First Stop Money, *Submission 17*, p. 9.

192 First Stop Money, *Submission 17*, p. 9.

193 Action Cash, *Submission 32*, p. 3.

> consumer. That way other lenders, while performing a Credit Check, could see any other active loan a customer has.[194]

5.157 Fundco challenged the notion of 'aware' in ascertaining whether a consumer has a previous loan, and was concerned that this term may create further implementation issues:

> How far are we to take this notion of being ‘aware’? Is the current practice of making sufficient enquiries and verification enough, or will there be another yardstick introduced to measure this by? This aspect of the draft Bill is difficult to implement in practice.[195]

5.158 The prohibition on re-financing small amount credit contracts was also of concern to First Stop Money. It was argued that the prohibition would:

- restrict consumer access to credit
- put additional stress on consumers when payments are due that they may have trouble meeting
- remove the additional time that consumers may need to resolve their issue without having to 'self-exclude' by claiming hardship whereby a responsible lender will not lend to them again
- create additional costs to the consumer using unauthorised overdrafts
- increase the likelihood of default and impact on the consumer’s credit record
- increase the likelihood of consumers 'borrowing from Peter to pay Paul' and deliberately misleading lenders to open up a new credit account, and
- reduce the opportunity to a consumer to 'shop around'.[196]

Restrictions on credit increases

5.159 Similar concerns were raised regarding the proposed restriction on increasing credit limits under credit contracts. First Stop Money argued that by prohibiting credit providers from increasing credit limits, consumers will be encouraged to borrow larger amounts to cover any contingencies. This will create greater indebtedness and leave consumers more vulnerable to financial hardships.[197]

5.160 Fundco agreed with First Stop Money's claims, and argued that the RLO requirements adequately protect customers from falling into a debt trap:

> This piece of draft legislation implies that by eliminating the rights of consumers to apply for more than one loan, refinance an existing loan or

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194 Can Do Credit, *Submission 15*, p. 2.

195 Fundco, *Submission 35*, p. 3.

196 First Stop Money, *Submission 17*, p. 11.

197 First Stop Money, *Submission 17*, p. 12.

> increase their credit limit as and when they require it, will avoid them falling into a debt trap. The only way consumers will not fall into a debt trap is if they disclose all existing loans to potential lenders at the time of their application. We would never give a loan to a consumer if we were aware that they were falling into a debt trap as we would be the only loser. Introducing a piece of legislation that is difficult for the lender to comply with will result in failure for all concerned.[198]

5.161 Action Finance put to the committee that '[i]t is certainly not in our interest or benefit to have them [customers] in a debt trap or a spiral. Far from it.'[199]

Caps on credit contracts – potential impact on industry

10 and 2 per cent cap for small credit contracts

5.162 It was apparent that the effect of the reforms was not clear to all short-term loan providers. There appeared to be a misconception that the 48 per cent cap (inclusive of fees and charges) would apply to all loans including loans that would come within the definition of 'small amount credit contracts'.[200]

5.163 None the less, the committee heard strong concerns that the proposed 10 and 2 per cent cap for small amount credit contracts would affect the viability of the short-term lending industry. Mr Paul Baril, Committee Member, Financiers' Association of Australia, advised:

> Under ASIC, to even stay in lending you have to show that you can make a profit. It cannot be done in this country...The 10 and two per cent is absolutely not viable by any means.[201]

5.164 Mr Paul Baril also informed the committee of the experience of introducing caps for short-term loans in New Hampshire, America, and in Canada:

> The consumer advocates are right: there is capping in Canada. But it is a fixed dollar capping. It does not operate on an APR, because everybody in their right mind knows that 48 per cent does not work on a short-term loan... In Canada, with regulations licensing, it is a two-page contract. I know the consumer advocates have attacked and said that we should have an APR on ours regardless, but consumers understand what the cost of the contract is. To do a loan in Ontario, which is the size of New South Wales,

198 Fundco, *Submission 35*, p. 3.

199 Action Finance, *Submission 36*, p. 1.

200 See, for example, Min-it Software, *Submission 34*, p. 21.

201 Mr Paul Baril, Committee Member, Financiers' Association of Australia, *Committee Hansard*, 24 October 2011, p. 19.

> the government worked out with the industry that they needed to make a small profit, and they came up with a total of $21 per $100.[202]

5.165 There was a general consensus among short-term loan providers that the proposed caps on fees and interest will render the small loans credit industry unviable. Money 3 emphasised that the proposed caps will not support a viable industry, stating:

> To put it simply, businesses cannot operate under the proposed establishment cap of 10% of adjusted credit amount plus 2% per month for credit under $2000 or 2 years duration. Or the 48% cap which includes third party fees and charges for all other credit.[203]

5.166 It was argued that the 10 per cent fee and two percent monthly fee will not be sufficient to recoup costs. First Stop Money advised that the cost for assessing and administering an average loan of $320 is approximately $81. However, under the new 10 and 2 per cent provisions of Schedule 4 of the bill, First Stop Money would only be able to recoup $32, leaving a shortfall of $49.[204] Figure 5.2 demonstrates First Stop Money's estimates.

Table 5.2: Actual Costs compared with Proposed Revenue[205]

Loan Amount	Loan Term	Establishment Fee	Monthly Fees	Cost to First Stop Money	Lender P/L
$200	3 weeks	$20.00	$4.00	$81.00	-$57.00
$300	3 weeks	$30.00	$6.00	$81.00	-$45.00
$500	3 weeks	$50.00	$10.00	$81.00	-$21.00
$1,000	6 months	$100.00	$120.00	$81.00	$39.00
$1,500	6 months	$150.00	$180.00	$81.00	$99.00

5.167 Similarly, Super Nexus claimed that they incur costs of $96.66 on an average loan of $320.[206] The committee was advised that if the proposed caps are implemented, Super Nexus' shortfall will total approximately $64.66. Figure 5.3 below details their costings:

202 Mr Paul Baril, Financiers' Association of Australia, *Committee Hansard*, 24 October 2011, p. 19.

203 Money 3, *Submission 7*, p. 3.

204 First Stop Money, *Submission 17*, p. 13.

205 First Stop Money, *Submission 17*, p. 14.

206 Super Nexus Pty Ltd, *Submission 24*, pp 2–3.

Table 5.3 – Super Nexus Financial Result per Average Cash Advance[207]

Income	**$110.84**
less Expenses	
Administration	
Direct	$34.59
Indirect	$39.39
Other	
Bad Debt	$14.71
Interest	$1.90
Income tax	$6.08
Total Expenses	**$96.66**
Profit per Cash Advance	**$14.18**

5.168 Cash Converters also argued that 48 per cent annual cap on a $320 one month loan would be below cost.[208] Cash Converters advised that they will lose approximately $37.60 per transaction, based upon their current fee structure. To substantiate this claim, Cash Converters cited a pilot study by the National Australia Bank (NAB), drawing the committee's attention to the following findings:

> Based on the economic insights we have gained from the pilot, we do not believe it is possible to place a 48% cap on loans under $2,900 with loan terms a year or less. As such, given the clear demand for fringe credit, NAB believes the imposition of a 48% interest rate cap on all forms of fringe lending may in fact lead to the disappearance of many forms of fringe lending, or make it partially a 'black market' industry.[209]

5.169 A fee structure was submitted to the committee by Cash Converters to demonstrate the impact of the proposal on their business profitability:

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207 Super Nexus Pty Ltd, *Submission 24*, p. 2.

