Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011

December 2011

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Duties of the Committee

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the Parliamentary Committee's duties as follows:

(a) to inquire into, and report to both Houses on:

(i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

(ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

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Acronyms and Abbreviations

ABA	Australian Bankers Association
ACL	Australian Consumer Law
ADI	Authorised deposit-taking institution
AFC	Australian Finance Conference
APR	Annual percentage rate
APRA	Australian Prudential Regulatory Authority
ASIC	Australian Securities and Investments Commission
ASF	Australian Seniors Finance
CDFI	Community Development Financial Institutions
CSB	Community Sector Banking
COAG	Council of Australian Governments
DHS	Department of Human Services
EDR	External Dispute Resolution (Scheme)
FaHCSIA	Department of Families, Housing, Community Services and Indigenous Affairs
FIS	Financial Information Service
FFA	Fair Finance Australia
FSCRIT	Financial Services and Credit Reform Implementation Taskforce
ICRCG	Industry and Consumer Representatives Consultation Group
LILS	Low interest loan schemes
MFAA	Mortgage and Finance Association of Australia
NAB	National Australia Bank
NILS	No interest loan schemes
NCCP Act	*National Consumer Credit Protection Act 2009*

NCC	National Credit Code
NFSF	National Financial Services Federation
NLA	National Legal Aid
RIS	Regulation impact statement
RFC	Registered financial corporations
RLC	Redfern Legal Centre
RLO	Responsible Lending Obligation
SEQUAL	Senior Australians Equity Release Association
UCCC	Uniform Consumer Credit Code

Recommendations

Recommendation 1

1.49 The committee recommends that the Government consider extending the commence date for Schedule 1 (enhancements) to 1 January 2013.

Recommendation 2

2.51 The committee recommends that clause 72 be amended to require borrowers to provide reasonable information to assist credit providers to assess their application and to give credit providers reasonable opportunity to seek this information from the borrower where it is not initially provided.

Recommendation 3

2.52 The committee recommends that 'orally' be removed from subclause 72(1), to require hardship applications to be made in writing.

Recommendation 4

2.53 The committee recommends that Government work with industry stakeholders to develop a plain English, user-friendly information pack about borrowers' rights and obligations in relation to hardship variations. The Government and industry should consider including a link to the information on the MoneySmart website about financial counselling assistance. Industry should be required to provide a copy of this information pack on their websites and at customer service centres.

Recommendation 5

3.37 The committee recommends that clause 133DB be amended to not prescribe the method by which a credit provider must provide projections to potential borrowers, but rather to require credit providers to ensure that a potential borrower receives and understands the projections before entering into the reverse mortgage contract.

Recommendation 6

3.38 The committee recommends that the Government consider whether clause 133DB can be improved to provide further clarity as to the conduct required of credit providers, and to take into account time required by credit providers to ensure they will be in a position to comply with the procedural requirements.

Recommendation 7

3.39 The committee recommends that the Government consult industry to ensure that clause 18A only excludes matters that are of a minor nature and that do not pose measurable risk to the credit provider's interests.

Recommendation 8

3.40 The committee recommends that Subdivision B, Division 1, Schedule 2, be amended to ensure that sales, particularly between related parties, stand the market test of fair market value.

Recommendation 9

3.41 The committee recommends that the definition of reverse mortgages at item 2 of Schedule 2 be amended to clearly exclude other forms of credit arrangements that provide the option of interest only repayments.

Recommendation 10

4.24 The committee recommends that the regulations under clause 175D require the statement of account to contain a clear statement that the lessee will not own the good at the completion of the lease.

Recommendation 11

4.25 That Schedule 5 be amended to restrict the liability of lessees under consumer leases for which the goods have been lost or stolen to the fair market value of the goods as at the time the goods were lost or stolen. This would not, however, apply in circumstances of fraud on the part of the lessee.

Recommendation 12

5.243 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.

Recommendation 13

6.12 The committee recommends that Part 3, Schedule 1 be amended to confirm that ADIs may provide pre-approval for personal and business contracts.

Recommendation 14

6.31 The committee recommends that the circumstances that may constitute unfair or dishonest conduct at paragraph 180A(3)(f)–(g) be amended to only apply where the credit provider is aware of the borrower's special disadvantage and seeks to exploit this.

Chapter 1

Introduction

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

1.1 On 22 September 2011, the House of Representatives referred the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 to the Parliamentary Joint Committee on Corporations and Financial Services for inquiry and report. The committee initially resolved to report by 10 November 2011. The reporting date was subsequently extended to 2 December 2011.

1.2 The committee notes that on 21 September 2011, the Senate Selection of Bills Committee referred the Enhancements Bill to the Senate Standing Committee on Economics for inquiry and report by 23 November 2011. The reporting date was extended to 7 December 2011. As of the date of this report, the Economics Committee had not presented a report to the Senate.

Conduct of inquiry

1.3 The committee advertised in the *Australian* newspaper. Details of the inquiry, the Enhancements Bill and associated documents were placed on the committee's website.

1.4 The committee wrote to 96 organisations and individuals inviting submissions by 14 October 2011. Appendix 1 lists submissions received from 53 individuals and organisations and lists answers received to questions on notice.

1.5 A public hearing was held on 24 October 2011, at Parliament House, Canberra. A list of witnesses who gave evidence at the hearing is at Appendix 2.

Acknowledgements

1.6 The committee thanks the organisations and individuals who made submissions to the inquiry, and those who gave evidence at the public hearing.

Notes on references

1.7 References to submissions are to individual submissions as received by the committee, not to a bound volume. References to the *Committee Hansard* are to the official *Hansard* transcripts available on the parliamentary website.

Background

1.8 In July 2008, the Council of Australian Governments (COAG) agreed to transfer to the Commonwealth responsibility for the regulation of all consumer credit products, including mortgages, mortgage brokering, margin lending and short-term lending (also known as pay-day lending).[1] COAG agreed the transfer would be implemented in two phases.[2]

1.9 Phase one was implemented through state and territory referral legislation, and the enactment of Commonwealth legislation that established a national framework for the regulation of consumer credit. Phase one was completed by July 2010, with the commencement of the *National Consumer Credit Protection Act 2009* (the NCCP Act), the National Credit Code, the *National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009* and the *National Consumer Credit Protection (Fees) Act 2009.* [3] Further information about the NCCP Act and the National Credit Code is provided at paragraphs 1.12 – 1.16.

1.10 COAG resolved that phase two of the transfer would address identified issues with the operation of state and territory consumer credit regulations that had not been resolved at the time responsibility was transferred to the Commonwealth.[4] These matters include regulation of short-term lending, credit cards, store credit, personal loans and investment and small business lending.[5] COAG initially agreed that phase two would be completed by mid 2010. The Government has advised that in April 2010 COAG 'endorsed an amended implementation plan.[6] The Enhancements Bill forms part of the implementation of the phase two reforms.[7] Further information about the phase two reforms is at paragraphs 1.17 – 1.21.

1.11 As a phase two measure, the Bill should be considered against the background of the broader consumer credit reforms and the existing lender requirements and borrower protections in the NCCP Act and the National Credit Code.

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1 Council of Australian Governments, Communiqué 3 July 2008, http://www.coag.gov.au/coag_meeting_outcomes/2008-07-03/index.cfm#financial (accessed 11 October 2011).

2 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).

3 The Consumer Credit Code is at Schedule 1, *National Consumer Credit Protection Act 2009*.

4 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 2.4.

5 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); Treasury, *National Credit Reform: Enhancing confidence and fairness in Australia's credit laws – Green paper*, July 2010, p. 106.

6 Australian Government, Consumer credit – COAG agreement', http://www.treasury.gov.au/consumercredit/content/coag_agreement/default.asp (accessed 26 October 2011).

7 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 1.5.

Phase one reforms – overview of the NCCP Act and the National Credit Code

1.12 As stated in Treasury's July 2010 *Green Paper*, the phase one reforms were intended to address 'systemic and regulatory gaps which jurisdictions have long sought to address.' To achieve this, the NCCP Act and the National Credit Code introduced 'better dispute resolution mechanisms, national rules on consumer credit, and a national credit licensing system with enhanced enforcement powers administered by the Australian Securities and Investments Commission (ASIC) as a single national regulator.'[8]

1.13 The reforms also included the introduction of the 'responsible lending requirements'. Contained in Chapter 3 of the NCCP Act, the requirements are designed to ensure that before credit is provided a credit licensee must assess the suitability of the proposed credit product for the borrower and the borrower's capacity to repay.[9] As stated by the then Minister for Superannuation and Corporate Law, Senator the Hon Nick Sherry, the responsible lending requirements 'make it illegal for brokers and other intermediaries, known as credit service providers, to suggest credit for a consumer that is unsuitable based on their needs and their financial capacity.'[10] As stated in the Treasury's *Green Paper*, the responsible lending requirements are intended to 'lift industry-wide lending standards and further enhance consumer protection.'[11]

1.14 Released in March 2011, ASIC's *Regulatory Guide 209* provides details of the procedures which credit licensees must complete in order to comply with the responsible lending requirements. The guide provides the following summary.

> Meeting your responsible lending obligations will require taking three steps:
>
> - make reasonable inquiries about the consumer’s financial situation, and their requirements and objectives;
> - take reasonable steps to verify the consumer’s financial situation; and
> - make a preliminary assessment (if you are providing credit assistance) or final assessment (if you are the credit provider) about whether the credit contract is ‘not unsuitable’ for the consumer (based on the inquiries and information obtained in the first two steps).
>
> In addition, if the consumer requests it, you must be able to provide them with a written copy of the preliminary assessment or final assessment (as relevant).[12]

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8 Treasury, *National Credit Reform – Green Paper*, July 2010, p. 1.

9 *National Consumer Credit Protection Act 2009*, s. 111.

10 The Hon Nick Sherry, Minister for Superannuation and Corporate Law, 'New national responsible lending laws', Media release 0. 38, 27 April 2009.

11 Treasury, *National Credit Reform – Green Paper*, July 2010, p. 1.

12 ASIC, *Regulatory Guide 209*, March 2011, p. 4.

1.15 A credit contract is unsuitable if it does not meet the borrower's objectives or requirements or if the borrower will be unable to meet the repayments or will incur substantial hardship in doing so.[13] As ASIC has noted, the responsible lending requirements apply not only to new credit contracts and consumer leases but to applications, or suggestions by a credit provider, for increased credit limits; and suggestions by credit providers that the borrower remain in a particular credit contract or consumer lease.[14]

1.16 The responsible lending requirements have not long been in operation. For authorised deposit-taking institutions (ADIs) and registered finance corporations, the requirements applied from 1 January 2011. For all other credit providers, the requirements applied from 1 July 2010.[15]

Phase two reforms – overview of measures

1.17 The Government resolved to progress the phase two reforms in two stages.[16] As outlined in the *Green Paper*, the following measures were included in stage one:

- enhancements to the regulation of and tailored disclosure for reverse mortgages
- consideration of the treatment of consumer leases including the disclosure and linked credit requirements
- regulation of other forms of credit for personal use including peer to peer lending
- enhancements to the regulation of credit cards
- extending unjust conduct provisions to credit service providers, and
- further enhancements to the Code.[17]

1.18 Stage two was allocated to measures that the Government considered required 'more in depth industry consultation'. As stated in the *Green Paper*, the measures include:

- the need for regulation of the provision of credit to small business
- the need for regulation of credit for investment loans other than margin loans and residential property investments
- examination of mechanisms, including State approaches to interest rate caps, to address predatory or fringe lending

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13 *National Consumer Credit Protection Act 2009*, ss. 118 – 119.

14 ASIC, *Regulatory Guide 209*, March 2011, p. 5.

15 ASIC, *Regulatory Guide 209*, March 2011, p. 4.

16 Treasury, *National Credit Reform – Green Paper*, July 2010, p. 1.

17 Treasury, *National Credit Reform – Green Paper*, July 2010, p. 107.

- an examination of the need for any enhancements to responsible lending conduct obligations
- a review of the regulation of credit advertising, and
- reform of mandatory comparison rates.[18]

1.19 The Regulation Impact Statement accompanying the Explanatory Memorandum to the Enhancements Bill explained that, in accordance with the COAG framework for the consumer credit reforms, phase two includes measures to address concerns with the operation of state and territory consumer credit legislation:

> During the course of Phase One of the National Consumer Credit Protection reforms, concerns were raised by various stakeholders about possible improvements to specific provisions in the State-based UCCC [the consumer credit legislation], which have been replicated in the National Credit Code. It was agreed these would be considered during Phase Two of the credit reforms...[19]

1.20 According to the Regulation Impact Statement, the following concerns were raised under phase one.

- Provisions relating to variations of credit contracts in circumstances of hardship.
- The absence of a general remedy for unjust conduct by brokers and other intermediaries.
- The absence of restrictions on the use of certain terms, including 'impartial'.
- The limited application of the prohibitions against the door-to-door canvassing of credit.[20]

1.21 The Enhancements Bill contains several measures considered under both stages of phase two, including measures to address concerns identified during phase one. The Bill is one of two pieces of legislation currently introduced as part of the phase two reforms.[21] The other, the *National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Act 2011*, which received Royal Assent on 25 July 2011, will, by 1 July 2012, require lenders to give prospective borrowers a fact sheet prior to entering into home loan and credit card contracts, prohibit lenders from sending unsolicited invitations to borrowers to increase credit limits, prohibit lenders

18 Treasury, *National Credit Reform – Green Paper*, July 2010, p. 107.

19 Regulation Impact Statement, Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 9.12.

20 Regulation Impact Statement, Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 9.12.

21 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 1.5.

from charging over-limit fees to customers who exceed their credit limit, and require lenders to allocate credit card repayments to higher-interest debts first.[22]

Purpose of the Bill

1.22 To implement phase two reforms, the Enhancements Bill contains proposed amendments to the NCCP Act and the National Credit Code. The amendments proposed include the following.

- Cap the maximum amount credit providers can charge under both short-term small amount credit contracts and all other credit contracts excluding bridging finance contracts and credit contracts provided by ADIs, and introduce additional obligations for short-term small amount contracts.
- Hardship variations: measures to assist borrowers to vary repayments under a credit contract in circumstances of financial hardship.
- Unfair or dishonest conduct: remedies for 'unfair or dishonest conduct' by creditors in relation to credit contracts, consumer leases and mortgages.
- Reverse mortgages: measures to assist borrowers to understand the implications of reverse mortgages and changes to the acceptable terms and conditions that may apply to reverse mortgages.
- Consumer leases: measures to align the regulation of consumer leases with regulations applying to credit contracts.

1.23 The Bill also includes a technical amendment to section 250R of the *Corporations Act 2001* to clarify the effect of amendments introduced by the *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act 2011*.

1.24 Through progressing phase two reforms, the Bill is intended to 'protect and improve the position of vulnerable consumers'.[23] The intention to address the needs of vulnerable consumers was highlighted in the Second Reading Speech for the Enhancements Bill by the Hon Bill Shorten MP, Assistant Treasurer, Minister for Financial Services and Superannuation, who stated that the measures are designed to ensure 'the balance of fairness is not lost, particularly for the most vulnerable of

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22 *National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Act 2011*, s. 2; Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 1.4.

23 The Hon Bill Shorten MP, Assistant Treasurer, Minister for Financial Services and Superannuation, 'New Consumer Credit Protections Introduced into Parliament', Media release 133, 21 September 2011.

consumers'.[24] The measures are also intended to support 'the growth and long-term sustainability of financial services businesses'.[25]

Views of the Senate Standing Committee for the Scrutiny of Bills

1.25 The Senate Standing Committee for the Scrutiny of Bills (the Scrutiny Committee) has considered the Enhancement Bill.[26] The committee raised concerns with the following matters.

- Prescribing currently undefined defences in regulations (Schedule 2, item 10 and subclause 133DD(4)).
- Setting aspects of the formula to calculate caps on credit contracts in regulations (Schedule 4, clause 32B).
- Retrospective application of proposed amendments to section 124 of the National Credit Code (Schedule 6, item 8).

1.26 The Scrutiny Committee sought the Minister's advice regarding these matters. As at the date of this report, advice had not been provided.

Possible Government amendments

1.27 The committee notes evidence before the committee that following the introduction of the Enhancements Bill on 21 September 2011, Treasury circulated, for stakeholder comment, two draft amendments to the Bill. The committee understands that the amendments concern the cap on certain kinds of credit contracts[27] and the unsolicited residential sale of credit dependent products.[28] As at the date of the report, the possible amendments had not been presented to Parliament. This inquiry took account of the available evidence regarding the possible amendments.

Timing of introduction of the phase two measures

1.28 The committee's attention was drawn to concerns with the timing of the introduction of the phase two measures, and the consultation that has occurred in their development.

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24 The Hon Bill Shorten MP, Assistant Treasurer, Minister for Financial Services and Superannuation, *House of Representatives Hansards*, 21 September 2011, p. 10950.

25 The Hon Bill Shorten MP, Assistant Treasurer, Minister for Financial Services and Superannuation, *House of Representatives Hansards*, 21 September 2011, p. 10954.

26 Senate Standing Committee for the Scrutiny of Bills, *Alert Digest 12/11*, 12 October 2011, pp 6 – 8.

27 National Financial Services Federation, *Supplementary Submission*, p. 1; Financiers Association of Australia/Smiles Turner Delegation, *Supplementary Submission*, p. 1.

