COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

**Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011**

MONDAY, 24 OCTOBER 2011

CANBERRA

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## PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

**Monday, 24 October 2011**

**Members in attendance:** Senators Hanson-Young and Thistlethwaite, and Mr Fletcher, Mr Griffin and Mr Ripoll.

**Terms of reference for the inquiry:**

To inquire into and report on:

Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011

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**Committee met at 09:04**

**CHAIRMAN (Mr Ripoll):** I declare open this public hearing of the Parliamentary Joint Committee on Corporations and Financial Services for its inquiry into the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011. The committee's proceedings today will follow the program as circulated. These are public proceedings. The committee may also agree to a request to have evidence heard in camera or may determine that certain evidence should be heard in camera. I remind all witnesses that in giving evidence to the committee, they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to the committee, and such action may be treated by the Senate as a contempt. It is also contempt to give false or misleading evidence to the committee. If a witness objects to answering a question, the witness should state the ground upon which the objection is to be taken and the committee will determine whether it will insist on an answer, having regard to the ground which is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera.

I welcome everyone here today and I welcome Mrs Julie Campbell, national sales operations manager, Australian Seniors Finance. Thanks for appearing today and thanks for your submission. If you want to make some opening remarks, that would be good. Thank you.

**Mrs Campbell:** I would first of all like to thank you for this opportunity to contribute to an important piece of legislation that I believe will protect many senior Australians and their families. Australian Seniors Finance has been in operation since 2004. We are a founding member of SEQUAL and we are Australia's largest specialist reverse mortgage provider and part of one of the world's largest specialist reverse mortgage companies. As one of the original employees of Australian Seniors Finance, I have been engaged in a number of roles within the company, ranging from sales and marketing operations to compliance.

I engage with clients as part of my management role on a daily basis and have a working knowledge not only of the product but of the needs of seniors themselves. Reverse mortgages are all that we do, therefore it is of paramount importance to us that our clients are protected and that the industry grows without the issues surrounding flawed products that have been available over the years around the world. As such, we have been strong supporters of hard-coding governance around the provision of reverse mortgages and home equity release in general. As someone who follows home equity release globally with interest, I consider Australia has developed in a high quality and consumer focused way to this point. We would like to see that continue.

Our submission has focused on two specific points of the bill that we fear will not provide any material borrower protection, may limit consumer access to the products and will add unacceptable complication to the product delivery. I refer you to part 3-2D of the bill, specifically 133DB—the requirement of projections to be shown in person to the consumer prior to preliminary assessment. We applaud the desire of the legislation to ensure the issue of compounding interest is explained to borrowers. It is one of the most important factors that borrowers need to understand. A professional illustration or chart is the best way to highlight this product characteristic. However, to attempt to mandate that in a face-to-face manner prior to an application will not be practical for a number of reasons. Firstly, no underwriting will have been undertaken, meaning that the information given will be generic and potentially misleading. Secondly, it will mean access to face-to-face advice in the initial stages of deliberation will become imperative. This is not always easy or even possible, particularly for those in rural and regional areas, or those with disablement issues. Thirdly, it will lift costs for many as brokers will need to become engaged and they will need to be renumerated. It is important to note that often these loans are quite small, therefore costs do need to be contained.

Finally, advice could well be variable. Often a phone conversation or discussion with a trained and experienced specialist, such as those at NICRI or the providers themselves, is more effective than a broker who may not necessarily deal regularly with home equity release products. This is likely to be the case for those in rural and regional areas. It is important to ensure that those in regional areas are not excluded from the product, nor that the quality of the information and education they are getting is jeopardised in any way.

We do agree that mandating the use of an illustration of this is very important, and support the following. Firstly, mandating use of a tailored illustration prior to loan execution to give a generic introduction and understanding of the real effect of compounding interest. Secondly, that the illustration becomes part of the loan documentation which is covered by the mandatory legal advice and intervention step. This will ensure that the actual loan details are reflected in the illustration and that compounding interest is understood by each and every borrower. Finally, that the ASIC calculator be mandated for both conservatism and consistency. We ask that this be reconsidered accordingly.

For my second point, I refer you to section 18A of the bill:

Provisions that must not be included in credit contract for reverse mortgage

Specifically 3(b):

(b) the debtor failing to give the credit provider evidence that the debtor, or another person nominated by the debtor to the credit provider, occupies or occupied the reverse mortgaged property;

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. However, 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.

Of interest, Australian Seniors Finance sends every customer an annual questionnaire which must be completed and returned. It is simple and cost-free, but is an important obligation and responsibility of every borrower. In the annual questionnaire we seek confirmation firstly, that the home is insured and that the rates have been paid; secondly that there have been no changes to the nominated residence and that they are still occupying and living in the property; and thirdly, that there are no known maintenance issues on the property.

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. A real example that I have dealt with recently was a daughter of our client not advising us of the passing of her father, renting out the home, retaining the rental income and completing the annual questionnaire fraudulently over a period of three years. Whilst this is clearly a breach of our contract, it may not be a breach of the law in the bill as it stands. It should also be noted that one of the issues with the original reverse mortgage products in the United Kingdom was that of beneficiaries not notifying lenders of the passing of borrowers and remaining in the property for several years after. Hence negative equity positions were reached, and this is a real risk to the product.

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.

In summary, we consider the two points noted both as relatively easy to rectify and as fundamental elements that need further consideration. We support these legislative changes, as they are protecting and educating the community whilst respecting senior Australians and their rights to make their own decisions. We hope that the legislation is supported by appropriate regulations that respect these rights and encourage a healthy industry. Let me assure you, Australian Seniors Finance and our follow SEQUAL members are totally committed to our obligation as an industry to provide well-designed products and to ensure that proper disclosure is provided to enable seniors to make informed and appropriate decisions. I hope that you have found these suggestions reasonable, and I am happy to answer any questions.

**CHAIRMAN:** Thanks very much. Could I just begin by just asking if you could paint a bit of a picture for the committee of how many people access these types of loans—the reverse loans? What is the scope of the market?

**Mrs Campbell:** Around Australia?

**CHAIRMAN:** Yes, around Australia. How many people do actually get reverse loans? How common are they? What sort of percentages?

**Mrs Campbell:** It depends on what period you are talking about. We have around 4,000 to 5,000 clients. I can talk from our perspective, but obviously there are other providers. But they are reasonably common, yes. There are certainly quite a lot of Australians that are using them.

**CHAIRMAN:** Because it is a pretty common tool.

**Mrs Campbell:** For seniors it is, obviously.

**CHAIRMAN:** People use them now in retirement?

**Mrs Campbell:** Yes.

**CHAIRMAN:** Would you have some data or information as to how common it is for all seniors from your perspective?

**Mrs Campbell:** At the moment, probably five to 10 cent are using it, if you are talking generically around Australia.

**CHAIRMAN:** Is that because there is not a great deal of need or because people are unaware that these types of facilities exist?

**Mrs Campbell:** I think it is a combination. Since the global financial crisis occurred, there have been fewer providers in the marketplace, so there has been less accessibility to these types of products, and no marketing has been occurring, so people have to seek them out—there is not generally huge awareness about them. But I would say that awareness is growing.

**CHAIRMAN:** You have outlined two areas where you see the bill having significant impact. Are there any other areas that you think need further enhancement in the bill, or is it your view that the bill generally deals with the circumstances around reverse mortgages and we should just tighten the existing arrangements?

**Mrs Campbell:** That is right. From our perspective and that of our fellow SEQUAL members, the bill mainly covers what we already do. We do not have any issues with the rest of the bill. They were the two areas. I was concerned about how borrowers are affected by this.

**CHAIRMAN:** Do you get hardship cases—do you have provisions for specific areas where people get into trouble at some point?

**Mrs Campbell:** Obviously we do get hardship cases. Are you are talking about cases where they have already started with a loan?

**CHAIRMAN:** Yes.

**Mrs Campbell:** You certainly do get hardship cases. The anniversary questionnaire often pulls out a lot of those hardship cases. And we do have provisions for managing them. Because no repayments are required on these types of loans, the hardship is generally associated not with the loans themselves but with other needs that the clients have.

**CHAIRMAN:** In those cases, is there a capacity to increase or vary the loan?

**Mrs Campbell:** Yes. It is dependent on the circumstances.

**CHAIRMAN:** Do you get many of those—is that common?

**Mrs Campbell:** Not generally. In my personal experience, I probably deal with one of those every three months. There is not an enormous number of them.

**CHAIRMAN:** Do you get any legal issues in terms of the expiry of a loan, at end of contract, if you like—particularly in terms of market valuations, where there is a discrepancy between—

**Mrs Campbell:** No. Generally, because there are low loan-to-value ratios, they are nowhere near the negative equity position. When the borrower or borrowers have passed away, their beneficiaries have 12 months, in our case, to repay the loan. At that stage they often sell the property, the family home. The issues that come up are often probate issues or family issues.

**CHAIRMAN:** Mr Fletcher?

**Mr FLETCHER:** Mrs Campbell, could you explain a bit about the business model and, in particular, how the client's indebtedness moves over the period of the loan?

**Mrs Campbell:** Basically, it is a loan against a security property which they live in. What we lend is based on the age of the youngest borrower. So, if it is a husband and wife, we use the age of whoever is youngest. The loans start at 15 per cent at age 60. The interest is compounding; they do not need to make repayments, but they can make repayments if they wish to. These are our specific processes—obviously there are different products. They can make repayments if they wish to but they do not have to.

**Mr FLETCHER:** Is the interest fixed or floating?

**Mrs Campbell:** Variable; there are various products on the market, but it is a variable rate. In terms of how the interest grows, it is compounded—ours is calculated daily and added monthly—and they get statements every six months.

**Mr FLETCHER:** Is it correct that the lender effectively takes the risk that the client ends up living in the home to a point such as the loan goes into negative equity?

**Mrs Campbell:** Correct. In all the products that SEQUAL members have, there is a no-negative-equity guarantee which basically means that, yes, the lender is taking the risk if the value of the property is to drop or if they were to live to a point where there is a negative equity position.

**Mr FLETCHER:** When the borrower dies or moves into other accommodation, such as a retirement village, what then happens?

**Mrs Campbell:** In our circumstance the beneficiaries or the borrowers have up to 12 months to repay the loan. They can do that however they wish. If they sell the property then obviously they need to repay the loan; it is like any mortgage, it needs to be repaid at that point.

**Mr FLETCHER:** How do customers find out about you?

**Mrs Campbell:** For a majority of our customers it is by word of mouth, I have to say, within the seniors community. We do not advertise; we do not do any advertising at all at this point. It is simply word of mouth or through our affiliations with credit unions and building societies and through other banks or solicitors. If people see that there is someone in there, then they are aware of these sorts of products.

**Mr FLETCHER:** Do you track customer satisfaction or do you have other measures of how well received the product is?

**Mrs Campbell:** We do. I have to say that our customer satisfaction level is very high. For a lot of people it is quite life changing. We have been going close to eight years so there are people who have had loans with us for quite some time.

**Mr FLETCHER:** You highlight one of the problems with the proposed legislation, which is a requirement to show the applicant projections before the point at which they commence a formal application.

**Mrs Campbell:** That is face to face. As I mentioned, we believe they certainly should get an illustration at the very beginning whether that be in the form of an information pack, online or however they do it. 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. All borrowers need to see their own solicitor before entering into the contract. I believe that at that time they should also get an illustration which is reflective of their actual loan, because prior to them being underwritten they do not know how much they will actually be borrowing. Therefore, giving an illustration at the initial stages is very much based on a hypothetical situation.

**Mr FLETCHER:** The other area I wanted to ask you about was the point you made about the draft legislation proposing specifically to ban certain events of default in the drafting of the mortgage. If I understand you correctly, you are making the point that it is of critical importance to the business model to know if the occupant to whom you had advanced the loan is no longer living there.

**Mrs Campbell:** Correct. The no negative equity guarantee and business model hinges on certain events occurring, and one of those is them leaving the property for whatever reason that might be. I am talking about a length of time, I am not talking about a week or a month or anything like that.

**Mr FLETCHER:** Did you have the chance to discuss that point with Treasury officials or other government officials?

**Mrs Campbell:** Yes, I did.

**Mr FLETCHER:** What was their response when you made that point?

**Mrs Campbell:** They made no response at that point. My submission with the information that I have provided to you was also provided at that point.

**Mr FLETCHER:** With the example you gave before about a person who had continued to fill in the annual questionnaire fraudulently for a period of three years: as your documents are presently drafted, that presumably constitutes an event of default?

**Mrs Campbell:** Yes, that is correct.

**Mr FLETCHER:** Your concern is that if the bill passed into law then with the drafting that you would be required to use in those circumstances that might not be an event of default?

**Mrs Campbell:** Yes. There would no obligation for them to provide that information to us.

**Mr FLETCHER:** Is it the case that if this proposed ban on that event of default were to pass into law, that would compromise your capacity to keep operating as you presently operate?

**Mrs Campbell:** Yes. It does have some impact on business modelling, obviously, because the business model is based on the negative equity position, and on longevity and things like that. As I pointed out, it was an issue in the United Kingdom's original product, where there was either no obligation to provide that information or they were not providing it.

**Mr FLETCHER:** Is it in turn a consequence of that that a product which is today demonstrably meeting the needs of a group of senior Australians might be either withdrawn or made available less widely?

**Mrs Campbell:** Potentially. To give you an example, part of our no-negative-equity guarantee is reinsured by an international reinsurer. Obviously, these sorts of events are important to them in the reinsurance of such a situation.

**Mr GRIFFIN:** Just on that last point and the discussions you had with Treasury. They just gave no comments with respect to your concerns?

**Mrs Campbell:** Yes, I was part of a working group. It was put up in the working group and then it was passed to them in writing.

**Mr GRIFFIN:** You are saying it is a problem in relation to 3(b). Do you think that is an unintended consequence?

**Mrs Campbell:** I think it is a unintended consequence, yes. Unless you know the workings of the product and how they work on a day-to-day basis, I think it is probably—

**Mr GRIFFIN:** If you were going to amend the legislation, do you have a suggestion as to what wording you might use?

**Mrs Campbell:** I will take that on notice. I am happy to provide that.

**Mr GRIFFIN:** If you could. And on the earlier point in relation to the circumstances around showing the consumer projections in person: you are saying that the key point is that it is important people have the information as to what the actual detail of the circumstance will be around the particular loan prior to them making the decision, but not at the stage prior to the application being completed.

**Mrs Campbell:** No—certainly prior to the application being completed. It is the face-to-face issue.

**Mr GRIFFIN:** Just the face-to-face aspect of it?

**Mrs Campbell:** Yes. Certainly, they should have it and be given a generic understanding. It is certainly something that you do not want to hide; it is imperative that they understand that from the very beginning. And often it is an education process through the whole underwriting and filling out of the application. Certainly, it should be given to them at the very beginning, but it is the face-to-face part that just removes the delivery. It removes the options in delivery for the customers.

**Senator THISTLETHWAITE:** You said that one of the issues for your organisation is in respect of the face-to-face requirement, particularly pre-application. Do you have any statistics with regard to your client base about how many people actually make applications or have applications approved without having a face-to-face interview?

**Mrs Campbell:** They all see their own solicitor face to face, so certainly they do that. But I would probably say that for our organisation—and this is not for SEQUAL overall, all members have different statistics—around 30 to 40 per cent of our clients would not see anyone face to face at the very beginning. They certainly see someone during the process but not at the beginning.

**Senator THISTLETHWAITE:** And how are they lodging those applications? Is it mainly over the internet?

**Mrs Campbell:** No. There is a combination. It is generally not the internet. Often they will send in by mail. They might make initial inquiries via the internet, but there are always phone conversations. Generally they will send them in. Often seniors still like to see the packs and information, so it is via the mail.

**Senator THISTLETHWAITE:** And at what point to you provide them with that information about the payment calculator and that sort of thing?

**Mrs Campbell:** At the very beginning—as soon as they make an inquiry.

**Senator THISTLETHWAITE:** So it is pre application.

**Mrs Campbell:** Definitely. But it is always based on a hypothetical: what they think their house is worth, what they think they might need to borrow. You do not know that until the underwriting is completed.

**Senator THISTLETHWAITE:** Pardon my ignorance, but are these products only available for retirees and seniors?

**Mrs Campbell:** What you do as an occupation is irrelevant. It is an age factor. They are only available to seniors.

**Senator THISTLETHWAITE:** Okay. Pardon my ignorance again, but were these types of mortgages a factor in the United States in the lead-up to the global financial crisis? The issue was the house price not holding up in the market and borrowers being left short-changed, so to speak.

**Mrs Campbell:** No. In the United States they were not a factor in the global financial crisis. They are being affected, no doubt, by the global financial crisis. In the United States government backed organisations provide the no-negative-equity guarantee. Here in Australia the no-negative-equity guarantee is provided by the providers themselves. In the United States it is government backed, which obviously has caused numerous issues in terms of the drop in property prices and the exposure the government has to the negative equity position that they potentially hold on a lot of these loans. You are correct that they have been affected by the global financial crisis, but they were not one of the causes.

**Senator THISTLETHWAITE:** Thank you.

**CHAIRMAN:** To clarify the face-to-face process: you said roughly 40 per cent do not have an initial face-to-face—

**Mrs Campbell:** That is ours, yes.

**CHAIRMAN:** That is your particular business. But 100 per cent of people making an application get a face-to-face interview at some point?

**Mrs Campbell:** Correct—with their solicitor at the very least. But, yes, they do.

**CHAIRMAN:** So the finer point here is that the requirement would be for a face-to-face prior to the completion of the application.

**Mrs Campbell:** Correct.

**CHAIRMAN:** Could it not be that they are done at the same time or at the same place so that there is a face-to-face prior to completion and the completion is done at the meeting subsequent to that meeting? Or does that happen now?

**Mrs Campbell:** My suggestion is that they get it twice. They get it however they get it at the very beginning when they make an inquiry, because, as I mentioned, it is an education process. I do not believe it is something that you can just assume people know. Each client also gets the ASIC introduction book.

**CHAIRMAN:** In your view, does it state that it has to be at the very beginning? I thought it was more before completion. There is a fair gap between a beginning and a completion. With a beginning there could be six telephone meetings or interviews. There could be a lot of exchange of information. In a final process, that process might be that prior to completion a face-to-face has taken place at the point at which you would have the face-to-face meeting anyway.

**Mrs Campbell:** That makes sense. As the draft is now, it is suggesting that the face-to-face must be done prior to when an application is even put in. I suppose my recommendation is that it needs to be given and then should be a part of when they sit down with their solicitor with the loan agreements when completion actually occurs, which is when they sign the loan agreements.

**CHAIRMAN:** You talked about the no-negative-equity position. Is that built in through the LVR that you apply?

**Mrs Campbell:** That is right. Obviously each company does it differently, but most of us have similar loan-to-value ratios. It is an actuarial calculation. The LVR based on the age of the youngest person means that, whoever predeceases whomever, they can both live in the home for as long as they live. That actuarial calculation is based on longevity, obviously, and that is how the LVRs are worked out. LVRs are initially done based on a normal interest rate cycle. People should still have 40 to 50 per cent equity remaining in their home by the time we would expect them to pass away.

**CHAIRMAN:** Do you set a cap? Is there a cap in place?

**Mrs Campbell:** No, there is no cap. There are equity protection options if people wish to put a cap on it. If they wish to say, 'I wish to be ensured that, at the end of the day, I've got 20 per cent of equity remaining in my

home' or '50 per cent of equity remaining in my home', they can elect that; however, there is no cap. The cap is that you have a no-negative-equity guarantee. We have a cap in terms of what we lend, but in terms of the growth of the loan it is purely dependent on how long the loan goes for.

**CHAIRMAN:** Okay. Thank you very much for your submission and your appearance here today.

**Mrs Campbell:** Thank you.

**CONLON, Mr Kevin, Chief Executive, Senior Australians Equity Release Association**

[09:36]

**CHAIRMAN:** Welcome. You may make an opening statement or speak to your submission.

**Mr Conlon:** Thank you for that invitation and the opportunity to speak to the issues that are directly impacted by the proposed legislation. The largest generation within the Australian population today is now entering retirement poorly prepared for that part of their lives. They have low levels of personal savings, they have high levels of residual consumer debt and their superannuation accumulation is not going to be sufficient to see them through their post-working life. The good news is that the vast majority of Australians have achieved the great Australian dream of owning their own home. Over 70 per cent of those aged over 65 own their own home, and that home represents over 70 per cent of their personal wealth.

The question is what they will do with the stored wealth in this indivisible illiquid asset. Will they reduce their living standards in order to survive on the pension when their alternative sources of savings for retirement are exhausted? Will they access their equity either through selling the home—and moving away, which will often mean moving away from social networks—or will they embrace the new category of products known as equity release products? The good news for this generation is that they are going to live longer than any generation before them. The so-called baby boomers intend to live well in retirement and lead active lives. The overwhelming majority of senior Australians have expressed through a number of research projects their desire to stay in place. They want to live in their homes as long as they possibly can rather than migrating away from their neighbourhood or even moving into aged care.

Equity release products provide the opportunity to meet these challenges, but they are not easy products to bring to the market. From a lender's perspective, equity release products involve cash out the door to the customer and then no cash flow for an unknown duration because it is in the hands of the customer when that facility will be repaid. The global financial crisis has had a significant impact on the availability of equity release products in Australia. The strength of the Australian equity release market is that it is comprised of major, substantial financial institutions as well as the specialist lenders—the non-banks. There is a likelihood that the increasing demand that is driven by the inevitable demographic shift will be met, but it will be met by fewer stronger financial institutions than might have been the case had competitive tension been preserved.

SEQUAL represents the vast majority of equity release providers in Australia. We have made representations to government in the past that there is a role for government to ensure that these products are available to senior Australians when they are needed. We do not believe that it is the direct intervention of government in competing with industry that is the solution; rather it is to look at some of the systemic difficulties and how these products need to be developed. We have made it clear that we would welcome an amendment to the selection criteria for the Australian Office of Financial Management to underwrite reverse mortgages and other equity release products in the way that they have done for the forward mortgage market in order to preserve competition in the market.

There was a brief discussion earlier this morning about the US model. As was mentioned, in the US it was the government that saw the need to intervene in the market by providing the underwriting for the no-negative-equity guarantee. These are all interesting strategies that may see the equity release market deliver on expectation in Australia, but we must not be complacent about the availability of these products.

Senior Australians need to be respected. They have an entitlement to deal with their assets in the way that they deem appropriate to fund the challenge of living longer. By and large our customers are well informed and capable of making informed decisions. Where industry, legislators and regulators need to pull together is to ensure that we preserve choice and focus on the important task of ensuring that people are provided with the information they need to make informed decisions. We think much work needs to be done on seniors' financial literacy. We also believe that it is inappropriate for the legislation to touch too heavily on product design. Neither it is appropriate or helpful to consumers for regulations to overburden an industry that has developed in this country over an extended period as both efficient and ethical. I remind the committee that the chief ombudsman for the Financial Ombudsman Service recently said that, of the 45,000 customers that have a reverse mortgage in Australia today, with $3 billion outstanding, he has dealt with a very small number of complaints, all of which without exception have been resolved in favour of the providers based more on the ignorance of the product than any systemic failure of the market or poor design of those products.

So this is a market that has grown well under the self-regulatory environment represented by SEQUAL as the peak industry body. As I have said publicly, we commend the government for having proper regard for those high standards of practice when developing the legislation. The real challenge now is to make sure that, as we move into the regulatory phase where the legislation is going to be interpreted, we maintain that focus on not depriving

senior Australians of choice, not overburdening the market and focusing on those things that we have a joint interest in: informed decisions by people who are capable of dealing with their assets in the way that suits them. Thank you very much.

**CHAIRMAN:** Thank you. You have mentioned a whole range of issues, particularly around the aged and financial security. I wonder if you could give us a picture from your perspective of the size of the market, how it applies and what has changed, particularly since the GFC.

**Mr Conlon:** There are more than 45,000 customers today, as I mentioned, with a total outstanding amount of $3 billion. The average age of a reverse mortgage customer is 74, so they are actually quite deep into their retirement before they look at equity release strategies. It possibly reinforces the view that their alternative forms of savings are inadequate. The average loan size has risen from approximately $50,000 to around $75,000. This is what people are now taking out, usually in a combination involving a lump sum to meet some urgent need, whether that is to retire the debt that they can no longer service, to purchase a new vehicle or to undertake some modifications to the home to make it liveable given their advancing years and then an ongoing instalment payment which is intended to ensure that their standards of living are preserved where the pension has fallen short of that expectation.