208 Cash Converters, *Submission 27*, p. 7.

209 Cash Converters, *Submission 27*, pp 7–8. *Do you really want to hurt me? Exploring the costs of fringe lending*—A report on the NAB Small Loans Pilot (March 2010), p. 41.

Table 5.4: Cash Converters Fees Calculation[210]

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

Typical Store Volume

Loans	• $110,000 loaned each month
	• Average *Cash Advance* loan is $320
	• 350*Cash Advance* transactions per month ($110,000 ÷ $320 = 350)or 4200 annually
Income	• Gross income from $320 loan = $112 ($35 per $100, i.e. $320 x 0.35)
Expenses	• Annual overheads for a Cash Converters store estimated at $216,200
	• Average cost per transaction equates to $51.47 ($216,200 ÷ 4200)

Typical Expenses (stores overheads)

Item	Amount
Rent/outgoings allocation	$25,000
Wages	$70,000
Postage & Stationery	$1,700
Uniforms	$1,500
Tele/Broadband	$ 6,300
Electricity	$1,500
Insurance	$1,500
Workers comp	$2,000
Super	$6,300
Security costs	$4,800
Advertising	$48,000
Bad debt (at 3 per cent)	$39,600
Collection fees	$5,000
Cleaning	$2,000
Staff amenities	$1,000
Total	***$216,200***

- Rental for an average store with average space allocation for Personal Finance Centre
- Note – no allowance has been made for the cost of Advertising at a local level.
- Staff assumptions, one full time staff [approx $40,000 per annum] and two casual/part time staff.
- Bad Debt at 3 per cent or $3,300 per month x 12 = $39,600 annually.

5.170 While clarifying the figures for the committee, Mr Cummins informed the committee that small loans make up approximately 50 per cent of a typical Cash Converter store's business:

> **Senator THISTLETHWAITE:** On page 13 of the Cash Converters' submission there are some figures for typical store volumes. I assume most of your businesses are franchises; is that correct?
>
> **Mr Cumins:** The majority is franchised, yes.
>
> **Senator THISTLETHWAITE:** You say that the gross income from a $320 loan is about $112.
>
> **Mr Cumins:** Correct.
>
> **Senator THISTLETHWAITE:** Typical store volume is about $110,000 worth of loans a month. I am calculating that we are talking about an

210 Cash Converters, *Submission 27*, p. 13.

> average gross income of about $40,000 a month from these types of loans for a typical store based on those figures; is that correct?
>
> **Mr Cumins:** Correct.
>
> Senator **THISTLETHWAITE:** Can you give us an idea of what percentage that $40,000 would be of the total gross income for a business like that—is that five per cent or two per cent?
>
> **Mr Cumins:** It would be higher than that. It would probably be over 50 per cent.
>
> **Senator THISTLETHWAITE:** These types of loans make up 50 per cent of the business of a typical store?
>
> **Mr Cumins:** Correct. The balance of profit at store level comes from the retail sales of second-hand goods and interest collections on the pawnbroking loans.[211]

5.171 The committee makes two comments on the data Cash Converters provided. First, it is noted that the data records that the typical expenses associated with store overheads are borne predominantly by small-credit borrowers. While this was apparent from the spreadsheet, this was not clarified with the committee. Second, the figures appear to apply a 48 per cent cap to loans that would fall within the category of 'small amount credit contracts'. It is noted that Schedule 4 would require a cap of 10 and 2 per cent to apply to these loans, rather than a 48 per cent cap. None-the-less, it can be presumed that there would be greater concerns with the introduction of a 10 and 2 per cent cap. As the Financiers' Association of Australia stated '[t]he reality is that whether it is a 10, two or 48 per cent, as proposed, for under $3,000 it will not cover fixed costs.'[212]

5.172 It was strongly put to the committee that the introduction of the caps for small amount credit contracts would result in the discontinuation of the market. Money Centre submitted that '[t]he proposed legislation will force hundreds of lenders to close their doors forever'.[213] Action Finance succinctly argued: '[l]ike any business a profit must be made or close the door...that is exactly what will happen to the micro finance industry'.[214] Action Cash stated that:

> ...the Government now believes it hasn't gone far enough and intends to regulate the profit earnings of those individual small businesses, to the point where the business model proposed will not make it viable for my group of

211 Mr Cumins, Managing Director, Cash Converters International, *Committee Hansard*, 24 October 2011, p. 53.

212 Mr Phillip Smiles, Financiers' Association of Australia, *Committee Hansard*, 24 October 2011, p. 18.

213 Money Centre, *Submission 1*, p. 3.

214 Action Finance, *Submission 36*, p. 1.

> franchisees to continue in supplying the service that our clients expect and appreciate.[215]

5.173 The Financiers' Association of Australia strongly agreed with these concerns, stating 'no lender will continue to lend the current average payday loans of $275 and $325.'[216]

5.174 It was argued that the withdrawal of credit providers from the small amount credit market would exacerbate financial hardship for vulnerable consumers. Similarly, comments in regard to the measures in Schedule 3, for example restrictions on multiple concurrent contracts, the Financiers' Association of Australia concluded that the proposed cap for small amount credit contracts 'would encourage larger amount and shorter term loans'.[217]

5.175 Action Cash argued:

> It is far better for a responsible licensed credit lender to be assessing and controlling the number of loans issued and the finance limit of any loans a client receives, than forcing them into the hands of less scrupulous lenders.[218]

5.176 Similarly, Super Nexus Pty Ltd stated:

> ...the blunt introduction of a fixed 10% cap on establishment fees and 2% cap on monthly fees will make it impossible for legitimate lenders to make commercially viable payday loans; the introduction of those caps would be tantamount to outlawing payday lending by making it economically unviable; legitimate lenders will cease offering payday loans; loans will instead likely be offered only by unscrupulous, unethical operators[219]

5.177 Mr Paul Baril, Financiers' Association of Australia, also commented on the potential expansion of unregulated credit providers:

> I also brought along a one-page article today. This is out of the state of New Hampshire, where they capped payday lending at 36 per cent, which basically drove the business out of the state. Now they are going to reintroduce it and it will go through. Payday lending will be allowed back in New Hampshire, because of the fact that they capped them so low over rate, the illegal lenders came in. They spent more money now chasing illegal lenders than they do watching the ones that are legalised[220]

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215 Action Cash, *Submission 32*, p. 1.