28 Direct Selling Association of Australia, *Submission 31*; p. 1.

The consultation process

1.29 Evidence before the committee indicates that the following consultations occurred prior to the introduction of the Enhancements Bill in the House of Representatives on 21 September 2011.

1.30 The Regulation Impact Statement advised that 'extensive consultations' have occurred for the development of the Enhancements Bill. As recorded in the Regulation Impact Statement, several consultation groups were established:

> The primary vehicle for consultation with stakeholders was the Industry and Consumer Representatives Consultation Group (ICRCG). Its membership comprised of representatives of the banking, financial services, mortgage and finance brokers industries, consumer credit legal services, consumer advocates, ASIC, and the Department of the Treasury. All major industry bodies are on this group, and are able to disseminate information to their members and provide their feedback.
>
> Consultation with this group has generally occurred on a monthly basis. Between January 2010 and October 2010, 7 meetings were held in relation to the Phase Two reforms. The usual structure for these meetings was for Commonwealth Treasury staff to circulate papers on Phase Two topics, with the topics then discussed in detail at the meetings. This format allowed members of the group to provide comments and feedback at all stages of the development of options canvassed in this Regulation Impact Statement, and also enabled differences in views to be explored in detail. This structure enabled prompt and detailed exploration of issues with stakeholders and was important in the refinement and development of different options.
>
> The Financial Services and Credit Reform Implementation Taskforce (FSCRIT), comprises representatives from State and Territory departments and agencies, ASIC and the Department of the Treasury. Its main role in relation to Phase Two is to ensure proposals are developed in accordance with the COAG timetable. FSCRIT consultations have been conducted on a monthly or bimonthly basis, according to need.[29]

1.31 Measures relating to reverse mortgages, consumer leases, short-term small amount credit contracts, hardship variations, remedies for unfair or dishonest conduct and restrictions on the use of certain terms were outlined in the *Green Paper* publicly released on 7 July 2010. It appeared that there was a one-month public consultation process, with comments on the proposed measures due by 6 August 2010.[30] Treasury received 75 submissions.

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29 Regulation Impact Statement, Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 9.16.

30 Treasury, *National Credit Reform - Enhancing confidence and fairness in Australia's credit law*, http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1852 (accessed 27 October 2011).

1.32 The Exposure Draft of the Enhancements Bill was released on 5 August 2011 for public comment by 17 August 2011.[31] This did not include proposed measures relating to the cap on the maximum amount credit providers can charge under certain credit contracts and the additional obligations relating to short term small amount credit contracts, which were released on 25 August 2011 for comment by 5 September 2011.[32]

1.33 It is also noted that it appears that the Bill includes measures to address concerns that were identified during the process of introducing the phase one reforms. Therefore, the consultation taken in phase two builds on consultations that occurred for the introduction of the NCCP Act and the National Credit Code.

1.34 The consultation process was noted in evidence presented to the committee. Referring to the overall implementation of the consumer credit reforms, Mr Ian Gilbert, Policy Director, Australian Bankers' Association, noted that the level of stakeholder engagement fluctuated:

> This process—and this bill is in the middle of a process—has been characterised by, at some points, extensive consultation but then quite a long time before final settings are actually achieved, whether it be via the primary legislation or through subordinate legislation.[33]

1.35 It is also evident that the degree of concern with the consultation process varied across the different categories of measures proposed in the Bill. For example, in relation to reverse mortgages, Mr Kevin Conlon, Chief Executive Officer, Senior Australians Equity Release Association (SEQUAL), whose submission related to the reverse mortgages reforms, commented that 'there has been proper consultation with industry around the development of the bill'.[34] The committee was informed that the reverse mortgages reforms were developed in consultation with a Treasury Working Group of stakeholders.[35] The Australian Finance Conference submitted that the proposed reverse mortgage provisions 'reflect the negotiated outcomes of that consultation'.[36] In contrast, as will be explored in chapter five, industry representatives expressed strong concerns with the consultation process for the proposed cap on

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31 Treasury, *Exposure Draft - National Consumer Credit Protection Amendment (Enhancements) Bill 2011*, http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=2116 (accessed 27 October 2011).

32 Treasury, *Exposure Draft - National Consumer Credit Protection Amendment (Enhancements) Bill 2011*, http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=2131 (accessed 27 October 2011).

33 Mr Ian Gilbert, Policy Director, Australian Bankers' Association, *Proof Committee Hansard*, 24 October 2011, p. 12.

34 Mr Kevin Conlon, Chief Executive Officer, SEQUAL, *Proof Committee Hansard*, 24 October 2011, p. 9.

35 Australian Finance Conference, *Supplementary Submission 29a*, p. 8.

36 Australian Finance Conference, *Supplementary Submission 29a*, p. 8.

certain credit contracts and other obligations applying to short-term small amount credit contracts.[37] The Smiles Turner Delegation/Financiers' Association of Australia made the following criticisms of the consultation process:

> 1. as to the intolerable demands of repeated discussion papers and the Exposure Draft Bill, with ridiculously short invitation periods (often 1 week or 10 days) to comment. Such ignoring the fact that there are representative bodies on both sides of the argument associated with the issues and Bill in question, whose members deserve the opportunity, within their organisation, to be briefed and participate in discussion, before that organisation responds with a submission to government, and that time is required to facilitate the necessary communications within the organisation;
>
> 2. concerning meetings confirmed with Treasury and the Minister at 48 hours or less notice;
>
> 3. being asked to repeatedly comment on issues that have been presented in Treasury Discussion Papers previously, but with just enough difference to demand near complete reconsideration and no “cut and paste” from a previous submission;
>
> 4. being asked to repeatedly comment on yet another Treasury Discussion Paper or an Exposure Draft Bill which demonstrates that little, if anything, of the content of previous submissions or discussions has been recognised in any way...[38]

Timetable for commencement of phase two measures

1.36 It was apparent that stakeholders are concerned with the timing of the introduction of the phase two measures. As evident in the view expressed by the Australian Finance Conference, it was questioned whether the proposed further reforms are premature:

> We acknowledge that the Government’s focus with these proposed reforms is to protect the vulnerable consumer or consumer in financial distress. However, given the majority of the NCC Law changes effectively commenced from 1 July 2010 (a little over 12 months ago), we submit that further amendment of the hardship provisions may be premature.
>
> The AFC recommends that the Phase 1 reforms be given a chance to bed-down and following a reasonable time to take effect that empirical research should thereafter be undertaken to determine whether these reforms have achieved the underlying policy of protection of the vulnerable consumer and to identify areas where further reform may be required.[39]

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37 For example, see Financiers Association of Australia/Smiles Turner Delegation, *Supplementary Submission*, pp 4 – 6; First Stop Financial, *Additional Information*, p. 1; Min-it Software, *Submission 34*, pp 5 – 7.

38 Financiers Association of Australia/Smiles Turner Delegation, *Supplementary Submission 40a*, p. 4.

39 Australian Finance Conference, *Supplementary Submission 29a*, p. 2.

1.37 Representatives of the short-term lending industry (also known as 'pay-day loans') also questioned the need for additional measures to ensure appropriate conduct on the part of credit providers. It was put to the committee that the responsible lending requirements effectively ensure that consumers are protected from unsuitable credit contracts, and therefore the measures proposed under the Enhancements Bill in relation to short-term loans are unnecessary.

1.38 The compliance burden on industry resulting from the consumer credit reforms was also noted with concern. ADI representatives, the Australian Bankers' Association and Abacus – Australian Mutuals, were in agreement about the resources and lead time required to ensure ADIs could adhere to the new consumer credit requirements from their commencement.

1.39 The Australian Bankers' Association noted the multiple consumer credit reforms that are intended to commence in the coming months, and questioned whether the resulting burden on industry has been adequately appraised:

> In all, there are 3 substantial pieces of credit regulation requiring industry implementation over the next 7 months.
>
> In setting the commencement timing for these reforms, little account appears to have been taken by the Government of industry's need to plan its resourcing and IT systems modifications and implement necessary compliance frameworks...These are chances that have to be made in a planned and orderly way and not just by the "flick of a switch" to ensure change risk is minimised. Management of change risk not only includes IT systems changes but also all relevant processes, documents and staff training to avoid risk to both the bank and its customers.[40]

1.40 Abacus – Australian Mutuals commented:

> The majority of the consumer credit protection provisions contained in the Bill will commence on 1 July 2012.
>
> This coincides with the commencement of: new credit card key fact sheet obligations; Future of Financial Advice reforms; new minimum repayment warnings obligations on credit cards; and the new national account switching regime. These reforms will require extensive and costly IT solutions, business systems changes and additional staff training obligations to ensure Abacus members achieve compliance...
>
> If this is the case, Abacus members will be under significant pressure to achieve compliance with yet another tranche of complex credit reforms within only seven months. This problem is compounded by the fact the Bill seeks to prescribe extensive policy details in yet to be developed regulations.
>
> Abacus would expect the draft regulations will be subject to an adequate industry consultation process. However, given the December/January

40 Australian Bankers' Association, *Submission 43*, p. 3.

> holiday season, consultation commencing in February 2012 would leave less than four months for industry to consider the implications of the entire reform package, and implement the necessary provisions of the Bill by 1 July 2012.[41]

1.41 Both industry representatives submitted that additional lead time is required to ensure efficient implementation of the reforms, and recommended that commencement be delayed.

1.42 In contrast to the views of industry, the Regulation Impact Statement predicted that the reforms would have, on the whole, 'minimal' resource implications for industry.[42]

Committee view

1.43 The committee considers that extensive consultation has occurred in the development of the measures in the Enhancements Bill. However, the committee notes with concern evidence that on some occasions stakeholders were given relatively short timeframes in which to respond to what were at times complex proposals. Measures for which, in the committee's view, further consultation is required are noted in subsequent chapters.

1.44 The committee notes concerns by industry representatives, including representatives of the short-term loan industry, that the proposed measures are unnecessary due to the reforms under phase one. The committee considers that the phase one reforms, particularly the introduction of responsible lending obligations, will have a substantial, positive impact on the consumer credit market.

1.45 However, the committee notes that the COAG decision contemplated that additional measures would be required post the introduction of the phase one reforms. In relation to short-term loans, the committee notes that the COAG communiqués draw particular attention to the need to consider further reforms to this area. However, as explored in subsequent chapters, the committee would be particularly concerned with regulatory overlap or the introduction of measures that do not adequately take account of existing obligations on credit providers.

1.46 The committee notes the compliance burden on credit providers to ensure infrastructure is in place to comply with the requirements by the commencement date, and acknowledges the uncertainty that may result from piling new requirements on top of relatively new legislation. It is also noted that the Bill provides for significant elements of the reforms to be determined by regulations.

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41 Abacus – Australian Mutuals, *Submission 38*, p. 4.

42 Regulation Impact Statement, Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 9.15.

1.47 Given the need to develop regulations in consultation with industry, and the regulatory burden on industry to ensure it is in a position to implement the reforms, the committee considers that commencement of certain provisions in the Bill should be postponed. On the basis of evidence presented to the committee, it is apparent that the additional six months will greatly assist credit providers to be in a position to comply with the new requirements upon their commencement. Allocating credit providers sufficient time to prepare for the new regulatory requirements will also ensure that customer service is not compromised by resource limitations.

1.48 The committee recommends that Schedule 1 should commence on 1 January 2013. Issues with the commencement date for the measures in Schedules 3 and 4 will be explored in chapter five. On the basis of evidence to the committee it did not appear that the commencement date proposed for Schedules 2 (reverse mortgages), five (consumer leases) and six (amendment to the Corporations Act) posed significant concern.

Recommendation 1

1.49 The committee recommends that the Government consider extending the commence date for Schedule 1 (enhancements) to 1 January 2013.

Report structure

1.50 Chapter two considers the proposals relating to variations to credit contracts in circumstances of hardship.

1.51 Chapter three considers the proposed regulations relating to reverse mortgages.

1.52 Chapter four considers the proposed regulations for consumer leases.

1.53 Chapter five considers the proposed regulations, including the introduction of caps, for small amount credit contracts and other credit contracts excluding bridging finance and credit contracts provided by ADIs.

1.54 Chapter six considers other aspects of the Bill about which concerns were raised during the course of the committee's inquiry, namely:

- restrictions on certain representations and advertisements
- restrictions on the use of certain terms including 'independent' and 'financial counsellor'
- remedies for unfair or dishonest conduct, and
- the proposed amendment to the Corporations Act.

1.55 Chapter seven considers concerns with proposed regulation of direct selling as contained in the Exposure Draft of the Enhancements Bill.

Chapter 2

Hardship variation and enforcement of credit contracts

2.1 The National Credit Code currently provides for borrowers to seek variations of credit contracts in circumstances of hardship.[1] Under the existing legislation, borrowers with credit contracts for less than $500 000 may apply for hardship variations if they are unable to meet their repayment obligations due to 'illness, unemployment or other reasonable cause'. There are only three kinds of variations available, namely:

- extending the period of the contract and reducing the amount of each payment due under the contract accordingly (without a change being made to the annual percentage rate or rates);
- postponing for a specified period the dates on which payments are due under the contract (without a change being made to the annual percentage rate or rates); or
- extending the period of the contract and postponing for a specified period the dates on which payments are due under the contract (without a change being made to the annual percentage rate or rates).

2.2 The borrower must include information that demonstrates that the borrower could meet the changed repayment obligations.

2.3 Within 21 days of receiving the application, the credit provider must send written notice to the borrower either agreeing to the proposed change or informing the borrower of the reasons why the application has been refused and providing the borrower details of an approved external dispute resolution scheme. Failure to do so is a strict liability offence with a penalty of 30 penalty units.[2]

2.4 Credit providers are not required to respond to hardship variation requests before commencing proceedings to enforce the debt.[3]

2.5 The Enhancements Bill would extend the circumstances in which hardship variations may be sought and reduce the procedural requirements on borrowers. As outlined in the Explanatory Memorandum, the following amendments are proposed.

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1 National Credit Code, s. 72.

2 Strict liability offences do not require proof of fault. That is, a person commits the offence if he or she carries out the prohibited conduct. It is irrelevant whether the person, for example, intended to commit the conduct. For further information see the *Criminal Code*, section 6.1. 'Penalty unit' is defined in section 4BB of the *Crimes Act 1914* as $110.

3 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, table: 'Comparison of key features of new and current law', p. 13.

- All borrowers may apply for hardship variations, regardless of the value of the credit contract.
- The hardship notice may be made orally or in writing.
- While called a ‘hardship notice’, the Bill does not expressly state that in order to apply for the contract to be varied the borrower's capacity to repay must be affected by hardship. The application therefore does not have to contain reasons why the borrower is unable to meet the repayment obligations.
- The Bill also does not impose limits to the form of hardship variation that the borrower may request.
- The borrower is not required to demonstrate that he or she could meet the changed repayment obligations.
- Within 21 days of receiving the notice a credit provider must either notify the borrower that they are prepared to negotiate a contract variation or are refusing the request. If refusing the request, the credit provider must provide reasons for the refusal and details of an approved dispute resolution scheme.[4]

2.6 The credit provider would commit an offence by failing to either notify the borrower within the 21 day timeframe that they are prepared to vary the contract as requested or by refusing the request to negotiate a contract variation. If providing notice of the credit provider's refusal to negotiate, the credit provider would still commit an offence if the notice does not provide reasons for refusing to negotiate, details of an approved external dispute resolution scheme of which the credit provider is a member and details of the borrower's rights under that scheme. The offence is a strict liability offence with a maximum penalty of 30 penalty units.

2.7 The Bill would also introduce clause 89A, which would alter the requirements for seeking to enforce credit contracts in response to borrower default. Under the revised regulatory framework, creditors would be required to respond to hardship notices before seeking to enforce the credit contract. If a hardship notice is given prior to or after the creditor has issued a default notice, the creditor must not commence enforcement proceedings until 14 days after responding to the hardship application. The credit provider would commit an offence if initiating enforcement proceedings in contravention of these restrictions. The offence would also be a strict liability offence and would expose the credit provider to a maximum penalty of 50 penalty units.

2.8 Proposed clause 94 would also provide borrowers the right to request or demand credit providers delay proposed enforcement proceedings for 14 days.

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4 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, table: 'Comparison of key features of new and current law', p. 13.

2.9 The new lending environment would commence on 1 July 2012,[5] approximately two years since the National Credit Code, and the hardship variation provisions it currently contains, came into operation.[6] The Explanatory Memorandum clarifies the intention underlying the proposed amendment, stating that the reforms will 'make it easier for debtors to apply for hardship variations, by making the procedures more flexible.'[7]

2.10 Details of the background to, and the rational for, the proposed changes were provided in Treasury's July 2010 *Green Paper*. The paper explains that the existing provisions in the National Credit Code replicate the hardship provisions in state and territory consumer credit regulations but do not address issues with their operation. The paper argues that the Council of Australian Governments (COAG) envisioned that the issues would be the subject of further consultation and legislative proposals progressed under phase two of the national consumer credit reforms:

> As part of the transitional arrangements agreed between the Commonwealth, State and Territory Governments and industry, minimal changes were made in replicating the UCCC [Uniform Consumer Credit Code] as the National Credit Code on the basis that these issues would be given further consideration during Phase Two.[8]

2.11 The paper informs readers that the identified issues included whether further enhancements are required for the hardship variation provisions and the enforcement provisions.[9] The paper goes on to provide the following rationale for amending the framework for hardship variations and enforcement proceedings.