**CHAIRMAN:** You also said there were very few complains in relation to these types of products to the ombudsman or elsewhere. Is that the case because the product is not actually acted upon until the person's death and there is an enormous gap between when a loan is taken out and when there is any action? Is that the case because there is no activity for long periods of time?

**Mr Conlon:** Not really. Like any financial product, customers' circumstances change over time. They may become dissatisfied with the amount of money they can access through the product. They may have some concerns that they have released equity too early in their retirement and they are now facing a repeated problem of cash flow issues. I think we face the same challenges that any other financial product would. I do not think we would get away with nothing happening for a long period of time; we have to face these issues as they arise. I think what the Financial Ombudsman had to say is a testimony to the fact that the products are well designed and by and large the providers have disclosed the facts that enable people to make informed decisions. I think it is a track record that stands on its own merit.

**CHAIRMAN:** What is SEQUAL's membership base as an organisation? Who do you cover? Do you cover everybody in this particular space?

**Mr Conlon:** No. Membership of SEQUAL is not compulsory, and there are providers in the marketplace that are not members of SEQUAL. This really reinforces the need for this legislation and the support that this industry has for the government's initiative. SEQUAL membership imposes some very high standards of practice on its membership which delivers good outcomes for consumers. So, to the extent that there are providers out there that are not members of SEQUAL, we would hope that they all meet the standards of the example set by SEQUAL. If they do not then I think it is appropriate that legislation pick up that gap.

**CHAIRMAN:** Thank you.

**Mr GRIFFIN:** With respect to the legislation that we are looking at, I look to your submission on page 13. You list a number of points about the proposed act. I want to get clear and on the record if at this stage there are any particular problems you have with the act as it stands. I note that there are several things where you are waiting for the detail that might come out in regulations and I take your general point about the need to have a soft touch rather a hard one; but, if there are any particular points you want to stipulate, it might be a good time to put that on the record.

**Mr Conlon:** Thank you very much. In doing that I also pay tribute to the work completed by Gadens Lawyers, who provided this as a handout for those attending this morning's committee hearings. That document reflects the technical issues that would be of concern to SEQUAL members. As the witness before me stated, some of the practical issues around face-to-face interview with the customer need to be properly considered. There is no question that consumers need to be provided with adequate information to make informed decisions. They need to receive that information early on in the transaction—certainly before they are committed in any way to proceeding. I would therefore suggest to you that the outline that is provided in the submission serves as a general framework for the regulators rather than the legislators. We are generally happy with the legislation and, as I have said publicly, we believe there has been proper consultation with industry around the development of the bill. It is important, though, that we maintain that focus as we move to the regulations that will interpret the legislation.

There are some issues around leaving property vacant and absolving the borrowers or nominated residents to notify the provider if the property were to be vacated. These are issues that should not endure the consideration of

the bill. They would have an impact on the product. As I say, there has been a competitive tension that has delivered what we do believe to be a world-class product in this country. When we tinker with product design, it is a bit like what was described elsewhere as a hot water bottle: you push one end and it affects something else. If we are on the same target of informed decisions and proper disclosure then I think we need to look carefully at the impact of any legislative impost on product design.

I have some comments to make around 179(7), where it is proposed that lenders should have an obligation to ensure that the customer is aware of whether there are other products available that might be more suitable. I am mindful of the suitability test under the NCCP. I believe that should be limited to other products that that provider is able to offer the customer. I think it is unreasonable to expect any market participant to know what the range of products is that is available elsewhere, but certainly in terms of their own raft of products the suitability test must be respected.

In terms of comments around section 3, where a property remains unoccupied or there is a failure to pay rates, these are good comments but I think there need to be some timing limitations around them. I would have thought something more in the order of six months rather than 60 days of the property no longer being occupied for the reasons earlier stated. Rate payments are often an indicator of a person having deceased or no longer being at the property. It is an important trigger to close the facility down if it is appropriate to do so, so perhaps something in the order of 12 months. There is some common sense to come into these provisions, but generally we think the framework is pretty much on target.

In respect of 86(A)—the borrower terminating at any time by paying the market value of the secured property—that is a commercial risk that the SEQUAL members are prepared to take. At the end of the day, the integrity of the no-negative-equity guarantee is that in a worst-case scenario the customer will never owe more than the value of that property; so, if there is an opportunity for them to play the market, that is a risk that lenders and other providers consider when they develop these products. I would suggest that perhaps there should be an obligation on the borrower that the sale be at arm's length to a non-related party so it at least is a legitimate, in-the-market sale.

**Mr FLETCHER:** You talk in your submission about the proposed section 86(A), which would give a borrower the right to terminate by paying the market value of the property even if the market value is below the amount that had been leant or the amount to which the loan had now compounded. What implications would that have for the commercial incentives for lenders?

**Mr Conlon:** As I mentioned before, these are not easy products to engineer. They require substantial financial institutions that can face the longevity risk and the absence of cash flow. Similarly, because of the nature of the consumers we are dealing with—people in retirement who may have very few options to look at a way to refinance these facilities—it brings with it a high duty of care around how the product faces the consumer. I would think that what is proposed in 86(A) is self-limiting in the sense that it would reduce competition, but that in this case would be a good thing. Only those institutions that can meet those standards of consumer protection should be participating in this market. So again I say that in the current model in the Australian market it is the providers that wear the risk around the no-negative-equity guarantee provisions. It is interesting to note, though, that in the US the equity release market grew far more significantly on the back of government providing those no-negative-equity guarantees. If the government were to consider that type of market intervention in order to ensure that the absence of competition that is currently characteristic in the market could be overcome then that would be something that industry would welcome.

**Mr FLETCHER:** I want to understand the thinking behind that proposed provision. I recognise that it is not your organisation that has put it up. It has appeared in the draft legislation. I am right, though, am I not, in understanding that the products that your members offer protect borrowers against the risk of negative equity?

**Mr Conlon:** That is right.

**Mr FLETCHER:** Do you have a view as to what the rationale was for putting this provision into the draft legislation?

**Mr Conlon:** The no-negative-equity guarantee is a very significant feature of the reverse mortgage product in particular but, more generally, other equity products such as the home reversion schemes, aged care bonds and other products will evolve in the market and will not be reverse mortgages but will have the same characteristics. I think the no-negative-equity guarantee has to be a paramount concern for how these products are developed. I would suggest that the motivation for this drafting is to ensure that the no-negative-equity guarantee protection was not limited in some way to the extent where a customer would have to die, move into aged care or permanently vacate in order to gain the protection of that provision.

People change their minds. Sometimes reverse mortgages are used for a very short period of time. A really good example is around aged care, where the prohibitive cost of entry into aged care sometimes cannot be met by the candidate unless they sell their home. Far better for many to delay selling the home, move into aged care through an equity release strategy and then revisit the idea of selling the home into an orderly market or when it suits them. In that case, people will look at reverse mortgages as short-term bridging facilities, and I think the intent here was to draft it to ensure that people could voluntarily repay but still be limited in their liability to the value of the security.

I will make one point, if I may. We should not assume that taking out a reverse mortgage or any other equity release product is a one-way road to having no equity in your home. It is really important that we and consumers understand the interplay between future property values, the growth of the debt in the case of reverse mortgages and how long that facility runs for. In this country the loan devaluation ratios—LVRs—have always been very conservative. They start off at 15 per cent. Therefore, the prospect of preserving equity even though you do undertake a reverse mortgage is reasonably high in most centres of Australia.

**Mr FLETCHER:** To be clear, what is SEQUAL's view on the proposed section 86(A)?

**Mr Conlon:** We believe that that provision can be tolerated by the industry without significant adverse effects. However, 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.

**Mr FLETCHER:** You talk on page 15 of your submission about government involvement in the equity release market. Can you explain the point you were making there in a bit more detail?

**Mr Conlon:** Sure. It is true to say that the equity release market has suffered significantly as a consequence of the global financial crisis in the sense that, where the SEQUAL membership was once in excess of 20, it is now less than 10. Although SEQUAL still represents the vast majority of providers, it is very clear that a lot of providers can no longer fund these facilities. Essentially, post GFC the federal government initiated some incentives for the Australian Office of Financial Management to act as an anchor investor in the securities that underpin funding for these types of products. They did so for the forward market to ensure that the home loan market was protected. In dedicating $8 billion to that strategy, the Australian government ensured that $4 billion of it would be carved out for use by non-banks so that the competitive tension was preserved as well. We lobbied government at the time to consider whether the selection criteria given to the Australian Office of Financial Management could be altered to ensure that they could act as an investor in securities that support reverse mortgages, and the market dynamic remains the same today: that need still exists. It is a question of whether government feels that it has a role in ensuring that this industry survives in a way that makes these products available when senior Australians need them as they start entering retirement in very large numbers.

**Mr FLETCHER:** You cautioned in your opening statement against the risk of legislation which seeks to prescribe too closely product design. Could you expand upon that?

**Mr Conlon:** I hope I am not repeating myself too earnestly, but I repeat that these are difficult products. They require very strong financial institutions. The design of the products is heavily affected the end investors of the securities that support the products, so you have an underwriting preference of those who would fund these products. if you start interfering with that product design without having a proper regard for the impact on investor appetite, you may well deprive the market of those types of products. here is also that old risk of cherry picking the best features of each of the providers' products and in some way trying to push it together as the best product. Very often there are reasons why some features cannot be delivered by a particular product, and it would be a false hope that you could amalgamate all the best points of each product into one. Certainly the way the market stands today—and I am very mindful of the superannuation review where Jeremy Cooper suggested that perhaps these products would benefit from the involvement of other non-bank participants such as the large superannuation funds—I think as this market grows we will see strong diverse providers who will develop product and have appropriate product features. We do not want to set up barriers to entry around product design, in my view.

**CHAIRMAN:** That is fine; that covers it all. Thanks very much. We appreciate your time.

**CLARKE, Ms Jade Kerry, Senior Policy Analyst, Australian Bankers' Association, Inc.**

**GILBERT, Mr Ian Bruce, Policy Director, Australian Bankers' Association, Inc.**

[10:01]

**CHAIRMAN:** Welcome. If you would like to make some opening remarks in terms of your submission, or if you would like to add anything, that would be welcome.

**Mr Gilbert:** I would prefer to proceed to questions, if that suits the committee, given that this is a relatively short hearing. I would like to thank the committee for the opportunity to assist it and particularly for the committee's flexibility in allowing us to participate by teleconference this morning.

**Mr FLETCHER:** On page 3 of your submission, Mr Gilbert, you talk about the lead times faced by financial institutions in making necessary changes to IT systems, in training staff, in changing business procedures and so on. Could you expand upon that with reference to some of the measures that are contained in the legislation that we are considering?

**Mr Gilbert:** Yes. The comment was directed particularly to the range of reforms that were coming through from the end of 2008 right through to now. This enhancements bill is one of a series of about three pieces of legislation, commencing with the National Consumer Credit Protection Act, an amendment to that shortly afterwards dealing with home loan key facts sheets and credit cards, this enhancements bill, and there will be a further enhancements bill on which consultation will be taking place before the end of this year.

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. An example of that is the fact that the credit cards regulation supporting the home loans and credit cards amendment bill that was passed earlier this year have only now reached their final setting, and our members have from now until 1 July next year to get those credit card changes into place. This bill that we are now considering is intended to commence on 1 July 2012, and there will be some process changes required with respect to the financial hardship provisions. That is not to say that we oppose them; we think that some of the changes are fine, however, we have perhaps an alternative approach which we would like the opportunity to take the committee through. But with any regulatory change there is always some sort of change that is required, and that change equals risk because there are both criminal and civil penalties in much of this legislation, which obviously means the legislation has to be taken seriously. You need to get legal signoffs. You need to ensure that your procedural manuals and processes are properly done, that documentation is properly done and that your staff have been properly trained to comply.

The information system technology changes are, in some respects, the most complex because any bank has to run its IT systems on a normal business process and has to plan interventions into those IT systems to make amendments or changes. Some changes are done simply because of business needs and requirements, the ordinary course of banking business, and others are because of regulatory change. You cannot simply intervene in a system without planning that process and developing a project plan.

**Mr FLETCHER:** Just on that point, have you had the opportunity to discuss with Treasury officials these implementation issues? Have you found them responsive?

**Mr Gilbert:** I believe Treasury understands in the broad sense the types of interventions and implications that are required. However, it is often the case that Treasury does not dictate the timing and outcome of these particular timetables. Treasury is attentive to those concerns and I believe it understands in the broad sense the sorts of things that an organisation as large and as complex as a bank has to undergo to make sure that it has the legislative obligations clear and under control and ensure that it is complying with them.

**Mr FLETCHER:** I want to ask some questions about the hardship notice regime. Firstly, is the ABA supportive of the concept that a hardship notice can be given orally?

**Mr Gilbert:** There are some mixed views about that. In the existing law there is a requirement that the customer provide some form of notice. The important part of that is that before a bank can start to think sensibly about what sort of problem the customer has it is important that the bank knows what that problem is, and putting something in writing is an extremely helpful way of getting a process started. We understand that the oral or in writing hardship note a customer can give is to reduce barriers to access to the hardship teams that our members have. But 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

requirement, with a criminal penalty at the end of it if you do not comply. This is where staff training becomes so important—for people to listen attentively.

So, yes, there are problems and we understand the problems with an oral-only notice. Our preference would be for something in writing. In our chart that we have provided to the committee we have suggested that there be some formality around the provision of information by the customer and that the clock should not start ticking until such time as a reasonable level of information has been obtained from the customer. That works well for both parties, bank and customer.

**Mr FLETCHER:** Just on that point, as I read the provisions and your submission the question that was going through my mind was: what is the capacity on the part of a customer to trigger these provisions and the set of time periods that follows from them without providing any additional information at all?

Is it the ABA's view that as the provisions are drafted that would be open to a customer?

**Mr Gilbert:** Perhaps Jade Clarke could respond to that question.

**Ms Clarke:** In that context the customer will have the ability to make a hardship notice either orally or in writing and then not provide any further explanation to the credit provider as to their circumstances or their ability to meet obligations should their credit contract be changed. However, the issue that arises in a practical sense is that, if the credit provider does not receive relevant information, the credit provider will issue a section 72(2)(b) notice stating their unwillingness to negotiate due to a lack of relevant information. This will essentially lead to a detrimental circumstance for the customer, in that their application will be rejected, and this could lead to an increased number of complaints going to the Financial Ombudsman Service.

We believe, therefore, that an obligation contained within the law on a customer to provide information reasonably required by the credit provider to assess the hardship notice would be a much better situation. That would lead to hardship notices being assessed on a case-by-case basis and a credit provider being able to make an assessment of whether to negotiate, or whether to change the contract, within the context of having that information.

**Mr GRIFFIN:** On page 8 of your submission you comment regarding section 74. Are you actually saying that you think there needs to be a change or a clarification on that or are you happy that it does what you intend it to do?

**Mr Gilbert:** We did not seek a change in respect of section 74. This is a much broader basis on which a court could require a variation to a credit contract. In section 74 the option to extend the term of the contract is not available under the existing law and an amount payable would increase if more interest was incurred. There is a slight tension in the way that the section would actually operate.

**Mr GRIFFIN:** But you do not think it requires any action as such? The way I saw it is that you are noting the fact that this will be the implication as to what occurs but that you are not suggesting a change.

**Ms Clarke:** We are not necessarily suggesting a change. We are just noting the point that that could leave the customer worse off and that it would be taken into account when such court orders are made. As to whether a change in the bill should actually ensure that that situation could not arise, that is something that potentially should be taken into consideration by Treasury.

**Mr GRIFFIN:** Do you want to make any particular points about your comments regarding section 89A and the degree of complexity?

**Mr Gilbert:** It is quite complex. The law is confined to a prohibition on the beginning of enforcement proceedings, and we understand that that is the intended outcome. There were just some queries about the clarity of the drafting in terms of the way it is presented in the bill.

**Mr FLETCHER:** You have got some comments on your submission on page 13 about proposed clause 128 (aa). As I understand it, that clause would impose some limits on banks being able to notify a customer had been pre-approved for a loan. Can you explain the issue and the concerns that the banks have?

**Mr Gilbert:** 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 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—

**Mr FLETCHER:** Can I make sure that I understand this correctly. Are you saying that this bill contains a draft provision, the impact of which would prevent banks from telling their customers that they were okay to bid up to a certain amount in an auction to buy a house?

**Mr Gilbert:** That is an interpretation that we have reached on the provision. We accept the fact that you cannot write to people and say, 'Congratulations, you're preapproved.' It is very clear that the policy intent is about that. By stating, 'You'll be eligible when you come back to us for a loan if you bid up to such and such a price at the auction' it is questionable.

**Mr FLETCHER:** You are saying that some bureaucrats in Canberra have decided that it is going to be impossible for people to have the confidence of knowing before they go to bid on a home how much they are likely to borrow from their bank?

**Mr Gilbert:** That is our concern. We understand that this provision is directed primarily as a practice which is now being regulated or will be regulated next year under the credit card amendments to the credit legislation, where a practice was that a credit card issuer would send a letter inviting someone to accept an offer of a credit limit increase. Some of the language used in those offers was a bit like 'Congratulations, you're preapproved.' We understand and accept that the government has moved to regulate that space.

**Mr FLETCHER:** Have you had the opportunity to raise this concern with Treasury officials and if so what response have they given you?

**Mr Gilbert:** We certainly raised the bit about bidding at an auction.

**Mr FLETCHER:** What did they say?

**Mr Gilbert:** If it is about credit cards, it is something that we obviously have to accept because that is clearly what regulatory policy is.

**Mr FLETCHER:** But what do they say about the point about bidding at auction?

**Mr Gilbert:** That is testing my memory. Something along the lines that they did not think this would cause that degree of inflexibility—

**Mr FLETCHER:** That will be a question for a court on interpreting the words of the legislation?

**Mr Gilbert:** Ultimately or for ASIC or whomever, or a dispute resolution service—

**Mr FLETCHER:** Do you know if any of these people have ever tried to buy a house in Sydney?

**Mr Gilbert:** No, I do not.

**Mr FLETCHER:** I would not expect you to be able to answer that question.

**Mr Gilbert:** I am not sure whether Canberra is any better.

**Mr FLETCHER:** Fair call. On page 16, you talk about a matter which is not going to be of direct relevance to your members, assuming the legislation continues to contain the carve out for ADIs, but it is a question of the calculation of the quote's cost rate. Can you explain that point?

**Mr Gilbert:** The first thing we did say on page 16 is that as a matter of principle the ABA is not amenable to regulation which controls pricing and that if market conduct is the issue then market conduct should be addressed. But we have left our comments with respect to what are called small amount credit contracts, which essentially, in the minister's second reading speech, were described collectively as 'payday lenders'. We have left alone that issue for that particular part of the sector to deal with.

The cost rate is effectively a calculation derived from some New South Wales legislation that was legislated in 2010 and it is to be adopted into this piece of legislation. But for the fact that ADIs are to be exempted from this, we thought that we would want to put on the record the reasons that the cost rate was problematic in an interpretation sense, and there are some examples on page 16 of the sorts of things that are unpredictable and could include factors unknown to the credit provider which inadvertently could cause the cost rate to exceed 48 per cent. Again, we included those comments purely for the record. However, we are appreciative that the government has seen it appropriate that ADIs, which include not only banks that credit unions and building societies and mutuals, from this regulation.

**Mr FLETCHER:** Are you saying that the model for the calculation of the cost rate is essentially unworkable, that it is unable to produce certainty?

**Mr Gilbert:** If the factors are known that make the cost rate then I would say it is workable. But there were some concerns about whether fees payable to third parties that were unrelated to a credit contract may be unknown to the credit provider. Even if the credit provider had introduced the customer to this third party, the credit provider may not know what fees they were. That could be an insurance premium; it could be a range of things. We put these points to the New South Wales government at the time. We felt that it was quite inappropriate and unfair to expose a credit provider to the risk of exceeding a cap at the same time as the credit provider not knowing that certain fees and charges had been added to the cost to the consumer. We thought that that was wrong.

**CHAIRMAN:** There are no further questions, so, thank you, Mr Gilbert and Ms Clarke.

**Mr Gilbert:** I thank the committee very much.

**Proceedings suspended from 10:24 to 10:44**

**BARIL, Mr Paul, Committee Member, Financiers Association of Australia/Industry/Smiles Turner Delegation**

**BIRSE, Mr Russell, Delegated Member, Financiers Association of Australia; Committee Member, Financiers' Association of Australia/Industry/Smiles Turner Delegation**

**BRYANT, Mr Robert James, Chief Executive Officer, Money3 Corporation Ltd**

**ELLIS, Mr Gregory Ian, Co-Chief Executive Officer, Cash Doctors**

**PROSSER, Mr David, Chief Executive Officer, Money Plus Pty Ltd**

**SMILES, Mr Phillip, Consultant, Financiers' Association of Australia; Coordinator, Financiers Association of Australia/Industry/Smiles Turner Delegation**

**TEAHAN, Mr Sean, Co-Chief Executive Officer, Cash Doctors**

[10:45]

**CHAIRMAN:** Thanks, gentlemen. Who would like to start first to make some opening remarks?

**CHAIRMAN:** Who would like to make some opening remarks?

**Mr Ellis:** I am happy to go. Thanks very much for giving us the opportunity to present today. Sean and I are the co-founders of Cash Doctors. 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. About 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.

Cash Doctors is distinctly different from the other players in this space. We have a technology and data driven approach and extremely rigorous underwriting, application and approval methods. We approve just 17 per cent of all those who apply with us and we lend between $100 and $600—importantly, this is for a maximum of 45 days. The average loan is $421 for just 21 days, and we do not permit rollovers. Our business relies mainly on technology, creating economies of scale and referrals from happy customers who have a positive experience.

We are asking for three changes. We agree that we need to protect vulnerable consumers, but we also want to maintain choice for our demographic of credit averse, fully employed and tech savvy people. Firstly, we are asking that the product be available for full-time employees only and that it not be extended to those whose primary source of income is Centrelink. Secondly, we concur strongly with the prohibition on rollovers. Finally, we ask that there is an increase in the permitted establishment fee from the 10 per cent and two per cent to 27½ per cent, which will recognise the true costs and strike a balance between protecting consumers and allowing them to enjoy the choice to use legitimate operators.

**Mr Teahan:** One thing I would like to add is that 65 per cent of our applicants have a perfectly clear credit history. They have a choice to use other financial products but they choose to use us because they only want a small amount of money for a short period, and they trust us to give them that service without it evolving into long-term indebtedness. These are not vulnerable consumers; they are financially literate and they are credit averse. At the same time we recognise that there are vulnerable consumers and low-income consumers who rely on Centrelink payments, and the three points that Greg mentioned will achieve these dual goals of protecting vulnerable consumers and our demographic of consumers.

**CHAIRMAN:** Thank you.

**Mr Bryant:** Thanks for the opportunity to present here. I understand the difficulty of showing a DVD, but what I feel has been missing in the debate for the last 11 years has been the voice of the consumers, and I wanted to bring them alive in the room. I urge you to have a look at the DVD—there are four stories of consumers and they are not all working all the time. People have different circumstances. Similar to Greg's views, we really do not want to discriminate, so we make loans available to many people, including Wendy, in a wheelchair, who is on a carer's pension, but she needed a motel room when her bathroom was being fixed after having an horrific accident.

We serve over 25,000 customers per year, and 95 per cent of those loans are paid back. We are a publicly listed company and we service that group of people that might be deemed financially excluded—2.65 million people in the NAB report. It is interesting: all the reports that are in my submission are not from what you would consider our side of the fence; they are independent studies, including the regulation impact statement. Nobody accepts

that caps are the answer. However, I accept that there are rogue elements in the industry and I am very hopeful that this process will work through that.

The 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. I am fearful for our customers, who are the salt of the earth, who deserve a second chance and whom the banks did leave. The banks are not prepared to lend under $5,000, for obvious reasons: the administration costs are so high.