216 Financiers' Association of Australia, *Submission 40*, p. 21.

217 Financiers' Association of Australia, *Submission 40*, p. 17.

218 Action Cash, *Submission 32*, p. 3.

219 Super Nexus Pty Ltd, *Submission 24*, Attachment A, p. 2.

220 Mr Paul Baril, Financiers' Association of Australia *Committee Hansard*, 24 October 2011, pp 19–20.

5.178 It was also argued that the rationale for the introduction of the 10 and 2 caps is unclear. First Stop Money commented:

> First Stop Money does not understand how 10% of the adjusted credit amount can reflect the reasonable cost of determining the application for credit and the initial administrative cost of providing the credit and would welcome the opportunity to see how the Government reached these figures and covered all true costs.[221]

5.179 The Financiers' Association of Australia commented that it 'is intrigued at the justification for this 10%'. The Association put forward that:

> [t]hey [the government and media] are ignoring the detail of the current Bill that demands that it be 'reasonable [expenses]' 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.[222]

5.180 Evidence provided by Treasury, while explaining the policy rationale, does not provide details of economic modelling:

> The approach we took there was the 10 and two model. This is different from other models, which have a simple percentage. The Canadian and American models typically take anywhere between 17 and around 20, 25 or 30c for every dollar advanced. We were looking at a model which addresses that tension. Where you are looking for someone with a small amount of money, there are going to be fixed costs upfront, but you also do not want to distort the way in which the lending operates so that there is an incentive to provide other short-term loans, which are probably the most problematic, because the ratio of the establishment or upfront costs that you can charge is higher. So the model we developed looked to both allow some upfront costs and also try not to distort the market for very short-term loans by allowing a return over time.[223]

The proposed 48 per cent cap

5.181 The committee heard concerns with the proposed introduction of the 48 per cent cap. First, it was argued that the introduction of the cap would be futile as the New South Wales model on which the cap is based is flawed. The Financiers' Association of Australia advised that 'the New South Wales cap has not worked. There are six avoidance strategies to get around it.'[224] Mr Robert Bryant, Chief Executive Officer, Money 3 argued that:

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221 First Stop Money, *Submission 17*, p. 14.

222 Financiers' Association of Australia, *Submission 40*, p. 18.

223 Mr Christian Mikula, Manager, Consumer Credit Unit, Retail Investor Division, Department of the Treasury, *Committee Hansard*, 24 October 2011, p. 73.

224 Mr Phillip Smiles, Consultant, Financiers' Association of Australia, *Committee Hansard*, 24 October 2011, p. 18.

> [t]he issue that is on the table and that you are looking at is a model that cannot work. It has failed in New South Wales, yet that has not come up. We are overlaying the New South Wales model on the federal sphere, but nobody has tested the veracity of its success in New South Wales. Customers, whether they are in New South Wales, Victoria, Queensland or anywhere else, are paying the same fees. My colleague who has eight stores in Sydney can tell you exactly what his method of viability technique is. Phillip Smiles can tell you any number of viability techniques that are being used in New South Wales. The 48 per cent cap and its intent are not being covered, yet we are transferring that model Australia-wide.[225]

5.182 Cash Converters submitted:

> To date, the interest rate caps that have been put in place in various forms around the country by State Governments have had little effect in changing the charges payable of a short term loan.
>
> This is primarily due to measures that have been taken by lenders to operate lending models that fit the state's regulations on interest rate caps. These measures include the application of an establishment fee when taking out a loan.
>
> It is worth noting that this mechanism is critical to the business as the short term loan product could not be offered without fees that truly reflect the cost of loan establishment and administration. There is no evidence of concern about this mechanism from consumers; consumer concern and stress increase when access is denied.[226]

5.183 The Australian Finance Conference stated that the association is not aware of 'any evidence that the caps, where enacted, have been enforced with any demonstrable consumer benefit.'[227]

5.184 Second, it was put to the committee that the proposed formula for the 48 per cent cap is unworkable. The Australian Bankers' Association provided seven potential flaws with the model proposed:

> (1) A fee or charge payable by a debtor will be included in the calculation whether it is paid under the credit contract or otherwise as set out in circumstances in (3) (b) (i) and (ii), despite a credit provider potentially being unaware of the payment.
>
> (2) A credit provider would have to establish systems to detect any payments made, and the time they are made, to third parties in order to make the relevant calculation to ensure the cap is not exceeded.
>
> (3) Ordinarily credit providers do not have access to information about fees charged by or paid to third parties unrelated to the credit contract even

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225 Mr Robert Bryant, *Committee Hansard*, 24 October 2011, p. 17.

226 Cash Converters, *Submission 27*, Attachment 4, p. 15.

227 Australian Finance Conference, *Supplementary Submission 29a*, p. 9.

> though the credit provider introduced the third party to the customer. For example, a customer may ask their bank to suggest a financial planner to assist with advice about an investment property loan but the credit provider would not know the specifics of what the planner will charge the borrower for the financial planning service. If the financial planning services continue as an ongoing service what further third party fees would have to be included in the recalibration of the credit cost amount.
>
> (4) Third party service providers, for example insurers to whom the customer is referred or roadside assistance and maintenance providers (related to car loan packaging) would be captured in the credit cost calculation.
>
> (5) In addition, there are difficulties in differentiating between an insurer to whom the bank has referred a customer, and debtor-sourced insurance that the bank simply finances for the customer.
>
> (6) Further, loan originators have the option of charging consumers a direct origination fee, which is genuinely a payment to the originator and which the bank would often not know about.
>
> (7) Possibly reward programs may be involved in the calculation depending on whether the credit provider is a linked credit provider with respect to the third party.[228]

5.185 The Financiers' Association of Australia also expressed concerns with the formula, questioning whether it would be feasible to calculate and further commenting that '[t]he formula...creates a distortion where there are irregular payment amounts and dates.'[229]

5.186 Third, similar to the concerns raised with the introduction of a cap for small amount credit contracts, it was put to the committee that the 48 per cent cap would result in a reduction of the number of short-term lenders and therefore a growth in the number of unlicensed credit providers. In support of this Cash Converters cited a NAB's pilot study *Do you really want to hurt me.* The study claimed that the 48 per cent cap would not be viable for businesses that have a portfolio of 3000 loans or less, to the value of $1700 or less per loan.[230] NAB further summarised their modelling:

> The pilot tested the minimum interest rate required to have a sustainable lending program in the fringe lending sector. It tested a specific market segment (loans between $1,000 -$5,000 over 12 months) and it did not lend to everyone who applied.
>
> It showed it is possible to lend small amounts of money (around $2,900) in this market; make a modest profit and be well below government regulated interest rates of 48% per annum.

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228 Australian Bankers' Association, *Submission 43*, pp 16–17.

229 Financiers' Association of Australia, *Submission 40*, p. 28.

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

> For loans of this size the pilot confirmed that a rate of 32.8% per annum (annual percentage rate or APR) needed to be charged to breakeven. To put it another way, this equates to $18.70 interest for every $100 lent.[231]

5.187 NAB also stated that the 48 per cent interest rate cap could work providing that a lender has a portfolio totalling more than five million loans:

> ...the modelling suggests that you cannot lend below an APR of 48% for a loan portfolio of less than $5 million and an average loan size of $2,900 or less for a loan term of one year.