> The limited range of variations that can be requested on the basis of financial hardship may lack sufficient flexibility to enable the most mutually beneficial outcomes for both lenders and consumers. Furthermore, having a monetary threshold above which a consumer does not have a right to request a variation applies an arbitrary limitation. Neither of these restrictions are entrenched in the industry codes of conduct.
>
> In most situations it is likely to be advantageous to both lenders and consumers to keep a credit contract out of default, provided that the consumer can reasonably be expected to meet their commitments following

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

6 *National Consumer Credit Protection Act 2009*, s. 2. The National Credit Code commenced on 1 April 2010.

7 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 2.6.

8 Treasury, *National Credit Reform: Enhancing confidence and fairness in Australia's credit laws – Green paper*, July 2010, p. 81.

9 Treasury, *National Credit Reform: Enhancing confidence and fairness in Australia's credit laws – Green paper*, p. 81.

> a variation and the lender is able to receive repayment within a reasonable timeframe.[10]

2.12 The Regulation Impact Statement provides further insight into identified problems with the regulatory framework as it currently stands. The statement provides an overview of research conducted in 2009 by the Australian Securities and Investments Commission (ASIC) into the hardship practices of 15 major lenders. The ASIC research draws the following conclusions about the availability of hardship variations.

> One lender would only consider an application made in accordance with the statutory requirements, and that otherwise it would not offer any assistance. All the other lenders did not differentiate in their responses.
>
> Lenders preferred to provide a similar response irrespective of the borrower's situation; typically this was short term assistance such as a three month payment moratorium. This response did not require an assessment of the consumer's circumstances and needs and then varying the contract to match those needs.
>
> Lenders generally have a far wider range of options for responding to hardship than those set out in the Code, but in practice tend to provide a much narrower range of options.[11]

2.13 The statement draws on anecdotal evidence provided by the Financial Ombudsman Service and the Credit Ombudsman Service, as well as the ASIC research, to make the following conclusions about the utility of the hardship variation schemes established under the state and territory consumer credit legislation:

> ...borrowers only have a right to seek a variation to address short-term hardship on relatively narrow grounds, and where their request conforms to precise legal requirements. This creates a risk of two distinct problems for borrowers:
>
> - the lender may refuse to consider a variation of their contract because the borrower's request did not conform to the requirements under the Code; or
> - lenders may only provide a variation that is one of the three options set out in the Code, when a different response would more effectively address the borrower's situation.
>
> In both cases the consequence for the borrower is the same, namely that they may default under their credit contract and face enforcement action when, in some situations, this could have been avoided.
>
> There is evidence from a number of different sources that some lenders are not properly meeting the obligations in their voluntary code in relation to

10 Treasury, *National Credit Reform: Enhancing confidence and fairness in Australia's credit laws – Green paper*, p. 83.

11 Regulation Impact Statement, Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 9.140.

> hardship, and that they are only complying with the requirements in the Credit Act. They therefore have practices which mean they do not actively seek to resolve, in a broader way, the position of borrowers who are in financial hardship.[12]

Support for the new approach to hardship variations and enforcement of credit contracts

2.14 On the basis of evidence before the committee, it appeared that the Enhancements Bill generally addresses concerns of consumer advocates with the existing legislative provisions governing consumers' access to hardship variations.[13] The views of Anglicare Victoria seemed representative of the perspective of the consumer advocates who participated in the inquiry:

> Anglicare Victoria supports the provisions...that protect debtors in cases of hardship and make it easier to apply for hardship variations, by making procedures more flexible.[14]

2.15 Good Shepherd Youth and Family Services provided the following comments in support of the Bill:

> We support the changes which place greater onus on the credit provider to inform consumers of their rights when seeking hardship protections. Often people who seek these provisions need to ask for those explicitly when dealing directly with their credit provider. Without the intervention of a financial counsellor or other advocates, many people are not aware of hardship provisions or able to access them. Even in the instances where a financial counsellor is able to assist, the burden of proof can make accessing these provisions difficult if not impossible. Our financial counsellors often find it challenging to support people experiencing hardship, particularly when clients are maintaining their debt obligations at the expense of other needs.[15]

2.16 Good Shepherd Youth and Family Services also approved the proposed enforcement procedures, arguing that these address a deficiency in existing legislation and would therefore increase protection for vulnerable consumers:

> We understand there is a need to allow sufficient time for credit providers to assess claims and develop means of addressing these. However, that time in the interim can be critical to those being affected by hardship. We believe section 89A addresses these concerns by prohibiting credit

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12 Regulation Impact Statement, Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraphs 9.136 - 138.

13 For example, Consumer Action Law Centre, *Submission 20*, p. 16; Consumer Credit Legal Centre (NSW), *Submission 47*, p. 12.

14 Anglicare Victoria, *Submission 39*, p. 2.

15 Good Shepherd Youth and Family Services, *Submission 23*, p. 3.

> providers from taking collection action while claims for hardship are being assessed.[16]

2.17 It appeared that the proposed changes have in-principle support from sectors within the credit provider industry. However, as the extract from the submission from the ANZ demonstrates, while there is support for the policy objective there were strong concerns with details of the proposal as drafted:

> We support the Government's intention to make it as easy as possible for customers to apply for hardship assistance. However, there are a number of practice issues with this section.[17]

Concerns with draft provisions relating to hardship variations

2.18 With the exception of the submission from the Mortgage and Finance Association of Australia, submissions received from industry were consistent in the view that the provisions as drafted will present substantial practical difficulties for credit providers.

2.19 The Mortgage and Finance Association of Australia argued that the provisions uphold the principle of supporting borrowers, which is a feature of the association's code of practice:

> MFAA has long supported the need to support borrowers in hardship. Our Code of Practice has included, for some years, hardship provisions. That being the case we support the new section 72(1) which allows borrowers to give lenders a 'hardship notice' orally or in writing, if unable to meet their obligations, without the need to specify the nature of the hardship in detail.[18]

2.20 In contrast, the committee's attention was repeatedly drawn to industry concerns that the revised hardship variation procedures would not be feasible for industry nor provide certainty for the borrower. Concerns were raised with the following aspects of the proposal.

- Removing the requirement for the borrower to demonstrate they could reasonably be expected to meet the revised repayment obligations.
- Allowing hardship variation notices to be given verbally.
- Extending the hardship variation regulations to apply to credit contracts valued over $500 000.

16 Good Shepherd Youth and Family Services, *Submission 23*, p. 4.

17 ANZ, *Submission 41*, p. 2.

18 Mortgage and Finance Association of Australia, *Submission 3*, p. 1.

No requirement for borrowers to demonstrate capacity to meet the varied repayment requirements

2.21 As noted, the amendments to subsection 72(1) contemplate that hardship applications would not be required to contain information that demonstrates that the borrower could meet the changed repayment obligations. Evidence before the committee indicated that the absence of this requirement is a serious concern to several key industry stakeholders. The Credit Ombudsman Service argued that:

> ...it would be extremely useful, if not critical, for the proposed new section 72(1) to retain in some way the implicit requirement in the existing section 72(1) that the credit contract should be varied where the borrower reasonably expected to meet their obligations under the contract if the contract was changed in a particular way.[19]

2.22 Concerns were also expressed in more emphatic terms, with the committee being advised that, in the absence of a requirement for borrowers to demonstrate ability to meet the revised repayment obligations, the hardship variation system would be 'unworkable'. As GE Capital argued:

> ...we do <u>not</u> believe that variation is warranted if there is no reasonable expectation that the proposed variation to the contract will enable a debtor to meet his or her obligations that the proposed variation to the contract will enable a debtor to meet his or her obligations under the credit contract. This is the key to whether a variation to the credit contract should be made. The loss of this...key component will render section 72 unworkable.[20]

2.23 GE Capital stressed that credit providers 'must be able to decline to vary a credit contract on hardship grounds where there is no reasonable expectation that the proposed variation to the contract will enable a debtor to meet his or her obligations under the credit contract.'[21]

2.24 Abacus – Australian Mutuals also considered the provisions to be unworkable. The committee was informed that the provisions as drafted will limit, rather than increase, borrowers' access to hardship variations in legitimate circumstances. It was argued that accordingly the provisions would increase the burden on borrowers and credit providers:

> The problem in practice with the procedure proposed in the Bill would be that, in many cases, the debtor—although prompted to do so by the credit provider—will not in fact provide the information needed, either at all or within a reasonable time, for an assessment of whether hardship relief can be offered to be made. In such cases the credit provider, in order not to breach the provision, will have little alternative but to refuse to negotiate a

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19 Credit Ombudsman Service, *Submission 2*, p. 2.

20 GE Capital, *Submission 25*, p. 2.

21 GE Capital, *Submission 25*, p. 2.

> hardship change even if it would have been prepared to do so had it been in possession of the information needed to make an assessment.
>
> This appears to be a perverse and unintended outcome. We would emphasise, however, that it is not a merely theoretical one.[22]

2.25 ANZ also noted the potential for the provisions to increase the administrative burden on borrowers and credit providers:

> On a practical level, this will mean that debtors can notify credit providers of their inability to pay without there being any likelihood that they can discharge their repayment obligations in the short to medium term. It is ANZ’s view that this will also substantially increase customer correspondence without deriving consumer benefit.[23]

2.26 The committee was further informed that the borrower's capacity to meet the varied repayment obligations is the threshold test currently applied by the court in determining credit contract variation disputes. As the Credit Ombudsman Service stated:

> [w]e whole-heartedly support the changes proposed to be made by Part 1 (Protection of debtor in cases of hardship), but urge the Committee to recommend a change to the proposed new section 72(1)...There would otherwise be little or no guidance for a Court or an EDR scheme to determine if a credit contract should be varied.[24]

2.27 Having recommended the inclusion of a requirement for borrowers to demonstrate capacity to repay under the amended contract, submitters also recommended further procedural requirements to remove any uncertainty. First Stop Money submitted that borrowers should be required to provide 'documentary evidence within 30 days of requesting hardship.'[25]

2.28 An alternative approach was recommended by the Australian Bankers' Association and Abacus – Australian Mutuals, which submitted that the 21 day timeframe should not commence before the credit provider receives sufficient information to assess the application.[26] As Abacus – Australian Mutuals stated:

> ...the 21 day period that the credit provider has to give the debtor a notice in response to a hardship notice in s72(2) would only commence from the day the debtor has provided the credit provider with the financial information it reasonably requests in order to assess the debtor's financial position.[27]

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22 Abacus – Australian Mutuals, *Submission 38*, p. 2.

23 ANZ, *Submission 41*, p. 2.

24 Credit Ombudsman Service, *Submission 2*, p. 2.

25 First Stop Money, *Submission 17*, p. 4.

26 Mr Ian Gilbert, Policy Director, Australian Bankers' Association, *Committee Hansard*, 24 October 2011, p. 13; Abacus – Australian Mutuals, *Submission 38*, p. 3.

27 Abacus – Australian Mutuals, *Submission 38*, p. 3.

2.29 ANZ supported this proposal, stating that this was of particular importance in the context of a breakdown in the relationship of joint borrowers:

> The trigger of the 21 day response time commencing immediately upon verbal notification from a customer, rather than once sufficient information has been provided to enable an assessment to be made, is of particular concern in the context of a joint mortgage and where there has been a breakdown in the relationship between the borrowers. In order to make an assessment of whether to negotiate, a credit provider will need information for all parties to the loan. In the case of a joint loan, the refusal of one party to provide information can impede our ability to assess both or one of the borrowers for hardship assistance. If a credit provider simply declined to negotiate a change on the basis of not having sufficient information, it is likely to result in increased complaints to external dispute resolution schemes.[28]

2.30 The Australian Finance Conference, whose comments in general also referred to the hardship variations proposed to apply to credit contracts under Schedule 3 of the Enhancements Bill, argued that this measure would be consistent with ASIC advice regarding the existing hardship provisions under the National Credit Code:

> We also note the compliance difficulty the wording of s. 72 currently raises for lenders and the ASIC response (October 2010) to assist. In short, to address concerns expressed by lenders in relation to the timeframe for decision where insufficient information has been provided by the borrower, ASIC clarified its position in *Information Sheet 105: Dealing with Consumers & Credit*. In ASIC's view the 21 day period commences only after the borrower makes an application with sufficient information to allow the credit provider to make a final decision. Where insufficient, the credit provider will need to identify what further information is required and advise the borrower as soon as practicable. Until that information is provided, ASIC will not regard an application as having been made and the 21 days will not have commenced.[29]

2.31 An additional step was also proposed to promote best-practice by credit providers. Abacus – Australian Mutuals submitted that the Bill 'might also be amended to oblige the credit provider to seek any financial information it requires as soon as possible after receiving the hardship notice.'[30]

Removing the requirement for hardship notices to be provided in writing

2.32 It was a view expressed across industry submissions that informal, that is, verbal applications would lead to misunderstandings between the credit provider and the borrower. It was further argued that this would therefore thwart the intention to increase borrowers' access to hardship variations. As the ANZ stated:

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28 ANZ, *Submission 41*, p. 3.

29 Australian Finance Conference, *Supplementary Submission 29a*, p. 4.

30 Abacus – Australian Mutuals, *Submission 38*, p. 3.

> The fact that a debtor is only required to give a hardship ‘notice’ rather than make an ‘application’ is too vague and uncertain and potentially triggers the need to issue formal correspondence in too many cases.
>
> In practice, this would make it difficult for credit providers to ascertain whether their obligations under s. 72 have been triggered. For example, there may be instances where a debtor says that they ‘notified’ branch staff or a call centre operator of difficulty in making repayments, but this may have been expressed in such a way or interpreted as something other than notification, for example, a complaint.[31]

2.33 The ANZ also submitted that verbal notifications will remove existing flexibility to address borrowers' needs:

> The proposed amendments remove flexibility in the way ANZ can offer temporary repayment arrangements to assist customers to deal with short term financial instability.
>
> ANZ will often offer very short term relief arrangements for customers who are experiencing a temporary difficulty in meeting repayments. This difficulty may be due to an unexpected expense incurred by the customer that, while causing some financial instability in the very short term (meaning the customer may miss one or two repayments to their loan), is not indicative of financial hardship. In these cases, once the cause of the short-term difficulty is explained by the customer and ANZ is comfortable the issue is temporary, ANZ will often be able to offer an arrangement over the telephone, with a minimum of ‘red tape’ for the consumer.
>
> However under the current proposed amendments, these scenarios will need to be treated in the same way as a financial hardship situation, requiring the issue of formal correspondence within 21 days, without any added perceived consumer benefit. We expect the added administrative burden in this area of our customer assistance team (mainly involving the preparation and dispatch of confirmation letters) will cause delays in responding to customers seeking short-term informal relief arrangements.[32]

2.34 This view was shared by the Australian Bankers' Association, which outlined the following scenario:

> ...a customer may advise the credit provider of their inability to meet one of their credit card repayments on the due date or make their monthly home loan repayment on time but will do so in two weeks’ time and could request an extension of time to make the repayment. Under the current law, such a notification could be solved immediately through an agreed arrangement between the credit provider and customer without a formal process being needed.
>
> Notwithstanding the flexibility of the current law, the Bill proposes that such a notification would trigger the formal hardship process, thereby

31 ANZ, *Submission 41*, p. 2.

32 ANZ, *Submission 41*, p. 2.

> increasing the number of hardship notifications received by credit providers and an associated increase in the resourcing requirements of credit providers. A credit provider would have to issue a section 72(2)(a) notice agreeing to negotiate and then a section 73 notice setting out a change to the contract if it is agreed to. This would delay the commencement of the arrangement to the detriment of the customer.
>
> In these situations this prescriptive process would be completely unnecessary and confusing for the customer.[33]

2.35 Noting that failing to respond within the 21 day timeframe is an offence, the Australian Bankers' Association argued that verbal applications would entail significant risks for industry:

> ...if someone rings up and is unclear about what it is they are actually seeking then the whole process of getting a better understanding of it is very awkward. It could be just a chance comment in a branch or it could be a chance comment over a telephone that someone does not recognise is someone saying, 'I don't think I'm going to meet my obligations under the credit contract.' If that is not acted upon, inadvertently that triggers a 21-day notice, with a criminal penalty at the end of it if you do not comply.[34]

2.36 The Australian Finance Conference also noted the offence provision, arguing that it should be removed:

> The proposed reforms are designed to facilitate flexibility by the consumer with the process of soliciting variation on the basis of hardship. Again, the AFC supports this. However, for it to be a mutually beneficial outcome in line with the Government’s objective, similar flexibility needs to be adopted for the compliance obligations of the lender. In particular, AFC recommends that strict timeframes should be replaced with concepts like “within a reasonable time;” and offence provisions should be removed.
>
> This would have the benefit of allowing lenders to minimise regulatory risk while working with customers on a specific or targeted basis with the primary aim of assisting the customer to overcome their short-term financial difficulty while continuing to meet their contractual obligations.[35]

2.37 The committee heard that, to promote best-practice, the option for hardship applications to be made verbally should be removed.[36]

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33 Australian Bankers' Association, *Submission 43*, p. 5.

34 Mr Ian Gilbert, Australian Bankers' Association, *Committee Hansard*, 24 October 2011, pp 12–13.

35 Australian Finance Conference, *Supplementary Submission 29a*, p. 3.

36 Australian Finance Conference, *Supplementary Submission 29a*, p. 3; Mr Ian Gilbert, Australian Bankers' Association, *Committee Hansard*, 24 October 2011, p. 13.