A company like Money3 will survive; there is no question about that. We serve 43,000 customers in the loans sector where the average loan is $177, and we make revenue of $2.1 million from that. We serve 10,000 customers a year whose average loan size is $1,600, and we make $6.9 million or something very close to that in revenue per year. We serve 653 customers with loans over $5,000, and we get revenue of $4.4 million. I can assure you our money and our resources will be going to that higher end market if this bill comes through.

I would be devastated to lose the staff, who love their customers to bits. I would be devastated if the options were not there for those customers. I really implore you to look at the submissions as closely as you can. Thank you for your time.

**CHAIRMAN:** Thank you. Money Plus?

**Mr Prosser:** Thank you. Money Plus operate exclusively in Sydney, and we have done since 1999. We are one of the originators there. When they brought in the New South Wales legislation, they never consulted the industry, with the result that the industry just went around the law which was intended to close us down. We have made it viable, we have put in many options to make it viable, and all it has done is confuse the customers. But we do operate within the law. The New South Wales legislation, in my opinion, has really just kept out our competition, because publicly listed companies, I believe, would find it very difficult to operate in Sydney. We would prefer to be open and transparent. We expected there to be competition. I believe that there is a lot of competition which has not gone into Sydney, and I think that it would make it more open and more transparent.

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.

**CHAIRMAN:** Thank you very much.

**Mr Smiles:** I ask for the committee's indulgence to accept two minor amendments to the submission before the committee. First, I ask that the figure of $23 noted on page 5.5, line 6, be amended to read $18.50. That is my fault. I included an average when I wanted to include a lower figure to give a range. Secondly, there is a typographical error, where the word 'been' is minus an 'N' later in the submission. I table the corrections.

**CHAIRMAN:** The committee will have a look at that and make a decision on it. That is fine.

**Mr Smiles:** I would also like to table a supplementary submission. Since your committee's call for submissions, you will be aware that Treasury has released a discussion paper with regard to section 32A(2) as in the draft exposure bill. As that has come to our attention we have a strong view that, without some awareness of the dynamics of that discussion paper and its contents, the committee's consideration of the whole of the rest of the bill would be deficient. So I make this request to table the supplementary submission.

**CHAIRMAN:** Thank you. Leave it with the secretariat and we will consider the extra submission.

**Mr Smiles:** Thank you. To commence I would like to make a few brief points. Point 1: Firstly, Treasury has admitted to no economic modelling behind the 10, two and 48 per cent cap regime. Secondly, the regulation impact statement prepared for this bill was prepared, quite rightly, after the conclusion of the green paper process in August/September last year. Unfortunately, it contains none of the information presented by industry and particularly the delegation since that time. I have no criticism when a document is prepared at a certain time, but I think it is important that the committee understand that that regulation impact statement is a dated document and that there are considerable deficiencies. We do make some points in our submission with regard to areas of concern, but I particularly draw to your attention the dated nature of that regulation impact statement and associate with that also of course. The committee would be aware that ASIC has been reviewing the industry,

particularly the payday side of the industry, and ASIC of course has yet to prepare a report on that review, which again I believe is a considerable deficiency with regard to the opportunity of this committee to consider the whole context of this legislation.

Point 2: there is no demand for this legislation from the consumers. In fact, the consumers are voting with their feet. At the moment the industry, over the last three years, has been enjoying an 18.5 to 18.6 per cent compound increase in business.

Point 3: we have no demand for industry particularly punitive legislation from the great bulk of the counsellors and consumer advisers. Yes, many of them want some amendment and reform, and the FAA and delegation supports that. However, I think it is important to be aware that it is a small minority of the consumer advocates who seek the major punitive reforms that are included in this bill.

Point 4: the minister has announced an examination of alternatives to the commercial lenders to be undertaken. It is most unfortunate that the discussion paper promised is yet to be released and it is most unfortunate that it may well be that this committee will have packed up and gone home before that process is undertaken. That is a very disturbing issue because this bill essentially abolishes a substantial part of the finance sector we are talking about. Unless the committee has a clear understanding of the alternatives available, the committee's consideration of this bill will be deficient.

Point 5: the bill, as I have indicated, indicates abolition. The truth of the matter is, in the context of an old Trade Practices Act or ASIC Act circumstance, this bill would achieve some critical comment from a court because the term 'enhancements' included in the title really should be replaced with 'abolition'. The reality is that the minister has recently announced an increase in funding to this sector, frankly, to replace the commercial lenders that are going to be abolished under this bill if it proceeds. The minister will have to increase that financial allocation by at least 60 times just to cover the loan book capital.

Point 6: 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.

Point 7: the economics. We focus on whether there is a profit per loan. The 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. There are other economic realities. Under current circumstances, where a lender has a bad loan—a bad debt—it takes on average 8.3 further loans of that nature to recover the funding to be back to the starting point, as it were. With the provisions of this bill, it will take—depending on the length of a loan—between 27 and 60 loans of similar kind to recover. The fundamental of that is this: in business, if you have to make eight winners after a loser, you are running the risk that one of those eight will not work; but with luck you will get by. The reality is—just statistically—that if you have to run 40 to 71 loans thereafter and have every one of them work, your chances are Buckley's.

Even before we talk about profitability per loan, we have this fundamental issue of how to recover your basic investment when one loan goes bad. There will no possibility of profitability. The reality is that, for those lending under $3,000, it will be totally uneconomical to be involved. However, for those that lend $3,000 to $5,000, there is the dynamic of the proportion of their loan book that is in that area and the proportion underneath. Eighty per cent of the lenders who lend $3,000 to $5,000 also lend under $3,000. The problem with the bill is that, for those people with their opportunities under $3,000 gone, the amount of money they can make in the $3,000 to $5,000 loans will not cover the loss they will make if they keep up their current lending.

Point 8: as my colleagues on the table have said, the New South Wales cap has not worked. There are six avoidance strategies to get around it. When the cap was introduced, 12 members of the FAA—then nearly 100 membership—left the industry and about eight are now planning to go. When the cap was introduced in New South Wales, GE Money and Amazing Loans told the world that they could survive with payday lending. The reality is that GE Money, as you know, now does not lend under $3,000 and Amazing Loans went out backwards.

Finally, I have a point about the supplementary submission. Section 32A(2) has now been discussed with Treasury. It is a package of dynamite in its interface with the rest of the bill. The reality is that today we are not talking about a 48 per cent cap. On the presumption that one option included in the section 32A(2) discussion paper—and any option—is introduced, we will in fact have to guess what the maximum interest rate will be. But I can assure you that it will be somewhat less than 40 per cent. In any calculation by the industry or the committee on interest rate caps, please be aware that the 48 per cent is now a fiction; it will be considerably under.

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 $5,000 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 subsidised ANZ and NAB sector you will have to, one way or another, provide a 100-fold increase in funding for that sector. I hope there is an opportunity for the committee to call witnesses to explain what the alternatives will be if the bill proceeds and the greater proportion of lenders now lending in the commercial small-amount short-term market are gone. Thank you.

**CHAIRMAN:** Mr Baril, did you want to add anything?

**Mr Baril:** Yes please. Committee members, thank you for letting me speak today. I originate out of Canada. I am an Australian citizen now. I was one of the originators of Payday lending in Canada; we started in about 1992. I took the opportunity to bring with me today a current contract that is used in Canada right now. They went through two years of legislation with the government and working collectively with the government—a position that was a little bit different to the one we were in. Ernst and Young, one of the largest accounting firms in the world now, broke down the cost. 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. So I would like, if I can, to leave with the committee this two-page contract to look at.

I represent Cash Stop Financial Services, who are primarily in Sydney. Our current contracts for writing a loan are 19 pages under the new NCCP Act, even if it is for $100. 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, 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. On behalf of Cash Stop I have brought today—and I am happy to submit in confidence—a P&L statement ending June 2010 showing the profits we make from the loan product against the cost of operation. We are reporting seven per cent to the bottom line before tax.

We did the modelling on the future of surviving under the 10 and two per cent. That would reduce probably 60 per cent of our profit. 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 minimum wage in Canada is $10 an hour. Here, all financiers fall under a financial award where you are paying salaries of $40,000 a year. Rents, bricks and mortar are at least 30 per cent higher here than they are in Canada. For our location—we have one on George Street—rent is $14,000 a month. It is a small location of 60 square metres. The 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.

We met with Treasury, and I was a little confused. I have been invited to three meetings, which were fine. Treasury presented to the minister that we needed $30 on $100. It was totally dismissed and nothing happened. Then we got caught sideways with the 10 and two per cent, so that took me by surprise. Mr Smiles, who is sitting next to me, talked earlier about a company called Amazing Loans in New South Wales. The company went to the Labor government back when they set the capping originally and said, 'We can do this under 48 per cent; you don't need these Payday lenders anymore.' I brought with me a recent article by the consumer advocates. It is dated 21 September 2011. The concerns I have for the industry and probably some of the companies here is that some of this information—and I am happy to present this again to the committee members for a quick look at—talks about, for example, a bankrupt mother on a loan of $5,000 paying back $12,000.

First off, this happened six years ago, way before the NCCP kicked in. The company, Amazing Loans, that did this and were doing these type of loans were competing against GE. They were not even really microlenders. Their minimum term of loans were four to five years. What they were doing was instead of lending a person $1,000, which they could pay back, they were lending them $5,000 over five years, which totally defeats the purpose. Consumer advocates in some of the reports were saying it is better to put these customers into a longer term loan. I have been in this industry 30 years and it is absolutely nonsense to suggest putting someone who needs a $500 loan or a $700 loan, whether it be to buy some food or to go out, into a loan of $2,000 or $3,000 on that part of it. It does not work from that perspective.

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.

As Phillip pointed out, it is not just the capping fees here that will destroy the industry; it is some of the other regulations—the ones about prohibition on having another loan of any sort. The NCCP created what we call 'responsible lending with disposable income'. Not everybody is on Centrelink. Cashed-up does serve Centrelink customers and we are proud to be doing it, and we have been doing it for 10 years here. We do not believe that these people should be segmented from the market. They have needs just like everybody else does. Going further with this here is about not having another loan with disposable income. If I go into a 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 same lender to do the loan. They cannot go to anybody else. The other thing is how is the other lender supposed to know exactly how many loans there are. There is a reasonable amount of inquiries you can make. That is all I have to say from my end.

**CHAIRMAN:** Thank you, Mr Baril. Mr Smiles, you said that it is not possible to have a cap of 48 per cent on anything under $3,000. What would you suggest is a cap? Forty-eight per cent is almost half. That would seem like a lot of money to people if you are borrowing $3,000 and you have to pay back $4,500. How do you explain that?

**Mr Smiles:** It is the absolute dichotomy of attempting, as we all do, to compare a 25-year housing loan mortgage with short-term lending. The challenge is to get away from—and I do not present this in advocacy; I present this as an economist—the first stop of looking at the percentage. The challenge is to start by looking at the costs. Look at the fixed costs: $11 minimum for compliance, since 1 July last year; and $7 average for a Veda check. Governments around the country are keen on people being paid award wages. The minimum award is about $18.60, or $18.00 in this case. The average counter staff member in the retail or bricks-and-mortar lenders are being paid $23.00 an hour. Before we look at what a good percentage is, first consider that 48 per cent on a couple of a hundred dollars for a month, or ten per cent and two per cent on a couple of hundred dollars a month, does not even cover the things that responsible lending demands—credit checks—and does not even cover what the government demands, which is obeying the law.

**CHAIRMAN:** How does that operate with a $3,000 loan over a longer period of time? What is the measure, cap or limit? I understand your point about a smaller loan over a very short period of time, but 48 per cent on a $3,000 loan over a longer period of time would seem more than generous.

**Mr Smiles:** Yes, that is true. If you can go five years or the like, that is fine. But that raises the very point that Mr Baril was making: if you force the market away from the $200 loans for a month, six weeks or two months into that lengthy loan then you have to question whether you are making any contribution debt spirals and you certainly have to recognise that you are increasing—as you do every time you go up in size and every time you lengthen a loan—the opportunity for default and the further problems associated with default. In terms of the dollars, frankly in our view the dollars should be determined by the market. That is why we have advocated for a 48 per cent interest rate to please those who see 48 per cent as having some sort of magic. Borrowing the minister's concept with regard to the 10 per cent/2 per cent, we say let the market determine the establishment fee. Could I guess at what I would want as a lender? Yes, I could. It would be inappropriate for me to say it, because Mr Baril and Mr Birse might dramatically disagree.

**CHAIRMAN:** Mr Baril, you mentioned also the figure of $21 per $100 as a base.

**Mr Baril:** In Canada.

**CHAIRMAN:** What would be an equivalent base here?

**Mr Baril:** The equivalent base here would have to be $30 on $100. I would like to add one thing about the 48 per cent, too. There seems to be this myth—and the consumer advocates use this a lot—that they would be able to make money on 48 per cent. But it is daily reducing interest. On a $100 loan for two weeks you make $1.10. You simply need to do the math on it. But the way it is drawn out people say, 'If they can't operate under 48 per cent they shouldn't be in business.' You are not making $480 on $1,000 for a year. You are only making about $260-odd on it. With the cost of producing that loan, never mind the paperwork and the compliance and everything else, it cannot be done. In the NAB study they found that you could not do a loan under 48 per cent under one year under $3,000. This is without the bricks and mortar. They did not do an analysis on what you pay there. They were saying that even for them to do it would not be possible—and they have the bricks and mortar and they do all the other services.

The other great risk here, too, is putting a customer into a $3,000 loan over five years will pretty much wipe every small lender because your capital to carry on that would be massive and only publicly listed companies could probably afford to do that. The small lenders still have to get their capital from the banks to even do that. It would not work.

**CHAIRMAN:** Are you talking about $30 in a $100 on every $100?

**Mr Baril:** That is correct.

**CHAIRMAN:** Not just the first $100 but every $100 up to $5,000.

**Mr Baril:** Up to $2,000. If you went over $2,000, adjustments could be made. We talked about this in our submissions. There is the 48 per cent APR and then what you call an administrative fee to go along with that. That should be driven by the associations that are represented, because they have all the members included. They can negotiate with government on that.

**CHAIRMAN:** What are the default rates in your own businesses as compared to general banking?

**Mr Prosser:** Our default rate has for 10 years been under five per cent. Currently, it is sitting at about 3.4 per cent. I am talking about bad debt. Our dishonours are miniscule, but that is because we chose some years ago just to lend to people who are employed. These people are more responsible. We found that people who are on government benefits have an entitlement mentality, so we had enormous administration costs there. As Rob said, we should not be prejudicing, but we have been forced to, unfortunately. Everyone should have equal opportunity

**Mr Bryant:** Of cash advanced, we write off about 5.5 per cent. With the lower end loans, the percentage may be higher, but on average it is 5.5 per cent. It is a portfolio that covers a wide range of people. To answer your question regarding the 48 per cent and how much profit is made there, a painter went to a financial counsellor and they said: 'Sell your house, Brad. You've gone too far. You've got a bit of an alcohol problem. You're going to lose your car.' That was a path that was going to bankrupt him. Fortunately, he had a mate in our business and so after two years Brad has saved his house, saved his car and is working in the mines. The banks could not look at him: he was gone; he was past the point of no return. We take a risk on those. Yes, the bad debt is not that high as such but the amount of administration at the lower end—which is a bit higher there—is very expensive.

**CHAIRMAN:** And Cash Doctors?

**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 principal. 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 clear 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 and they will pay it off in a few weeks. Then they can move on and forget about it.

**Mr Birse:** There is also an aspect of fraud that needs to be considered in those numbers as well. There is a component in that of customers borrowing without the intention of ever paying back the money. If the avenue for that widens then there is a chance that those numbers could go much higher as a result of that.

**Mr Smiles:** We undertook some substantial research in this area in November and February. We found that of lenders in the unsecured area, 9.3 per cent had a default rate between zero and five per cent, 83.4 per cent of loans had a default rate between six and 10 per cent and 6.8 per cent of lenders had a default rate of 11 per cent to 15 per cent.

**CHAIRMAN:** Thanks, Mr Smiles. If you could table that, we would be happy to accept those figures.

**Mr FLETCHER:** Starting with Cash Doctors, could you explain into a bit more detail why it is that your customers come to you and why, for example, they do not use a cash advance on a credit card?

**Mr Teahan:** The reason is that a credit card can evolve in long-term indebtedness. So, for example, if you get a $5,000 limit on your credit card, you can spend that in the space of two weeks and then be paying it off for the next three or four years. With our product, we make them pay it off within a matter of weeks. The average loan period is three weeks. They trust us to be able to deliver that. They want to just be able to borrow and then move

on. Speaking with clients, they have told us that they prefer the ability to be able to use a short-term fund just for short-term needs and then move on.

**Mr Ellis:** So they are not tempted into using more credit. They appreciate that.

**Mr FLETCHER:** Have you had the opportunity to make these points to Treasury officials, for example? If so, what kind of response did you get?

**Mr Ellis:** Only in as much as the submission that we have made. As far as the fees go, we charge that 27.5 per cent now and we make $4 profit per loan, and that is with a highly automated, software driven business model. We would make a $69 loss per loan on the 10 and two. We are happy to share our financials to validate that if required. We have nothing at all to hide.

**Mr FLETCHER:** You have not had Treasury officials come to meet with you to understand your business model? They have not come to your offices?

**Mr Teahan:** No, but they are more than welcome to do so.

**Mr FLETCHER:** You talked about it being highly automated. Could you expand on that. Is it mobile handsets?

**Mr Ellis:** The application process is online through mobile handsets or any PC. But probably the real difference is that we have been building a software system for six years with multiple software developers. It does credit checks. There are a lot of data mining and credit risk engines sitting in the background that look at the data that we receive from the client plus other publicly available data. We will compile that with the Credit Bureau data and our data to date from our client base to try and make the best decision possible and minimise the instances of people going overdue.

**Mr Teahan:** We confirm their employment as well to make sure of how much net income they are earning.

**Mr FLETCHER:** Are you able to do that with less face-to-face time and less employee time than others?

**Mr Ellis:** We have no face-to-face time. We just make a quick call to their payroll officer at the moment to check that.

**Mr Teahan:** We lend throughout Australia online.

**Mr FLETCHER:** Mr Bryant, in your submission you talked about a suggested minimum repayment term of one month. Could you expand on the thinking behind that.

**Mr Bryant:** My biggest fear is that our consumers are going to be worse off under this bill. There are practices such as bullet payments being taken, with customers having to make the whole repayment in one go. When we bought our businesses under the Uniform Consumer Credit Code 10 years ago the first thing that we did was extend the loans to a minimum of one month. This notion of having someone's whole income, almost, taken at the next pay was abhorrent. Unfortunately, there are rogue elements who are not going to miss a step under this bill. 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.

**Mr FLETCHER:** Mr Smiles, you talk in your submission about an alternative cap model. Do you have a view as to what proportion of the industry supports that alternative cap? Have you been able to discuss that across the industry?

**Mr Smiles:** Yes. The alternative cap involves a recognition—as you would have read—of the current bills 10/2 idea with regard to those who are below a certain net income threshold. We have suggested that the proposed minimum ATO tax threshold would be a useful one to look at. The area that is most important in our alternative is loans to those consumers who are not under that minimum income threshold. There, as you are aware, we propose 48 per cent plus a market driven establishment fee. That has almost universal support in the industry, with both the FAA and the National Financial Services Federation agreeing with that approach.

**Mr FLETCHER:** Have you had the opportunity to discuss that with Treasury officials?

**Mr Smiles:** Yes, but only in the context of the earlier models. The concept of 48 per cent and some sort of market driven component has been part of our discussions. But we have not discussed the totality of the model, because that came as a surprise with the draft exposure bill. But we made a submission to Treasury over that and, in fairness, Treasury kindly met with industry representatives the day after the exposure draft was released and we were able to make limited comment on the work that we had done overnight.

**Mr FLETCHER:** Coming back to Cash Doctors, when you developed your business model you presumably identified that there was an underserved segment of the market. Could you expand upon that. How was that segment underserved absent your product?

**Mr Ellis:** We had been that segment not so long ago. Basically, whether you are on $25,000, $30,000, $40,000, $50,000 or $100,000, if you add up your savings and your income, depending on what is happening in your life—there will be vicissitudes—your expenditure matches your income. If you were to graph that, occasionally there will be a shortfall. Everybody can identify with that. You cannot deny that even people on fairly high incomes have that problem. They are the people who we are there to serve. We give them a legitimate, transparent and technologically driven alternative. These guys are comfortable transacting online. They are professional, office bound people.

**Senator HANSON-YOUNG:** My first question is to Cash Doctors. In your submission, you go to great lengths to explain the make-up of your customers. You do not say in your submission that you do not accept people as customers who are on government welfare benefits or some type of pension. But is that what you are saying?

**Mr Ellis:** That is right.

**Senator HANSON-YOUNG:** It does not actually say that in here, but—

**Mr Ellis:** If it is the primary source of income, certainly not. You could have someone on $80,000 getting child support endowment, and that would be fine.

**Senator HANSON-YOUNG:** Sure, but the primary source of income would need to be through an officially registered employer?

**Mr Teahan:** Yes, and it has to be minimum amount as well.

**Mr Ellis:** Receiving sick and holiday pay; not contractors or casuals.

**Senator HANSON-YOUNG:** So not contractors or casuals?

**Mr Ellis:** No, not at the moment.

**Senator HANSON-YOUNG:** So how do you determine that?

**Mr Ellis:** We make a call to their payroll officer. Alternatively, they can send in documents if they are perhaps a little shy about that. That is how we verify their employment when they first join up with us.

**Senator HANSON-YOUNG:** What is the reason for you making those types of restrictions on your own client base? What made you say, 'This is going to be our set criteria'?

**Mr Teahan:** Apart from it being ethical, compliant and something we are confident doing ourselves, it is also how we grow our business. We actually depend on more demand through customer referrals. Obviously, we help customers out when they need it but if they are not able to repay on time and are overdue and we are rolling it over they are not going to have a good experience and are not going to share their experience with other people. This can be negative. That is how we grow our business. Our average client takes just five loans in the year where typically the industry report it as 10 loans in a year. They use us for a short period of time and then we get more referrals from that, and that grows our business so it is combining our commercial goals with compliance and ethical goals.

**Senator HANSON-YOUNG:** You talked about the data you collect and keep for your own purposes of building the business. Have you been able to do any analysis of what days people come in and ask for a payday loan? What day of the week?

**Mr Teahan:** That is an important piece of data. It is definitely something we analyse. We have a huge number of variables and data that goes into our scoring system. That is what we call behavioural analysis. That would help us. As we get more sophisticated with our scoring we will start to monitor and be able to see if a customer has three loans and is borrowing in such a way that indicates they may get into trouble. You would be able to figure that out by analysing the data, which is what we do. We have a team of mathematicians who help us work that out.

**Senator HANSON-YOUNG:** So what day of the week do most people come in to one of your shopfronts and apply for a loan?

**Mr Ellis:** We are on the internet only. We do not see them. I actually do not know that. As Sean alluded to there, that is a project due for next year. Once people do join us then we will be looking to model and predict when they are on the ropes using that sort of variable exactly.

**Mr Teahan:** We could find out for you.

**Senator HANSON-YOUNG:** Could you take that on notice?

**Mr Teahan:** Yes, we could research that.

**Senator HANSON-YOUNG:** Mr Bryant, what restrictions do you put on your customers? We have heard from Mr Ellis that they only lend to people who are primarily in employment and they do not take casuals or contractors. What are your restrictions?

**Mr Bryant:** Just inside of our mission of advancing people's lives we do not make judgments on the people at all. We look at their capacity to repay. We look at their bank statements for the last three months and we conclude what sort of surplus they have as a result of that. Of course, you have to weigh in a few other things like their employment et cetera. I make no bones about it, 60 per cent of our customers are working and 40 per cent are not gaining most of their income from work.

**Senator HANSON-YOUNG:** So you do not have the same restrictions?

**Mr Bryant:** No restrictions. It is capacity to repay and responsible lending.

**Senator HANSON-YOUNG:** Walk me through this. When somebody walks in to apply for a loan they bring in their bank statement—

**Mr Bryant:** Yes, for the last three months. Pay slips or Centrelink statements, a utility bill that shows where they live and they have to give us two references of people who are next of kin and then we assess on that basis and ask a lot of questions of them. It is in our interest to have them repay. We are building up our case to manage them as we go further on. We want success stories not failures. We have been with COSL since 2008. We have had two complaints to COSL that were referred back to us and handled quite well, so that part is quite good. We work in the customer's best interest.