5.188 Cash Converters also provided research by Policis into the overseas short-term lending markets, which concluded that:

> [t]here is also a significant risk of creating the conditions for unlicensed lenders to enter the market, a development likely to be highly damaging and which is likely to greatly increase the cost of credit for borrowers unable to obtain credit legitimately.[232]

5.189 Commenting on the effect of the cap in New South Wales, Moneyplus also advised that the measures proposed in the Enhancements Bill will result in decreased availability of small amount loans:

> I will compare some figures which will probably tell the story of the New South Wales legislation. In 2004, we were serving roughly 140 customers—this is in one store—per week. Our fees were $15,000 per week. In October 2011, it was 55 and 60; and $28,000 and $22,000 were our fees. Where have we channelled our business? We have moved to the higher end, with fewer customers. We now do not lend to people on any government benefits. We have gone for only the people who are employed. I see that as unintended consequences of the legislation.[233]

5.190 It is noted that the Regulation Impact Statement appears to give credence to industry's concerns. Commenting on the anticipated effect of the introduction of a national 48 per cent cap, the statement concludes:

> Some lenders would exit the market — There is evidence that following the introduction of comprehensive caps in New South Wales and Queensland at least 27 lenders have ceased trading in the last two years. These lenders are most likely to be smaller businesses who find the cap makes lending unviable, or those running an inefficient business model. This impact would be greatest in those jurisdictions that do not currently have a cap (Northern Territory, South Australia, Tasmania and Western Australia), and more limited in other jurisdictions that have already adapted to existing caps

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231 *Do you really want to hurt me? Exploring the costs of fringe lending*—A report on the NAB Small Loans Pilot (March 2010), p. 5.

232 Cash Converters, *Submission 27*, Attachment 1, Anna Ellison and Robert Forster, *The impact of interest rate ceilings*, p. 7.

233 Mr David Prosser, Moneyplus, *Committee Hansard*, 24 October 2011, p. 17.

> (where the majority of lenders who could not operate with a cap may already have exited the market).[234]

Industry alternatives

5.191 There was a general consensus among industry representatives that phase two reforms will be implemented.[235] Therefore, a number of possible alternative measures were put before the committee. It was apparent that, collectively, the representatives of the short-term loan industry agreed with the need for better regulation and consumer protection, but not at the expense of industry viability. However, there was no consensus as to the details of a possible regulatory framework—their views are discussed herein.

Caps for small amount credit contracts

5.192 It was put to the committee that the cap for small amount credit contracts must be increased. Cash Converters proposed a 20 per cent cap on establishment fees and a 4 per cent monthly fee.[236] It is suggested that this formula will enable Cash Converters to make a 4.25 per cent profit per loan.[237] Another alternative was proposed by the National Financial Services Federation. They suggested a 28 per cent fees cap on establishment fees and a 2 per cent cap on monthly fees.[238] Similarly, Mr Paul Baril, Financiers' Association of Australia stated:

> [t]he 10 and two per cent is absolutely not viable by any means. We have put in submissions on what we believe we need: 28 and two percent will be submitted, and we also submitted 26 and two per cent. [239]

48 per cent cap

5.193 Modifications to the 48 per cent cap, which would apply to credit contracts other than small amount credit contracts, bridging finance, and credit contracts provided by ADIs, were also recommended. The National Financial Services Federation recommended the cap be removed, and replaced with 'a Permitted Establishment fee and Daily Reducing Interest capped at 48%'.[240] The following rationale was provided:

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234 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Chapter 11: Regulation Impact Statement June 2011, paragraph 1.143.

235 See for example, *National Financial Services Federation*, Submission 22, p. 7ff; First Stop Money, Submission 17, p. 15; Cash Converters, *Submission 27*, pp 8–9.

236 Cash Converters, *Submission 27*, p. 9.

237 Cash Converters, *Submission 27*, p. 9.

238 National Financial Services Federation, *Submission 22*, p. 9.

239 Mr Baril, *Committee Hansard*, 24 October 2011, p. 19.

240 National Financial Services Federation, *Submission 22*, p. 18.

> The pricing controls for credit contracts other than Small Amount Credit Contracts, must allow the credit provider to recover reasonable costs and make a profit. The Government's proposed section 32B, which effectively adopts the New South Wales interest rate cap formula, does not allow this to occur for short-term loans.
>
> The State of Victoria, the only state to undertake a major research project4 into credit, found that imposing the price capping structure as included in section 32B was not required and could have unintended consequences.
>
> The drafting of the Amendments effectively locks out mainstream lenders from ever re-entering this market space due to the restrictive price controls for small amount and short term loans.[241]

5.194 The Financiers' Association of Australia recommended that the formula be modified to avoid 'distortions where there are irregular payment amounts and dates'. The Association submitted that the definition of 'j' be amended to 'a multiple of days'.[242]

Caps for lower income earners

5.195 First Stop Money suggested a tiered approach to fees and capping. It was proposed that for consumers with incomes below the Henderson Poverty Line, an establishment fee of 30 per cent should be charged with a daily reducing interest of 48 per cent per annum.[243] For consumers with incomes above the Henderson Poverty Line, they argue for a market driven establishment fee and an annual interest rate of 48 per cent.[244]

5.196 Cash Converters also proposed an alternative approach directed at low income earners who Cash Converters defines as customers earning below $19,468.80 per annum (the value of the single age pension).[245] This alternative proposes the implementation of the 10 per cent and two per cent model as the bill intends. The rationale for this is explained:

> Loans to these customers will occur below cost but the trade-off will be that the customers who are better off pay the market rate which effectively subsidises the low income consumer. This is a win-win solution. On the one hand, the Government has genuinely addressed the 'vulnerable' consumer's hardship. On the other hand, industry has a free market to do business with those who do not need the protection of caps.[246]

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241 National Financial Services Federation, *Submission 22*, p. 18.

242 Financiers' Association of Australia, *Submission 40*, p. 28.

243 First Stop Money, *Submission 17*, p. 15.

244 First Stop Money, *Submission 17*, p. 15.

245 Cash Converters, *Submission 27*, p. 8.

246 Cash Converters, *Submission 27*, p. 9.

Short-term credit forum

5.197 Some submitters called for a Short-Term Credit Forum,[247] where the government, industry and consumers can work out the appropriate framework for further reform. The National Financial Services Federation recommended

> [i]nitiation by Government of a regular forum between the credit industry and consumer groups to exchange ideas and ensure best practice. It could also include the Credit Ombudsman and Government regulators.[248]

5.198 Similarly, Money 3 suggested:

> ...the formation of a Short Term Credit Forum similar to the UK model where industry bodies, consumer organisations, government departments and consumers are brought together to work out the best outcomes.[249]

Consultation on further amendments - Industry concerns

5.199 Three organisations provided supplementary submissions to address the issues raised by the late amendment. The National Financial Services Federation and the Financiers Association of Australia were strident in their criticism of the amendment arguing that the amendment is 'unviable and unworkable.'[250] The National Financial Services Federation and the Smiles Turner Delegation were of a similar mind about the threat that the provision posed to their business.