Extending the hardship variation regulations to apply to credit contracts valued over $500 000

2.38 Aussie submitted that hardship variations are unnecessary for loans over $500 000:

> It is important that lenders have commercial certainty on large investment loans. Borrowers already have sufficient protection under new laws in any event without the need to provide defaulting borrowers with additional mechanisms to further delay the recovery process.[37]

2.39 Accordingly, Aussie recommended the $500 000 cap be retained, or, as an alternative, be only available for loans over $500 000 that are secured by the borrower's principle place of residence rather than residential investment property.[38]

Concerns with provisions relating to enforcement of credit contracts

2.40 Concerns were raised with clauses 89A and 94, which would alter the requirements for seeking to enforce credit contracts in response to borrower default and give borrowers the right to request or demand a 14 day delay in the commencement of enforcement proceedings. The Australian Bankers' Association argued that the clause was unduly complex, and could be used by the borrower to stall enforcement proceedings.[39] The Association recommended the Bill be amended to make it clear that a borrower may only seek to delay enforcement proceedings once under clause 94:

> If this provision is retained, it is necessary for the Bill to clarify that a customer can only delay the enforcement proceedings once on this ground. This will ensure that an abuse of process does not take place on the part of the customer.[40]

2.41 Aussie also questioned whether the postponement could delay dispute resolution procedures, noting that any delay in dispute resolution once the matter has been referred to an approved dispute resolution provider could entail significant costs for both the borrower and credit provider.[41]

2.42 The Australian Finance Conference did not support the introduction of clause 89A, arguing that it was unnecessary:

> ...the current postponement provisions and financiers’ practices of trying to proactively manage customers who are in difficulty mean there is ample

37 Aussie, *Submission 10*, p. 1.

38 Aussie, *Submission 10*, p. 1.

39 Australian Bankers' Association, *Submission 43*, pp 8–9.

40 Australian Bankers' Association, *Submission 43*, p. 9.

41 Aussie, *Submission 10*, p. 2.

> opportunity for customers to seek assistance before proceedings are commenced...
>
> We are advised by our Members that it would be operationally extremely difficult to implement a process to comply with its requirements. They also submit that the customer may be disadvantaged through the process; an outcome that should be avoided.[42]

Committee view

2.43 The committee endorses the intention to establish a hardship variation scheme that provides appropriate support to vulnerable consumers while providing commercial certainty. Hardship variations are an essential part of an effective credit market, ensuring consumers can continue to participate despite unanticipated financial distress. The provisions also allow industry to retain clients despite unforseen changes in the clients' financial circumstances. This in turn can build client loyalty.

2.44 However, the committee considers that impractical procedures would undermine the intention to strengthen vulnerable consumers' access to hardship variations. The committee notes industry concerns that the hardship scheme proposed may not be practical due to the absence of a requirement on borrowers to provide all necessary documentation regarding the kind of hardship variation they are seeking and their capacity to repay. This appeared to be a particular concern in relation to verbal applications.

2.45 The committee considers that the proposal to allow hardship applications to be made verbally tips the balance too far in the direction of the consumer. It is not at all clear to the committee that the proposal is practical and it would most likely reduce the flexibility that is currently in the system which allows providers to vary contracts in the face of short term financial need on behalf of the consumers.

2.46 Evidence that the revised scheme may not be practical for industry is all the more concerning as the offence for failing to respond to the consumer's application in one of the two required way is an offence of strict liability. It is therefore all the more essential for the requirements on credit providers to be clear and practical to implement.

2.47 For this reason, the committee recommends that clause 72 be amended to require borrowers to provide reasonable information to assist credit providers to assess their hardship application. The clause should be further amended to provide credit providers reasonable opportunity to request this information where it is not initially provided.

2.48 The committee notes the concerns raised by Good Shepherd Youth and Family Services that the threshold to demonstrate hardship and capacity to repay currently applied by credit providers can be too high. The committee draws this

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42 Australian Finance Conference, *Supplementary Submission*, pp 6–7.

concern to the Government's and industry's attention, and encourages industry to consider how Codes of Conduct can practically respond to the challenges that borrowers may face in providing documentation and other evidence required to establish hardship and the borrower's capacity to repay.

2.49 The committee considers that the hardship variation scheme would be strengthened through greater consumer awareness and understanding of the availability of hardship variations and their associated rights and obligations. To this end, the committee recommends Government work with industry to develop a plain English, user-friendly information pack outlining the application of the hardship variation scheme and the steps which borrowers can take to vary their repayment obligations. To further assist vulnerable consumers, the information pack could provide a link to the details of financial counselling services as provided on ASIC's MoneySmart website.

2.50 The committee also notes concerns with the operation of clause 89A and clause 94, particularly the Australian Bankers' Association's view that the clauses may result in a cycle of default notices and postponement applications that would prevent credit providers from enforcing the credit contract. On the basis of information provided to the committee it is not clear that the provisions as drafted would allow for this scenario. However, the committee brings to Government's attention the concerns with the effect of the provisions as drafted.

Recommendation 2

2.51 The committee recommends that clause 72 be amended to require borrowers to provide reasonable information to assist credit providers to assess their application and to give credit providers reasonable opportunity to seek this information from the borrower where it is not initially provided.

Recommendation 3

2.52 The committee recommends that 'orally' be removed from subclause 72(1), to require hardship applications to be made in writing.

Recommendation 4

2.53 The committee recommends that Government work with industry stakeholders to develop a plain English, user-friendly information pack about borrowers' rights and obligations in relation to hardship variations. The Government and industry should consider including a link to the information on the MoneySmart website about financial counselling assistance. Industry should be required to provide a copy of this information pack on their websites and at customer service centres.

Chapter 3

Reverse mortgages

3.1 Schedule 2 of the Enhancements Bill would introduce significant changes to the requirements for reverse mortgages under the NCCP Act and the National Credit Code. In their submission to the inquiry, the Redfern Legal Centre provided the following summary of the regulations currently applying to reverse mortgages.

> Under the current law, the NCCP Act regulates reverse mortgages contracts consistently with all other credit contracts. It does not include any additional responsible lending conduct obligations or requirements in relation to reverse mortgages. In addition it does not include any disclosure requirements specific to reverse mortgages, nor does it include any maximum limitations with respect to a borrower's liability in relation to the debt. Further, the obligations imposed on lenders do not require the disclosure of either projections of future enquiry or certain information on the contract nor do they require the provision of a reverse mortgage information sheet.[1]

3.2 The Enhancements Bill would introduce the following requirements specific to reverse mortgages. As outlined in the Explanatory Memorandum,[2] the Bill would:

- introduce a 'no negative equity guarantee' that would prohibit credit providers from requiring or accepting loan repayments exceeding the market value of the property (subject to certain exceptions);
- require borrowers to receive legal advice before entering into a reverse mortgage contract;
- require credit providers to disclose the way the reverse mortgage would apply to non-title holding occupants;
- require credit providers to attempt to contact borrowers in person where the reverse mortgage is in default; and
- exclude the following circumstances from constituting default under the loan:
  - the borrower failing to inform the credit provider that another person occupies the property;
  - the borrower failing to provide the credit provider evidence of who lives at the property;
  - the borrower leaving the property unoccupied while the property was the borrower's principal place of residence;

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1 Redfern Legal Centre, *Submission 18*, p. 7.

2 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 3.1.

- the borrower failing to pay a cost to a person other than the credit provider (for example rates);
- the borrower failing to comply with a provision of the credit contract, if the credit contract is unclear about what is required;and
- the borrower breaching another credit contract with the credit provider.

3.3 The Bill would also require credit providers to undertake the following steps before making an assessment or pre-assessment of a borrower's application. Credit providers would be required to provide prospective borrowers:

- an equity projection calculated through a website approved by ASIC;
- a reverse mortgage information statement; and
- a notification of additional information that will assist the borrower to determine whether to enter into a reverse mortgage contract.

In-principle support for the proposed regulation of reverse mortgages

3.4 The proposal for a separate regulatory scheme for reverse mortgages received approval from consumer advocates and industry representatives. All three consumer advocates that commented broadly supported the proposal.[3] The Consumer Credit Legal Centre (NSW) submitted that reverse mortgages are 'a complicated area of credit' and therefore should be distinguished from other credit contracts.[4] Similarly, the Redfern Legal Centre stated that the Centre 'is strongly supportive of creating additional product specific obligations and protections to address the particular risks associated with reverse mortgages.'[5]

3.5 Industry representatives SEQUAL and Australian Seniors Finance (ASF) also supported the proposal.[6] Both organisations commented that the proposal broadly reflects best-practice industry standards. Mrs Julie Campbell, General Manager, ASF, informed the committee that 'the bill mainly covers what we already do'.[7] Mr Kevin Conlon, Chief Executive, SEQUAL, stated 'we commend the government for having proper regard for [industry] high standards of practice when developing the legislation.'[8]

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3 Consumer Action Legal Centre, *Submission 20*, p. 19; Consumer Credit Legal Centre (NSW), *Submission 47*, p. 12; Redfern Legal Centre, *Submission 18*, p. 7.

4 Consumer Credit Legal Centre (NSW), *Submission 47*, p. 12.

5 Redfern Legal Centre, *Submission 18*, p. 7.

6 SEQUAL, *Submission 44*, p. 13; Australian Seniors Finance, *Submission 4*, p. 3.

7 Mrs Julie Campbell, General Manager, Australian Seniors Finance, *Committee Hansard*, 24 October 2011, p. 3.

8 Mr Kevin Conlon, Chief Executive, SEQUAL, *Committee Hansard*, 24 October 2011, p. 8.

3.6 While the proposal was supported, the committee's attention was drawn to concerns with technical aspects of the provisions as drafted. It was put to the committee that to ensure that the provisions are practical and will best meet the needs of industry and consumers, '[t]here is some common sense to come into these provisions.'[9] However, as reflected in the statement by the ASF, while concerns were raised with technical aspects, this did not detract from the general approval for a separate legislative scheme and the high lending standards proposed:

> Overall, we believe that the approach in the Enhancements Bill is positive and we remain supportive of the additional consumer protection, however, it is important to ensure that there are no unintended consequences that could jeopardise consumer access to a competitive market place and robust products.[10]

Concerns raised with technical aspects of provisions

3.7 Concerns were raised with the practicality of the following provisions.

Requirement to provide projections

3.8 SEQUAL and the ASF both supported the proposal under clause 133DB to provide prospective borrowers projections of equity before providing credit assistance or entering into a credit contract. In the ASF's view, potential borrowers 'certainly should get an illustration at the very beginning.'[11] SEQUAL submitted that:

> ...there can be no doubt that consumers are better placed to make informed decisions if they are provided with the opportunity to develop and consider projections (based on reasonable assumptions) that may impact their expectations for preserving some level of home equity.[12]

3.9 However, concerns were raised with the drafting of the provision. As evident in the following statement by SEQUAL, the committee was informed of industry concerns that 133DB would require the projections to be provided in-person:

> ...it may not always be practical for such projections to be “shown” to the borrower in a “face to face” meeting and it should be possible for an equity release provider to make available an ASIC approved calculator on their own website. There are a number of compelling reasons why there should be some flexibility as to the method of delivering this information to the consumer including, but not limited to, costs to the consumer and preserving consumer choice.[13]

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9 Mr Kevin Conlon, SEQUAL, *Committee Hansard*, 24 October 2011, p. 10.

10 Australian Seniors Finance, *Submission 4*, p. 3.

11 Mrs Julie Campbell, Australian Seniors Finance, *Committee Hansard*, 24 October 2011, p. 4.

12 SEQUAL, *Submission 44*, p. 13.

13 SEQUAL, *Submission 44*, p. 13.

3.10 The ASF provided further details of industry concerns with a requirement that projections be provided in-person:

> **Mrs Campbell:** ...I pointed that out because we do have many people who are in regional areas and for them to access face-to-face appointments is often not easy.
>
> **Mr FLETCHER:** Is it fair to say that you are making the point that the principle of the applicant seeing a projection in advance is one that you support?
>
> **Mrs Campbell:** Absolutely.
>
> **Mr FLETCHER:** But the precise way in which the provision has been drafted would impose cost and compliance burdens and might, in fact, lead to some applicants being denied the service because you would simply have to refuse to engage with them?
>
> **Mrs Campbell:** Yes. It is about having choice on how they engage initially.[14]

3.11 The ASF and SEQUAL also noted the general nature of equity projections that would be provided before a preliminary assessment was made. SEQUAL advised that:

> [i]t is important to note that in the initial stages of the application process, the projections would be generic in nature due to the absence of more detailed underwriting information that would normally be collected as the application process proceeded.[15]

3.12 Accordingly, industry representatives advocated that a further projection should be provided.[16] As SEQUAL submitted:

> Once an application has been confirmed and the details of the loan have been confirmed, a more personalized illustration should be provided as part of the loan documentation covered in the legal advice process.[17]

ASIC approved website

3.13 The Australian Bankers Association (ABA) noted that the requirement that lenders calculate equity projects through the use of an 'ASIC-approved website' is unclear and therefore open to interpretation. The ABA submitted that as the Bill does not give guidance as to which websites may be ASIC approved, it is unclear whether credit providers are required to construct a website and submit it for ASIC's approval,

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14 Mrs Julie Campbell, Australian Seniors Finance, *Committee Hansard*, 24 October 2011, p. 4.

15 SEQUAL, *Submission 44*, p. 13.

16 SEQUAL, *Submission 44*, p. 13; Mrs Julie Campbell, Australian Seniors Finance, *Committee Hansard*, 24 October 2011, p. 4.

17 SEQUAL, *Submission 44*, p. 13.

or whether ASIC will provide guidance on which websites may be used.[18] The ABA further argued that requiring providers to develop websites would impose significant costs and increase the lead time required to comply with the equity projection requirements.[19]

Circumstances constituting default

3.14 SEQUAL and the ASF were also concerned with subclause 18A(3), which would exclude certain circumstances from the factors that constitute default under a reverse mortgage. While not expressly stated, the Explanatory Memorandum implies that the exclusions are not intended to risk the credit provider's security interests:

> As a result of the exclusion of these terms from reverse mortgage contracts borrowers should not be in default (and at risk of enforcement action) because of minor oversights or for reasons which bear no relationship to the risk to the credit provider from the default.[20]

3.15 The ASF and SEQUAL raised concerns with three circumstances that, under clause 18A, could no longer be considered to constitute default. First, failure on the part of the borrower to inform the credit provider of changes in occupancy; second, failure by the borrower to pay costs to third parties, for example rates; third, the property being left unoccupied. Evidence provided to the committee indicates that industry disagreed that these three circumstances have no bearing on risks to the credit providers' security interests.

3.16 It was put to the committee that failure to notify the lender of changes to occupancy is at odds with standard industry practices designed to protect the lender's security interests. The ASF provided an extensive explanation of industry's concerns with the proposed exclusion.

> ...when read literally the clause also means that the borrower or their estate has no obligation to advise the provider when the residence is no longer inhabited. When the borrower no longer resides in the property through a lifestyle decision, ill health or death this provides the key trigger for loan repayment under reverse mortgage and hence it is of fundamental importance [...]
>
> Introduction of this clause could mean that a client could no longer be in the home for many years, building up a negative equity issue for the provider, and have no legal obligation to advise the provider of that circumstance [...]
>
> Whilst this is clearly a breach of our contract, it may not be a breach of the law in the bill as it stands.

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18 Australian Bankers' Association, *Submission 43*, p. 15.

19 Australian Bankers' Association, *Submission 43*, p. 15.

20 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 3.63.

> In addition to the issue of the negative equity position being jeopardised it should also be noted that an unoccupied residence may raise an increased likelihood of vandalism or damage, and may in fact void an insurance policy. This is of serious consequence to both borrower and lender alike, hence we can consider rewriting this clause accordingly as warranted.[21]

3.17 SEQUAL concurred with this view, stating:

> This exclusion, as it stands, seems to remove the requirement of borrowers and their beneficiaries from informing lenders that they no longer occupy the property, this is in contradiction to the essence of the trigger for repayment of Reverse Mortgages, that is death or moving into long term care of the surviving nominated resident. In practice this leaves lenders with no recourse if the resident has passed away and a beneficiary chooses not to inform the lender, this would greatly jeopardize the Negative Equity position.[22]

3.18 SEQUAL further submitted that a borrower's failure to pay rates, taxes and other costs entails 'a risk that the lender's security interest could be compromised as the property could be sold for rate arrears.'[23]

3.19 While being concerned with the operation of clause 18A, the ASF was supportive of the intention to ensure that the factors that may constitute default do not include minor or inconsequential matters:

> We understand the clause is trying to protect borrowers from falling into a default situation simply through an extended absence, and additionally that it is ensuring that providers make appropriate efforts to contact the borrowers before enacting a default. We agree with this sentiment.[24]

3.20 The ASF further submitted that the risks that may result to the credit provider's security interests if clause 18A was introduced in its current form were likely an 'unintended consequence'.[25]

3.21 SEQUAL proposed two measures to address the concerns. First, that the exception for failure to meet third-party costs such as rates be 'limited to a reasonable period of time of rate non-repayments'.[26] Second, that the clause be amended 'so that default only occurs if the property is left vacant without the lender's approval for a

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21 Mrs Julie Campbell, Australian Seniors Finance, *Committee Hansard*, 24 October 2011, p. 2.