**Senator HANSON-YOUNG:** How long does the application process take?

**Mr Bryant:** Anywhere from a minimum of three-quarters of an hour up to a couple of hours, depending on the complexity and the size of the loan.

**Senator HANSON-YOUNG:** Many people have multiple bank accounts and a variety of store cards. How do you manage to cover off all those things in that amount of time?

**Mr Bryant:** How do we manage to be a responsible lender? We look where their income is going. That is the key. We have to know where their main source of income is going. We have to look at the bank statements. Then there will be transfers to another account. Kathy, who works with us and is a former customer, could answer those questions very well if you wanted to talk to her at any point.

**Senator HANSON-YOUNG:** I thought I recognised her picture.

**Mr Bryant:** She's come up all right, hasn't she? Kathy in 2004 borrowed from us as a single mum. You know the story: she got the credit cards thrown at her at 18 or 19; single mum gets $500. Kathy is an absolute treasure in showing just what can happen when people are believed in. That is what we sell; we do not just sell money. We sell self-esteem.

**Senator HANSON-YOUNG:** What happens when somebody is not able to repay?

**Mr Bryant:** We take a motherly approach. We do not have heavy handed debt-collecting tactics. We have a phone conversation: 'Look, you promised to do this; you're not taking responsibility; you know that's often happened in your past. We want to give you a go and yet you're failing again.' We coach on conversations. It is one conversation at a time. If you want to advance someone's life, you have to shift the way the circumstances occur for them. And so we put a lot of training into shifting the way those conversations are conducted, because you really want to turn people around to be their worth.

**Senator HANSON-YOUNG:** When somebody comes in and applies for a loan, after that 45-minute to three-hour application process, do they walk out with a bit of paper that says exactly how much they will owe?

**Mr Bryant:** Absolutely, yes.

**Senator HANSON-YOUNG:** What is the time frame for the repayment based on?

**Mr Bryant:** The total amount they walk out with and the time they have to pay it back is based upon what they are purchasing—the purpose of the loan. If they need to buy a fridge—

**Senator HANSON-YOUNG:** Do you require them to tell you what the loan is to be spent on?

**Mr Bryant:** Absolutely. You have to know.

**Senator HANSON-YOUNG:** Looking through the submissions, it is not everybody's requirement.

**Mr Bryant:** It is part of NCCP now. You have to know the purpose of the loan. Anyone who is not doing that needs to look at their practices. I am really confident that the NCCP's first phase is working quite well. You look at the purpose of the loan. If it is an emergency that has come up quickly and they have the capacity in their surplus to repay that quickly, then you do it for a short period of time. If they are a new customer, you lend a smaller amount to see whether or not they can do it. In Kathy's case, for example, it was a smaller amount and then she got another loan. Now she has a home loan with someone else. It is often retraining people—that is how we look at it. The loan must match the purpose.

With the Amazing Loans model—which Paul alluded to earlier—they came in with a big bang. They said, 'We can operate inside the 48 per cent cap of New South Wales.' And they did: they grew to 48 branches, but what they missed was matching the loan amount to the customer's need. They were giving money to people who had sometimes been irresponsible in the past and then expecting them to be responsible with that larger amount of money. But they go and spend it straight away and they have the liability over five years. The people were in more trouble. That has caused more trouble for the industry than anything.

**Senator HANSON-YOUNG:** What would be the average amount that a customer borrows from Money3?

**Mr Bryant:** There are three different products. The small amount, that loan for a month—the pay-day lending, if you like—averages about $203. The larger amount—

**Senator HANSON-YOUNG:** On $203 what is the average amount they end up paying back?

**Mr Bryant:** $250.

**Senator HANSON-YOUNG:** $250 in addition?

**Mr Bryant:** No, no.

**Senator HANSON-YOUNG:** In total?

**Mr Bryant:** $250.

**Senator HANSON-YOUNG:** And over what period?

**Mr Bryant:** A month.

**Senator HANSON-YOUNG:** If they miss that month's payment, what would it cost them the following pay?

**Mr Bryant:** Not the following pay. If they are paid fortnightly, there are two payments that come out, and they would—

**Senator HANSON-YOUNG:** Let us clarify. If they miss a month, you renegotiate?

**Mr Bryant:** No, that loan is put on hold.

**Senator HANSON-YOUNG:** So when do you start compounding the extra fees on top of that?

**Mr Bryant:** We never would compound extra fees, except for a default fee. If they go out of communication, we would then charge them a default fee of $50. If the loan has gone into arrears and they have gone out of communication, they could be charged $50. Now, that is after they have gone out of communication.

**Senator HANSON-YOUNG:** After they have missed the month's payment?

**Mr Bryant:** No, they do not get charged $50 straight up. If they have missed that month's payment, then you have the phone conversation. You say, 'Would you like to pay $5, $10, $20; what can you do?' So you are bringing them back into line. You are retraining them. We have it in the contract that, after 60 days, you can charge a default fee of $50. So we do not roll a loan. If they cannot pay it back, we have made the mistake. The contract stops. Then, if conversation does not get them back to honouring their word, you can take the legal path.

**Senator HANSON-YOUNG:** So is there a default fee or not, after they have missed that first month?

**Mr Bryant:** The process is as follows. If they have direct-debited and it has failed and they are on a low income, there is no charge; if they are on a higher income, there is a charge.

**Senator HANSON-YOUNG:** Is okay. What is your low-income classification?

**Mr Bryant:** Centrelink customers.

**Senator HANSON-YOUNG:** So 40 per cent of your customers?

**Mr Bryant:** Yes.

**Senator HANSON-YOUNG:** I am still confused about this extra $50 fee. If there is no communication and you cannot get in contact with them, at what stage does that kick in—after they have missed three phone calls?

**Mr Bryant:** If they have not returned the third phone call or replied to the third letter—

**Senator HANSON-YOUNG:** Is it the third, or is that me putting words into your mouth?

**Mr Bryant:** No, it is the third. The policy is that you make two attempts to debit their account and, if they fail, you do not do any more debits and you start the arrears process. That is very much covered under NCCP. You send an arrears note and then a default notice some time later, and then you are able to charge the fee. 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. Does that make sense?

**Senator HANSON-YOUNG:** And you are saying that includes all of the other things?

**Mr Bryant:** Everything. 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. That is where you are heading. I see it, I understand it, I am with you completely. It is captured in this bill. Do not lose it. For people have not worked out the way you want, cap the total amount that can be charged at 100 per cent of the loan amount.

**Senator HANSON-YOUNG:** So what would your preferred cap be? We had a reference to $30 to $100. What is your preference?

**Mr Bryant:** For those low loans, I am clear that anywhere in the high 20s is fine. You can make a profit at that level, and we would stay in that market.

**Senator HANSON-YOUNG:** What is the figure you charge at the moment?

**Mr Bryant:** For a first-time customer, it is $30 for $100; the second time, it is $25. And, say, for a $200 or $300 loan, it is $50 and $75.

**Senator HANSON-YOUNG:** Okay. So that proposal is pretty much what you already charge?

**Mr Bryant:** Pretty close—and that is for those lower end loans. I actually suggest that we bring that short-term credit to $500 being the maximum, not $2,000 as it is now, because that averages $200 from everyone. These chaps are under $600; that is the real short-term payday lending that we are talking about. All other credits should be above $500, in my view. Then the only tweak we need in that is that there is a 48 per cent cap, as it is, and then an establishment fee based on competition. And the competition will be rife; there is no question about it. That particular part of the market is very appealing, and there will be competition to drive that down—but it cannot operate under the 48 per cent inclusive. We just need to have an establishment fee that is then responsible lending, and the Trade Practices Act comes into that.

**Senator HANSON-YOUNG:** Out of the 60 per cent employed and 40 per cent on government support payments, is there a difference with the amount of money that is loaned on average?

**Mr Bryant:** Yes, very much so. We have a restriction on a government pensioner. Not so much a pensioner—you have to be careful, because there are many single mums who are on a reasonably good wage. So we still look at their capacity. But the general rule is $100 for a line of credit is the maximum that can be paid to a Centrelink person unless they have got very good capacity from some other income.

**Mr GRIFFIN:** One of the issues raised by a number of witnesses is the question of—putting it in simplistic terms—the federal legislation proposed being based on the New South Wales system when the New South Wales system is fundamentally flawed. It is fundamentally flawed in the context of its operation now, therefore, if you expand it across the federal level you will have problems.

Given the time I will try to paraphrase it. Those problems will be that you will basically drive lenders out of the smaller loan area, down to the $3,000 mark. The circumstances in that situation are that you will dry up available legitimate credit options. People will either (a) not be able to access credit legitimately, or (b) go to less savoury lenders out there in the broader community. I want to focus on those points so if people have something they want to say that illustrates that point or otherwise, I would like to hear about that.

**Mr Smiles:** There is no one lending on 48 per cent under $3,000 in New South Wales. The cap is a failure. I told the committee earlier that there are six models to, we say, 'accommodate'—we know others say 'exploit'—loopholes. We know that others say 'attempt anti avoidance'. Please do not think the New South Wales cap can work in a legitimate market—it cannot.

**Mr GRIFFIN:** So it fails in what way? What has happened?

**Mr Smiles:** It fails firstly because you just cannot survive. You cannot cover costs in the totality. It is absolutely true, as the chairman has alluded to, that at the higher end—the $3,000-$5,000 end—you can make money on that individual contract. But we are talking about the other end.

**Mr GRIFFIN:** So if I am someone at the bottom end—I am a punter, I am a Centrelink client et cetera—what do I now do in New South Wales?

**Mr Smiles:** You go to a lender who offers you a loan that, according to very well-advised lawyers and other experts, satisfies the legislation in its black letter; but, yes, it does not satisfy the legislation in the original intent.

**Mr GRIFFIN:** What does that mean for me as someone who is borrowing through that system?

**Mr Smiles:** Ironically, you do not pay any more than if you were in a state that did not have the legislation. The most interesting thing in the pricing of small amount short-term lending across Australia is that it is relatively uniform in its range in each state. So the New South Welshman or woman does not suffer a price disadvantage to their colleagues in Western Australia, Tasmania, South Australia or the Northern Territory or, for that matter, even Queensland, albeit that they—

**Mr GRIFFIN:** But they end up paying more than 48 per cent?

**Mr Smiles:** Yes.

**Mr GRIFFIN:** And that is done through additional fees, or how?

**Mr Smiles:** As I said, it is done by structuring the loan in six different ways—by now they should be well known to ASIC—and they are done legitimately, according to the black letter of the law. But I repeat that it does mean that a straight 48 per cent loan for the small lender does not exist. In this market the loans between $3,000 and $5,000 constitute about 8.6 per cent of the total loans, so your great majority of loans are under $3,000.

**Mr Baril:** I will share a Cash Stop perspective. We were just dealing in gold, but we started getting into pawn broking about a year and a half ago. This is the reality if the payday lending is gone: customers revert back to pawn broking. I guess if this is what the government wants, but in pawn broking you can charge unlimited fees. They tried to bring them under 48 per cent in Victoria and it almost killed the industry. Break and enters and crime then started to skyrocket. With Cash Stop, we preferred not to go fully into pawn broking. I personally believe that the person should have the right to watch their TV without having to go to a pawnbroker and leave it there to get a loan. Our unsecured loans give the customer a chance to pay off the loan in a short period of time, and if they need the loan again they can come in and get the loan.

In Canada—we started in 1992—when payday lending came in crime statistics dropped. We operated our first store in Regent Street in Toronto, one of the toughest areas of the city. We had a very good relationship with the police department. There was a major drop in crime, because of unsecured loans and the fact that they could get access to these small loans. I think that if they wipe that part out people will just go back to pawn broking. I really believe in unsecured loans.

No-one has asked us what we do with our defaults. We are one of the biggest lenders in New South Wales, as a group. Cash Stop does close to 100,000 loans. We do not go to court on our payday loans. We would only go on the stuff that is with working people alone. We actually eat the cost of the loans.

We also started going into internet lending to try to compete in that market. We started that about a year and a half ago. You asked some questions on that and I will help you clear the air on it. You asked when the majority of the people do the loans. For us it is quite simple when we write the most loans. It is on Monday, Thursday and Friday. That is your answer. That is when most of the people are doing the loans, whether it be on the internet or whether it be payday lending. It has not changed between the two because we have bricks and mortar. Whether government is trying to push people more into the internet or whether it is bricks and mortar I personally lean more towards the brick and mortar, and people from the internet will differ here. With bricks and mortar you have your customer in front of you. We ask to see their bank statements, which as Mr Rob Bryant mentioned, for three to four months. It helps you in the evaluation. On the internet part of it you do not have that part of it. On the internet we do lend to Centrelink customers but, again, as part of responsible lending we strictly look at the number of loans they have with others.

**Mr GRIFFIN:** Do you have any comments on the New South Wales experience?

**Mr Prosser:** Our contracts are for two years. Our latest contract is for two years and we have a deferred application fee. We ask the customer to pay it back voluntarily within three months. That is how it works in New South Wales.

**Mr GRIFFIN:** So you get around it by setting the contract up for a longer term—

**Mr Prosser:** Setting the contract up to fail. It is negative; it is terrible. We were never ever consulted in New South Wales. The law comes in so we react; it is a negative reaction, not a positive reaction. But that—

**Mr FLETCHER:** On this point about giving people a longer loan term than they are really after, what I have heard from you, and I think from Cash Doctors as well, is that one of the appeals of your product to a customer is

that by setting a deadline it helps them manage the repayment process. So what you are putting to us is that you have not had to go to a longer repayment term and for your borrowers, while they might desire to repay in the shorter time, the experience is that they tend to leave the term out for longer. Is that right?

**Mr Prosser:** The contract is for two years, but the customer wants to pay it back in the shorter period of time. Most of our customers want to pay it back in one month and three months. That is how it is even for new customers. We have been in business for 10 years and some of our customers have come in to pay off their credit card. It sounds incredible. We have heard some of the stories where they have $5,000 debts and they can never ever pay off their credit card. So they come to us—and I totally agree with Paul Baril about face to face contact—and there is a definite commitment and relationship with that customer. Most people, 90 per cent of the community, want to do the right thing.

**Mr GRIFFIN:** What are the implications for a customer who comes in and is seeking a shorter loan for a smaller amount of money but ends up in a situation where they have to take a longer loan, and maybe a higher degree of loan, in the first place? What is the problem for them in that situation?

**Mr Prosser:** Our type of customer who wants a longer loan will most times have problems. They default. We focus on the customer paying it back in three or six months.

**Mr GRIFFIN:** The problem with having someone come in and seek a smaller loan for a shorter period of time but having a legislative situation where they have to get a larger loan for a longer period of time is potentially a high degree of default—

**Mr Prosser:** Yes—

**Mr GRIFFIN:** a greater degree of indebtedness—

**Mr Prosser:** Yes—

**Mr GRIFFIN:** and more significant problems, therefore, for their own financial circumstances because of the structure of the agreement? I am trying to get stuff on the record so that we can actually have the discussions about what those points are so that they can be refuted or otherwise argued by other witnesses. I am not agreeing with you I am just saying I want to get it—

**Mr Prosser:** Yes, that is totally correct, from our experience.

**Mr GRIFFIN:** The other thing that was said, I think by Mr Bryant, is that a number of companies have got out of New South Wales—and Mr Smiles said that, as well—as a result of the changes that were made. That is also correct?

**Mr Bryant:** You only have to see that Cash Converters has a lot fewer branches in New South Wales compared to the other states. We cannot operate in New South Wales.

**Mr GRIFFIN:** The other boarder question is that if it is correct that lenders have worked around the New South Wales system, to an extent, from outside, if you move the system nationally what will be the result of that? Will it lead to another problem in relation to the operation of the system?

**Mr Prosser:** It will create another problem. It would become more convoluted. The consumers want something simple. There is a need for it.

**Mr Bryant:** On that point the problem is with the bill in its current form; it is New South Wales on steroids. For example, we created the deferred establishment fee. I do not mind saying it. It is a viability mechanism. To be able to give some customers that option we created a legal, fully compliant system. But it is not simple and it is not something you can roll out. The deferred establishment fee is now captured in the new bill. ADIs are exempted from this so, unfortunately, the people who are giving all the grief to this are actually not going to be pulled into line by this current bill.

**Mr GRIFFIN:** And, again, to put it on the record, potentially, if you put people in a situation where they have to borrow more in order to meet the requirements of the system, the actual point around the 48 per cent cap or any other cap you might have is actually deluded by the fact that they are actually borrowing more and therefore the actual total sum cost can be more?

**Mr Smiles:** Absolutely. Every three months you will double your default rate. Secondly, if I could respond to the issue of taking the flawed New South Wales model nationally, we have one difference. The one difference is that the drafters of this current bill before the committee and the community have been very clever. In the many years I have been looking at legislation and how you get around it—sorry, accommodate it—I will tell you that this bill is very, very clever and it is going to be extremely hard to get around. So, where we as an industry have been able to accommodate New South Wales by, frankly, getting around it—and it distresses me that you have an industry forced to do this—the bill before the committee now is so cleverly structured and has so many provisions

allowing the minister of the day to introduce regulations, that it is pretty close to watertight already and it would take a minister one month to make it totally watertight.

**Mr GRIFFIN:** Your point is that, if this goes ahead on that basis, rather than getting around the legislation the circumstances will be that commercially you will have people leaving the industry and will therefore have less choice. That will put people in a situation where they have to face other choices around how they access short-term credit.

**Mr Smiles:** I will put it even stronger. You will have a socioeconomic disaster.

**CHAIRMAN:** Thank you for your evidence.

**VENGA, Mr Raj, Ombudsman, Credit Ombudsman Service Ltd**

[12:00]

**CHAIRMAN:** Welcome. I invite you to provide some opening remarks.

**Mr Venga:** Thank you for your invitation to address the inquiry. I have a few words about the Credit Ombudsman Service to give some context to my evidence. We have about 15,500 members, mainly non-bank lenders, small amount lenders, mortgage brokers and debt collection firms. Significantly we are ASIC approved. This means that, among other things, our services are absolutely free to consumers, and we are required to be impartial and independent of both consumers and industry. Relevantly more than one-third of all our complaints relate in some way to financial hardship. These complaints are accorded first priority in our complaints-handling process. It may interest the committee to know that unemployment or reduced household income accounts for 30 per cent of financial hardship cases we receive, increased cost of living and other debts account for 21 per cent, illness of the borrower or family member accounts for 19 per cent, business failure accounts for 14 per cent, interest rate increases account for eight per cent, relationship breakdowns account for seven per cent and natural disasters and floods for one per cent.

We have considerable expertise in financial hardship applications and secure a satisfactory outcome for consumers in more than 40 per cent of the cases we deal with. The median number of days it takes us to close a financial hardship complaint is 45 days and 35 per cent of the financial hardship complaints are closed in less than 30 days. We have been dealing with financial hardship complaints for more than four years and are therefore in a unique position to inform the inquiry of our experience in this area.

We welcome and strongly support the changes proposed to be made to section 72 of the National Credit Code. Indeed we have for some years lobbied Treasury and the government for the very changes that are now being proposed, firstly, that there be no prescribed monetary threshold above which a borrower is denied the right to apply for a hardship payment variation. It might be noted that the removal of the monetary threshold does not in itself oblige lenders to provide the relief sought. About 16 per cent of financial hardship cases we receive are in relation to loans of more than $500,000. Secondly, the other change proposed to be made is that there is no restriction of the types of variation a borrower can ask for. Although, appropriately, a court cannot make an order that reduces the total amount ultimately payable by the borrower. This means that the lender's yield on the loan is always protected.

I can tell you that our lender members do not generally object to payment variations other than those described in the existing legislation. You will recall that the existing legislation allows only three types of loan variations, namely, an extension of the loan term with a reduction in the amount of the payments, the postponing of payments for a specified period, or a combination of both. In contrast, it is reasonably common for our non-bank lenders to, for example, waive some or all default fees and default interest, waive all or part of the arrears, extend periods of reduced or nil repayments, capitalise all or part of the arrears, allow the borrower time to sell the property or refinance the loan, and sometimes reduce interest rates for a specified time.

Another change proposed to be made and which we have been asking for is that there be a requirement for a lender to respond to a hardship application within 21 days and, if declined, a requirement that the lender provide its reasons for its decision and direct the borrower to the lender's EDR scheme. Yet another change proposed to be made is to prevent a lender from commencing enforcement proceedings until and unless the lender has responded to the hardship notice, oral or written. This change is long overdue. Indeed, the Code of Practice of the Mortgage and Finance Association of Australia, for example, has for some time required its lender members to suspend any enforcement action until the lender has informed the borrower whether or not it will vary the payment terms.

It is noteworthy that in 71 per cent of the cases we see the borrower has either been served with a default notice or the lender has commenced legal proceedings. Yet, 45 per cent of the financial hardship cases we close are resolved satisfactorily in favour of the borrower. This suggests that many lenders, before issuing default notices or commencing enforcement action, are not properly considering whether a change in the borrower's payment obligations may be appropriate in the circumstances. In view of this, such lenders are in no position to argue that they should not be prevented from continuing enforcement action. While, as you can see, we wholeheartedly support the changes proposed to be made, we ask that the proposed new section 72(1) be amended such that the borrower must also reasonably expect to discharge his or her loan obligations if the contract were changed in a particular way. This is required under the existing legislation. It makes it clear that, when asking for a payment variation, it is not enough for the borrower to only offer to make such payments as they would like to. The relevant test is: would the borrower be reasonably able to meet their payment obligations if the credit contract was changed in a particular way. If so the credit contract should be varied. This has long been the threshold test for a

hardship variation as enunciated by Cate McKenzie, Deputy President of the Victorian Civil and Administrative Tribunal in the Capital Finance Australia Ltd and Fairservice case in 2006.

The reality is that in some unfortunate circumstances the borrower will be unlikely or not be able to repay the loan even if the credit contract is changed. In these circumstances the lender should not be obliged to vary the credit contract. It would therefore be extremely useful, if not critical, for the proposed new section 72(1) to retain the implicit requirement that the credit contract should be varied where the borrower reasonably expects to meet their obligations under the contract if the contract were to be changed in a particular way. There would otherwise be little or no guidance for a court or an EDR scheme such as COSL to determine if a credit contract should be varied.

I notice from today's program that small amount lending is in the spotlight given the changes proposed to be made. Would the committee be interested in some of the statistics that we have?

**Mr GRIFFIN:** Yes, please.

**Mr Venga:** We have, as members, more than 1,000 small amount lenders and their franchisees. That is about seven per cent of our membership base. In the last financial year we received 114 complaints about small amount lenders, which is about 5.4 per cent of the total number of complaints we received that year. Fifty two per cent of the complaints, that is 114, were against five of the largest small amount lenders. The remaining complaints were in relation to 38 other small amount lenders who received less than three complaints each. Of the 94 complaints we closed: 30 per cent were resolved in favour of the borrower; 25 per cent were resolved partly in favour of the borrower; three per cent were resolved in favour of the lender; 20 per cent saw no further response from the borrower; nine per cent were withdrawn by the borrower; five per cent were about the wrong respondent; and seven per cent were not within our jurisdiction.

For the last financial year: 20.5 per cent of complaints were about collections activity, for example, the incorrect default listing on the borrower's credit file; 16 per cent of complaints were about hardship; 12.5 per cent of complaints were about imprudent lending, that is, the borrower alleging that he or she did not have the capacity to repay the loan; 11 per cent of complaints were about fees being too high; and five per cent of complaints were about interest rates being too high.

**CHAIRMAN:** Thank you. I was going to ask you about how many complaints there were, but you detailed that very well. Could you give us an idea of the size of these loans that people are complaining about such as whether they are at the smaller end or at the larger end or if there is a normal distribution?

**Mr Venga:** I am sorry, I do not have that information with me. I can take it on notice.

**CHAIRMAN:** Yes, thank you. That would give us some guidance as to whether it is a distribution of the complaints you receive in size of loan.

**Mr GRIFFIN:** And geography as well.

**CHAIRMAN:** What sort of complaint do you get? Is there something you can identify that we can relate to?

**Mr Venga:** I can break that down for you and will send it to you as well. There is only one other statistic I have not mentioned which is that, roughly, 20 per cent of the complaints involve consumers who have had more than one small amount loan, which may be relevant.