5.200 In a detailed submission, the National Financial Services Federation concluded that:

> [T]he inclusion of section 32A(2) in the Enhancements Bill will make the administration of low value personal loans and similar products almost impossible and substantially reduce product flexibility and choice for consumers.
>
> This will not be a good outcome for anyone.[251]

5.201 The Financiers' Association of Australia attacked the amendment and the manner of its last minute introduction arguing that it will 'have major implications in regard to the provisions included in the rest of the Bill...concerning the 48% tier of the 2-tier interest rate/fees and charges cap.'[252] The Association also spoke strongly about

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247 Money 3, *Submission 7*, p. 3; National Financial Services Federation, *Submission 22*, p. 7.

248 National Financial Services Federation, *Submission 22*, p. 7.

249 Money 3, *Submission 7*, p. 6.

250 National Financial Services Federation, *Supplementary Submission 22a*, p. 1.

251 National Financial Services Federation, *Supplementary Submission 22a*, p. 10.

252 Financier's Association of Australia, *Supplementary Submission 40a*, p. 1.

the regulatory burden that the short term, small amount loan sector experiences to which this amendment would add.[253]

5.202 The Australian Finance Conference summarised the effect of the proposed amendment:

> As we understand, this provision would require a credit provider to undertake an interest rate calculation not just at the outset or prior to entry into a credit contract (other than a small amount credit contract) but potentially on a dynamic basis throughout the life of the credit contract (ie. cap must not be exceeded at any time). In effect, a credit provider would need to adopt a process that individually flags and calculates each change in a credit contract on a portfolio basis to automatically run a calculation to determine whether the 48% cap would be exceeded.[254]

5.203 Having noted the apparent consequences of the proposed amendment, the Australian Finance Conference advised that it would be opposed to such a requirement:

> We appreciate that this provision has not been included in the present Bill to allow further consultation. We also note that this has commenced with the release of an Options Paper by Treasury. However, we note that an option has not been proposed to omit inclusion of this dynamic requirement rather proposed modification of how it might operate. Again, without evidence of market failure or consumer detriment to justify this significant, operationally difficult and costly compliance requirement, the AFC opposes its enactment and will be responding to this effect to Treasury.[255]

Other sources of short-term credit contracts

5.204 The debate on the merits of the proposed reforms included discussion of the availability of alternatives sources of finance. Overall, it appeared that there are several alternatives options; however, views differed on whether the alternatives are viable for vulnerable consumers.

5.205 As has been previously noted, research strongly indicates that the key reasons vulnerable consumers seek short-term loans are to meet basic needs.[256] In this regard, the Department of Families, Housing Community Services and Indigenous Affairs (FaHCSIA) informed the committee that the widespread use of short-term lending is

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253 Financiers' Association of Australia, *Supplementary Submission 40a*, p. 17.

254 Australian Finance Conference, *Supplementary Submission 29a*, p. 11.

255 Australian Finance Conference, *Supplementary Submission 29a*, p. 11.

256 Cf. Banks, *Caught Short: Exploring the role of small, short-term loans in the lives if Australians – Interim report*, p. 14

symptomatic of financial exclusion.[257] FaHCSIA informed the committee that their overall strategy:

> ...should ideally be to reduce the need for small amounts of short-term credit. Having said that, there will always be such a need. In those cases, we need to improve or reduce the risk to consumers of various products...[258]

5.206 The committee was informed about a number of schemes that exist to assist vulnerable consumers with meeting the costs of fundamental services such as basic living expenses and access to affordable credit. Ms Catriona Lowe from the Consumer Action Law Centre, told the committee that:

> If someone is facing being kicked out of their house or having the electricity cut off and there is someone on the high street that is going to give them money to solve that problem now, then we think it is pretty understandable that consumers take those options. But one thing that concerns us about this is that there are in fact other options that are safer in the long term for consumers in those circumstances. Utilities are required to offer hardship variations, as are banks. There are low-interest and no-interest loans, products available for purposes that are going to improve a consumer's position in the longer term and we would prefer that consumers are accessing those products.[259]

5.207 Ms Lowe and Mr Brody, also from the Consumer Action Law Centre, informed the committee of the following alternatives:

> **Ms Lowe:** We think that there will be a reliance on the other hardship mechanisms that are available to consumers. We accept that it is not necessarily pleasant to call your utility and your bank and say that you are struggling, but they do have options at those institutions for people rather than paying incredibly high interest rates or fees to be able to manage those bills. So we would expect to see people getting in touch with their utility providers or their bank. We would expect to see that there will be, as the government is seeking, an expansion of the availability of NILS and LILS. We also hope to see useful reform in the Centrelink area that will bring in more flexibility around things like Centrelink advances and such so that people who are in receipt of government benefits are able to access credit for appropriate purposes in appropriate circumstances.
>
> **Mr Brody:** For example, one of those reforms relates to Centrepay—Centrepay is the budgeting arrangement for Centrelink recipients—and expanding the use of Centrepay for something like a vehicle registration, which is a known cost for most households, but yet, in the research that Consumer Action did, almost 20 per cent of those loans were advanced for

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257 Dr Miller, Section Manager, Innovation and Design, Money Management Branch, FaHCSIA, *Committee Hansard*, 24 October 2011, p. 73.

258 Dr Miller, Section Manager, Innovation and Design, Money Management Branch, FaHCSIA, *Committee Hansard*, 24 October 2011, p. 73.

259 Ms Catriona Lowe, *Committee Hansard*, 24 October 2011, p. 37.

> someone to pay their vehicle registration. We think that having the ability to budget that simply fortnightly would be a much more sensible solution[260]

5.208 The following list provides a brief description of the alternatives to payday lending as highlighted in evidence before the committee:

- No Interest Low Schemes (NILs) are available from agencies accredited such as Good Shepherd Youth and Family Service. These loans are interest and charge-free for up to $1200, or more in special circumstances, and are available to individuals and families on low and limited incomes and who have a Centrelink Concession Card.[261]
- The Low Interest Loan Schemes (LILs) are also available from accredited agencies accredited. Individual loans range from $800 to $3000 and may be used to meet personal, domestic or household needs. Interest on the loans is fixed at a low rate and the loans are available to individuals or families receiving Family Tax Benefit Part A or who are holding a Centrelink Concession Card. Loans can be repaid over three years.[262]
- Centrepay is an initiative administered by Centrelink. This is a 'free direct bill-paying service' administered by Centrelink and available to borrowers who receive Centrelink payments. The service deducts regular amounts from the borrowers' Centrelink payments to pay the borrowers' rent, utility bills, child care fees, and related fundamental living expenses.[263]
- The Centrelink advance scheme enables Centrelink customers to receive an advance on their regular payments to help pay for utilities and other essential bills. According to the Department of Health Services, payments eligible for advances include: Family Tax Benefit Part (A); pension payments such as the Age Pension, Carer Payment; and non-pension payments such as ABSTUDY, Austudy and Newstart allowance. The minimum and maximum amounts available for advance have been set by Centrelink and individual amounts payable to customers are determined according to their individual rate of payments and their ability to repay the advance over the subsequent 13 fortnights.[264]

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260 Ms Catriona Lowe and Mr Gerard Brody, Director, Policy and Campaigns, Consumer Action Law Centre, *Committee Hansard*, 24 October 2011, p. 38.