22 SEQUAL, *Submission 44*, p. 14.

23 SEQUAL, *Submission 44*, p. 14.

24 Mrs Julie Campbell, Australian Seniors Finance, *Committee Hansard*, 24 October 2011, p. 2.

25 Mrs Julie Campbell, Australian Seniors Finance, *Committee Hansard*, 24 October 2011, p. 5.

26 SEQUAL, *Submission 44*, p. 14.

reasonable period of time provided that at all times that period of vacancy does not otherwise cause a fault (e.g. Valid property insurance cover etc.).'[27]

Repayments

3.22 Clause 86A would allow borrowers to end the reverse mortgage at any time by paying the market value of the property. This option would continue to be available where the market value was less than the amount owing. The Explanatory Memorandum explains that this would uphold the 'no negative equity guarantee'.[28]

3.23 The committee recognised that this provision could lead to borrowers 'playing the market' to avoid repaying the entire amount owing. However, industry did not raise concerns with the introduction of a 'no negative equity guarantee'. As SEQUAL advised, '[w]e believe that that provision can be tolerated by the industry without significant adverse effects.'[29]

3.24 However, SEQUAL advocated for safeguards to be introduced to mitigate the risk that borrowers would 'play the field':

> ...we believe there should be a condition on it that the sale in question be at arm's length to a non-related party. We want to make sure that that sale stood the market test.[30]

3.25 The Consumer Action Law Centre also raised concerns with the provision. In contrast to the views of SEQUAL, the Centre submitted that the circumstances in which the 'no negative equity guarantee' would be available should be broadened. Noting that the provision would not apply in circumstances where the property's value was reduced by deliberate damage on the part of the borrower or where the borrower made a misrepresentation or engaged in fraud at the time the contract was made, the Centre made the following recommendations.

> We recommend that:
>
> - section 86E(a) be amended to include the words 'caused with intent to devalue the property' after 'deliberate damage'. Without making this clarification, this paragraph will capture a debtor who innocently or accidently damages the property (for example, while making repairs or renovations). Alternatively, the Explanatory Memorandum could be amended to clarify that good faith attempts to repair or renovate the property will not be considered 'damage' for the purposes of section 86E.

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27 SEQUAL, *Submission 44*, p. 14.

28 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 3.79.

29 Mr Kevin Conlon, SEQUAL, *Committee Hansard*, 24 October 2011, p. 11.

30 Mr Kevin Conlon, SEQUAL, *Committee Hansard*, 24 October 2011, p. 11.

- section 86E(b) be amended to replace 'misrepresentation' with 'fraudulent misrepresentation'. This is to make clear that this provision is concerned with fraudulent conduct and should not catch innocent or even reckless misrepresentations.[31]

3.26 The Explanatory Memorandum does not clarify what is intended to be encompassed by the term 'misrepresentation', nor does it provide guidance as to whether it is intended that 'misrepresentation' be interpreted with reference to fraud.[32]

Definition of reverse mortgages

3.27 The committee's attention was also drawn to concerns with the proposed definition of reverse mortgages. The Bill proposes the following :

> **13A Reverse mortgages**
>
> (1) For the purposes of this Code, an arrangement is a reverse mortgage if the arrangement involves a credit contract, except a bridging finance contract, and a mortgage over a dwelling or land securing a debtor's obligations under the contract and either:
>
> - the conditions in subsections (2) and (3) are met; or
> - the arrangement is of a kind declared by ASIC under subsection (4) and is made on or after the commencement of that declaration.
>
> *Conditions*
>
> (2) The first condition is that the debtor's total liability under the credit contract or mortgage may exceed (to a limited or unlimited extent) the maximum amount of credit that may be provided under the contract without the debtor being obliged to reduce that liability to less than that maximum amount.
>
> *Note: The debtor's total liability can exceed the maximum amount of credit because interest and some other fees and charges are not included in an amount of credit: see subsection 3(2).*
>
> (3) The second condition is that, if the regulations prescribe any prerequisites for the arrangement to be a reverse mortgage, those prerequisites are met.
>
> *Declarations by ASIC*
>
> (4) ASIC may by legislative instrument declare specified kinds of arrangements involving a credit contract and a mortgage over a dwelling or land securing a debtor's obligations under the contract to be reverse mortgages.

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31 Consumer Action Law Centre, *Submission 20*, p. 19.

32 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 3.87.

3.28 According to the ABA, the definition would encompass forms of lending that are not intended to operate as reverse mortgages. These include overdrafts and lines of credit, for which 'a bank may normally require that a customer's debt be reduced to the maximum amount of credit and not to an amount less than that maximum.'[33] The ANZ shared this concern, stating that the definition could capture hardship variations to credit contracts.[34]

Committee view

3.29 The committee supports the proposal for separate regulations tailored to reverse mortgages. The committee approves the adoption of the industry-developed best-practice standards, and notes that their incorporation into national consumer legislation will ensure that the standards are required for all product providers. The measures set a high bar for industry, which, on the basis of evidence received, the committee is confident will be embraced by product providers.

3.30 However, the committee considers that the high standards that the Bill seeks to support may be jeopardised by the technical deficiencies in the Bill as currently drafted. These should be corrected to ensure that the proposed consumer protections can be promptly and effectively implemented.

3.31 The committee acknowledges the concerns raised by the ASF and SEQUAL regarding the provision of equity projections to potential borrowers. In the committee's view, the measure is intended to ensure that potential borrowers are fully informed before entering into reverse mortgage contracts. The committee therefore supports flexibility in the method of providing projections. The key matter is that the prospective borrower receives and understands the projection. Accordingly, the committee considers that the Bill should not be prescriptive in the method of delivery, but rather require the credit provider to ensure that the borrower receives and understands the projection before the reverse mortgage contract is entered into.

3.32 The committee supports the proposal that an additional projection be provided as part of the loan documentation. However, the committee notes that in the absence of an Australian Financial Services Licence, legal advisers are not in a position to provide financial advice. Therefore, the committee considers that it is appropriate for the credit provider to ensure borrowers understand the equity projections.

3.33 In line with the principles of Commonwealth criminal law best practice, as outlined in the Commonwealth Attorney-General Department's *A guide to framing Commonwealth criminal offences, civil penalties and enforcement powers*,[35] the committee considers that criminal offences should be clear, being simple to read and

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33 ABA, *Submission 43*, p. 15.

34 ANZ, *Submission 41*, p. 5.

35 Attorney-General Department, *A guide to framing Commonwealth criminal offences, civil penalties and enforcement powers*, December 2007, pp 14, 16–17.

comprehend. The committee notes the ABA's concerns that the requirement to calculate a projection through an 'ASIC approved website' is unclear. The committee draws the concerns to the Government's attention, for its consideration as to whether the clause 133DB could be improved to provide further clarity as to the steps required of credit providers, and to take into account time required by credit providers to ensure they will be in a position to comply with the procedural requirements.

3.34 The committee agrees that defaults should not be triggered by minor and inconsequential matters. However, on the evidence before the committee it is not clear that all the circumstances covered by clause 18A are of a minor nature or pose no measurable risk to the credit provider's interest. The committee recommends that the Government undertake further consultations with industry to ensure that clause 18A only excludes matters that are of a minor nature and that do not pose measurable risk to the credit provider's interests.

3.35 The committee agrees that safeguards should be introduced to ensure the 'no negative equity guarantee' does not provide an opportunity for borrowers to 'play the field'. Accordingly, the committee recommends clause 86A and related provisions in Subdivision B, Division 1, Schedule 2 be amended to ensure that the sale stands the market test.

3.36 The committee would be concerned if the no negative equity guarantee was undermined by unintended misrepresentations, particularly in circumstances where the misinformation was minor and inconsequential. The committee draws the Government's attention to the Consumer Action Law Centre's recommendation regarding subclause 86E(b), and recommends that the Government consult stakeholders as to whether clause 86E should be amended to refer only to fraud and deliberate misrepresentations.

3.37 The committee notes concerns that the definition of reverse mortgages may capture credit products other than what industry and consumers understand to be reverse mortgages. To avoid this undesirable outcome, the committee recommends the definition be amended to clearly exclude other forms of credit contracts that provide the option of interest only repayments.

Recommendation 5

3.38 The committee recommends that clause 133DB be amended to not prescribe the method by which a credit provider must provide projections to potential borrowers, but rather to require credit providers to ensure that a potential borrower receives and understands the projections before entering into the reverse mortgage contract.

Recommendation 6

3.39 The committee recommends that the Government consider whether clause 133DB can be improved to provide further clarity as to the conduct required of credit providers, and to take into account time required by credit providers to ensure they will be in a position to comply with the procedural requirements.

Recommendation 7

3.40 The committee recommends that the Government consult industry to ensure that clause 18A only excludes matters that are of a minor nature and that do not pose measurable risk to the credit provider's interests.

Recommendation 8

3.41 The committee recommends that Subdivision B, Division 1, Schedule 2, be amended to ensure that sales, particularly between related parties, stand the market test of fair market value.

Recommendation 9

3.42 The committee recommends that the definition of reverse mortgages at item 2 of Schedule 2 be amended to clearly exclude other forms of credit arrangements that provide the option of interest only repayments.

Chapter 4

Consumer leases

4.1 The National Credit Code and, by extension, the NCCP Act currently apply to certain consumer leases under which the consumer has the option or an obligation to purchase the goods that are the subject of the lease arrangement. These kinds of consumer leases are regulated in the same way as credit contracts, as the legislation classifies such arrangements as credit contracts.[1] However, the legislation does not provide the same protections for parties to consumer leases that do not provide the option to purchase or to consumer leases that, while providing the option to purchase, do not require the consumer to pay more than the cash price of the goods.

4.2 Statements in the Explanatory Memorandum contend that the dual regulatory framework 'may lead to avoidance behaviour and adverse competitive impacts on supplies of credit contracts relative to consumer leases.'[2] It is argued that the regulatory distinctions between credit contracts and consumer leases leave lessees 'particularly vulnerable to unscrupulous behaviour,' which reportedly includes:

- lessees mistakenly believing that they have an ability to buy the goods when they do not; and
- the amount paid under the lease may be significant (that is, greater than that paid under a credit contract to purchase similar goods) but the lessee has no right to the goods when the lease ends.[3]

4.3 It is understood that the current distinction mirrors regulation in state and territory legislation.[4] As stated in the Second Reading Speech, and as reportedly intended by the development of a two-phased COAG consumer credit reform process,[5] the reforms are designed to draw on the experience of state and territory regulations to rectify any weaknesses identified. At the introduction of the Enhancements Bill, Parliament was informed that state and territory experience demonstrates that the distinction between the regulation of certain forms of consumer

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1 National Credit Code, s. 9.

2 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 6.8.

3 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 6.9.

4 The Hon Mr Bill Shorten, Assistant Treasurer, Minister for Financial Services and Superannuation, *House of Representatives Hansard*, 21 September 2011, p. 10954.

5 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 2.4.

leases and credit contracts facilitates lessors 'cherry picking what suits the lender not the borrower'.[6]

4.4 While this level of detail was not provided in the Explanatory Memorandum, further information is contained in Treasury's July 2010 *Green Paper*. The paper notes that the experience under state and territory legislation identified three issues with the regulatory approach to consumer leases, namely:

> 1. some providers of leases are offering a product where the consumer has no right or obligation to purchase the leased goods (rather than a credit contract or a lease where the consumer has this right or obligation), because of the lower regulatory burden under the Code;
>
> 2. consumers are being misled about whether or not they will own the goods, or have a right to purchase them, under the lease; and
>
> 3. the exclusion from the Code of short-term or indefinite leases results in some providers being able to avoid the Code entirely.[7]

4.5 The *Green Paper* also provides details of a 2007 study of consumer lease arrangements by the Micah Law Centre, which identified the following key concerns with the state and territory regulatory variations between consumer leases and credit contracts:

- the use of lease agreements instead of loan agreements by financiers as a means to avoid the stricter obligations that apply to credit contracts;
- complex or misleading clauses relating to final ownership of the goods;
- misleading and confusing marketing of lease agreements in stores;
- relatively high cost of lease agreements; and
- the impact of the marketing of these contracts to low-income consumers.[8]

4.6 To address these issues, under Schedule 5 of the Enhancements Bill it is proposed to align the regulation of consumer leases with the regulations applying to credit contracts under the NCCP Act and the National Credit Code.

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6 The Hon Mr Bill Shorten, Assistant Treasurer, Minister for Financial Services and Superannuation, *House of Representatives Hansard*, 21 September 2011, p. 10954.

7 Treasury, *National Credit Reform: Enhancing confidence and fairness in Australia's credit laws – Green paper*, July 2010, pp 72–73.

8 Treasury, *National Credit Reform: Enhancing confidence and fairness in Australia's credit laws – Green paper*, July 2010, p. 70; citing Micah Law Centre, *A loan in lease clothing: Problems identified with instalment based rent/purchase contracts for household goods*, 2007.

Support for the proposed regulation of consumer mortgages

4.7 Of the six submissions commenting on the proposed changes to the regulation of consumer leases, five were strongly in favour of alignment between regulations for consumer leases and regulations governing credit contracts.[9]

4.8 While noting that its members do not provide consumer leases, Abacus – Australian Mutuals supported aligned regulations:

> As a matter of general principle, except to the extent that the different product structures require a differentiated approach, we consider it appropriate for consumer leases to be regulated comparably with consumer loans where the lease contains a right or option to purchase. In our view, consumer leases are functionally identical with consumer loans in these circumstances. Generally comparable regulatory treatment is therefore appropriate from both a consumer protection and a level regulatory playing-field perspective.[10]

4.9 Submissions from consumer advocates supported the view that the current regulatory dichotomy creates loopholes that may be exploited to the detriment of the consumer.[11] The following statement by Redfern Legal Centre reflects the views of consumer advocates as depicted in evidence before the committee:

> RLC is strongly supportive of creating rights and protections for lessees under consumer leases that substantially mirror the applicable rights and protections available for debtors under credit contracts...Addressing this gap in consumer credit laws is important to prevent unscrupulous industry participants from taking advantage of the loophole in order to bypass their obligations under the Act.[12]

4.10 The committee was provided with case examples of the effect of the regulatory distinction currently drawn between certain consumer leases and credit contracts. Cases include the following example submitted by the Consumer Credit Legal Centre (NSW) Inc as an example of the conduct that may be left unchecked due to regulatory loopholes:

> A consumer wanted to buy her son an X-box for Christmas but did not have the cash and had voluntarily cut up her credit card. She knew she did not have time to replace the card before Christmas as it was only two days away. She was offered a consumer lease instead. The terms were very expensive – even compared to a credit card – the equivalent of between 30

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9 Anglicare Victoria, *Submission 39*, p. 7; Consumer Action Law Centre, *Submission* 20, p. 14; Consumer Credit Legal Centre (NSW) Inc, *Submission 47*, p. 10; Redfern Legal Centre, *Submission 18*, p. 9.

10 Abacus – Australian Mutuals, *Submission 38*, p. 4.

11 Consumer Action Law Centre, *Submission* 20, p. 14; Consumer Credit Legal Centre (NSW) Inc, *Submission 47*, p. 10; Redfern Legal Centre, *Submission 18*, p. 9.

12 Redfern Legal Centre, *Submission 18*, p. 9.

> and 40% interest after 12 months of payments. The salesperson said that for one extra payment the goods could be retained...The 12 monthly payments were made and then a 13th to secure ownership of the goods. The direct debit, however, continued to come out for a 14th month. The consumer contacted the lease company to complain. They said that contrary to what the salesperson had said it was necessary to contact the company and negotiate the amount of the final payment or the lease would continue indefinitely! This meant that the final cost of the goods could not be accurately estimated in advance and clearly exceeded the 30 or 40% per annum the consumer had reluctantly agreed to pay.[13]

4.11 Similarly, the Redfern Legal Centre provided the following case study as evidence of the deleterious effects of the regulatory dichotomy:

> Lauren is a mother of five. When her car broke down, Lauren went to a well-known car dealership to buy a second hand car. After speaking with the sales representative, Lauren signed a contract and drive off with a second hand vehicle. Lauren soon ran into difficulties meeting her repayments. She came to Redfern Legal Centre for advice. Lauren was shocked to learn that she had in fact signed a consumer lease, and that at the end of the lease she would not own her vehicle. This had not been made clear to her when she went to the dealership with the intention of buying a car.[14]

4.12 Advocating that the amendments will offer appropriate and needed protections for consumers party to consumer leases, Anglicare Victoria drew the committee's attention to the merits of the following aspects of the proposed regulations.

> *A unilateral alteration of a lease by the lessor will be void without the lessee's agreement.*
>
> This alteration will allow consumers to continue to budget appropriately for the leased item, without variation. This will give the consumer the opportunity to maintain household budgets without unexpected hidden costs appearing six months into a signed contract.
>
> *Consumer leases can be changed under hardship grounds or on the basis the transaction is unjust.*
>
> This will allow consumers in the event of changed circumstances eg changed income, relationship breakdown or illness to alter the amount repayable without the difficulties faced previously.
>
> *A criminal penalty for harassment applies to the lessor or supplier*.
>
> Lessees with low incomes are particularly vulnerable because they tend to forego other essential expenses to maintain these repayments especially if they are leasing a car for work purposes or replacing broken whitegoods.

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13 Consumer Credit Legal Centre (NSW) Inc, *Submission 47*, p. 11.