**CHAIRMAN:** The other 80 per cent then are those who are first-time?

**Mr Venga:** Yes, as we understand.

**CHAIRMAN:** How does that particular segment of the market compare to ADI institutions?

**Mr Venga:** In terms of ADIs we have, as members, mutual building societies and credit unions. We do not get a lot of complaints about them. It is just the way they do business. In terms of finance brokers, the large majority of them do not get complaints. Obviously the larger of our members, the non-bank lenders and small amount lenders, will get more complaints simply because they have more transactions. I am not sure if I can actually say that they are troublesome in any way when we treat all of the complaints in the same way.

**CHAIRMAN:** Is this a lot of complaints or not? Do you see this as being a lot of complaints? It is this a problem area, or is this a normal distribution that you would find in any society?

**Mr Venga:** I suspect that it is reflective of our general membership insofar as a small-amount lender may not receive a single complaint similarly to a single-finance broker. A larger one may well receive more complaints because of the number of transactions in the same way as a non-bank lender would; it is proportional. I do not think it stands out quite yet—there is no evidence that it does, anyway.

**CHAIRMAN:** Sorry, I did not write it down—how many complaints do you get per annum?

**Mr Venga:** Total?

**CHAIRMAN:** Total amount; all complaints.

**Mr Venga:** Over 2,000.

**CHAIRMAN:** So you get 114 specifically in relation to—

**Mr Venga:** Small-amount lenders.

**CHAIRMAN:** So payday lenders or—

**Mr Venga:** And microlenders and the like.

**CHAIRMAN:** Are they resolved in the same manner? If we take 114 out of the 2,000—let us just say, for round numbers, 1,900—you said you had 30 that were resolved in favour of the borrower, 25 per cent were resolved mostly in favour of the borrower, three percent were resolved in favour of the lender et cetera. Would that be reflective of the other—

**Mr Venga:** No, it would not. Generally speaking, the resolutions in favour of members and consumers tend to be almost equal. You would have something like 15 percent to 17 percent either way—so it is quite equal—and then you would have another chunk of, let us say, 25 per cent that was resolved in favour of both. What it means to say is, 'The consumer has asked for this, and they did not get it all,' so it is partly in favour. Normally we would have, say, 15 percent in favour of the borrower, and in the case of small-amount lenders it would be 30 percent—that is, almost double. We say that 25 per cent of complaints are resolved partly in favour of the borrower, and it is similar with the small-amount lenders; there is not much difference. Another discrepancy is the fact that only three percent of complaints are resolved in favour of the small-amount lender, whereas generally speaking we are looking at about 15 percent.

One of the things my case managers tell me is that, when we do get a complaint, it is quite common for the member—the small-amount lender—to write off the loan or something like that to resolve the issue rather than it going through our process. It is understandable, in a way, because there are costs involved. It is totally industry funded, so as it progresses through the investigation stage there are costs involved.

**Mr GRIFFIN:** So they are more likely to concede the decision was worthwhile following—

**Mr Venga:** Exactly. You can see it when you are looking at a loan for 300 or 400 bucks.

**Mr GRIFFIN:** Is it also probably true that it is less likely that people would complain again because of the amounts of money involved?

**Mr Venga:** That is a possibility too. You would have to ask the consumer advocates about that.

**CHAIRMAN:** Just following up on that, given that you understand that particular segment of the market—it is a different market to other, larger, longer term loans—is there any comparative difference or something that you can characterise out of that which says 'this is why it happens'? Is it because it is at the end of the market where it is smaller loans and shorter periods and where more problems could arise? Is there anything in particular that you are aware of?

**Mr Venga:** I could not talk about any more research. It is an unsecured market. There is hardly any security given as far as I know. We do not see a lot of that, unlike for home mortgages, which we do more often. The amounts are small, so you are quite right: we may not get many complaints about them unless they have gone through a financial counsellor, in which case we would get them through there. I could not answer that question with any sort of expertise.

**Mr GRIFFIN:** I just have one question, basically. I think you were here for the previous set of witnesses, and you would have heard the last exchange with respect to their views on the New South Wales system and its implications for going across federally. Although I know it is not directly your area, I just wonder whether you have any comments to make on that.

**Mr Venga:** No, but I am hoping the demographics will show something as well.

**Mr GRIFFIN:** Say again.

**Mr Venga:** You asked me to provide you with a breakdown of where the complaints come from in terms of states, and I am hoping that might answer some of that question. But I cannot really answer that without looking into it—sorry.

**Mr FLETCHER:** I just want to make sure I understand the amendment that you are proposing to new section 72(1). If I am reading that correctly, it would somewhat narrow the range of circumstances in which a customer could give a hardship notice.

**Mr Venga:** Yes and no. What I am asking for is a reinstatement of part of section 72(1). There are two parts. One is subsection (2), which is the three limitations, and I am happy for that to go. I am just talking about the second part, which gives it a threshold test whereby we can all say, 'If, for example, the person simply cannot make those repayments despite making a change in the contract, we should know this rather than trying to'—

**Mr FLETCHER:** So your point is it would be a fairly pointless process to go through if the customer had no reasonable prospect of repaying the loans?

**Mr Venga:** That is it.

**CHAIRMAN:** As there are no other questions, Mr Venga, thank you very much for your submission and your evidence today.

**Mr Venga:** I appreciate it and I will get back to you on the other issues.

**BRODY, Mr Gerard Gavan, Director, Policy and Campaigns, Consumer Action Law Centre**

**LOWE, Ms Catriona, Co-Chief Executive Officer, Consumer Action Law Centre**

[12:16]

**CHAIRMAN:** Welcome. If you would like to make some opening remarks or speak to your submission you are more than welcome.

**Ms Lowe:** Thank you. We have prepared some brief opening remarks. Firstly, we would like to thank you for the opportunity to appear before you at today's hearing. Committee members will have received our detailed submission to the bill, so we are not proposing to repeat a lot of what we have included there, and we note that the committee is looking into a bill that is proposing a range of reforms to the National Consumer Credit Protection Act and the National Credit Code.

We want to limit our initial remarks to three aspects of the bill, which all arise out of schedule 3 and the proposed regulation of small-amount credit contracts. We have had the opportunity to review some of the submissions the committee has received from industry and have also had the benefit of hearing some of the remarks made here today, so we would like to respond to those comments and reiterate some related commentary in our submission.

Firstly, we would like to deal with the argument that the impact of the proposed reforms on the payday lending industry would harm consumers. We strongly contest that assertion. Secondly, we want to talk about high-cost short-term loans in the context of existing consumer protections and particularly the operation of the current responsible lending reforms under the national credit laws. Thirdly, we want discuss the issue of avoidance, which has obviously also been canvassed here today. We probably would also like to add a brief word about complaints and complaint numbers at this early stage.

Turning back to the first point, we are aware that many lenders argue that the laws are designed to shut them down and that this would harm consumers. We should, in our view, remind ourselves of the government's policy objective in proposing this law to the parliament, which we strongly support—that is, to have a significant impact on the availability of high-cost loans, particularly the very short term loans. The government has indicated that it does not want to see lending to low-income borrowers cease. Indeed, the government is supporting affordable microfinance programs involving institutions, large banks and community finance institutions. Financially, inclusion is of course an important policy goal and involves low-income and other excluded groups having access to financial services that will help them build wealth and assets and become more financially resilient. Financial inclusion does not mean access to all financial products regardless of the cost or consequences. It is about providing appropriate products such as affordable credit, savings programs and affordable insurance, not providing access to products that are designed or used in a way which strips wealth rather than creating it and creates unsustainable debt.

In our view, reducing the availability of high-cost, short-term loans will not harm consumers but in fact protect them. This is because these loans in most cases do not improve a borrower's financial position but in fact make their situation worse. The research from our own report, *Payday loans: helping hand or quicksand?*, demonstrates that most short-term loans are used for day-to-day living expenses—indeed, 75 per cent of borrowings from our survey respondents were for current, everyday living expenses: food, rent, electricity bills and things of that kind. After repayment, when regular income is received, whether that is benefit or wages, many borrowers then return to the lender to get another loan to afford their living expenses the following fortnight, because, of course, the loan repayment has been directly debited from their account. It is actually a very low-risk way of collecting the money, from the lender's perspective.

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.

What is also clear from the bank statement is how lucrative this form of lending is for lenders, because they time direct debit payments to coincide with income payments, in this case a pension, and they obtain effectively a first stake in the income of that low-income borrower which includes their very large fees and charges. In the case

of Cash Converters, their advance product charges $35 per $100 lent over a two-week period at virtually no risk, as we say, because that direct debit is the first thing that comes out of that borrower's account. Not only does this ensure that payment is made; it often also ensures that the borrower will run out of funds and need to come back to take out a further loan.

Our second point responds to the argument that existing responsible lending laws, which came into effect in January, operate to protect vulnerable borrowers. We are very great supporters of these laws—we would like to state that very clearly—and they are operating to improve the quality of credit assessment across a range of lending providers, including banks, credit unions and finance companies that provide mortgages, car finance and personal loans, but they are not well suited to protect borrowers of high-cost, short-term loans.

Some committee members may have seen in the media that our centre has recently supported a Melbourne disability support pensioner to take action against a prominent short-term lender where he is alleging breaches of the responsible lending laws. We would like to make a couple of points about the case and the somewhat unique nature of this particular borrower. He, despite being extremely vulnerable and suffering ill health, has demonstrated a particular will to enforce his rights and is adamant that he wants to use the legal system to do so. We are supporting him in this; however, his view on this is by no means representative of most payday loan borrowers and, indeed, most consumers that we meet. In the main, payday loan borrowers are embarrassed about their predicament and have a highly ambivalent relationship with the lenders. Many of them experience a range of social problems, health problems, disabilities, addiction and/or family and relationship problems. In these vulnerable situations they generally do not want to admit that they have had problems with high-cost short-term lenders. In vulnerable situations many borrowers describe themselves as becoming hooked or addicted to the ease with which they are able to obtain access to this money and, indeed, appear in the short-term to resolve a crisis. A recent report from RMIT University called *Caught Short* confirms this. The research found that borrowers had contradictory relationships with the lenders and borrowers said the process was too easy, too flexible and too fast. Borrowers also said that they felt caught in a vicious cycle of being trapped or being stuck, which reflects the general lending pattern of being continuously indebted to one or more short-term lenders for considerable periods of time. Those in this position are extremely unlikely, and unlikely to be able, to complain and seek to enforce their rights. This not only leads to a very small proportion of individuals using the courts, or even ombudsmen's schemes, but also reduces the chance that individuals will be prepared to give statements and act as witnesses, as you would recognise would be necessary for enforcement action by regulators under those responsible lending laws.

In contrast to that position, this bill would set a clear line in the sand—a bright line, if you like—that would enable a regulator to easily determine contracts which are lawful and contracts which are not, without requiring that inquiry into the individual circumstances of borrowers and without relying on those individuals to be brave enough and resilient enough to work through a process of many years to get to an enforcement outcome. Instead, they would be able to effectively enforce the law on a documentary basis and, we would say, be much more likely to be able to effect necessary systemic change in the sort of lending that is going on.

Finally, we would like to raise one word of caution with the drafting of the current bill. As we have outlined in our submissions, and as you have heard today, where interest rate caps have been introduced in various states lenders have sought to establish contractual and business structures to avoid the laws. One benefit of a national law will be to reduce the ability of lenders to do this by setting up sham interstate contractual relationships. But we are concerned that one other common method of avoidance is still left open by the current drafting of the bill. That is effectively what is sometimes referred to as the broking arrangements. Some lenders establish more than one contract. One is to advance the loan and the other is effectively to introduce the consumer to the lender. In many cases, fees under these peripheral contracts are paid to different entities and, from the documents, they may appear to be unrelated entities. The issue with the bill as it stands at present is that whilst it would be unlawful to introduce someone to a contact which exceeds the caps that are proposed by the bill, in our view on the present drafting it would not be a breach to introduce and charge a fee for that introduction to a contract that does not infringe the cap. But obviously if a related entity were able to enter into such an arrangement, that would enable them to, in effect, infringe the cap and recover more funds, even though they were doing it on apparently two separate transactions. That issue is dealt with in relation to contracts that are over two years to which the 48 per cent cap applies, and we would urge the committee to recommend that effectively the provision in relation to the 48 per cent loans is mirrored in relation to the short-term lending provisions.

We are certainly not blind to the reality that avoidance by rogue and exploitative lenders may occur; that is why we also suggest we need a very well-resourced regulator to act early, to monitor lending practices and to step in to enforce the law where required. This may include where lending may be unlicensed as well as where it is at

high cost in breach of the cap. Lastly, we would like to make a quick comment around the number of complaints received from consumers. We would simply reiterate that, firstly, the direct debit arrangement actually means that it is quite a low-risk arrangement for the lenders and, as we have mentioned, consumers are unlikely to complain given the ongoing ambivalent relationship with lenders. Even when they do, we suggest to you that it may take quite a lot of time for those complaints to flow through the system. The consumer, for whom we are acting in the litigation, had in excess of 64 loans over three years and it was not until after that three -year period that he came and saw us because his situation had become completely unsustainable. It took that long for the complaint to come through the system, whereas the jurisdiction with the Ombudsman schemes has only been in place since July last year. So we think there is still a lot of flow-through to come.

**CHAIRMAN:** You paint a fairly bleak picture of not only the people who seek loans but also the provision and the methods that go around loans. Is the picture that you paint the norm or is it the exception? There is obviously always going to be cases—and you have given us some bank account statements—but are you saying that the vast bulk of people are in these circumstances?

**Ms Lowe:** That is exactly right. We would say that the typical payday lending customer is a low-income consumer. They are typically borrowing for essential everyday living expenses and they are having those funds direct debited out of an account that is not having very much go into it in the first place. That combination of factors leads them to go back to the lenders. It is those factors in combination that cause the harm, but that is the typical case.

**Mr Brody:** Can I just say that that is also confirmed by some of the public statements by the lenders. In the annual reports, for example, some of the lenders are trumpeting the fact that they have repeat borrowers, they have someone who has come back again and that it is good business.

**CHAIRMAN:** Going to some of your earlier statements, you were saying that it is in the design and that, in relation to direct debiting, if people are left with very little funds they need to continue to borrow. If this is the rule rather than the exception, at some point you have to pay it back, and I assume no-one pays in perpetuity, particularly given the figures that we have been shown and that have been supplied to us about people paying off loans and so forth. Does that not set up a scenario where people are never paying back the loan at all or they are defaulting from those loans? Is this not a default position?

**Ms Lowe:** Of course, the default only occurs at the point at which there are so few funds in the account that, effectively, the repayment exhausts the account because the repayment comes out first. That is the issue: there might be enough money—

**CHAIRMAN:** So you are effectively saying that all of these loans are designed to do that? Is that what you are saying?

**Ms Lowe:** We hear the industry talk about the need for repeat, loyal customers to sustain the business model. If everyone was simply dipping in and using them in a one-off way, we would not see the amount of growth in the industry that we have seen over the last 10 years and we would not see 31 community and welfare organisations writing to the government talking about the impact that they see.

**CHAIRMAN:** It is the same pool of people? The growth is not new customers; it is existing customers? The growth is internal growth?

**Ms Lowe:** We suspect there is the odd customer that might dip in and dip out, but if you look at the research in this area—for example, the *Caught Short* report, which has recently been released by the RMIT researchers—you will see that close to 50 per cent of those borrowers had had at least 10 loans and many of them had many more than that. That is the typical profile.

**Mr FLETCHER:** You say on page 8 of your submission that short-term lending began in 1998. What was the position before then?

**Ms Lowe:** That is part of what we think is interesting. It was not in place. There was a fairly modest and small pawn-broking industry but, prior to that time, it did not exist. That is why I suppose we have some difficulty with the argument that somehow the world is going to come to an end if there is less of it going forward, because we did manage without it before. Indeed many civilised Western democracies manage without it today.

**Mr Brody:** Also, at that stage, many traditional mainstream institutions probably did not lend smaller amounts. The mainstream banks over the years have increased their minimum amount for a personal loan. For example, you once could get a $500 loan from a bank; these days you cannot.

**Mr FLETCHER:** On page 5, you say:

… there is rarely a case for price regulation in competitive, well functioning markets …

What, in your view, are the criteria for a competitive well-functioning market?

**Ms Lowe:** Consumers with genuine choice and a capacity to exercise it and the ability to signal their preferences and needs in a way that requires the market to respond to it. As you would see from our submission, those features do not apply in these markets. We have had the industry in place for 10 years, it has grown phenomenally during that time and, on any ordinary view of competition, that growth in the industry ought to bring in new entrants, it ought to bring prices down and it ought to offer more options to consumers. We have not seen that occur. We note that we are coming to you as a consumer and community agency, but there is support in very different sectors for regulation of this kind in this space, because it is recognised that competition does not tend to operate. Adam Smith in *The Wealth of Nations* has in fact supported the use of interest rate caps as a break on usury.

**Mr FLETCHER:** Was he commenting on the Australian payday lending market of 2011?

**Ms Lowe:** Not back in the 1700s, no. But it is a very similar argument around the productive use, if you like, of capital.

**Mr FLETCHER:** Are you putting to the committee that every user of the services of short-term lenders is a vulnerable and disadvantaged consumer?

**Ms Lowe:** We would not say every single one, but we would say the typical user of these products.

**Mr FLETCHER:** So you reject the evidence that we have heard today from some industry participants that there are many instances of these products being a successful means of meeting consumer needs?

**Ms Lowe:** We say that there simply is not evidence that supports that proposition, either here or overseas. All of the research that has been done in the United States and here tends to suggest that repeat borrowing is a necessary feature of this market.

**Mr FLETCHER:** So you believe that either all consumers or the great majority of consumers who use these products are really doing so against their will. They are effectively coerced; is that what you are putting to us?

**Ms Lowe:** We would not say that they are coerced as such. We would say that their set of circumstances is such. It is quite understandable. We are not seeking to demonise borrowers here; quite the contrary. 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.

**Mr FLETCHER:** Can I go back to what we heard from Cash Doctors earlier, who argued that their customers are employed and effectively making a conscious and informed choice. You do not accept that?

**Ms Lowe:** All that we can say to you is that the research that we have done and that overseas organisations have done are generalised pieces of research, of course, so it is difficult to comment about the borrower profile of a particular company. That is not publicly accessible information. But all of the research that has been done strongly suggests that people are below average in their income. Of course, people can be working and still be well below an average income. It is borrowing that is occurring for recurrent everyday living expenses.

**Mr GRIFFIN:** I would have thought that, overwhelmingly, the people who are in that situation would be people who are relying on government benefits.

**Ms Lowe:** There is a very large proportion, indeed, of people relying on government benefits.

**Mr FLETCHER:** I just want to clarify your response to the argument that is put by the industry: if the bill is passed in its present form, they will be unable to deliver many of the products they deliver today. Do you say, 'We don't think that's right, factually. They would say that, but they're crying wolf,' or do you say, 'That is true, but we don't care because we think the greater good is served by them exiting,' or do you say something else?

**Ms Lowe:** We say that the government is right in its intent to cause adjustment in the very short-term lending end of this market, because it is causing harm to consumers. Markets exist to serve consumers.

**Mr FLETCHER:** By 'adjustment' do you mean a reduction in supply?

**Ms Lowe:** It might mean a change in what is being supplied, but, yes, a reduction in the numbers of the low-amount, high-cost, short-term loans that are currently available on the market.

**Mr FLETCHER:** What do you think will then happen? Will the demand be met by other sources?

**Ms Lowe:** If this is a reference to the rise in illegal lending argument that is sometimes put, we do not accept that—

**Mr FLETCHER:** No—I am just asking what you think will happen. If there is a market there in which a product is being supplied and there is going to be a regulatory constraint that will reduce supply, what will happen?

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

**Mr FLETCHER:** Are measures to do that included within this bill?

**Mr Brody:** I do not think there are any measures at the moment around the Centrepay option and vehicle registration specifically, but we have called for that as well.

**Mr FLETCHER:** I want to understand the risk. If the bill goes through as presently drafted and supply of these products is reduced, and the other things that you talk about which you hope do not happen do happen, is that something that we as a committee ought to be concerned about?

**Ms Lowe:** We would certainly very strongly welcome any recommendations from this committee around those additional reforms in the Centrepay area. The committee is obviously properly concerned about the impact if these were gone, but we would say that one of the reasons 31 Community and welfare agencies wrote to all of the MPs in parliament supporting these bills is that people are still eventually turning up at an emergency relief agency or at a financial counsellor. What these loans are doing in effect is deferring the inevitable. They are not curing a problem; they are simply deferring something. Those mechanisms are there for people now and they will be there if this bill is passed.

**Mr FLETCHER:** Your proposition to us is that all, or the great majority, of these loans end in tears and the people who take them out are ultimately going to end up worse off.

**Ms Lowe:** If they are doing anything other than borrowing as a once off then yes.

**Mr FLETCHER:** Do the studies that you have talked about say that all or almost all of the loans that are made by short-term lenders produce an unhappy outcome?

**Ms Lowe:** That is an extreme summary of what some of them would say, but they all talk about the repeat-borrowing nature and the low-income nature of the borrower and the essential character of the expenses for which the borrowing is done. You can see as a matter of logic that, if you do not have enough income today to pay the electricity bill, buying expensive credit to help you is not going to make your position better.

**Mr FLETCHER:** I am not contesting for a second that this has been the experience of your centre and other groups. The question that is going through my mind is: are you seeing a representative sample? In other words: isn't it the case that people who have a successful experience are not going to be coming to you?

**Ms Lowe:** Sure, but the research has not been based on our casework, if I can put it that way. Obviously some of the case studies we have shared with you have been, but in our case we did an internet study. In the case of the RMIT University study they stood out the front of lending institutions and asked people to speak to them. They deliberately did not just seek the clients of financial counsellors, for example, because they wanted to make sure that they were speaking to a representative sample of the borrowers, and still their results showed a very high proportion of Centrelink recipients and a very high proportion of repeat borrowing. Some of these people had not sought help at all. They were walking out of the lending institution.

**Mr FLETCHER:** I just want to make sure I am understanding your position. Is it correct that you would argue that there are no circumstances in which a consumer ought to be able to make a judgement to take one of these products?

**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.

**Mr FLETCHER:** One of the things that has been put to us as a potential approach here is to say, for example, that you might use the consumer's circumstances—are they in employment, are they a Centrelink recipient, or is the bulk or totality of their income Centrelink benefits—as a criterion. How do you respond to that as an approach?

**Ms Lowe:** That alone as the criterion would be insufficient. It would also be necessary to look at the purpose for which the borrowing was occurring. Reference has been made to a study that was done by National Australia Bank—not the most recent RMIT piece but an earlier piece—when they effectively costed a small-amount lender. One of the most significant findings in that report, in our view, was that they turned away approximately 90 per cent of the borrowers that sought the service because of the purpose for which they sought the borrowing—that is, a recurrent every-day living expense. Buying credit, if you cannot afford the cost of living, is simply not a sensible economic proposition for any consumer.

**Mr FLETCHER:** Again, I want to make sure I understand correctly what you are putting to us. Would you accept that there is a segment of the market—a proportion of consumers—who are equipped to make the judgment about whether these products are appropriate for them?

**Ms Lowe:** We would say that it is not a question of whether they are equipped. It is a question of their personal circumstances. We suspect that there may be a small proportion of consumers that have an adequate income to have a reasonable cost of living and, for whatever reason, at one point in their life may need to access a product of this kind. But they are far from the typical borrower from a pay-day lender.

**Mr FLETCHER:** So if I were to ask you, 'What are the consequences of a product being removed from the market place and a choice being withdrawn?' I presume you would put to me that only a small proportion of people, in your view, are appropriately able to exercise that choice. Is that right or not?

**Ms Lowe:** Again, I would say that it is not a choice. If you are facing having the electricity bill cut off or being kicked out of your house, there is not a choice in terms of solving that problem, in the traditional economic sense of 'choice'. I do not think it is judgment in the cool, rational sense of judgment. For those reasons that set of events coming together makes it a harmful product. It is not about the capacity of the consumer to exercise judgment; it is about the circumstances in which they find themselves.