261 Good Shepherd Youth and Family Services, *Loans*, http://www.goodshepvic.org.au/stepupandnils (accessed 4 November 2011).

262 Good Shepherd Youth and Family Services, *Loans*, http://www.goodshepvic.org.au/stepupandnils (accessed 4 November 2011).

263 Department of Human Services, *Centrepay*, http://www.centrelink.gov.au/internet/internet.nsf/services/centrepay.htm (accessed 17 October 2011). See also Department of Human Services, *Submission 37*, pp 6–7.

264 For more on this scheme see Department of Human Services, *Submission 37*, pp 3–4.

- Utility hardship schemes are compulsory initiatives designed to help customers pay their water, electricity, phone and/or gas bills should they fall into hardship. Typically, there are necessary criteria that need to be met, such as holding a Centrelink Pension Health Care Card. Customers need to speak to a 'hardship' officer, who can assist in working out a payment plan.

5.209 In his media release, the Hon. Bill Shorten, MP, Assistant Treasurer and Minister for Financial Services and Superannuation, provided the following table to demonstrate alternatives to payday lending:

Table 5.5: Payday lending alternatives[265]

Expense	Possible lower cost alternatives
Utility bills	Centrelink advance and Utility provider's hardship policies
Food	Centrelink advance
Vehicle repairs & registration	LILs and Centrelink advance
Rent	Centrepay
Mortgage payments	Lender's hardship policies
Other essentials	NILs & LILs and Centrelink advances

5.210 Moreover, in February 2011, the federal government awarded a contract to Community Sector Banking (CSB) 'to conduct a pilot of Community Development Financial Institutions (CDFI).'[266] The committee understands that this initiative is part of the Government's strategy to encourage banks to re-enter the payday lending market.[267] The national pilot program is 'aimed at helping Australia's most vulnerable individuals end the debt cycle and build financial wellbeing.'[268] To achieve this, CBS has partnered with the following organisations:

- Anglicare South Australia
- The O Group, Tasmania
- Access Community Group, New South Wales

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265 The Hon Bill Shorten MP, Assistant Treasurer, Minister for Financial Services and Superannuation, 'Reforms to payday lending', Media release no. 123, 25 August 2011.

266 Community Sector Banking, *Submission 11*, p. 3.

267 'Reforms to Payday Lending', *Media Release* No. 123, the Hon. Bill Shorten, MP.

268 Community Sector Banking, *Submission 11*, p. 3.

- St Luke's Anglicare, Victoria
- Centre for Aboriginal Enterprise and Independence, Queensland
- Kimberley Employment Service, Western Australia, and
- Traditional Credit Union, Northern Territory.[269]

5.211 The committee also received information about the CDFI pilot from Fair Finance Australia (FFA). The committee was informed that, in partnership with Foresters Community Finance and as part of the CDFI pilot, the FFA is conducting a micro-loan of 'appropriate loans from $1000 to $4000 for terms up to 2 years.' The FFA explained the ethos behind the pilot micro-loans program:

> Our approach is very client / case focused and this leads to a lending experience that helps our clients either achieve their loan goal in a responsible way or gives them an understanding why a loan would be unsuitable for them at the present time and what sort of options they need to pursue to start their pathway to financial inclusion.[270]

5.212 The Government has also passed legislation enabling customers to access their superannuation benefits early on specified compassionate grounds. Currently this initiative is co-run by Department of Human Services (DHS) and the Australian Prudential Regulatory Authority (APRA), but legislation has been passed which will transfer full responsibility for this initiative to the DHS portfolio.[271]

5.213 Additional to these financial services, DHS also provides an Income Management program on behalf of FaHCSIA and a Financial Information Service. These services are not limited to recipients of Centrelink payments. DHS' Income Management program seeks to help people stabilise their financial situation 'so that they can care for their children and/or return to the workforce.' DHS informed the committee that the program:

> ...assists customers to participate economically and socially they can cover the costs of essentials goods and services. In cases where children are at risk of neglect, it also makes sure that welfare payments are spent in the best interests of children rather than on tobacco, alcohol, gambling or other harmful items.
>
> It does not reduce a customer's entitlements, rather it sets aside a percentage of certain income support and family payments to be spent on priority goods and services such as food, housing, clothing, education and health care. Customers receive the remaining part of their payments as usual, and have total discretion to spend that money as they wish.[272]

269 Community Sector Banking, *Submission 11*, p. 3.

270 Fair Finance Australia, *Submission 51*, p. 2.

271 Department of Human Services, *Submission 37*, p. 8.

272 DHS, *Submission 37*, p. 6.

5.214 The Financial Information Service (FIS) run by DHS is an 'education and information service available to everyone in the community. FIS Officers help people to make informed decisions about investment and financial issues for their current and future financial needs.'[273]

5.215 However, as previously mentioned, whether or not these alternatives can fill the gap should short-term lenders exit the market is highly disputed by industry representatives. The following position statements reflect the general concern that, given the market demand for small-credit, viable access to credit for low-income earners would be uncertain. Can Do Credit Pty Ltd argued:

> The assumption that local LILS and NILS schemes will be able to pick up any lending requirements that will exist after the Micro Lenders vacate the industry is unrealistic. These schemes will simply not cope under the weight of need that will exist within the demographic of which we deal with.[274]

5.216 Similarly, Money 3 submitted:

> Currently, our industry cash advances $800 million and serves 500,000 customers annually. Money3 supports the No Interest Loan Schemes (NILS) and Low Interest Loan Schemes (LILS) supported by the welfare agencies and major banks. We welcome directing customers to these services. In the 2011-12 budget, Federal Government committed $60.6 million over 4 years to the programs and banks have committed to make philanthropic contributions. However, these schemes provide just 15,000 loans annually and in reality cannot fill the gap created if micro-lenders were to exit the industry.[275]

5.217 Also questioning the adequacy of alternative sources of credit, Mr Phillip Smiles, Consultant, Financiers' Association of Australia informed the committee that to become a viable alternative for consumers the sector would require 'a 100-fold increase in funding.'[276] Money 3 held a similar view, stating:

> The problem is this: if you and the parliament proceed with the bill as it is, the problem will not be the lenders – they will have gone; the problem will be yours. There are 750 000 individuals now borrowing microloans of under $5000 per year – 2010. They are borrowing $1.2 billion a year. As I have said, the market is increasing exponentially, over 18 per cent. The problem is that the only alternative now – the non-commercial lender – is lending less than $20 million a year. If you leave the commercial sector's consumers to go to the non-commercial NILs, LILS et cetera and the

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273 DHS, *Submission 37*, p. 8.