14 Redfern Legal Centre, *Submission 18*, p. 9.

> These provisions address the current lack of legislation that has led to lessors pressuring lessees in financial hardship to enter into unrealistic repayment arrangements for arrears...heavy handed tactics are not beneficial in working towards an amicable resolution for either party. Reports of abusive phone calls, letters and upsetting collection procedures only deter consumers from communicating.[15]

4.13 Accordingly, it was argued that the proposed alignment of regulations between consumer leases and credit contracts 'is welcome and long overdue.'[16]

Additional measures proposed

4.14 While strongly supporting the proposed alignment, consumer advocates proposed additional measures for the regulation of consumer leases.

4.15 The Consumer Action Law Centre and the Consumer Credit Legal Centre (NSW) Inc argued that the regulations under clause 175D must require periodic statements of account to include a clause drawing the lessee's attention to the fact that the goods remain the property of the lessor at the end of the lease.[17] In support of this recommendation, the Consumer Action Law Centre advised:

> [o]ne of the most common complaints we hear from consumers regarding consumer leases is that they were misled or otherwise unaware that had entered into a consumer lease (rather than a credit contract) and that they would not own the goods at the end of the lease term.[18]

4.16 Proposals also included making lessees only liable for the market value of the goods as at the time the goods were lost or stolen.[19]

4.17 National Legal Aid (NLA) also noted that the proposed regulations do not include a cap on costs, as is proposed under Schedule 4 of the Enhancements Bill in relation to credit contracts excluding bridging finance arrangements and credit contracts provided by ADIs. In support of this recommendation, National Legal Aid submitted:

> The National Credit Code now provides in s.9 that leases over goods on hire purchase are regulated loans and provides that the cost of credit is the amount payable over the term of the contract less the cash price of the goods (definition in Part 13).
>
> This strengthened definition of cost of credit meant that some high cost lenders changed from offering goods on hire purchase to consumer leases,

15 Anglicare Victoria, *Submission 39*, p. 8.

16 Consumer Action Law Centre, *Submission* 20, p. 14.

17 Consumer Action Law Centre, *Submission* 20, p. 15; Consumer Credit Legal Centre (NSW) Inc, *Submission 47*, p. 11.

18 Consumer Action Law Centre, *Submission* 20, p. 15.

19 Consumer Credit Legal Centre (NSW) Inc, *Submission 47*, p. 11.

> effectively meaning that they went from no regulation to "lighter-touch" legislation and were outside the ambit of 48% interest rate caps applicable to hire-purchase contracts.
>
> In NLA's view, there is no reason to artificially distinguish between goods that retain some value to the lender at the end of a consumer lease and goods which are paid for entirely by the borrower who takes ultimate possession.
>
> The cost of credit for a consumer lease ought to be regulated by the interest rate caps. This could be done by amending the National Credit Code to ensure that the cost of credit is defined as the amount payable over the term of the lease less the cash price up-front using the Part 13 definition and the market value of the goods (if any) upon termination.[20]

4.18 The Redfern Legal Centre questioned drafting differences between the provisions in the NCCP Act and National Consumer Code relating to credit contract and the provisions proposed as part of the Enhancement Bill. In particular, the Centre noted stylistic differences in terminology and language used and recommended greater consistency between the provisions.[21]

Concerns with the proposal to align consumer lease and credit contract regulations

4.19 The views of industry representative, the Australian Finance Conference (AFC), were in stark contrast to the approval provided by consumer advocates. The AFC questioned the need for regulatory alignment, arguing that existing regulations under the NCCP Act are sufficient to promote market integrity in relation to the provision of consumer leases.

> AFC is not aware of evidence to substantiate regulatory or market failure in the provision of consumer leases that would justify additional regulation either under the newly enacted NCC law or elsewhere. We understand that a principal driver is concern of regulatory arbitrage, but remain concerned with the level of evidence-based research or empirical analysis that would give credence to this justification for change.[22]

4.20 The AFC also submitted that the introduction of aligned regulations would be premature, given the relatively recent introduction of the NCCP Act and the Consumer Credit Code.[23] Were the alignment measures to be introduced, the AFC recommended the following amendments to the provisions:

> Statements of account – we continue to question the need for the issue of a statement of account other than in response to a request from a customer.

20 National Legal Aid, *Submission 19*, p. 5.

21 Redfern Legal Centre, *Submission 18*, p. 9.

22 Australian Finance Conference, *Supplementary Submission 29a*, p. 12.

23 Australian Finance Conference, *Supplementary Submission 29a*, p. 2.

> Given the static nature of the repayment amounts and period, this requirement appears to add compliance cost with no real customer protection benefit.
>
> End of lease term – we submit that a provider should be able to contact a customer within 90 days of the end of the lease term to explore options rather than the current approach. This contact would, in the experience of our members, be far more meaningful to the customer given its relationship with the lease term and would therefore benefit both customer and financier.[24]

4.21 In addition, and as canvassed in chapter two, the AFC were concerned with the provision allowing consumers to seek to vary consumer leases on hardship grounds and the proposed framework for enforcement proceedings.[25]

Committee view

4.22 While noting the AFC's concerns with the timing of the introduction of the measures, the committee considers that the same protections should be afforded to consumers under all categories of consumer leases, and, therefore, between parties to all consumer leases and credit contracts. The committee notes that the provisions are intended to address problems for consumers that have arisen under state and territory consumer credit legislation. Evidence provided in the *Green Paper* and in submissions received for this inquiry strongly indicates that the dual regulatory system has created loopholes that allow unscrupulous lenders to avoid consumer protection requirements. This is neither conducive to prudent market regulation or to supporting a market in which vulnerable consumers can confidently participate.

4.23 The committee agrees with the view that periodic statements should clearly confirm that the arrangement does not transfer title to the lessee. This is an important clarification that will assist consumers to make informed credit choices. The committee also considers that there is merit to limiting the outstanding obligations on lessees to the market value of the goods where the goods are lost or stolen.

Recommendation 10

4.24 The committee recommends that the regulations under clause 175D require the statement of account to contain a clear statement that the lessee will not own the good at the completion of the lease.

Recommendation 11

4.25 That Schedule 5 be amended to restrict the liability of lessees under consumer leases for which the goods have been lost or stolen to the fair market value of the goods as at the time the goods were lost or stolen. This would not, however, apply in circumstances of fraud on the part of the lessee.

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24 Australian Finance Conference, *Supplementary Submission 29a*, p. 12.

25 Australian Finance Conference, *Supplementary Submission 29a*, p. 12.

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

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

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

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

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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]

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]

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

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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

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

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:

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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]

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.

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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

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

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:

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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:

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)

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

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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

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

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]

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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.

Chapter 6

Other matters

6.1 This chapter addresses other aspects of the Bill canvassed in evidence presented during the inquiry, namely:

- restrictions on certain representations and advertisements;
- restrictions on the use of certain terms including 'independent' and 'financial counsellor';
- remedies for unfair or dishonest conduct; and
- the proposed amendment to the Corporations Act.

Restrictions on certain representations and advertisements

6.2 Part 3, Schedule 1, items 12–18 of the Enhancements Bill would amend the responsible lending requirements in Chapter 3 of the NCCP Act to prohibit credit providers from making representations that a consumer is eligible to enter into a credit contract prior to assessing whether the proposed contract is 'unsuitable'. The amendments would commence on 1 July 2012.

6.3 The Explanatory Memorandum notes the intended effect of, and policy rational for, the amendments.

> The effect of these amendments is to prohibit credit providers from making representations to consumers that they are eligible to enter into a contract, or have their credit limit increased irrespective of, for example, their personal circumstances or credit history. These types of representations can encourage a consumer to apply for credit because of the certainty their application will be accepted, but where the resulting terms on which the credit is provided may be more onerous than those offered by other credit providers.[1]

6.4 As currently drafted, it appears that the amendments will apply across the broad range of credit providers and credit contracts. The Explanatory Memorandum does not provide an explanation for the broad application. However, it is clear that the amendments encompass credit advertising. As stated in the Explanatory Memorandum:

> [t]hese provisions will also prevent credit providers or lessors from using advertisements which represent that a consumer is eligible to enter into a

1 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 2.58.

contract, even where they have poor credit. Advertisements of this type will need to be suitably qualified.[2]

6.5 It was also put to the committee that the amendments target credit card offers. While not referenced in the Explanatory Memorandum, the ABA informed the committee that the amendments are intended to address unsolicited representations about a consumer's eligibility to obtain credit under a credit card arrangement. Specifically the amendments target unsolicited credit offers that informed the customer that he or she is 'pre-approved'.[3]

6.6 The Consumer Action Law Centre and Redfern Legal Centre also submitted that the amendments are designed to regulate initial offers of credit cards. The Centre supported the restriction on credit card advertisements, noting the findings of its 2008 report *Congratulations, you're pre-approved* that the representation that a consumer is 'pre-approved' is used 'to encourage consumers to take on more credit impulsively.'[4] Redfern Legal Centre also interpreted the provision as applying to initial credit card advertisements, providing the following example in support of the amendments.

> *Case study*
>
> Warren is a 45-year-old man from Redfern, with limited understanding of financial matters. He sought advice from Redfern Legal Centre in relation to his various credit card debts. Warren had 6 credit cards. When queried as to why he had so many credit cards, Warren said that whenever he got a letter in the mails stating that he had pre-approval for a card or was told by a salesperson that he was eligible for a credit facility, Warren assumed that that meant that he could afford the credit facility. He assumed that salesperson or the credit institution had made an assessment of his income. Warren was pleased to receive such offers of credit because he thought they meant that he had a good income and was a good credit risk from the perspective of the credit provider. He always accepted such offers.[5]

6.7 However, while the Consumer Action Law Centre and Redfern Legal Centre supported the application of the amendments to initial credit card offers, the ABA questioned whether unfair representations in relation to initial credit card offers are currently adequately restricted under the NCCP Act. It was noted that Division 4, Part 1, Schedule 1 of the *National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Act 2011* will restrict certain unsolicited offers relating to credit cards. While the Act refers to offers from credit card providers to increase credit

2 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 2.63.

3 Mr Ian Gilbert, Policy Director, ABA, *Committee Hansard*, 24 October 2011, p. 14.

4 Consumer Action Law Centre, *Submission 20*, p. 17.

5 Redfern Legal Centre, *Submission 18,* p. 6.

limits, rather than to provide initial credit,[6] the ABA submitted that the provisions are sufficient to prohibit this conduct.[7]

6.8 In addition to conflicting views regarding the actual and intended application of the amendments, the committee was informed of a significant concern with the effect that the proposed restriction might have on business and consumer confidence. The ABA submitted that the restriction will limit prudent business practice in relation to providing finance for property purchased at auction.[8] The committee was informed that the breadth of the restriction will undermine consumer certainty by limiting a bank's capacity to inform the consumer of the amount available for purchases at auction.

> It is part of current practice in terms of good customer relationships. Say a customer who is known to the bank wants to bid at an auction and asks the bank, 'Am I going to be okay to bid up to such and such a price?' The bank would run through some rudimentary points with the customer just to establish that nothing had changed since they last had dealings with them and say: 'You'll be fine. Go up to that amount. We're happy to entertain an application from you.' Of course, it depends [on] things like whether the property comes up to the value that it is expected to reach and so forth. The point is that the way this legislation is drafted, you really will not be able to say that. You might say: 'Go ahead and bid. But we are required to conduct a full assessment of your circumstances,' because that is what the responsible lending obligations in the law require. So for an addition to that law that says, 'We can't tell you that you're going to be eligible to apply or enter into a contract with us, but the indications are reasonably good,' there is a question of our legal compliance[9]

Committee view

6.9 The committee endorses the responsible lending requirements as contained in the NCCP Act. However, the committee notes the concerns with the seemingly broad application of the amendments restricting representations regarding a consumer's eligibility to enter into credit contracts.

6.10 In relation to the concern that the restriction is not necessary to ensure fair conduct in credit card advertising, the committee would be concerned were separate provisions in the NCCP Act and National Credit Code targeted towards the same conduct. Such legislation would duplicate the regulatory burden on business without measurable gains for consumer protection. The committee draws the concerns to the Government's attention for its consideration.

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6 *National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Act 2011*, s. 133BC.

7 Mr Gilbert, ABA, *Committee Hansard*, 24 October 2011, p. 14.

8 ABA, *Submission 43*, p. 13.

9 Mr Gilbert, ABA, *Committee Hansard*, 24 October 2011, pp 13–14.

6.11 The committee shares concerns that the amendment would restrict consumers from obtaining pre-approval for personal or business loans, particularly in circumstances where pre-approval was sought to purchase property at auction. This unintended consequence is at odds with the policy objective to strengthen consumer protection, and, in turn, strengthen market confidence. If left in its current form, the committee considers that the Bill would undermine certainty for consumers and the business sector, as it is not suited to current commercial arrangements particularly in the property market. Accordingly, the committee recommends that Part 3, Schedule 1 be amended to confirm that ADIs may provide pre-approval for personal and business credit contracts, particularly contracts relating to the purchase of property at auction.

Recommendation 13

6.12 The committee recommends that Part 3, Schedule 1 be amended to confirm that ADIs may provide pre-approval for personal and business contracts.

Restrictions on the use of certain terms including 'independent' and 'financial counsellor'

6.13 The Enhancements Bill proposes to limit the circumstances in which credit providers and intermediaries may use certain terms when explaining, or otherwise describing, their role in the credit process. Clause 160B, Schedule 1 would prohibit credit providers and intermediaries from using the words 'independent', 'unbiased', and 'impartial', or words with similar meaning, in representations about their role and services. The restriction would not apply if the credit provider or intermediary:

- does not receive any commissions apart from commissions that are rebated in full to the consumer ('commissions' does not include fees paid by the consumer for the service);
- does not receive other gifts or benefits from lenders or lessors that may reasonably be expected to influence the licensee;
- is not subject to any restraint on product offerings; and
- is not subject to any conflict of interests.

6.14 Under clause 160C, Schedule 1, the Enhancements Bill would also limit the circumstances in which licensees could use the terms 'financial counsellor', 'financial counselling' or words with a similar meaning. As outlined in the Explanatory Memorandum, the restriction would not apply to, and thereby not restrict the work of, Government funded and not-for-profit financial counsellors.[10]

10 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 2.79.

6.15 Submissions before the committee support the proposed restrictions. Abacus Australian Mutuals strongly supported measures to restrict the use of the terms 'independent', 'impartial' and 'unbiased', submitting that the restrictions will raise the standard of broker conduct:

> In our view, commission based remuneration structures inevitably compromise the capacity of brokers to provide genuinely disinterested recommendations, and consumers should not be given an exaggerated impression of the benefits associated with the broker channel. Excessive claims about the value of brokers' services also have the potential to impact negatively on the competitive position of credit providers who do not make extensive use of broker networks to initiate business (including the majority of our members).[11]

6.16 The proposal to regulate the use of the terms 'financial counsellor' and 'financial counselling' was also strongly supported. Anglicare Victoria argued that the current absence of restrictions on the use of the terms can mislead consumers as to the natures of available services. The organisation submitted that the restriction would prevent cases of 'unscrupulous individuals...preying on the disadvantaged and vulnerable in the community.'[12] The Consumer Action Law Centre also supported the proposed restriction. However, the Centre is concerned that the restriction will not address unlicensed credit providers from advertising as, or otherwise claiming to be, financial counsellors:

> We believe it needs to be broadened again so that the prohibition will extend to anybody passing themselves off as a financial counsellor. We acknowledge that a person falsely claiming to be a financial counsellor could be subject to action under section 18 of the Australian Consumer Law for deceptive or misleading conduct. However, having created the prohibition at section 160C, we see no reason for limiting it only to credit licensees.[13]

Committee view

6.17 Misleading conduct in the credit sector threatens market integrity and consumer confidence. The committee has previously commented that it is essential that financial advisers provide proper disclosure regarding their independence from a recommended financial product.[14] The committee considers that the proposed restrictions are in keeping with the principle of proper disclosure, and will require such disclosure by intermediaries and credit providers. Accordingly, the committee approves the proposed restrictions on the use of terms 'independent', 'unbiased', 'impartial' and related terms.

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11 Abacus Australian Mutuals, *Submission 38*, p. 3.

12 Anglicare Victoria, *Submission 39*, p. 4.

13 Consumer Action Law Centre, *Submission 20*, p. 17.

14 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009.

6.18 Evidence before the committee has highlighted the valuable services provided by financial counsellors. Their work promotes financial literacy and, in turn, facilitates the development of a market in which consumers are fully informed. The committee notes views that clause 160C should be cast more broadly to ensure that all misrepresentations regarding a person's qualifications as a financial counsellor are prohibited. The committee draws these views to the Government's attention.

Remedies for unfair or dishonest conduct

6.19 At Part 2, Schedule 1, the Enhancements Bill introduces a new category of conduct for which consumers may seek civil remedies. Clause 180A would create a new class of conduct, namely, 'unfair or dishonest conduct by credit providers'. As outlined in the Explanatory Memorandum, civil remedies are available from the court, at the court's discretion, if the court is satisfied that:

- a person provided a credit service to a consumer and engaged in conduct that was connected with the provision of the service and that was unfair or dishonest; and
- the conduct had one or more of the following results:
  - the consumer entered into a credit contract, consumer lease, mortgage or guarantee that they would not have entered into had the conduct not occurred;
  - the consumer entered into a credit contract, consumer lease, mortgage or guarantee with different terms to one that they would have entered into apart from the conduct; or
  - the consumer became liable to pay fees or costs to the person or a third party.[15]

6.20 The proposed definition of 'unfair or dishonest conduct' is based on the circumstances of the consumer credit transaction. The court must consider it likely that the conduct was unfair or dishonest if one or more of the circumstances outlined in the Bill existed and affected the consumer's interests. The circumstances that focus on the consumer are:

- the consumer was at a special disadvantage;
- the consumer was a member of a class of persons whose members are more likely to be at a special disadvantage;
- a reasonable person would consider that the conduct was directed at the class of persons more likely to be at a special disadvantage and of which the consumer was a member;

15 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraph 2.29.