**Senator HANSON-YOUNG:** We have heard some of the different groups at the table earlier. Their argument is that they are responsible, that they take into consideration people's vulnerabilities and that they are offering a service that, I assume, they believe consumers cannot get from elsewhere. How responsible do you think the application process is in ensuring that people do have the capacity to pay off these loans as quickly as possible and get on with normal living?

**Ms Lowe:** We would say, based on our experience, we do not think that they are effective at assessing that in an ongoing way. Are they able to pay the money back? Yes. Are they able to afford to live after they have done so? Not in our experience.

**Mr Brody:** I would like to add that it might be that on the first occasion that there is some sort of assessment done but our experience is that with those follow-up loans it is so quick and easy. They often have a card or some other relationship signifier with that lender that makes the lending happen really quickly because they have had a loan with them before.

**Senator HANSON-YOUNG:** So that 45-minute to three-hour assessment, where they have to bring their bank statements in, is only for the first time they lend.

**Mr Brody:** If then.

**Ms Lowe:** Much of the marketing, particularly in our experience for the on-line lending, is actually about how quick it is—not about how thorough the application process is.

**Senator HANSON-YOUNG:** When you get a case and you sit down and work out if there is something that can be done, do you find that you are asking the consumer questions that you would have assumed were asked at the time of application for the loan?

**Ms Lowe:** When we look at a consumer case, yes. We typically ask them what their income is, what their expenses are, what their commitments are and those sorts of things. As we have said, where a consumer at the start of the process or very early on in the process does not have the capacity to meet what are very basic recurrent living expenses, we find it difficult to understand how someone can be assessed as having the capacity to add expensive credit costs on top of those expenses and still be able to manage.

**Senator HANSON-YOUNG:** If these lenders were not able to lend to people on low incomes, do you think that they would survive?

**Ms Lowe:** We think that if there was proper assessment of capacity to pay being done, there would be a significant reduction in the number of loans being written—very significant indeed.

**Senator HANSON-YOUNG:** What are some of the more extreme examples of the total money owing of some of the cases that you have come across?

**Ms Lowe:** One example which is before a tribunal at the moment involves a consumer who has had 64 loans over a three-year period and paid in excess of $5,000 of his income in fees over that period of time.

**Senator HANSON-YOUNG:** How much would he have originally borrowed?

**Ms Lowe:** That is the issue: it is the cumulative effect, if you like. The borrowings, the loans, individually throughout the process were small.

**Senator HANSON-YOUNG:** How small?

**Ms Lowe:** Typically, $300 to $500.

**Mr Brody:** Around $200 to $300 even in that case, I think. One of the issues that exists with the current laws around responsible lending is that, if a small loan is assessed in isolation, just by itself, it is not clear that it would be unsuitable for the lender, as the test of the current legislation is. If it was looked at over a course of lending it might become clearer that it was not suitable. But the current law on responsible lending looks at each individual case. That is why we are saying that the responsible lending obligations do not seem to us well adapted to this small amount, short-term loans.

**Senator HANSON-YOUNG:** You made some comments in your submission about some lenders dressing themselves up as financial counsellors and advisers for people in those types of situations, where they are in a cycle of debt. Could you expand on your concerns in relation to that?

**Mr Brody:** The University of Queensland undertook some research last year, and it found that in many cases the borrowers saw the lenders as a friend—someone that they went to in a time of need.

**Senator HANSON-YOUNG:** We heard that at the table.

**Mr Brody:** Other research from RMIT confirms that and also says, from their qualitative side—because they had more time to go in and understand what the situation was—that that was actually a conflicted emotion. On one hand they kind of knew it was not good for their long-term situation but it helped their short-term crisis, and that was what was important at that time.

**Mr GRIFFIN:** Do you agree with the industry that if the proposal as it stands is implemented that it will actually lead quite a few of the lenders out of the market?

**Ms Lowe:** If they do not want to change their current business model, yes.

**Mr GRIFFIN:** The key point here is: if it financially creates a situation where it is no longer profitable for them, they will get out. I am trying to work out what we can agree on in this. Do you agree that that would be the result in the circumstances?

**Ms Lowe:** We think that is indeed the point.

**Mr GRIFFIN:** To be blunt, your view is—and I understand your view—that these products are inappropriate for people in those circumstances and therefore they should not be accessing for their own good, and there is an argument there. The argument from industry is that they are meeting a need and they will not be able to on a financial basis if these conditions are put in place. I am just trying to cut to the chase and ask whether that is the case. Can we agree on that impact of it?

**Ms Lowe:** We would expect this reform to cause there to be a lot fewer very short-term low amount loans to be written—so, yes.

**Mr GRIFFIN:** The key to stopping it in this context is to stop offering them, because the circumstances would be, from the point of view of the people you are concerned about, financially better for them if these conditions are in place because the cost to them of these loans would go down normally; correct?

**Ms Lowe:** Yes.

**Mr GRIFFIN:** So the issue there is that these changes will not affect demand; they will affect supply, basically. We are agreed on that?

**Ms Lowe:** Yes.

**Mr GRIFFIN:** I think it is an important point. There will be a significant impact there at that level. In terms of what you have said around the question of other alternatives—microfinance support, some work that has been done by government, you mentioned the situation around trying to get consumers to think more about how they use their available money and approaching instrumentalities or utility companies around the question of their circumstance et cetera—I guess what I am trying to work out is how much we can, through this legislation and consumer education, improve people making choices that are in their interests versus other choices that they may make which will relate to, if you like, the global requirement that seems to be represented at the moment by the short-term lending market.

**Mr Brody:** One of the provisions in the draft legislation is improved disclosure on these contracts and that lenders will have to tell people about other options that are available such as microfinance or a Centrelink advance. We would support that.

**Mr GRIFFIN:** Do you think there is enough of those options around at the moment? There is the issue of awareness and education—that is always an issue in this area—but then there is the issue of the actual volume, capacity and availability. Any comments on that?

**Mr Brody:** It might be worth directing some of those questions to some of the providers of those services. I think they are appearing this afternoon through Good Shepherd—the NILS providers, for example. But my understanding is that there is scope for increasing. They have a lot of capital that has not yet been placed in those programs and there is scope to increase them and it is about having the workforce and the means to do that.

**Mr GRIFFIN:** One of the industry representatives mentioned that, in fact, most consumer representatives were not seeking change in this area. I do not want to verbal them but my recollection is that they said that many financial counsellors were not seeking changes in this area. You mentioned 31 consumer and welfare support groups that had come forth to government. Would you care to comment on that point?

**Ms Lowe:** We certainly contest that organisations of our kind are not supporting these reforms. The peak body for financial counselling in Australia, Financial Counselling Australia, is a great supporter of this legislation and has been involved with us and a number of other agencies in a campaign supporting the imposition of an interest rate cap. I am very surprised to hear that. There are signatories from 31 peak and operational consumer and community agencies.

**Mr Brody:** Just to confirm that: I do not want to steal the thunder off Financial Counselling Australia, but they are releasing a report today looking at the views of their financial counsellors around Australia. I believe that they have around 340 responses from financial counsellors. I believe there was only one—

**Mr GRIFFIN:** Just finally, there was quite a bit of discussion earlier around the question of the New South Wales experience. I note in your submission that you refer to that. I guess the problem that I have with that element of the submission is that you refer to the New South Wales situation in terms of having not produced some of the problems that have been talked about, and yet the part of the submission from industry was that that is because, in effect, it has been worked around. Would you care to comment on that particular issue?

**Ms Lowe:** There is no doubt at all that if this reform is implemented we would expect to see avoidance and that is why we would like to see the regulator resourced to address that avoidance. The experience in every jurisdiction where effective regulation has been introduced is that there is avoidance activity and that it is necessary to act quickly in the face of that avoidance activity.

**Mr GRIFFIN:** I think that is a fair point, but my other point is that in your submission you partially refer to the question that there has not been some of these problems in New South Wales in terms of the actual impact of the change but you also can see that there has been avoidance. I guess the question, therefore, is whether we have properly got an understanding of what the implications of the changes are in that situation.

**Ms Lowe:** I suppose we could look then to the overseas experience where, certainly, there is an oft-referred to concern about the rise in illegal lending as a consequence of these sorts of reforms. There is simply no credible evidence anywhere in the world that that has occurred. We think that, given the number of states in America that have introduced caps and the number of jurisdictions in Europe and in other places that have either introduced caps or don't have lending, there is not evidence of a marked difference in terms of illegal lending there. The one report that tends to get referred to has been widely discredited. There is no credible evidence of that problem.

**CHAIRMAN:** Just one question, just to try to get the context right. Obviously, this legislation is not about banning any of these loans; it is just about trying to re-jig, if you like, a formula. The intent is to make this a more affordable product. Given that, and I agree with Mr Griffin, if we get this formula right product availability might actually go up even though supply might come down. There might be fewer players in the market, but there could be more products available and more demand because they are more affordable. So people who currently get them might get more because they are cheaper.

**Mr GRIFFIN:** If they're provided.

**CHAIRMAN:** If they're provided, of course. I am trying to see what the context is of what you are describing, of trying to get people completely out of that segment of the market. You are clearly of the view that, given proper supervision, this would just eliminate that segment of the market—it would no longer exist under this regulation.

**Ms Lowe:** We would say that, to us, the purpose of the reform properly seems to be to reduce the harm that these products cause to consumers. That necessarily means a reduction in the very short-term low-amount products that are currently available in the market. What the industry chooses to do in the face of those reforms—I mean, reforms are at the end of the day directed to cause structural readjustment. The adjustment the industry makes in the face of those things we would say is a matter for it, but we would certainly support readjustment in this market, because at the moment it is a market causing serious harm to consumers.

**Mr Brody:** On supply, the government is facilitating adjustment of affordable alternatives through increasing funding for no-interest loans. It has also through FaHCSIA established the Community Development Finance Institution Pilot Project that is providing assistance to five organisations around Australia to provide small amount loans on an affordable basis. I think that is an appropriate response to sit alongside this reform.

**CHAIRMAN:** Thank you for your submission and for your appearance today.

**Proceedings suspended from 13:08 to 13:47**

**UHR, Ms Catherine Louise, Senior Solicitor and Consumer Advocate, Consumer Protection Unit, Legal Aid Queensland**

**CHAIRMAN:** Welcome.

**Ms Uhr:** Today I represent National Legal Aid. National Legal Aid represents all of the Legal Aid commissions in eight states and territories. It is a collective of directors or chief executive officers who cooperate to share best practice initiatives and reduce duplication.

Thank you for the opportunity. The honourable member for Oxley, chairman of this committee, and I have in common a deep respect and love for the people of Ipswich. As part of the Legal Aid Queensland flood response, I am helping fight insurance claim refusals for 226 Ipswich families. Our clients are culturally diverse, very generous, pragmatic, straight speaking, kind, incredibly decent, resilient and not owned by what they own but by their relationships and community spirit. It is fantastic to see this acknowledged with some of our clients getting to meet the Queen today.

A national interest rate cap provided by the bill under your consideration is another tangible way we can all help to make sure hard earned cash and Centrelink income in our communities, including Ipswich, go towards living with dignity. 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 rate that Legal Aid clients in Ipswich were frequently paying before the state cap was implemented in 2008. I am living proof we survived before payday lending. Legal Aid Queensland first complained about the problem in February 2000. I quote from our first letter raising the issue to stakeholders. The letter reads:

> You may be aware of the existence of a new group of small loan, high interest fringe money lenders which have, since about the middle of 1999, begun to trade in Queensland. They often go by the names 'payday' or 'cheque exchange' lenders. A central feature of these loans is that the cost of the loan to the borrower is described not in terms of an annual percentage rate in interest but in terms of a fee, which varies depending on the size of the amount borrowed.

My colleagues around the country and I recall that the new industry was characterised by very high-cost lending. My memory is that it first appeared on the Gold Coast. These are not safe products. They are loans of last resort and the bill enables consumers to appreciate this in a market that warranted intervention because it has expanded since 1999 and is very often exploitative rather than competitive.

The casework experience of coalface lawyers and legal aid around the country confirms that the money is used chiefly for household bills. We are unsurprised by the 2008 Consumer Action Law Centre's research, *Helping hand or quicksand?* which found that the payment of basic living expenses was the reason for 75 per cent of borrowing. This includes 22 per cent to pay for car repairs and rego, 21 per cent to pay utility bills, 18 per cent for food and other essentials and 11 per cent for rent. Interim reports by both the RMIT and the University of Queensland dated September this year, entitled *Caught Short*, found that everyday essential expenditure was the key purpose for borrowing, with the third most common reason being, 'to pay back another loan.'

My colleagues and I agree that financial counselling, negotiating for hardship support, is more sustainable than increasing the debt pool for the majority of our clients. How can I further assist this committee?

**CHAIRMAN:** Thanks, Ms Uhr, and thanks for your submission as well. Could you give us an idea of some numbers across the sector in terms of people that you deal with, or if you have got other data or statistics which demonstrate particular patterns, particularly people who come and see you, as to what their issues are?

**Ms Uhr:** In terms of the data, I do not have that in front of me at the moment. But there was, in terms of Queensland, a diminution of clients coming for assistance after the state cap was introduced. In terms of the other states, it depended somewhat on what law was in place as to whether or not people identified these issues as legal. There has been research done in New South Wales on assessing whether or not people recognise they have got a legal problem. By and large, people go and see family and friends and their local community and do not go to get legal advice about a payday loan. However, the unit in which I work, the Consumer Protection Unit, pretty much did nothing else except repossess cars and land as a result of payday loans, up until about two years ago when there was a steep increase in the repossession of homes and our work became more mainstream. For eight or night years, we pretty much did nothing but payday lending complaints.

The majority of those complaints do not end up in court. Prior to the introduction of the cap in Queensland, we had the benefit of a court of appeal decision in the State of Queensland v Ward, which was a 2003 Queensland decision. This decision made it clear that a court would find that interest rates in excess of 100 per cent would be unconscionable under the Consumer Credit Code as it then was—now the National Credit Code. Despite this decision, unless consumer lawyers commence court proceedings case by case, they are unable to convince fringe

lenders that such interest was not recoverable against their client. What I am trying to tell you is that we have had to run each and every one of these cases; however, most of them settled as a commercial settlement. So you might run a file for a year and, at the end of the year, the file closes and the lender walks away, and you have not got anything to show in terms of a decision that would assist other borrowers. So we have been running these cases one by one, which is why responsible lending on its own unfortunately is not enough, because even with the decision of a court it was not enough. 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. That is what we have been doing since the cap was introduced in July 2008 in Queensland—for those who were complying with the law. There are some who have business models that are far more complex and no doubt there will eventually be litigation that will take many years to resolve. Or alternatively, each of our individual clients will settle their cases because we are lawyers who act in the best interest of clients. So, if the client is going to get a walk away, then it is not going to get a judicial decision. So we are not going to be able to create something to assist others.

**CHAIRMAN:** Can you explain what the legal proceedings are over?

**Ms Uhr:** I am going to confine my comments to Queensland because not all states have had loans where their security has been repossessed. In Queensland characteristically with these loans, although there are some lenders who are here today no doubt who only give unsecured loans, by and large they have been secured over cars and if people owned property, property in Queensland. So we have seen loans escalate. They were never going to be able to repay them in the first place. The reason they come to get legal advice is because they are losing the car, which is how they get to work, and therefore they will not be able to pay anything or alternatively they are losing their home.

**CHAIRMAN:** Is this on unsecured loans?

**Ms Uhr:** That is unsecured loans. It varies state to state, but you could go and get a judgment in a court for a $1,000 and sell someone's home up, yes. Have I seen that done? Yes, I have seen those proceedings and have had to intervene.

**CHAIRMAN:** The picture you are painting is not the norm. This is not a common occurrence. People's homes are not repossessed. It would not be short term, it would not be something that has just happened over a two-week loan of $300 dollars.

**Ms Uhr:** I have never seen a two-week loan of $300 dollars in my 11 years' experience. I only ever see loans that may start small but end up being repeat borrowing. I only see lenders who have credit card style facilities where there is really an ongoing relationship. If the person is judgment proof, they are on Centrelink income and they have no assets, then in a sense that is a risk that the lender is wearing. But, if they are someone who has got any asset, then, yes, I have seen wherever possible their security taken over asset. The market is quite broad in the same way that the experience state to state has been quite different. The market is also quite diverse and broad. Mostly I have seen small loans with security because it is easy enough to take security over the $2,000 car that you are driving as a part of the loan.

**CHAIRMAN:** You are saying that the security is taken. I thought we were talking about unsecured loans.

**Ms Uhr:** No, we are not talking about unsecured loans. Certainly a large number of lenders sign people up on direct debts. As you have heard Consumer Action say, that means it is a first call upon their income, and that, from the lender's perspective, is the best way for the debt to be paid because it is most likely to be paid. It is expensive and inconvenient to have to take repossession of security. In terms of the work that I have done on the coalface in my unit for the last 10 years, certainly a large part of it involves security.

**CHAIRMAN:** In the work that you have done, what are the numbers of people, roughly, in that particular segment of the market? Is it big numbers, half, a quarter or all of them?

**Ms Uhr:** In terms of who have security?

**CHAIRMAN:** No, in terms of the issue. You are painting a particular picture. In the picture you are painting, how many people fit into the category that no-one pays it off, that it is a revolving door and that it is a credit card style facility? In the picture you are painting, I am trying to understand the numbers.

**Ms Uhr:** I will have to take on notice the numbers, because I have not brought those here today, and I do not have those for New South Wales which are also informative. But I have personally in our unit only once seen someone who had only one loan. Normally you have either had a relationship with one particular lender that has gone on for a period of time before you seek legal assistance, or alternatively a number of clients have shopped around and have a number of payday loans going at the time. For that matter they may also have credit cards and other facilities. In terms of responsible lending, there is a lag time before cases come in the door. The impact of responsible lending should, you would think, curtail and shrink the numbers of people who come in just

overburdened with debt that should never have been offered to them in the first place. It is clearly not in the lender's best interest to be lending to someone when they have a myriad of other debts that have an equal call upon the borrower. That is what we have characteristically seen throughout the period since 1999 when this sort of lending became frequent.

**CHAIRMAN:** One of the figures quoted to us—give or take a little difference—is about five per cent in terms of defaults, or bad debts that are written off. What is your response to that?

**Ms Uhr:** The Office of Fair Trading in Queensland did a snapshot before the cap was introduced in that state and then a snapshot after. There were a myriad of small lenders with small loan books. The experience of one lender is not necessarily like that of another lender. I think many of them do write off small debts. But, from my perspective, it would be impossible to say. Do they write the ones off that comes to us? Yes, frequently.

**CHAIRMAN:** Is there a lack of information in the marketplace? You talk about responsible lending and somebody not lending to someone if they know they have other debts. Is there a lack of information? Is there a capacity to legally collect that information or find out that the information is there and then obtain it if the person is prepared to offer it up?

**Ms Uhr:** Under the NCCP, which commenced just last year, responsible lending goes hand in hand with better credit reporting. There will be access to a credit report that is probably going to have more detail. Another support to that is licensing. It is much harder to work out what someone's debts might be if a lender has literally arisen overnight, been in the market for a short period and then gone. It should now be easier to find out.

**CHAIRMAN:** Things have happened in the past. There have been a number of changes and there has been continual improvement. There has been an enormous amount of reform and improvement, which means a lot of those excesses should no longer be there or be very much minimised. In your view, does the legislation before us go far enough, too far or not far enough? Does it provide a facility in a market that, if properly regulated, can deliver a service? Are all the things you are talking about mitigated by the Uniform Consumer Credit Code, by responsible lending obligations, by having a cap in place and by a whole range of other systems, including further information? Or does none of it make any difference and it all goes on?

**Ms Uhr:** There was certainly a diminution in the outrageous products in the Queensland market after the introduction of the fees-inclusive 48 per cent cap. You would expect that, with the combination of responsible lending and auditing to see whether responsible lending is indeed taking place, there would also be a measure of improvement. This legislation is necessary so that there is an even playing field throughout the country. Will there still be some avoidance? I have heard it said today that this is watertight legislation. I am a lawyer; I will never say that. Do I expect there to be some avoidance?

**CHAIRMAN:** I have not heard that. You will have to remind me.

**Ms Uhr:** There will be some avoidance. I do not believe that it will be watertight.

**CHAIRMAN:** I do not know that anybody said that it is watertight. I did not hear that; I never picked that up.

**Ms Uhr:** I heard that there were six creative ways in which lending is taking place in New South Wales at this time. I clearly heard—unless I misheard it—that, on introduction of this particular enhancement bill, many of the potential loops will be wrapped up.

**CHAIRMAN:** We certainly hope that it wraps up many of them but I do not know that it will be watertight. That is not a major issue. Can you explain a bit further the issue of the secured loans? The types of loans were not in my thinking.

**Ms Uhr:** This is any loan.

**CHAIRMAN:** It needs to be clear otherwise I will not understand it and it will not be useful to me or the committee. When you say 'secured loans' you are not talking about borrowing for a car or a house. If somebody is borrowing less than $3,000, what is commonplace for security? If there are exceptions, tell me those as well, but what is commonplace for security from payday lenders?

**Ms Uhr:** I should make it clear because it will be confusing otherwise: in the enhancement bill those special short-term loans will be unsecured. But at the moment it is carte blanche. At the moment it is up to the model for the lender. They can take security over existing assets. They are prevented from taking security over household assets, but that is just a recent amendment to the code. Five years ago, I frequently saw security being taken over the cutlery and the beds in the house.

**CHAIRMAN:** But in today's environment—

**Ms Uhr:** In today's environment it is the car. It is not every lender's model; there are some lenders here today who will never take security but rely upon the reliability of direct debit and, if they tell you it is five per cent

default, then it is. But there are many others. There is nothing stopping you charging up to 48 per cent and taking security over the house. State to state is different.

**CHAIRMAN:** How would you take security over somebody's home? You would need deeds—

**Ms Uhr:** You just sign a mortgage.

**CHAIRMAN:** It would be a fairly complicated and expensive process, wouldn't it?

**Ms Uhr:** We see it done—

**CHAIRMAN:** I am just trying to understand this because you are the one telling me this. If somebody wants to borrow 500 bucks, obviously they are not going to have security over their home. I assume, if you own your home or are paying a mortgage, you are not going to sign away the mortgage deeds to your home on the basis of borrowing $1,000. Or am I wrong?

**Ms Uhr:** I have seen that done. Have I seen it done as a matter of course? You would have to go back to the first loan anyone has ever taken out and ask if they offered security. The answer is that they were probably given an asset list, so they will have explained what their income is. With some lenders there will be a comprehensive asset list and, if there is a vehicle or a home, then, yes, there is the opportunity to take security. But, again, the problem here is that there are state-by-state differences, so the impact on some states will be greater than on other states that have other protections that are not under the auspice of federal legislation.

**Senator THISTLETHWAITE:** Some of the submissions that the committee has received from payday lenders make the claim that it is unfair to consider these types of loans based on the interest rate alone. They make the claim that, typically, they are for small amounts of money. One of them points out that, typically, for a $100 loan the repayment is about $135. What is your response to that claim?

**Ms Uhr:** The response is that there is a disproportion if there is a small short-term loan compared to the same amount of paperwork for a larger amount for a longer term. The short-term lending provision in the bill is a compromise. It is not as good as a uniform 48 per cent cap; it is providing for those types of loans.

**Senator THISTLETHWAITE:** Earlier when we were talking about the state regimes, you mentioned some creative practices that had developed in New South Wales in the wake of the cap being brought in. Would you outline for the committee some of those creative practices.

**Ms Uhr:** Not very succinctly. It would be better if I took that on notice because it is so complex. I am not very good at giving a short answer to that question. For instance, one model involves buying diamonds, and I have explained it about 30 times and I still have trouble.

**Senator THISTLETHWAITE:** I assume that what they do has the same effect but it is done in a manner to avoid the regulation. Is that correct?

**Ms Uhr:** No doubt there are people here better placed to explain the six models that we heard about today. There is some difficulty here because it may well be that some of the complex models that have been set up are within the current law; it may well be they are not. I have not seen them tested. When we have tested schemes, sometimes people are surprised by the judicial consequences. However, I know of one case that is before a tribunal as we speak in relation to one scheme. Consumer action clearly have one case, but that is based on responsible lending, so it may not test the modus operandi that is in place for the lending. If you are thinking, 'In 10 years why haven't you run some cases and got some decisions?' the answer is that they settle. They settle one by one. It seems to me that, if you are in business, it would be commercially sensible to settle a case over $5,000. Even if you have a proactive screeching consumer advocate on the other side who instantly wanted a decision, you are not going to get a decision just because you want one.