274 Can Do Credit Pty Ltd, *Submission 15*, p. 2.

275 Money 3, *Submission 7*, p. 2.

276 Mr Phillip Smiles, Consultant, Financiers' Association of Australia, *Committee Hansard*, 24 October 2011, p. 19.

> subsidised ANZ and NAB sector you will have to, one way or another, provide a 100-fold increase in funding for that sector.[277]

5.218 The relevance of NILs and LILs to all consumers who access short-term loans were also questioned. Noting that their client base is ' fully employed, IT savvy, and financially literate', Cash Doctors advised that the credit options were of no relevance to their customers:

> ...we submit that the "choices" that are being referred to here – the advances on Centrelink payments, no or low interest loans, or hardship relief programs with utility providers - are generally NOT available to our customer. We submit that customers choosing to use our product are not making a "bad choice", they are making an informed choice about a financial product that is suitable to their needs.[278]

Committee view

5.219 The key question before the committee is whether the proposed short-term loan reforms strike the right balance between consumer protection and the continuation of a viable short-term loan industry. The national consumer credit reforms centred on the need to strengthen consumer protection through the introduction of nationally consistent consumer credit regulations. In addressing identified weaknesses in state and territory consumer credit legislation, the reforms also sought to raise the bar, that is, to create a more equitable market for consumers by bringing all jurisdictions to the highest common denominator. The need for additional protections for consumers when accessing short-term loans was flagged at the outset of the national consumer credit reforms.

5.220 It was put to the committee by industry representatives that the additional measures proposed in Schedules 3 and 4 of the Enhancements Bill are unnecessary. The committee notes the argument that the responsible lending obligations, introduced as part of phase one of the national consumer credit reforms, effectively deter inappropriate conduct and therefore ensure adequate protections for consumers. This argument presupposes that the vulnerabilities of consumers who access short-term loans is no greater than that of the broader consumer population in Australia.

5.221 The committee notes with concern the lack of evidence from Treasury regarding the need for measures in addition to the responsible lending obligations. Limited evidence can be found through mining the Regulation Impact Statement attached to the Explanatory Memorandum for the Enhancements Bill. However, the statement does not explain how the proposed short-term reforms will sit against and interact with the responsible lending obligations. Nor does it comprehensively explain why the measures in Schedules 3 and 4 of the Enhancements Bill were selected rather than other options that on the basis of evidence before the committee seem available.

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277 Mr Robert Bryant, Money 3, *Committee Hansard*, 24 October 2011, p. 19.

278 Cash Doctors, answer to question on notice, 24 October 2011 (received 3 November 2011).

5.222 The committee also notes evidence that there is a growing number of middle income earners accessing the short-term loan market. The committee agrees with views of industry representatives that this growing client base cannot be considered to have the same vulnerabilities as lower income earners and, in particular, consumers whose income is substantially derived from Centrelink benefits. However, the committee was struck by the high cost of short-term finance, whether calculated according to the API or, perhaps more accurately, in dollar terms.

5.223 High-cost finance for any amount is undesirable but in itself is not a risk. While the web-based, middle income earner client base appears to be expanding, the short-term loan industry attracts significant numbers of consumers who are in financial hardship. The very nature of a small amount short-term loan indicates that the loans are being sought to address financial difficulty. In entering into a pay-pay loan contract, consumers exchange what appear to be substantial fees for a rapid injection of cash. For consumers in financial hardship, or those not understanding the financial implications, this may be a perilous path. The committee considers that the short-term loan market is a complex market in which a proportion of consumers are not fully informed.

5.224 Therefore, additional measures are required to compliment, not duplicate, the responsible lending obligations. Accordingly, the committee agrees in principle with the introduction of measures tailored to protect consumers accessing the short-term loan market. The committee supports the introduction of minimum standards for the short-term loan industry and credit contracts. However, having considered the available evidence, the committee concludes that the short-term lending reforms proposed in Schedules 3 and 4 of the Enhancements Bill do not strike the right balance between consumer protection and industry viability. It can be strongly questioned whether all the measures proposed will result in a viable industry. The committee further considers that it can be questioned whether all the proposed reforms represent the optimal approach to enhancing protections for consumers accessing short-term loans.

5.225 Accordingly, the committee draws the Government's attention to areas of concern with the short-term loan reforms and to options for improvements.

Schedule 3 - Web-based disclosure statements

5.226 The committee strongly supports measures to promote financial literacy among consumers. Accordingly, the committee approves the measures proposed in relation to web-based disclosure statements for small amount credit contracts.

5.227 However, to ensure that all consumers have the opportunity to be fully informed prior to entering a short-term loan, it would be appropriate for this requirement to be extended to all credit contracts covered by Schedules 3 and 4, and for store-front lenders to be required to provide this statement to prospective customers prior to entering into a credit contract under Schedules 3 and 4.

5.228 The utility of a web-based disclosure statement would also be improved were it to include a link to the financial counselling information on the ASIC MoneySmart website. The information contains, among other matters, details of the free, confidential financial counselling services available via the Financial Counselling Hotline (1800 007 007). This service promotes financial literacy and is a valuable tool for consumers facing financial difficulties. The Government should consider how the consumer credit reforms can encourage greater use of existing Government-funded services.

Schedule 3 – Restriction on multiple concurrent contracts, refinancing and increasing credit limits

5.229 The committee notes concerns with the practicality of the proposed restrictions on multiple concurrent contracts, increasing credit limits and refinancing. The committee shares concerns that it is not practical for credit providers to know what credit contracts a prospective borrower may have with other providers. In this instance, the credit provider is dependent on disclosure by the prospective borrower. The restriction on multiple concurrent contracts would only be workable if it applied to loans within a credit provider's portfolio. However, on the whole, the proposed restrictions did not appear to be an appropriate means of increasing consumer protection.

5.230 The committee notes with concern industry views that, rather than increasing the protections available to vulnerable consumers, the restrictions may lead to increased financial hardship. It is also questionable whether the proposed restrictions are appropriate for consumers who are not financially vulnerable.

5.231 The restrictions appear to be incongruent with the responsible lending obligations, save for one exception. The committee notes evidence that, while the responsible lending requirements were intended to ensure that consumers are protected from unsuitable credit contracts, the obligations do not require the lender to consider the consumer's commitments under other credit contracts. On the basis of evidence before the committee, it would seem appropriate to strengthen the operation of the responsible lending obligations in relation to short-term loans. The committee considers that a more appropriate response to consumer vulnerability would be to require short-term lenders to consider whether the proposed short-term loan or increased credit limit is unsuitable given the consumer's repayment obligations under existing credit contracts. This obligation should only apply to the extent that the short-term lender is informed of existing credit contracts by the consumer in response to the lender's inquiries.