- the consumer was unable, or considered him or herself to be unable, to enter into a credit contract, mortgage or consumer lease; or
- the terms of the contract were less favourable than the consumer could have obtained from another provider.

6.21 The two circumstances relating to the credit provider's conduct are:

- whether the credit provider could determine or significantly influence the contract terms; and
- whether the credit provider's conduct involved a technique that should not in good conscience have been used or manipulated the consumer.

6.22 The Regulation Impact Statement that accompanied the Explanatory Memorandum explained that the new provisions are intended to be an extension of existing remedies that allow consumers to reopen credit contracts on the grounds the contracts are unjust:

> The implementation of Phase One of the credit reforms has maintained in the Code the right for consumers to be able to have a credit contract, consumer lease, mortgage or guarantee reopened on the grounds that it is unjust. This provides a general remedy beyond those existing in other legislation. A remedy of this type in respect of credit contracts has been long-standing, and previously been included in money-lending legislation. The remedy has recognised the desirability of industry-specific protections that encourage higher standards of conduct by credit providers.
>
> However, the Credit Act does not provide any equivalent general remedy in relation to providers of credit services. There are two classes of such persons, those who provide credit assistance by arranging or suggesting a particular or identified contract (and are therefore required to comply with the responsible lending requirements in Chapter 3 of the Credit Act), and other intermediaries who only play a lesser role in the provision of credit or leases.[16]

6.23 Evidence before the committee indicates that there is in-principle support for the new class of actionable conduct.[17] However, there are concerns with the practicality of clause 180A.

6.24 The Consumer Action Law Centre supported the introduction of remedies for 'unfair and dishonest conduct', stating '[t]hese provisions may in our view extend greater protection to vulnerable or excluded customers who may find it difficult to

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16 Regulation Impact Statement: Phase two of the national consumer credit reforms, Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, paragraphs 9.238–9.239.

17 Aussie, *Submission 10*, p. 3; Consumer Action Law Centre, *Submission 20*, p. 16; Consumer Credit Legal Centre (NSW) Inc, *Submission 47*, p. 12; Good Shepherd Youth and Family Services p. 4.

prove unconscionability as defined by the *Australian Securities and Investments Commission Act 2001*.'[18] Similarly, the Consumer Credit Legal Centre (NSW) Inc argued that the measures are necessary to address existing regulatory gaps:

> Many of the cases dealt with by CCLC over the past 10 years have involved unfair and/or dishonest conduct by intermediaries such as finance/mortgage brokers. Without these amendments there is a risk that either consumers will be left without recourse, or that credit providers will bear the brunt of any remedy in circumstances where another party is at fault or partly at fault.[19]

6.25 While supporting the intention to provide redress for consumers affected by unfair or dishonest conduct, the Consumer Action Law Centre and Good Shepherd Youth and Family Services argued that the definition's focus on the consumer's 'special disadvantage' is too restrictive. The Consumer Action Law Centre recommended that 'special disadvantage' be replaced with the boarder term 'disadvantage', arguing that this would avoid ' a more conservative interpretation than is required'. The Centre also argued that the circumstance 'the transaction was less favourable than the terms of a comparable transaction' be replaced with 'the transaction was unfavourable to the consumer'.[20]

6.26 In submitting that the focus on the consumer's special disadvantage is too restrictive, Good Shepherd Youth and Family Services proposed that clause 180A be amended to 'not require "special disadvantage" to be established, only that the dishonest conduct led to the taking of the financial product'.[21] The recommendation highlights the issue of whether clause 180A requires a nexus to be established between the credit provider's conduct and the harm suffered by the consumer.

6.27 The ANZ also commented on the issue of causation, arguing that the proposed definition of 'unfair or dishonest conduct' is inappropriate and should be recast to focus on the appropriateness of the credit provider's conduct:

> The guiding circumstances in s. 180A(4) are heavily weighted towards the vulnerability of the consumer and the resulting credit contract. In ANZ’s view, any finding of unfairness or dishonesty should be based on the nature of the actual conduct engaged in by the defendant, rather than on the consumer’s particular circumstances.[22]

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18 Consumer Action Law Centre, *Submission 20*, p. 16.

19 Consumer Credit Legal Centre (NSW) Inc, *Submission 47*, p. 12.

20 Consumer Action Law Centre, *Submission 20*, pp 17–18.

21 Good Shepherd Youth and Family Services p. 5.

22 ANZ, *Submission 41*, p. 4.

Committee view

6.28 The committee is concerned that as presently drafted, clause 180A does not require a causal nexus between the credit provider's conduct and the harm suffered by the consumer. Defining 'unfair or dishonest conduct' primarily with reference to the borrower's circumstances and without reference to the credit provider's knowledge of those circumstances may create an incentive for credit providers to cease to lend to disadvantaged persons. Therefore, failure to provide this nexus may undermine consumer protection and access to finance for vulnerable consumers.

6.29 The committee is also concerned with the appropriateness of paragraph 180A(3)(f) and paragraph 180A(3)(g), which define 'unfair or dishonest conduct' by reference to whether the credit provider could significantly influence the terms of the credit contract or consumer lease and to whether the terms were less favourable to the consumer than terms of a comparable transaction. These provisions presuppose equal bargaining power between consumers and credit providers, and that variation in the terms of similar products is a sign of an unfair or inappropriate credit market. The Explanatory Memorandum has not provided sufficient explanation to justify equating either circumstance with injustice or dishonesty. A market may be operating fairly and prudently despite unequal bargaining power between parties to a consumer transaction. The committee also notes that product variation is one factor contributing to competition and market growth.

6.30 The committee recommends that the circumstances that may constitute 'unfair and dishonest conduct' in subclause 180A(4) be redrafted to include a nexus between the credit provider's behaviour and the harm suffered by the borrower. For example, the conduct covered by paragraph 180A(4) and 180A(4)(g) should only constitute unfair and dishonest conduct where the credit provider knew the borrower was at a special disadvantage and the conduct was undertaken in an attempt to exploit the special disadvantage.

Recommendation 14

6.31 The committee recommends that the circumstances that may constitute unfair or dishonest conduct at paragraph 180A(3)(f)–(g) be amended to only apply where the credit provider is aware of the borrower's special disadvantage and seeks to exploit this.

Amendment to section 250R of the *Corporations Act 2001*

6.32 Schedule 7 of the Enhancements Bill proposes an amendment to subsection 250R(5) of the Corporations Act. The schedule would commence the day after the Bill receives Royal Assent.[23]

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23 Item 2, Schedule 7, Consumer Credit and Corporations Legislation Amendment (Enhancements Bill) 2011.

6.33 The *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act 2011* (the Amendment Act) introduced an exception to the general restriction on key management personnel and closely related parties from participating in votes during annual general meetings regarding executive remuneration.[24] As stated in the Explanatory Memorandum, '[s]ome confusion has arisen as to whether this exception applies in respect of the non-binding vote required under section 250R.'[25]

6.34 The proposed amendment would clarify that the exception does not prevent the chair of annual general meetings, who is also defined as key management personnel or a closely related party, from voting undirected proxies in the non-binding vote if the shareholder provides express authorisation for the chair to exercise the proxy.[26]

6.35 Three submissions commented on the proposed technical amendment. The AFC supported the amendment, noting that the organisation 'understands that the amendment is one of clarification.'[27] Similarly, Charted Secretaries Australia approved the amendment, noting that it would address an anomaly in the Amendment Act.[28] The Australian Institute of Company Directors did not support the amendment, however, this was on the basis of concerns with the Amendment Act.[29]

Committee view

6.36 The committee supports the proposed amendment.

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24 Item 12, Schedule 1, Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011.

25 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements Bill) 2011, paragraphs 8.1 – 8.2.

26 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements Bill) 2011, paragraphs 8.3.

27 AFC, *Submission 29*, p. 2.

28 Chartered Secretaries Australia, *Submission 50*, pp 2–3.

29 Australian Institute of Company Directors, *Submission 9*, p. 1.

Chapter 7

Unsolicited residential sale of credit dependent products

7.1 The committee received five submissions about a proposal in the Exposure Draft Enhancements Bill to extend existing restrictions under the National Credit Code on the unsolicited residential sales of credit.[1] While the measure is not contained in the Enhancements Bill as presented to the House of Representatives on 21 September 2011, the committee notes advice from the Direct Selling Association of Australia that on 7 October 2011 Treasury circulated revised draft legislation, allocating two weeks for industry comment.[2] The committee therefore outlines the concerns with the proposal as presented in evidence before the committee, for use by Government and Parliament should the proposal be further considered.

7.2 Currently, under section 156 of the National Credit Code, it is an offence for credit providers to visit a place of residence to offer credit contracts without prior invitation. Subsection 156(2) expressly states that the offence does not apply to the unsolicited residential sale of credit dependent products. That is, credit providers may approach residential property, without invitation, to offer a credit contract to finance the purchase of simultaneously advertised goods. Colloquially, such sales are known as 'direct sales' or 'door-to-door sales' that include the provision of credit.

7.3 As outlined the Exposure Draft, the proposal would repeal existing section 156 and replace with a section that would prohibit the unsolicited residential sale of credit dependent products. The committee was not provided with a copy of the draft legislation as circulated by Treasury on 7 October 2011. However, the committee note that the proposal was set out a clause 156 of the Exposure Draft, which is extracted in full at Appendix 5.

7.4 As contained in the Exposure Draft, clause 156 would also limit the circumstances in which the conduct would be considered to be invited.[3]

Concerns with the proposal

7.5 The submissions addressing the proposal are highly critical. The Direct Selling Association of Australia argued that if introduced the proposal would

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1 Australian Finance Conference, *Supplementary Submission 29a*; A Better Chance Pty Ltd, *Submission 46*; Direct Selling Association of Australia, *Submission 31*; Tony Davis and Associates, *Submission 48*; UCFS Australia Pty Ltd, *Submission 6*.

2 Direct Selling Association of Australia, *Submission 31*, p. 1.

3 Treasury, *Exposure Draft National Consumer Credit Protection Amendment (Enhancements) Bill 2011, Commentary on amendments: Enhancements*, 5 August 2011, p. 5.

'effectively prohibit' door-to-door credit dependent sale of products.[4] The view was shared by A Better Chance Pty Ltd.[5]

7.6 The commentary that accompanied the Exposure Draft stated that it is necessary to prohibit the unsolicited residential sale of credit dependent products to 'address the particular risks associated with sales presentations in the home of the consumer as a result of an uninvited visit'.[6] However, this view was not supported by evidence submitted to the committee.

7.7 The Direct Selling Association of Australia argued:

> [t]he proposed changed is unnecessary as existing legislation in the National Consumer Credit Protection Act and the National Credit Code already contains significant consumer protections to prohibit unfair and unconscionable practices as well as a stringent licensing regime for credit providers...The existing ACL and National Credit Code provisions adequately cover any issues of consumer vulnerability and there is no evidence of widespread consumer complaint or prosecutions that could justify any wholesale policy shift.'[7]

7.8 A Better Chance Pty Ltd also noted the protection afforded to consumers under the NCCP Act and the National Credit Code, and further submitted that the introduction of the proposed measures was 'premature', as the effect of the NCCP Act and the National Credit Code on credit provider practice has not yet been evaluated.[8] Similarly, UCFS Australia questioned the evidence base for the proposal, stating that:

> [t]he proposal...assumes that the comprehensive provisions of the Australian Consumer Law so recently agreed by COAG in relation to unsolicited consumer agreements have already failed despite very limited opportunity to assess their effectiveness in relation to industry behaviour and despite the fact that the provisions remain untested by an Australian regulator.[9]

7.9 It was also questioned whether the proposal would facilitate an appropriate balance between consumer protection and a robust credit industry. Tony Davis and Associates characterised the proposal as 'dramatic overkill' and stated that '[t]he objective of protecting vulnerable consumers is greatly disproportionate to the impact the proposed section would have on certain business within the alternative marketing industry.'[10] Commending the Government for not including the proposed measure in

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4 Direct Selling Association of Australia, *Submission 31*, p. 1.

5 A Better Chance Pty Ltd, *Submission 46*, p. 2.

6 Treasury, *Exposure Draft National Consumer Credit Protection Amendment (Enhancements) Bill 2011, Commentary on amendments: Enhancements*, 5 August 2011, p. 3.

7 Direct Selling Association of Australia, *Submission 31*, p. 3.

8 A Better Chance Pty Ltd, *Submission 46*, p. 2.

9 UCFS Australia, *Submission 6*, p. 2.

10 Tony Davis and Associates, *Submission 48*, p. 2.

the Enhancements Bill, the AFC commented that the organisation 'looks forward to providing responses to the Discussion Paper on this issue with a view to ensuring a regulatory response that appropriately identifies and addresses market failure and consumer risk in this area.'[11]

7.10 Concerns were also raised with the consultation process. While noting discussion in the *Green Paper* about the regulation of unsolicited sales, the Direct Selling Association of Australia commented that no consultation had occurred prior to the release of the Exposure Draft.[12]

Committee view

7.11 As the proposal is not part of the Enhancements Bill as of the date of this report, the committee does not draw conclusions about the possible restrictions on the unsolicited residential sale of credit dependent products. However, the committee draws to the Government's attention the concerns with the possible restriction should the proposal be further considered.

Mr Bernie Ripoll MP

Chair

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11 AFC, *Supplementary Submission*, p. 7.

12 Direct Selling Association of Australia, *Submission 31*, pp 1–2.

Additional Comments by Coalition Members and Senators

1.1 Coalition Members and Senators make the following additional comments concerning the Committee's inquiry into the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011.

1.2 The Committee received evidence from one lender, Money3, that the industry provides cash advances of $800 million a year to 500,000 customers.[1]

1.3 This suggests the industry is meeting a substantial consumer need for short term, small amount (STSA) loans. Consideration of any regulatory restrictions must take account of the consumer detriment from reducing the availability of a product for which there is a proven demand.

1.4 Minister Shorten's media release, announcing the measures in the Bill, says they are intended to 'protect…vulnerable consumers.'[2] In other words, this Bill is based on the assumption that all STSA loans are inherently harmful and all who take them out are inherently vulnerable. We do not think this is correct.

1.5 Some witnesses argued that, in effect, any consumer who takes out a STSA loan is doing so because they are desperate. A good example is the view put by Ms Catriona Lowe of the Consumer Action Law Centre:

> **Ms Lowe:** It is not about a person making a judgement; it is about a person having a need to make a series of payments and it is about whether there are safe options available for that person to satisfy their need to make those payments. We do not consider that people need expensive credit; what they need is an adequate income to be able to afford the cost of living. Paying expensive credit when you do not have enough income is simply not a proposition that is going to help consumers. It is not about their judgement; it is about the objective outcome.
>
> **Mr FLETCHER:** You do not ever see a circumstance in which consumers ought to be permitted to make that judgement?
>
> **Ms Lowe:** No. That is not, with respect, what we are saying. What we are saying is that the product is harmful in the sorts of circumstances which are typical for the user of the product. Where a product is harmful, there are countless examples of where we as a society make a judgement that, if we are making that product available, we will regulate the basis on which it is available because of its potential for harm. We would say that this is such a product.[3]

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1 Money3, *Submission* 7, p 2.

2 Bill Shorten, Media Release, 25/8/11, 'Reforms to Payday Lending'

3 *Committee Hansard*, 24 October 2011, pp 38-39

1.6 Coalition Members acknowledge the important and difficult work done by consumer legal services and financial counsellors. But we respectfully disagree with the view that STSA loans are so inherently dangerous that their provision (to any consumer of any kind) should be tightly restricted.

1.7 This is a policy area which raises difficult issues. Clearly there are people who are incapable of making sensible financial decisions – be that due to addiction, substance abuse, limited decision-making capacity or other factors.

1.8 But the Committee heard persuasive evidence that, rather than STSA loans being used only by those who are vulnerable and desperate, many STSA loans are provided to people in employment who have made a rational decision that the product meets their needs better than other alternatives. The Committee heard that a number of providers specifically require customers to be employed or have a rule that they do not lend to those whose only income is government benefits. These include Money Plus, Money Centre, Dollars Direct, Cash Doctors and First Stop Money.[4]

1.9 Providers which do lend to welfare recipients, such as Cash Converters, gave evidence about their responsible lending practices in doing so.

> **Mr Day:** No, that is not the case. We at Cash Converters indicated that over 40 per cent of our customers are on welfare payments. We have a responsible lending structure in place that will lend a new customer a maximum of 10 per cent of net income and, out of that, we have a 97 per cent repayment rate. It does not necessarily happen at the end of the month. Some 30 per cent of them take longer, but there are no punitive penalties or additional costs involved in that.[5]

1.10 This evidence is not consistent with an assumption that STSA lending inherently and necessarily involves vulnerable and disadvantaged customers being forced to agree to terms which make it impossible for them to repay the loans.

1.11 The evidence highlighted several serious concerns about the approach taken in this Bill – leading us to conclude that it is a hastily-cobbled together attempt to grab a headline, rather than any meaningful attempt to come to terms with the policy issues raised by STSA loans. We set out our concerns below.