**Senator THISTLETHWAITE:** Are you saying that these creative practices are confined to New South Wales, that they are not happening in other states? If that is the case, is it because of particular regulations that exist in Queensland and the ACT?

**Ms Uhr:** It would be fair to say that the New South Wales model that incorporates brokers—in other words, payments to third parties—is the most rigorous in place at the moment. The Queensland version of the cap does not incorporate the broker fees, and neither does the ACT version as I understand it. Of course, Victoria does not have a 48 per cent fees and interest inclusive cap and South Australia does not have any cap. So are these practices in place in every state? From the national legal aid experience, the answer is yes, which is why all eight states and territories are concerned about the practices. There are complaints from borrowers in South Australia, where there is no cap.

**Senator THISTLETHWAITE:** I have read some of the examples you have outlined on page 3 of your submission. Typically, what happens when a case does not settle? Have you had experience of cases that do not settle on commercial terms?

**Ms Uhr:** Yes. In the last five years we have had one District Court decision where it just did not settle. There have been so many changes in the last 12 months. You heard from the Credit Ombudsman, Mr Raj Venga, today. Now, as part of your licence, you have to belong to an external dispute resolution scheme. So many of these complaints will now end up before the EDR schemes to make a decision. They needs some nice clear law so they know on what basis they can make the decisions, and part of this enhanced bill is giving them the law so that the Financial Ombudsman and the Credit Ombudsman, who are the two ombudsman in this space, can make decisions. At the moment there are also some lenders who are not currently licenced—perhaps they are not lenders. There are also some people who have clients walk in and they take money away; they are not members of the ombudsman scheme and perhaps they are not yet licenced. So there are some who seemingly are not captured and no doubt they are not represented by the peak organisations you have heard from today.

**Mr GRIFFIN:** In terms of the cases that have come to your attention, are we dealing predominantly with people who are on government benefits?

**Ms Uhr:** I am surprised to hear about people who are on middle incomes, for instance, approaching this sort of lending because it is not a really viable proposition for a borrower. I remember one elderly woman who came to me and had not understood the interest rate. She was outraged and wanted to know why there was not a law to protect her because she would never have guessed that the rate would be so high. About eight years ago I remember the claim being made that loans were being made to airline pilots. Clearly, we are not going to see them at a legal aid office. Clearly, we see the people who are encountering difficulties. My concern is that we want people who are in financial trouble to get free financial counselling and access the existing hardship programs in every state and territory in relation to utilities and to access the hardship programs that are now very tightly supervised in the financial services arena. That should be the first call. In terms of borrowing more just to put more money in the pool, it simply does not work.

**Mr GRIFFIN:** I think you were here before when there was some discussion about the implications for the small-loans industry on the basis that if the bill goes ahead as proposed, regardless of your view about whether it is a good thing or a bad thing, the industry will be affected by it. Do you agree with that?

**Ms Uhr:** I heard the same arguments before both parties supported the legislation in Queensland that was introduced for a 48 per cent cap. There certainly were lenders operating within the cap after the legislation came in. Everyone expected there to be a contraction of the industry with licensing and the global financial crisis did have an impact on people accessing funding. That was very obvious in that market at the time. I expect there will be lenders who are within 48 per cent. For instance, I understand that there is a new initiative being set up—Fair Finance are lending at about 33 per cent, supported by, I think, the National Australia Bank. That product is getting off the ground and I think it is undersubscribed. So there will be options within 48 per cent.

As to whether it is commercially viable to continue to lend $200 for two months at 48 per cent, my extensive experience, from speaking to hundreds of consumers every year—and in some years it is thousands that I speak to personally—is that $200 is not going to do it for this month or next month. That is not even going to get you through. What you need is a plan. Just as, if you were not able to pay a couple of mortgage payments, you would need 18 months to get back on track, it is no different if you scale it down and say that you cannot make payments. People need longer than that to get back up on their feet when their hours have been cut at work or when their circumstances change.

**CHAIRMAN:** Isn't that a different argument, though, from the one about trying to find a model for small, short-term loans? I do not necessarily disagree with you; what I am saying, though, is: isn't that a different case? You are talking about a case of trying to assist people and help people through hardship and through a whole range of more complex environments—separate to any loan or any money they access—to try to get their house in order, as it were. That is also separate very much to how they then access money, be it through traditional banking, credit cards, a payday loan, friends or whatever other method. I understand what you are saying, but there is the relationship of one environment to the next and then how that is accessed. How do you draw that link? If you remove one part, how does it assist? If people had no access to that $200 loan, for example, how would that help them, either in the short or long term?

**Ms Uhr:** From our experience, if we get people early enough we can save the car. We can work out what actually is the best option to get them out of the situation they are in. Remember that this is just a short medication. This is a very strong medication that people are using on a very short-term basis that does not have any impact on their medium- and long-term financial security. In fact, it can have a very deleterious impact

because it can just simply, in the cases we see, make it far worse. I would have thought that that was self-evident in the sense that if you borrow at 240 per cent, it is probably not going be too good. It is self evident that you are then going to be wasting a lot of your income—precious income, because of your financially strained position—on just repaying debt. That has always been my point here: this is not like other markets; this is Centrelink income we are talking about. So when we are having specific targeted regulation—

**CHAIRMAN:** Should there be a separation between those who are working and can make a choice and those who are not and should not get that choice? Is there a distinction? Should there be a distinction, because clearly if people are on welfare they may be looked at in a different light from people who are in gainful employment, whether at the low end of the market or not?

**Ms Uhr:** In terms of whether it would be practical for legislation to try to distinguish between the two, I think it is probably not going to be possible. Secondly, it is a spurious argument for me because I heard Cash Doctors today. They have not been in the market a very long time. As I said, there is usually a one-to-two-year lag before we see real problems arise. I heard what they said; as I said, I have just never seen anyone who was on much more than Centrelink income. We might be talking about a couple of hours—they might have a part-time job, and, to be fair to some of the lenders, they might tell the lender, 'This is my job,' but it just a small part of their household income. Their household income is reliant on Centrelink.

**Senator HANSON-YOUNG:** I apologise for missing your opening statement. I want to go to the summary of recommendations in your submission. You say there needs to be—while, of course, supporting the bill—some further clarification. You have put here section (39b), that the maximum amount recoverable includes enforcement expenses. Is that because you are worried that that is a way out? My understanding is that the bill is trying to cover those things that you do not think are clear enough. Is that right?

**Ms Uhr:** I would agree that this is a very comprehensive, well thought out bill that has taken many years of research and formulation. We often see clients who have letters demanding debt collection expenses. I noticed that the ACCC recently ran a case against a solicitor making threats in relation to collection expenses. So it is something that is a common feature for a Legal Aid lawyer in the consumer debt and credit market. To us it just seems to make sense to make that crystal clear so that there is no argument in relation to those third-party expenses.

**Senator HANSON-YOUNG:** Your fourth recommendation talks about enabling individual consumers to access the civil penalty regime. Could you expand on that little bit?

**Ms Uhr:** This is in terms of: what are the likely outcomes for consumers who challenge these sorts of debts? If the loan is for only $500 or $1,000, it is just a commercial risk of doing business to have to write some off because it gets into the hands of a lawyer. The problem that we have is making sure that there are also some mechanisms. I have heard Consumer Action talk about a funded regulator who is proactive in the market, and that is certainly a major part of the answer. Also, part of the answer is when consumers are able to commence their own proceedings for civil penalties. There is something that they get back as a result of taking what are very difficult proceedings for somebody who is already fairly fragile, as most consumers are when they are in severe financial distress. Remember that part of the reason they are in financial distress is because of marriage breakdown, sickness and other reasons.

**Senator HANSON-YOUNG:** Do you think that if there was that ability that people would raise their concerns more easily than without it?

**Ms Uhr:** It was an issue raised by His Honour Mr Justice Ambrose in the 2003 case that I mentioned: State of Queensland v Ward. He said that it had been extremely difficult for the Office of Fair Trading to marshal witnesses in circumstances where their loans had been fairly low and the lending had taken place a long time ago and yet there was no ability for him to directly compensate those borrowers for the unfair treatment and illegal treatment they had as a consequence of the Consumer Credit Code being breached. Remember that for most of these loans it is already too late because they have paid by direct debit, so they have already paid the money. So simply waiving the interest is not a sufficient incentive for any sensible low-income consumer to go through the onerous task of going through a Legal Aid office or a community legal service or even in keeping in touch with the regulator in order for these proceedings to take their proper course.

**Senator HANSON-YOUNG:** When clients come to you and you go through their case, is there often surprise that there were other avenues to secure the extra $500 or $170 to send their kid on a school camp? To me, part of the problem seems to be that the industry argues that this is about choice and the community sector says there is very little choice if you have nothing to pay your bills with and you are confronted with people knocking on your

door asking for bills to be paid. We will hear from some of the other community advocates later. At what point do you think people do not hear that there are other alternatives around?

**Ms Uhr:** It is an uncommon experience for one of our clients to have had any financial counselling at the time they get into trouble. So the constant complaint that I have and that is echoed by financial counsellors around the country is that we do not get people early enough, so their options have already narrowed by the time they come to see us and they are not aware of what else is out there. That is why we are highly supportive of the bill; it suggests that this information should be raised with consumers upfront. My concern is that the first port of call should be a financial counsellor rather than somebody who is just going to give you money; perhaps a cup of tea, which is welcome; perhaps some support and a chat. Some of the payday lenders have been successful because they have had street-front shops where they will talk to people face-to-face. But that does not change the fact that the product can be incredibly dangerous. It is a highly expensive way of borrowing.

**Senator HANSON-YOUNG:** How do you regulate the difference between somebody in the industry lending money to an individual and then providing financial advice?

**Ms Uhr:** I cannot see how there is not a serious conflict of interest for doing more than having to say a set spiel about options and hand out—a piece of paper would not be enough, because our clients rely on verbal communication. So in a sense there would have to be some interjection of some sort of a set spiel for this to really function well. It is no different to every other market—to the insurance market.

**Senator HANSON-YOUNG:** Do you think that is realistically going to happen, though? We have heard the representatives from the industry today who believe they are already being responsible.

**Ms Uhr:** The bill proposes that there be specific information provided, and there are no doubt many diligent employees working for these companies who genuinely believe that they are acting in the best interests of their 'clients', as they call them, and that they would therefore go through the information. Given that the financial counselling outlets operated by Lifeline and others are likely to be in the same street, they are not going to be that far away; it is simply that the people have not accessed that form of assistance. Once they get in the door, for some of the broader agencies, what they have is access to emergency assistance; they have access to, sometimes, money-back programs with private providers who will actually match dollar on outstanding bills; and they have access to working out what is the best option for all of their various debts, and there may be a different approach on each debt. All of that means that they are more likely to come out of there being able to pay for the children's shoes and the camp, whereas I do not see that you are going to be more likely to be able to pay for school shoes and a camp when you have gone and borrowed from the payday lenders.

**CHAIRMAN:** There being no further questions, I thank you for your submission and your time today.

**AUCHINCLOSS, Mrs Lucy, Commercial Director, First Stop Money**

**BURNS, Mr Stephen, Director and Board Member, National Financial Services Federation**

**CUMINS, Mr Peter, Managing Director, Cash Converters International**

**DAY, Mr Ian, General Manager Australia, Cash Converters International**

**DEAN, Mr Tim, Chief Executive Officer, First Stop Money**

**JOHNS, Mr Philip Keith, Chief Executive Officer, National Financial Services Federation**

**REDMOND, Mr Mark Augustine, Chairman, National Financial Services Federation**

[14:28]

**CHAIRMAN:** It is my understanding that the Cash Converters submission, which was originally in confidence, is now being tabled as a public document; I will take that as being the case. Thank you for that. There is quite a number of you and time is limited. We have received your submissions and I think we have a fair understanding of everything you have put on the table, but if there is a short statement, just a few remarks, you would like to make in terms of what you have submitted, I will give each of you an opportunity to do that first and then we will go straight to questions.

**Mr Day:** We were actually going to have a general outline from the National Financial Services Federation as a lead, if that is possible, Mr Chairman.

**CHAIRMAN:** Yes, you can do that.

**Mr Redmond:** In view of what you have said, I am going to have to edit it on the run, Mr Chairman.

**CHAIRMAN:** If you would, please, that would be good.

**Mr Redmond:** Firstly to you and to the committee, thank you for the opportunity; we sincerely appreciate it. We have been in close consultation with the government now for at least six years at state and federal level, and we have supported the federal government's major changes under the NCCP. A lot of the things that we actually recommended found their way in there as well. The changes do add significant cost to our industry, but our members have recognised the need to change for protection of consumers, for transparency and to discourage illegal lenders and disreputable lending practices.

As I said, we encourage transparency, efficiency, competition and enhancing consumer protection and choice. But the bill does drift away from the recent calls to have regulation and will have significant unintended consequences. As such, we ask the committee to recommend to the government (1) to remove the proposed restrictions that would prevent a person with an existing small amount credit contract from increasing or refinancing their loan with their existing lender or finding a better deal with another lender, whatever the genuine circumstance. Under the proposed bill a person's choice to meet emergencies or to shop around are gone—they are locked in until the loan is repaid.

Our second recommendation is to change the small amount credit contract establishment fee to 28 per cent with the two per cent and to adjust the threshold down to $500 and the term from two years to six months, and for larger loans to apply a market driven permitted establishment fee plus daily reducing interest capped at 48 per cent.

With regard to the government's proposed price restrictions on fees and charges, they have been set well below the cost of providing credit to consumers. Obviously if these caps at these levels are introduced, many federation members will close their doors or refocus their business on commercially viable areas. The result will be greater financial exclusion and greater demand for public assistance. The reality is that caps do not work and this has certainly been the case in major overseas markets. US Federal Reserve, UK Office of Fair Trading and Australian researchers have all agreed on this.

Our critics have drawn on so-called surveys in Australia that in effect are nothing more than a small collection of hardship cases that do not reflect the extent of the short-term lending and the extremely low level of complaints. The Credit Ombudsman said that there were only 60 resolvable complaints in a 12-month period, which is a complaint rate of 0.005 of one per cent of all transactions. I do not deny that there are hardship cases. These are very unfortunate and we all need to work towards minimising the potential for such cases.

There is also a clear need for extension of no-interest and low-interest loan schemes. We support theses, but the vast majority of our customers are neither disadvantaged nor vulnerable and would not quality for such schemes. Rather, those of our customers who have a need for additional cash to cover an unexpected expense or an

unusually large purchase are exercising choice. Our critics hold up the 48 per cent cap in New South Wales as a success but, as you have heard, it does not achieve its goal. Indeed, even our consumer advocates admit that all is not well in New South Wales. Again, the question must be asked: why exacerbate, extend and replicate the New South Wales inadequate legislative framework? The federation believes there is a better way to protect consumers rather than to financially exclude them.

Our proposal agrees with the government in a number of areas but differs in others. Our proposal includes the key introduction of a protected earnings amount, a cooling-off period of one business day and extending debt spiral controllers to include third parties plus a number of others. We also call for the establishment of a short-term credit forum which would include representatives from the credit industry and consumer groups who would meet regularly to exchange ideas and to ensure best practice.

As for the cap, if the government remains committed to instituting this form of price control, as mentioned, we recommend replacing the proposed 10 and two cap with 28 and two, which would reduce the cost of the loans to consumers below the current market average and allow a commercially viable provision of loans—but, no doubt, this would still result in some lenders leaving the market. The amount below which the proposal would need to apply would need to be reduced from $2,000 to $500 to more accurately reflect the marketplace.

The result is to reduce the cost of the loans to improve protection from over commitment for low-income consumers and to retain flexibility for consumers, not lock them in or out of loan contracts. The larger longer term loans need to reflect the time and costs of their provision as well. Accordingly, we propose, as I said, the permitted establishment fee plus an annual reducing interest rate capped at 48 per cent. The industry is up for change. We all want a well-regulated industry that protects consumers and avoids financial exclusion and one where lenders can exercise their obligation and to lend responsibly. The mantra that I often live by is: it is the right loan for the right amount for the right term for the right purpose for the right person. As I stands, the bill will prevent us from doing that and, worse, it will force us out of business. At the end of the day, the government will end up hurting the people it is trying to protect.

**CHAIRMAN:** You raised the issue of the cost to industry—that this bill will add a cost to industry. Could you explain that a bit further in terms of the cost of establishing a loan and the cost in terms of the cost of money—so the real costs and the cost of risk?

**Mr Redmond:** Just to clarify: what I said was that the changes already under the NCCP that we have supported have added significant costs to the industry. There has been the costs of putting a compliance program in place for a business that somebody operates—be they small or large. There are the licensing fees and there are the professional indemnity insurance costs as well, which has pushed up the cost of doing business. That is where we were coming from.

**CHAIRMAN:** And the others—the cost of money and the cost of risk? You have three broad cost areas. One is to establish a loan. If it is a small loan over a small period, obviously there are fixed costs that you cannot adjust.

**Mr Redmond:** There are, yes.

**CHAIRMAN:** There is also the cost of money. I would like to get some understanding from this group as to the cost of money. There is also the cost of risk. We have heard from the pay day lending market that there is low risk in the sense that there are very low default rates of around five per cent. I am interested in how you factor those three elements of cost into what you deem to be the cost to industry of being able to provide a facility.

**Mr Redmond:** As you just said, any business has its fixed costs, its wages and its variable costs. The cost of money varies across the industry. I would not think any two businesses are the same in that regard. You have got public companies through to small companies where private shareholders have put in capital.

**CHAIRMAN:** Do you guys want to add something?

**Mr Dean:** The cost of writing a loan is about $81 and it takes about half an hour for someone to assess an application. We carry out a number of Veda checks. Probably three will be unsuccessful for one successful Veda check. They can carry a cost of about $7 each and that is if you buy them in volume. You have got the cost of capital—say, 20 per cent payable to investors—and then you have got smaller costs such as disbursement and direct debit collection costs. They run at about $1.10 each. If someone is weekly paid, you may have four collections and one disbursement, and that is another $6. That aggregates up to a cost for us for writing an average loan of $320 of around $81. If you applied the proposed legislation, our income would just be $38.40. With a pre-default rate of the five per cent you mentioned, there would be a loss of $42. Economically, it is simply unworkable.

**CHAIRMAN:** But is that a consequence of trying to have a properly regulated, effective and efficient market or is it a consequence of it being just too expensive as a product?

**Mr Dean:** No, we do that already. They are the charges and the processes that we have to go through to write a loan. And we do not aggregate our costs. We as a business carry the debt spiral in place already and we already have cooling-off periods. We carry a lot of those provisions that are coming forward. We have the cooling-off period already in place. We have high-impact statements already in place. This is the simple economic cost of writing a loan of about $320 for 30 days. It is just not viable.

**CHAIRMAN:** You would have heard some of the evidence today, and I am sure you would have read other submissions, that it is a revolving door, that because you have first call through direct debit, there is very little risk and that is perhaps reflected in the five per cent default. Given that you get first call and there is little risk in the sense that you have direct debit, is the incentive and drive to complete a loan and to complete the repayment and be satisfied in terms of the income that is derived from that product or is it more the case of trying to retain people in the system?

**Mr Dean:** I know where the question is going. You are asking if the industry models on repeat business. I do not think there is any industry anywhere that does not require repeat business and some sense of customer loyalty. But factually—and, again, from our own business experience—we take about 10,000 applications a month and we write about 3,000 loans a month. We have been doing that for 18 months, and our average repeat rate by customers is 2.3 loans. It is not 10, it is not 12 and it is not 15; it is simply 2.3. So our experience is that our customers will come back. Yes, we would expect them to come back throughout the period of a year, but our experience is not that they come back repeatedly, repeatedly, repeatedly. Notwithstanding all of that, every 90 days we have to completely reassess their application. We check bank statements and go through all the provisions as a responsible lender.

**CHAIRMAN:** So you are lending on the principle that there is capacity to pay and that they do pay.

**Mrs Auchincloss:** Yes. We also only lend to people who are employed full time. We do not lend to Centrelink. We do not lend to people who would be framed financially vulnerable.

**CHAIRMAN:** Broadly speaking, are you—the people at the table—generally supportive of the legislation and understanding of what it is trying to achieve?

**Mr Dean:** Yes.

**Mrs Auchincloss:** Yes.

**Mr Johns:** Yes.

**CHAIRMAN:** Generally, is it just about getting a model right in terms of what is workable? If you have any particular views I am happy to hear them.

**Mr Cumins:** Perhaps I could just make a point from Cash Converters' point of view. We are currently the biggest provider of short-term loans in Australia. We operate in 21 countries around the world in various jurisdictions that have rate caps or do not have rate caps. It strikes me from what I have heard today, particularly from the consumer advocates—that is, that of those 650,000-odd transactions we are doing annually, each and every one of those persons should not borrow from us and should not have access to credit—that the numbers just do not support that concept. In our business, 40 per cent of our customers are through Centrelink or have some government payment, and 60 per cent do not—they are employed. That 40 per cent is a big number but represents only about 20 per cent of our profit, because they are much smaller transactions. Our main business is directed towards those people who have a job. I just cannot quite get my head around this concept that people actually believe that 600,000 transactions are taking place by people who do not understand the contract they are entering into, do not understand the costs or do not have a choice. There are many reasons someone will take a short-term loan, even though it is a high-cost product—and it is high cost because it is high cost to provide. We have heard from everybody in the industry today that our average cost for a $320 loan is $70.87, so we have the same high fixed costs—bearing in mind also that our repeat rate on 600,000-odd transactions is four loans per year on average.

**CHAIRMAN:** Is that for all of those 600,000 transactions, or just some?

**Mr Cumins:** Our average customer will transact four times in a year.

**Mr GRIFFIN:** Perhaps we can just examine that for a second. That means that there is a chunk of customers who have only one transaction per year. Is that correct?

**Mr Cumins:** Yes.

**Mr GRIFFIN:** And then it varies up from there. So your average is four, which means, in blunt terms, that for every one that has one you might have one that has eight.

**Mr Cumins:** Correct.

**Mr GRIFFIN:** Do you group your customer base into subsets so that you can say, 'X thousand make only one or two transactions and X thousand make more than 10'? Can you do that?

**Mr Cumins:** I do not have access to that information at the moment.

**Mr Griffiths:** But could you provide it?

**Mr Cumins:** We could provide that.

**Mr GRIFFIN:** We would be keen to get it.

**Mr Cumins:** 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.

**Mr GRIFFIN:** You mentioned before that there are a series of reasons why people may wish to access your services. Could you outline some of them so we get a clear understanding?

**Mr Cumins:** I will get Ian Day to present to the committee some testimonials that we have. In those testimonials customers have explained the reason they have used our service. For example, it could be that their car breaks down and somebody has a job but they do not have $800 to get the car repaired and they need it to deliver the children to school and to go to work. They would not qualify for a NILS or a LILS or for some emergency relief from government. They need to solve the problem. They want to be able to solve it themselves. We provide a choice for them to do that. That is an example of a customer who is using the service responsibly. There are very many of those sorts of things. Some people need to protect their credit rating. They may be in a position where they just do not have the cash flow to pay a bill, which could have a long-term effect on their credit rating. It is much better to get the bill paid. They can afford to make the repayments and they get on with their lives.

**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 talking about an 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.

**Senator HANSON-YOUNG:** Following on from Senator Thistlethwaite's questioning, do you at Cash Converters have much of a crossover between people who take out the payday loans and the people who are participating in the exchange of cash for goods? Do you have client databases that show that you do one and then move onto the other? Do you keep track of that?

**Mr Day:** It is not easy to track. We are working on a database that does track the full contact with a customer. We do not have that at this point. We know that many of our pawnbroking customers like the benefit of an unsecured loan. Even though a first time unsecured loan customer might be able to borrow only $50, it is

something that they do value. I will make one other point that was not made by Peter a moment ago. For welfare recipients, we have a responsible lending obligation framework under which we will lend a welfare recipient a maximum of 10 per cent of their net income, as opposed to 15 per cent for a wage and salary earner. That is an additional guide that we take advantage of, and 97 per cent of our customers do meet that obligation.