Schedule 4 – 10 and 2 per cent cap for small amount credit contracts and the 48 per cent cap

5.232 Evidence before the committee does not support the conclusion that the small amount credit contracts industry will remain viable were the 10 and 2 per cent restriction on fees introduced. Indeed, the evidence strongly indicated that the

availability of this form of finance will be significantly reduced, as there would be a high probability that providers would withdraw from the market and move to larger amount credit contracts. The contraction in the size of the small amount credit contract industry would be of further concern given the limited availability of alternative sources of finance.

5.233 The committee considers that the restriction on fees and charges for small amount credit contracts should be set at a level that will ensure the ongoing viability of the small amount credit contract sector. The committee strongly urges the Government to work with industry to establish a better balance between protecting the vulnerable and supporting a properly regulated small amount credit market.

5.234 The committee notes evidence that higher costs can be incurred for relatively short-term credit contracts compared to longer-term contracts. The committee is persuaded by evidence that the repayments required under relatively short-term loans can constitute a significant proportion of the borrower's income. In this regard, the committee notes data provided by the Consumer Action Law Centre that a $300 loan over 28 days can require repayments of $405, representing, in this case, 22 per cent of the borrower's income. If a person is in need of $300 due to financial hardship, it seems axiomatic that the person may encounter further difficulties through having to repay the principal and an additional $105 within a short timeframe. The committee considers that it is consistent with the principle of responsible lending for the loan repayment period to be reasonable according to the borrower's capacity to repay. The committee is of the view that it would be appropriate for the responsible lending obligations to require credit providers to consider a borrower's capacity to repay within the proposed repayment timeframe and to not require repayment within a period in which it would be unlikely the borrower could repay the loan.

5.235 The committee acknowledges that fees should reflect the cost of lending. However, the committee does not consider that it is best practice to impose a fee ceiling that is calculated using an APR. This method distorts the actual cost to the borrower, and the cost to the lender, and is therefore not the appropriate regulatory tool. The committee also notes with concern evidence presented of strategies to avoid the state-based 48 per cent caps. The evidence casts doubt on whether a 48 per cent cap is viable, particularly for smaller providers. In considering the method to impose a limit on the costs that borrowers may incur, the Government should be mindful of not undermining the COAG agreement and the state-based referrals of power.

5.236 The Government could also explore the feasibility and appropriateness of limiting the overall remuneration that a credit provider can receive for issuing a credit contract to which Schedules 3 and 4 apply, to an amount not exceeding twice the principal advanced. This would include remuneration obtained by third parties, all costs associated with product add-ons, such as DVDs, and fees payable in the event of default. This should not, however, include costs associated with enforcement.

Other matters – application of Schedule 4 to ADIs

5.237 It was put to the committee that the caps on costs proposed in Schedule 4 should be extended to ADIs. However, as the committee noted in its April 2011 report Access for small and medium business to finance, ADIs are required to comply with the comprehensive prudential regulatory framework overseen by the Australian Prudential Regulation Authority (APRA).[279] The committee has not been provided evidence that this framework would be insufficient to ensure appropriate conduct on the part of ADIs were they to offer short-term, small amount credit contracts. However, the committee recognises the potential impact on the principle of competitive neutrality of the proposed reforms and therefore considers that the Government should consider the implication of the proposed legislation for competitive markets and the adequacy of the prudential regulations for short-term, small amount credit contracts provided by ADIs.

Other matters - Use of direct debit repayment options

5.238 The committee notes concerns raised by consumer advocates with the use of direct debit repayment facilities by short-term loan providers. On balance, evidence before the committee does not indicate the repayment option is inappropriate for all consumers who enter into short-term credit contracts. The committee also notes that it is borrowers who have the first call on their financial resources and the monies debited from these resources, as it is they who ultimately control the account. However, consumers should not be locked in to inappropriate repayment methods. The committee would be concerned if direct debit repayments were being used inappropriately, or if alternatives were not provided. The committee therefore urges Treasury to monitor this area and to consult with credit providers on the viability of offering alternative repayment methods.

5.239 The committee would also be concerned if consumers misunderstood their rights regarding direct debit repayment options. The committee considers that it would also be appropriate for the web-based disclosure statements, and statements provided by store-front lenders, to include information setting out consumers' rights in relation to direct debit repayments, and directing consumers to other information sources such as the Financial Counselling Hotline.

Other matters - Alternatives to short-term loans

5.240 The committee notes with concern evidence that there may be a shortfall in the availability of finance from non-mainstream lenders were the number of providers to decrease following the introduction of the Enhancements Bill. It is the committee's view that the financially vulnerable must have access to appropriately regulated sources of finance.

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279 Parliamentary Joint Committee on Corporations and Financial Services, *Access for small and medium business to finance*, April 2011, Chapter three, p. 19.

5.241 The committee notes that the caps are not due to commence until 1 January 2013. It is essential that this window of time be used to develop additional sources of finance for consumers who currently access short-term loans. The committee notes that the Government is consulting with stakeholders about options to develop additional sources of finance, and supports the Government in this initiative. The committee recommends that the Government explore options to encourage ADIs to re–enter the short-term credit contract market.

Other matters - Consultation on further amendments

5.242 It is difficult for the committee to comment meaningfully about this provision. Only two of the submissions canvass the implications of the provision because of its late inclusion in the debate. As well, Treasury officials did not take the opportunity of explaining the amendment during the hearing. However, the committee draws to the Government's attention concerns with the proposed amendments.

Committee view – Conclusion

5.243 The inquiry identified that there is a need for additional protections for consumers when accessing short-term loans. However, evidence is not conclusive that the measures proposed are the best means of securing necessary protections for consumers. The evidence indicates that the measures regarding restrictions on multiple concurrent contracts, refinancing and increasing credit limits are at odds with the principles and effect of the responsible lending obligations. Measures should be introduced to strengthen protections for consumers accessing short-term loans, however, these should complement, not contradict, the responsible lending obligations. The committee has identified options to strengthen the responsible lending obligations in relation to short-term loans and draws these to the Government's attention. The proposed 10 and 2 per cent cap does not appear to be workable. In this regard, it does not appear that an appropriate balance has been struck between consumer protection and industry viability. As outlined above, the committee was also alerted to other options to increase consumer protection and financial literacy, while upholding consumer choice and the continued viability of the short-term loan market.

5.244 Accordingly, the committee recommends that the Government undertake further consultation with stakeholders to address concerns identified and, in doing so, develop additional measures that will increase consumer protection and lift industry standards.

Recommendation 12

5.245 The committee recommends that the Government revisit the measures proposed in Schedules 3 and 4 of the Enhancements Bill. Further consultation with stakeholders should be undertaken to address the concerns identified throughout the inquiry and to develop measures that will ensure cohesive and consistent national consumer credit legislation and an appropriate balance between consumer protection and industry viability.