1.12 The legislation in its present form would in our view be likely to seriously damage the STSA market. The Committee received evidence from a range of lenders that the proposed caps on fees and charges for STSA loans will make their business model unsustainable.

1.13 The government has adopted the simplistic 48 per cent cap first passed into law by the hopelessly incompetent NSW Labor government in its dying days –

4 Committee Report, paragraphs 5.72-5.76.

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

without bothering to consult with industry at all. This is explained in the submission by the Australian Bankers' Association:

> The proposed model for calculation of the "cost rate" is based on a model legislated under the Credit (Commonwealth Powers) Act 2010 (NSW) upon which there was no prior consultation with the credit industry. Subsequent representations to the New South Wales government were to no avail.[6]

1.14 Simple mathematics means that any short term loan (for a few days or even a month) is likely to breach a cap calculated on an annualised basis. (On a loan of $100 for two weeks, any fee greater than $1.85 produces an annualised interest rate of more than 48 per cent.) Coalition Members do not agree that short term loans are inherently problematic, and we believe that a formula which automatically deems short term loans to be unacceptable is inherently flawed.

1.15 The Bill would impose this flawed 48 per cent cap for all loans other than 'small amount credit contracts'. There would be a separate cap mechanism (of an upfront fee of 10 per cent of the principal amount, and a monthly fee of 2 per cent) for 'small amount credit contracts' (defined as being for less than two years and for less than $2,000). Coalition Members highlight the comment in the Committee Report that the Treasury evidence on this point did not give details of any economic modelling underpinning the '10/2' approach.[7] We would add that there is no evidence of this having been calculated so as to ensure a viable business model for STSA lenders.

1.16 The government seems to have given little thought as to what will replace the provision of STSA loans by private sector providers. Minister Shorten's media release identified some alternatives – but there is no persuasive evidence of these being available in sufficient volume.

1.17 The restrictions in the Bill specifically carve out Authorised Deposit-taking Institutions (such as banks and credit unions.) We cannot understand why. Competitive neutrality ought to be a core public policy principle. If you are going to intervene heavily in marketplace activity, you ought to take care to do so in a way which is neutral as between market participants. The government has failed to do this.

1.18 This Bill follows closely on the recent introduction of the responsible lending framework. STSA lenders argued that they are already prevented by this framework from making STSA loans to customers who will be incapable of repaying them. A similar argument was made by Fair Finance Australia:

> 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

6 Australian Bankers' Association, *Submission* 43, p 16

7 Committee Report para 5.180

> individuals do not have enough income to survive day to day and are clearly in poverty.[8]

1.19 If this is so, why are the measures in this Bill required? If the evil at which they are directed is lending to disadvantaged and vulnerable consumers who cannot repay their loans, is that evil not now addressed by the responsible lending requirements? No satisfactory answer was presented to this question in evidence before the inquiry.

1.20 The measures in the Bill involve highly detailed and prescriptive interventions in the business practices of STSA lenders. They include restrictions on multiple concurrent contracts and on increasing credit to a borrower when an existing loan matures. We believe these measures are undesirable in principle and unworkable in practice.

1.21 We question why government should be setting a cap on the prices that STSA lenders – or any other kind of lender – may charge. We support full disclosure of what is charged, and a requirement to calculate and disclose to the customer an annual rate calculated using a standardised methodology. But we are sceptical of the wisdom of outlawing prices above a certain level.

1.22 At the very minimum, before we could support the imposition of such a law, we would need to be satisfied that the caps had been carefully developed based on a study of the business models of industry participants and their costs. We recommend that the Productivity Commission or a similar agency be tasked to carry out this study and recommend pricing which would permit STSA lenders to achieve a reasonable return on capital.

1.23 We note the evidence provided to the Inquiry from a Treasury official that the government's objective is to maintain a viable STSA industry:

> **Ms Vroombout:** What I said in my earlier comments was that the government's objective with reforms and with the caps as outlined in the bill was to balance the social costs and improve the outcomes for vulnerable consumers while maintaining a viable industry. So that was the objective.
>
> **Mr GRIFFIN:** You are confident it will maintain a viable industry. That is what I am trying to get to. Okay, that is what you are saying.
>
> **Ms Vroombout:** I am saying that was the government's objective in setting that cap.[9]

1.24 If the government is serious about this objective, it must adopt the more rigorous approach we have suggested.

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8 Fair Finance Australia, *Submission51*, p 1.

9 *Committee Hansard*, 24 October 2011, p. 77.

Senator Sue Boyce

Senator Mathias Cormann

Paul Fletcher MP

Hon Tony Smith MP

Additional Comments by Senator Hanson-Young

Introduction

1.1 The Australian Greens share the concerns of many in the consumer protection and advocacy sector regarding payday loans. While we recognise that in some instances short-term loans play a valuable role in helping consumers meet unexpected and unusual expenses, the use of these high interest loans to meet essential living expenses can perpetuate a cycle of debt that has serious consequences for individual consumers and their families. Given our interest in consumer protection, we have limited our comments to Chapter Five of the Joint Committee on Corporations and Financial Services Report, which is concerned with the introduction of caps and new regulations for certain kinds of credit contracts.

1.2 The Government should be commended for attempting to address this issue through its Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill however we note with concern the limited scope of the majority report recommendations relating to payday loans. The Committee recommends that Schedules 3 and 4 relating to caps and regulations for credit contracts be subject to further review. It is an inevitable consequence of this recommendation that any meaningful action in relation to payday loans will be deferred in the short-term.

1.3 The Australian Greens believe a number of provisions could be strengthened in order to enhance consumer protection and our preference is for the Committee to recommend the bill proceed with amendment. The areas we have identified for potential amendment are outlined below.

Small amount credit contracts

1.4 The Australian Greens strongly support the application of a cap model for all credit contracts, including short term small amount credit contracts. This should be aligned with the cap model that operates effectively in the jurisdictions of Queensland, New South Wales and the Australian Capital Territory (including interest, fees and charges).

1.5 Rather than imposing a model of a 10 per cent establishment fee plus a 2 per cent monthly fee for short term contracts, the cap of 48 per cent per annum that has proved successful in capping the costs of high cost, short term credit in the above jurisdictions should be utilised.

Enforcement expenses under 39B

1.6 The Greens are concerned about the potential for enforcement expenses that are outside the remit of s39B to undermine the purpose of the provision. As noted by the Consumer Credit Legal Centre:

> Lenders could set up separate entities for the purpose of pursuing the consumer for payment and then charge these expenses back to the original entity to be added to the amount recoverable under s39B.

1.7 Enforcement expenses should be defined specifically and limited to only those allowed by the equivalent small claims jurisdiction in each State/Territory in Australia. This would ensure that lenders are unable to circumvent this requirement.

Implementation date

1.8 The bill is due to commence 1 June 2012 but Schedule 4 dealing with payday loans is being delayed until the following year. This should be brought forward, in recognition of the pressing need to take action on this issue.

Monetary obligations and fees and charges

1.9 We share the concerns of consumer advocates that the sections 23A and 31A provide scope for brokers and introducers to charge fees. To guard against this, we consider that sections 23A and 31A should be amended to prevent fees incurred with third parties, whether associated with a credit provider or not.

Web-based disclosure

1.10 The provision of information to consumers about alternate assistance and cheaper sources of credit is considered essential to any effective consumer regime. The web-based disclosure statements under Schedule 3 could be further strengthened by the inclusion of a link to financial counselling information.

Conclusion

1.11 The Greens believe that the payday loan industry is one in need of regulation. While there is potential to strengthen protections for consumers, the measures proposed in the Government's Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill do provide a workable framework. The inquiry process has been a valuable airing of key issues, but by deferring any substantive recommendations for reform, the majority report has missed a good opportunity. The Australian Greens will continue to pressure the Government to act on these reforms.

Senator Sarah Hanson-Young

Appendix 1

Submissions

1 Money Centre Fortitude Valley

2 Credit Ombudsman Service Limited

3 Mortgage and Finance Association of Australia

4 Australian Seniors Finance Pty Ltd

5 Mr Graham Smith, Muru Mittigar Aboriginal Cultural and Education Centre

6 UCFS Australia Pty Ltd

7 MONEY3 Corporation Limited

8 Dollars Direct

9 Australian Institute of Company Directors

10 Aussie

11 Community Sector Banking

12 Moneyplus

13 Mr Rob Legat, Fast Access Finance Pty Ltd

14 Anglicare Diocese of Sydney

15 Can Do Credit Pty Ltd

16 Consumer Finance Association (UK)

17 First Stop Money Limited

18 Redfern Legal Centre

19 National Legal Aid

20 Consumer Action Law Centre

21 Confidential

22 National Financial Services Federation

23 Good Shepherd Youth and Family Service

24 Super Nexus Pty Ltd

25 GE Capital

26 Confidential

27 Cash Converters

28 Financial and Consumer Rights Council Inc

29 Australian Finance Conference

30 Mrs Lorrae Pozzebon

31 Direct Selling Association of Australia Inc

32 Action Cash

33 Cash Doctors

34 Min-it Software and Financial Association Australia

35 Fundco Pty Ltd

36 Action Finance

37 Department of Human Services

38 Abacus - Australian Mutuals

39 Anglicare Victoria

40 FAA/Industry/Smiles Turner Delegation

41 ANZ

42 Cash Store

43 Australian Bankers' Association Inc.

44 SEQUAL

45 St Lukes Anglicare

46 A Better Chance

47 Consumer Credit Legal Centre (NSW) Inc

48 Tony Davis and Associates

49 Financial Counselling Australia

50 Chartered Secretaries Australia Ltd

51 Foresters Community Finance / Fair Finance Australia

52 Veritec

53 Choice

Additional information received

Statement from Ms Lucy Auchincloss, Commercial Director of First Stop Money (submission 17), received on 25 October 2011

Answers to questions on notice

1 Answers to Questions on Notice from the Credit Ombudsman Service Limited, public hearing, 24 October 2011, Canberra, received 27 October 2011

2 Answers to Questions on Notice from National Financial Services Federation, public hearing, 24 October 2011, Canberra, received, received 31 October 2011

3 Answers to Questions on Notice from Good Shepherd Youth and Family Services, public hearing, 24 October 2011, Canberra, received 2 November 2011

4 Answers to Questions on Notice from Cash Doctors, public hearing, 24 October 2011, Canberra, received 3 November 2011

5 Answers to Questions on Notice from National Legal Aid, public hearing, 24 October 2011, Canberra, received November 2011

6 Attachment to answers to Questions on Notice from National Legal Aid, public hearing, 24 October 2011, Canberra, received November 2011

7 Answers to Questions on Notice from Anglicare Victoria, public hearing, 24 October 2011, Canberra, received 1 December 2011

Appendix 2

Public hearing - Monday, 24 October 2011

Witnesses

Australian Senior Finance Pty Ltd

Ms Julie Campbell, General Manager

SEQUAL

Mr Kevin Conlon, Chief Executive

Australian Bankers' Association

Mr Ian Gilbert, Policy Director

Ms Jade Clarke, Senior Policy Analyst

Money 3 Corporation Ltd

Mr Robert Bryant, Chief Executive Officer

Money Plus Pty Ltd

Mr David Prosser, Chief Executive Officer

Cash Doctors

Mr Gregory Ellis, Co-chief Executive Officer

Mr Sean Teahan, Co-chief Executive Officer

Financiers' Association Australia/Industry/ Smiles Turner Delegation

Mr Phillip Smiles, Consultant

Mr Paul Baril, Committee Member

Mr Russell Birse, Delegated Member

Credit Ombudsman Service Ltd

Mr Raj Venga, Chief Executive Officer and Ombudsman

Consumer Action Law Centre

Ms Catriona Lowe, Co-Chief Executive Officer

Mr Gerard Brody, Director of Policy and Campaigns

National Legal Aid

Ms Catherine Uhr, Consumer Advocate, Legal Aid Queensland

Cash Converters International

Mr Ian Day, General Manager Australia

Mr Peter Cumins, Managing Director

First Stop Money

Mr Tim Dean, Chief Executive Officer

Ms Lucy Auchincloss, Commercial Director

National Financial Services Federation

Mr Philip Johns, Chief Executive Officer

Mr Mark Redmond, Chairman

Mr Stephen Burns, Director and Board Member

DollarsDirect LLC

Mr Daniel Shteyn, Managing Director

Good Shepherd Youth and Family Services

Ms Tanya Corrie, Senior Project Worker-Social Policy and Research

Anglicare Sydney

Ms Felicia Andersen, Community Care Sustainable Living Coordinator

Anglicare Victoria

Mr Paul McDonald, Chief Executive Officer

Mr Shungu Patsika, Financial Counsellor

The Treasury

Mr Christian Mikula, Manager, Consumer Credit Unit, Retail Investor Division

Ms Sue Vroombout, Gen Manager, Retail Investor Division, Markets Group

Department of Families, Housing, Community Services & Indigenous Affairs

Dr Paul Miller, Section Manager, Innovation and Design, Money Management Branch

Ms Paula Mance, Section Manager

Appendix 3

Clause 156 – Exposure Draft of the National Consumer Credit Protection Amendment (Enhancements) Bill 2011

Clause 156 Canvassing of credit etc. at home

(1) A credit provider, a prospective lessor under a Part 11 consumer lease or a supplier who has a linked credit provider or a linked lessor must not (personally or through an employee or agent) induce a person at the person's place of residence to do any of the following acts (each of which is a credit commitment act):

(a) apply for or obtain credit;

(b) enter into a Part 11 consumer lease;

(c) give information that may be relevant to a decision, to be made later by a credit provider or prospective lessor under a Part 11 consumer lease, whether or not to enter into a credit contract or Part 11 consumer lease with the person.

Criminal penalty: 100 penalty units.

Exception—invited visit to place of residence

(2) Subsection (1) does not apply if a person who resides at the place of residence invited the credit provider, prospective lessor, supplier, employee or agent to visit that place to enable a person who resides there to do a credit commitment act.

(3) For the purposes of subsection (2), the following acts by a person are taken not to be invitations to the credit provider, prospective lessor, supplier, employee or agent to visit that place:

(a) the person giving his or her name or contact details other than for the predominant purpose of doing a credit commitment act;

(b) the person contacting the credit provider, prospective lessor, supplier, employee or agent in connection with an unsuccessful attempt by the credit provider, prospective lessor or supplier (personally or through an employee or agent) to contact a person who resides at that place;

(c) the person agreeing to have someone visit the person's place of residence to give a presentation to help anyone at that place decide whether to purchase goods or services if:

(i) the agreement was made following contact by someone (the rep) operating in a place where the rep could readily make uninvited approaches to consumers in person; and

(ii) it is reasonable to expect that most consumers who do or will purchase goods or services through the rep do or will do so as a result of presentations made in their places of residence; and

(iii) the terms on which the goods or services mentioned in subparagraph (ii) are offered do not differ substantially on the basis of whether or not a presentation is made in the purchaser's place of residence.

Effects of contravention on credit contract, consumer lease etc.

(4) Subsections (5), (6), (7), (8) and (9) apply if:

(a) a person is induced in contravention of subsection (1) to do a credit commitment act; and

(b) at or after the time the person does the act, the person:

(i) enters into a credit contract with the credit provider who contravened that subsection or a credit provider who was, at the time of the contravention, a linked credit provider of the supplier who contravened that subsection; or

(ii) enters into a Part 11 consumer lease with the lessor who contravened that subsection or a lessor who was, at the time of the contravention, a linked lessor of the supplier who contravened that subsection. Subsections (5), (6), (7), (8) and (9) apply whether or not anyone is charged with, or convicted of, an offence against subsection (1).

(5) Despite the credit contract or Part 11 consumer lease, the person:

(a) is not liable (and is taken never to have been liable) to make a payment to the credit provider or lessor under the contract or lease; and

(b) may recover such a payment as a debt due to the person by the credit provider or lessor, in a court of competent jurisdiction.

(6) If goods are supplied to the person under a credit contract described in subparagraph (4)(b)(i), the goods are the property of the person, free from all mortgages, liens and charges of any description in favour of the credit provider.

(7) If goods are supplied to the person under a Part 11 consumer lease described in subparagraph (4)(b)(ii), the goods become the property of the person, free from all liens and charges of any description in favour of the lessor, unless the lessor:

(a) gives the person written notice within 60 days after the supply of the goods that the lessor intends to collect the goods from the person; and

(b) collects the goods from the person within 30 days after giving the notice.

(8) If goods become the property of the person under subsection (7), they do so:

(a) 60 days after the goods are supplied, if the lessor does not give notice as described in paragraph (7)(a); or

(b) 30 days after the lessor gives notice as described in paragraph (7)(a), if the lessor gives such notice but does not collect the goods from the person within that period.

(9) A guarantor of the person's liability under the credit contract:

(a) is not liable (and is taken never to have been liable) to make a payment to the credit provider under the guarantee; and

(b) may recover such a payment as a debt due to the guarantor by the credit provider, in a court of competent jurisdiction.

1.1 The committee understands this would prohibit the following unsolicited conduct by credit providers at residential properties:

- selling goods or services on credit
- inducing a consumer to apply for or to obtain credit
- inducing a consumer to enter into a consumer lease, and
- collecting information from a consumer relevant to any subsequent decision on whether or not to enter into a contract with the person.[1]

1 Treasury, *Exposure Draft National Consumer Credit Protection Amendment (Enhancements) Bill 2011, Commentary on amendments: Enhancements*, 5 August 2011, pp 3 - 4.