**Senator HANSON-YOUNG:** Okay. Just to clarify what you are saying, the product that is most popular is the short-term payday loan as opposed to exchange of goods. Is that right?

**Mr Day:** We lent almost a million customers a small amount of money on a pawnbroking loan last year and another 626,000 a cash advance, so they represent a significant part of our business.

**Senator HANSON-YOUNG:** You do not know what the crossover is? You would assume that some are the same clients or customers?

**Mr Cumins:** People that sell goods to cash converters are not necessarily selling goods to raise money. A big proportion of customers are selling unwanted goods for the convenience of being able to get cash on the spot rather than having a garage sale or going to a flea market to make a sale.

**Senator HANSON-YOUNG:** It is the same motivation.

**Mr Cumins:** No.

**Senator HANSON-YOUNG:** In relation to your own regulations that you just referred to, how do you manage that between the franchises?

**Mr Cumins:** That is software driven.

**Senator HANSON-YOUNG:** How do you enforce it if you are franchising?

**Mr Cumins:** We have compliance officers to ensure that the statistics that are generated by the system reflect what happens across the group. It would be obvious if a franchisee was elevating somebody's income so that they could lend them more money than 15 per cent of their actual salary. The way that we keep that consistency is software driven.

**Mr Day:** And we have field based auditors that look at transactions that are being undertaken on pretty much a monthly basis in each outlet.

**Senator HANSON-YOUNG:** It is 10 per cent for those on Centrelink benefits and 15 per cent for those who are employed?

**Mr Day:** Yes.

**Senator HANSON-YOUNG:** That is just for the actual loan amount; it does not include the fees and charges on top of that?

**Mr Cumins:** It is the loan amount.

**Senator HANSON-YOUNG:** Do you have any calculation that you use to ensure that people can pay the fees and charges?

**Mr Cumins:** We have two types of products. One is a 30-day cash advance. The other product is an instalment loan which runs over seven months on average.

**Senator HANSON-YOUNG:** What is the maximum for that?

**Mr Cumins:** The average loan there is around $1,500.

**Senator HANSON-YOUNG:** Up to how much can people be loaned?

**Mr Cumins:** They have to have 35 per cent of their income available for living expenses after paying the loan repayments.

**Senator HANSON-YOUNG:** But you do not have a capped amount you would lend people for that seven-months period?

**Mr Day:** It is income dictated. As Peter said, it is very much about what they have the capacity to borrow against.

**Mrs Auchincloss:** Can I just add to that from First Stop Money's experience. We 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.

**Senator HANSON-YOUNG:** It does include?

**Mrs Auchincloss:** Yes.

**CHAIRMAN:** I think it was Cash Converters who mentioned earlier that you have a rejection ratio of 10 to three: for every 10 that come in you accept three and reject seven. Was that what I heard?

**Mr Cumins:** I do not recall saying that.

**Mrs Auchincloss:** We mentioned that we carry out three unsuccessful Veda checks for every successful loan.

**CHAIRMAN:** What is your ratio?

**Mrs Auchincloss:** We will run four Veda checks, three of them will lead to customers being turned down, being unsuccessful, and one of them will go on to become a loan based on affordability.

**CHAIRMAN:** So it is one in four—one in four make it through your vetting process?

**Mrs Auchincloss:** That is purely through the credit reference checking side of it. With new customers, we normally fund about 10 per cent of our applicants.

**CHAIRMAN:** You only fund 10 per cent of them?

**Mrs Auchincloss:** Yes.

**CHAIRMAN:** So you reject nine out of every 10 that come through the door?

**Mrs Auchincloss:** Yes. We run a number of criteria based on income, income source, the time you have been at that job, and then affordability, by viewing bank statements. And as I say—and I have worked with other companies in the industry who do the same thing—we do not just look at what your income is but we also take a very firm look at provable income. I think provable income is a very crucial thing, because people do have a bit on the side, but we do not take that into account. We look at what they pay for their rent or mortgage. We look at what their regular bills are. We look at what other loans they have that are outstanding, whether they are small-amount credit contracts or long-term loans, and fit all of that into the profile. What we do not do is then say, 'Okay, I see you've had a couple of payday loans before, so I'll take that income into account as well.' We go on the basis of: if they do not have any other income from any other loans in the future, will they still pay it from their salary?

**Mr GRIFFIN:** So you guys would accept one in 10 of those who come through the door?

**Mrs Auchincloss:** Yes. Well, I say 'through the door'; we are online—so people who come through our application program, yes.

**Mr GRIFFIN:** Yes. How does that compare to the industry in general—and Cash Converters, for example, seeing you are here?

**Mr Day:** I think we focus more on the success rate of those who in fact repay. So the 97 per cent success rate gives us an indication that, over 12 years, the algorithm that we have built up in the system works pretty well for us, as well as the work that we do with a customer.

**CHAIRMAN:** So that is long term? You are saying there is a 97 per cent success rate, as in people have borrowed the money and paid it back?

**Mr Day:** That is for our short-term cash advance loan.

**Mr Cumins:** For our instalment loan product, we write off 7½ per cent of the principal lent. So, in the course of the year, if we lent $100 million, we would write off 7½ per cent of that principal, and that has been consistent over a period of 10 or 11 years.

**Mrs Auchincloss:** Can I just say that that would suggest that longer-term loans are more of a problem, if they are writing off a higher percentage over a longer term. It is just that longer-term loans are more of a financial problem than short-term ones for the right customer.

**Mr Cumins:** Correct. I just make the point that the reason our loans run over seven months is that, over time, we have found that, if an unsecured loan runs for longer than seven months, people's circumstances can change quite significantly. Somebody can lose their job, they can get sick, they can get divorced; there are a myriad things.

**CHAIRMAN:** So what happens to the nine or fewer out of 10 that you do not accept? Where do they go?

**Mr Johns:** I think you have raised a very important issue here, and it is simply that the one successful loan out of the X that get rejected must actually carry the real cost of assessing the loans which are rejected. Something that has been lost in this whole discussion for quite a while is that people have focused just on what the cost is to provision loan 1, but that is not how the industry works, how any shop works or how any business works. The successful loan carries the cost of the work to reject all the other loans down the track. So, as a business model,

that must be factored into any costs. When you are looking at this cap we are talking about, it is not about the single loan; it is about all the other loans to get to the next successful loan.

**CHAIRMAN:** The question remains, though: where do those people that you reject go? Do they go to other providers who will accept them? If Cash Converters or First Stop Money have said no, do they go next door, to another provider, from your experience in the market?

**Mrs Auchincloss:** From my experience—and I have been in this industry here for three years and in the UK for a number of years before that—people who are looking for money are going to continue looking for money. As you will see from looking at VedaCheck, there will be times when you can see that consumers have had one, two, three, four different searches done on them by different suppliers on the same day. Part of responsible lending is then to say, 'Well, you might have taken a loan with that person.' It is very easy to say, 'Ask them,' and you do, but I can promise you that they do not want to tell the truth. Veda found that one in 10 people lie on their credit applications. So as a lender, under responsible lending obligations, in the majority of cases you think: 'Well, they've taken four—they've either got one or they've been declined for four. There's a reason they have been declined for four. We may not pursue it.' They will continue to look until they find an option. Different business models have different purposes. Somebody who we decline because they are on Centrelink may well get a loan elsewhere. Somebody who is declined because they are on Centrelink may have to try to find other options or may even go without.

**CHAIRMAN:** Is there a general view from the sector or from—

**Mr Redmond:** Going back to the rejection rate, in the business that I manage we probably reject three to five for one we approve. I guess we really do not know what happens to those people after that, because they do not—

**CHAIRMAN:** To look at both sides, if I am to take the advice from the consumer side which says, 'The only ones that get a loan are the vulnerable and disadvantaged,' what would you call the ones that cannot get a loan?

**Mr Cumins:** They are excluded.

**Mrs Auchincloss:** Certainly in our case, if you are financially vulnerable or if you are on a low income you will not get a loan from us. I would be one of the perfect payday loan customers. If I was riding my bike, buckled the wheel it would cost $300 to get the wheel repaired. If I did not have the money right then maybe it will cost me $375 to get it done now but I would defer that over a couple of fortnightly payments. To me that makes sense. I would not put it on a credit card because I know for a fact that if you put some money on a credit card most people end up paying minimum payments only. It could be 20-odd years before you paid it off, and a lot more interest.

So, as somebody who uses credit as well as offers credit I would use this in the short-term because I see the cost-benefit of it. I cannot talk for Centrelink consumers and I cannot talk for the financially vulnerable but that is why consumers are coming to us at First Stop Money.

**Mr Day:** The reality is that some people are going to take their tellies into a Cash Converters store on a million occasions in a year to borrow $100. Maybe that is where some of those people end up. That is their option. That is their choice.

**Mr Johns:** You have asked a few questions about quantitative numbers around some issues. I would like to address some of those. The numbers I am going to talk about are based on some surveys our organisation has run over the years. With regard to the alternatives which the government proposes—such as low-interest and no-interest loan schemes—at a maximum we estimate that only three per cent of the current consumers who use a pay-day loan or a smaller-term loan would qualify. So there is, from our members' experience, 97 per cent of the market who do not qualify. That is a vast number of—

**CHAIRMAN:** Can we get some documentary evidence of that? Can you give us something which gives us something to—

**Mr Johns:** We can take on notice to give you copies of past surveys. The next point is in regard to the use of utility programs. We will be able to send to the committee a short research paper the federation has been looking at. There was an article which ran in the Queensland *Courier Mail* recently. It said that something like 25,000 people had their power or gas disconnected. That begged the question: if the utility hardship programs are in place and working why did 25,000 people last year have their power disconnected? The number is 36,000 in New South Wales. Around Australia something like 80,000 people last year had their power or gas disconnected due to non-payment.

Clearly consumers are making a choice. We have gone to the Ombudsman for these utility providers. There are some serious problems with these hardship programs. They are in place. Consumers see them as not being an

alternative because if they have their power disconnected they are up for reconnection costs. Some utility providers even have bonds which consumers then have to part with. So the consumer makes the choice: do I keep the power on and not have the reconnection cost? They make a commercial decision to take out a loan. So, yes, those hardship programs are there. Referring another 80,000 people to those utility programs next year I do not think is going to make that big a difference.

We understand the consumer advocates. They see, according to our best calculations, 0.005 per cent of the cases. So, yes, I understand when consumers advocates say they have never seen people who are on full-time employment turning up there. That is because there are a couple of hundred thousand other people who need, want and use the products responsibly every day. It is like a smash repairer or a doctor in the emergency ward. If you were to ask them their view of the world, they do not see the people who do not need their vehicle repaired or the people who are healthy. Consumer advocates have a role to play, and we agree with a lot of the stuff that they put forward, but the reality is that their experience of the world is not the reality of the vast number of users of this product in the marketplace.

**Mr GRIFFIN:** There were a number of comments made by consumer advocates earlier today. Were there any other points you wanted to make in response to what was said?

**Mr Johns:** We would agree with quite a few things they said. We agree that payday loans are not a long-term solution. Many of our members have a statement to that effect on the product that they supply saying, 'This is not a long-term financial solution.' We agree there needs to be more flexibility with Centrelink payments to help those who cannot get a loan from the commercial sector. We agree that the NILS and LILS definitely need far more funding and better coordination.

It is not unexpected that people end up with consumer advocates because, as was mentioned earlier, one in 10 people who evaded a credit reporting agency have said that people misrepresented either their expenses or income when applying for credit. It is a fact that credit providers are limited in the current environment. We work on negative credit reporting. Until comprehensive credit reporting takes a hold and is taken up by industry there are still going to be cases where the lender does not have the ability to fully check the consumer's financial position.

Our submission for the protected earnings amount for low-income people recognises all the issues the consumer advocates have raised. I do not know whether you have had a chance to look at our submission. It is a little bit like Cash Converters own internal voluntary policy. Our submission after basically hundreds of hours of research has said to protect a portion of their income for essential items but let us not discriminate them totally out of the marketplace.

The bill is trying to second guess how consumers will or will not react. The bill is trying to design a product. We have agreed with reform. We have been heavily involved in reform for many years. In fact all the major suggestions that the federation has put forward have been implemented into the act including the debt spiral control—that was our suggestion—to protect consumers.

We think the protected earnings amount is worthy of consideration. It ticks all the boxes. It stops loans being paid over a short period of time. That is because the cost to assess a loan for a low-income person or high-income person is the same. How do you address the issue of allowing consumers, who are on a lower income, to access this with the commercially viable price? The answer is: you force the repayments to be repaid over time. If you do that, that then addresses many other consumer issues such as continuing cycling of debt because the loan is pushed out. The protected earnings amount means they can only commit X dollars to their repayments per week. All of that is in our submission.

**Senator HANSON-YOUNG:** How do you manage in-store and what are your opinions around the need for financial counselling for people who use your services? There is a fine line, as we have heard from consumer advocates and from some of the other industry reps. One of them said that that is what they do. They provide support. It is a service to people. It is not necessarily a business, I think, was the kind of phrasing. Where is that line and how do you balance that?

**Mr Redmond:** It is a very fine line. To suggest to a person who has come in, 'You look like you're disadvantaged. I think you need to go and see a financial counsellor,' could quickly attract all sorts of adverse reactions. They are choosing to come and use our service as opposed to using a hardship service. But also we have to very careful that we do not just quickly put everyone in a box. I think that is very delicate. I have been in this industry since 2000 in Adelaide after being in mainstream banking for about 24 years. I can recall as a bank manager back in the early nineties that if someone came in and wanted to borrow $500 or $1,000 you would give them a personal loan. You would look them in the eye, and say, 'This is your big chance to make sure you get it right and that you manage your repayments and everything like that.' As time went on, if someone came in and

wanted to borrow $500 they would be given a credit card application and told, 'Let's round it off to $1,000 in case you need any more.' They would walk out the door and have the $1,000 spent in next to no time and would spend the rest of their life paying it off.

I guess what happened is an education thing went away. It disappeared. People were told, 'Here's the card; go for it.' When I got into this industry in 2000 it took me back to the days of what I thought that real banking was, where you knew your customers, where you sat down with them, where you explained to them their responsibilities et cetera. From comments that we heard earlier this morning, it sounds like it does not only happen in our office; it happens in a lot of other offices.

I was involved in the SA state parliamentary inquiry, and catching a taxi from my office to Parliament House the taxi drivers would ask me 'What do you do? What are you going to Parliament House for?' I would talk about it. Unfortunately to be a taxi driver it must be a criterion that you have been bankrupt. They had all got into strife though credit cards. When I talked about how we did short-term loans, they said 'I wish I knew you were around when I needed you.' The common theme in a lot of what those people used to say is that they wanted to be kept on a short leash rather than having a loan that went on forever or a credit card that went on forever. They were looking for short-term external discipline, if you like.

**Senator HANSON-YOUNG:** So do you believe then, part and parcel, that the service that you are offering your customers is some form of financial counselling as well as a loan?

**Mr Redmond:** I guess just by default it becomes a financial counselling thing where you talk to the person through the responsible lending process and ask the question, 'Can you repay this loan without hardship, taking into account all of your own analysis and procedures?' As was mentioned earlier, some people come in asking for $500 dollars and they walk out with $250. If you are going to deny someone $500 and give then $250 you need to explain why and also often give some suggestions as to how to deal with the circumstance that they are looking at with only $250 as opposed to $500. In some of those situations it might be that they have come in and they have said, 'We have three bills; I need $500 to take care of those bills.' You can then ask, 'What is the most pressing one? What one can you use a hardship scheme for?' So you are giving them some choices. One of the bills they might just have to pay; for the other one, they might then be able to ring up, say, the electricity provider. I guess that in a sense is financial counselling.

**Senator HANSON-YOUNG:** And you have that conversation. So are your staff trained in this type of advice?

**Mr Redmond:** In my case, all of my managers are in their 60s and they have all come out of banking backgrounds. That knowledge is passed onto the staff when a person gets a loan.

**Senator HANSON-YOUNG:** They do not have any formal financial counselling qualifications?

**Mr Redmond:** No. If I was a bit cautious in saying yes it is because, as I understand it, the AFSL legislation about financial counselling requires a licence. We are not licensed to do that, but I guess out of a service you provide your experience to people.

**CHAIRMAN:** We very much appreciate what you have provided. Thank you very much for your submissions.

**Mr Day:** You requested some commentary from our customers. Is that something that I can leave with the committee?

**CHAIRMAN:** If you submit that to the secretariat, that would be fine. We will take that on board and include it.

**Senator THISTLETHWAITE:** Am I right in saying that all of you expressed a view earlier that you do not lend to people on Centrelink payments? Is that correct?

**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.

**Senator THISTLETHWAITE:** Thank you.

**CHAIRMAN:** Thank you very much.

**SHTEYN, Mr Daniel, Managing Director, DollarsDirect LLC**

[15:16]

**CHAIRMAN:** Welcome.

**Mr Shteyn:** We are on online broker of short-term loans in Australia since our entry into the market in 2009. We are a subsidiary of Enova International, which provides subprime credit products online to over a million customers in the US, the UK, Australia and Canada. Enova itself is part of publicly traded Cash America International, which is listed on the New York Stock Exchange. I manage Enova's Australian and Canadian operations.

First of all, I would like to express my sincere gratitude for being invited to appear in front of this committee today. I flew in from Canada this morning in order to avail myself of this opportunity as I believe the committee is faced with an extremely important issue in the form of the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill. With no exaggeration whatsoever, at stake are hundreds of jobs, millions in tax revenue and the financial wellbeing of hundreds of thousands of Australian customers and consumers. I am here to provide you with some facts and opinions which I hope will prove helpful.

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. The short-term cash advance product which we broker has a simple and transparent cost structure which our customers fully understand and appreciate. They come to us because they make a conscious and rational decision on value vis-a-vis other products such as overdrafts and late fees, which are not as suitable for their needs.

Overall from our global perspective, demand for short-term credit is high among underbanked customers globally and in Australia, as they are consciously shunned by mainstream banks as risky and unprofitable. The real question, in my view, is not whether this demand will go away if the industry is effectively banned through a rate cap that sets prices too low—because it will not. Rather, the question is whether the supply of credit to meet this demand will continue to come from licensed players or from unlicensed operators. Illegal lenders would be more than pleased to fill the supply void created by any unintended consequence of regulation should Australia get it wrong. Numerous economic and government studies, and I can quote at least four right off the bat, in addition to our own experience in the United States, point to illegal and unlicensed lending as a real threat. As an example, within six months of the introduction of rate caps in Washington state at the beginning of 2010, unlicensed lending increased to take some three-quarters of the market, up from one-third prior to 2010, according to our internal estimates.

Moving on to the particulars of the draft bill, as you know, it proposes an establishment fee of 10 per cent plus another two per cent. Supposedly, this rate cap will prevent debt spirals, which would, of course, be a good thing. However, a rate cap which is set this low is effectively a ban on the product as almost all lenders would lose money. In our case, we estimate that we would incur a cash loss of approximately $10 to $15 per every $100 lent at these rates. This would undoubtedly force us to exit the market.

But let us pause for a moment to consider the utter absence of logic in a situation which would make it a criminal offence for brokers and lenders to refinance another short-term loan which could actually be better and cheaper for the consumer. I am referring to sections 124 and 133 of the draft legislation. In fact, this measure would eliminate all price competition in the cash advance market, where we believe we are probably one of the lower cost providers. Let us also not forget the basics of economics 101, which dictate that when the price of something goes down demand generally goes up. In other words, cheaper debt generally implies more debt. This does not sound like a solution to a debt spiral.

Such a situation would be hypothetical in any case given that almost no licensed lending would take place under these circumstances. The only lenders left would be illegals, which would be impossible to reach, especially if they are online, and by definition they do not care about rate caps. They will charge more, they will offer no access to statutory provisions and they will collect more aggressively.

All in all, we do not believe that the bill in its current form would allow a viable industry to operate in Australia, nor would it make consumers better off given that it will shut down the supply of licensed short-term credit as it currently stands. Our view is that both consumers and the industry would be better served through continued adherence to responsible lending obligations and the encouragement of fair collection practices, where lenders do not add to the debt burden of those who have already proved their inability to repay due to default. Additionally, we would support smarter, simpler and more effective regulation to put a hard limit on the possibility of debt spirals.

Our proposals, as detailed in our written submission, are as follows. First, we would propose to either eliminate the rate cap for non-desperate and vulnerable consumers, or at least increase it to $30 per $100 lent, as proposed by the regulatory impact statement prepared by Treasury. Our second proposal is to expand the scope of the 200 per cent total cost of credit cap to put a hard limit on debt spirals. As proposed, this cap currently applies only to defaulted loans. Expanding its scope to all loans addresses the root cause of debt spirals, which is continued growth in debt. This cap would also cover situations known as rollovers, where loans are extended when only the fees are paid. The limit on the total cost of credit would apply regardless of whether a loan is defaulted or extended once, twice or 100 times. In this situation, the provisions of section 39A become redundant. Our third proposal is to delete sections 124 and 133, which effectively ban refinancing of short-term loans. Such restrictions are impossible to implement currently given the absence of comprehensive credit reporting, the skimpy nature of Australian credit reports and the quasi-monopoly enjoyed by the incumbent credit bureau. As well, these sections will shut down all price competition and be directly harmful to consumers, who will become unable to refinance with cheaper, more suitable credit. In closing, I would like to say that, as part of a public company, we at Dollars Direct strive to live up to the highest industry and regulatory standards. If we are unable to recover our costs of doing business, we will exit the market. However, we very much hope that this will not be the case and that we will continue to provide access to credit to underbanked Australian consumers for the foreseeable future. This marks the end of my prepared comments and I am at your disposal to answer questions.

**CHAIRMAN:** Thank you for flying in to talk to us; we appreciate that as well as your detailed submission. You would have heard from other witnesses that they have a fairly high rejection rate for people who apply for credit through them. Please give us an idea of your acceptance and rejection rates.

**Mr Shteyn:** Firstly, as I mentioned, our underwriting criteria specify that we only underwrite customers who are employed. Secondly, we also insist on them being paid by direct deposit because we believe that it is easier to track their ability to make sure that the loan will be repaid. 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.

**CHAIRMAN:** Following through the figure of those who are acceptable and that meet your requirements, what is the number of defaults or bad debts?

**Mr Shteyn:** Out of the people we issue a loan to, the number of people who default is probably in the high single digits, somewhere between four per cent and nine per cent. The reason I am not putting an exact value to it is that even if people do not repay immediately, they can sometimes repay once we give them an instalment plan which happens upon initial default.

**CHAIRMAN:** How would you characterise that figure? Is that a product of being an online business and not having face-to-face contact or report, or is there some other reason behind it?

**Mr Shteyn:** As I said, I run a Canadian and an Australian business and I work most of the time in the United States which gives me exposure to the UK and the US as well. I can confidently state that our repayment rate in Australia is the best that we have seen across the globe. In other words, for a portfolio of loans of any given size, to have a repayment rate of that nature is extremely good. Generally our observation is that when you compare storefront operators to online operators, storefront operators' experience of bad debt is maybe a little better. This can be ascribed to the personal interaction and customer stickiness. But the difference in our Australian experience is probably not large.

**Mr GRIFFIN:** Please tell us the size of your business in Australia—the number of loans and the overall size of the loan business. I might have missed that.

**Mr Shteyn:** I am trying to think of the best metric to use. Let us talk about the number of loans: the number of loans which we extend in the Australian market is around the 50,000 loan-per-year mark, give or take.

**Mr GRIFFIN:** Around 50,000 actual loans per year?

**Mr Shteyn:** That is correct.

**Mr GRIFFIN:** Any idea how much of that is repeat business?

**Mr Shteyn:** I'm sorry?

**Mr GRIFFIN:** Any idea how much of that is repeat business? Is that 50,000 loans to 50,000 customers or is it 25,000 customers who average two loans each?

**Mr Shteyn:** My best understanding, and I had the data run before coming over, is that our customers generally take approximately four-point-something loans annually. So there is probably—

**Mr GRIFFIN:** That's an average?

**Mr Shteyn:** Yes. I would say that probably two-thirds of that amount would be non-unique repeat loans. In other words: the proportion of new customers coming in versus existing customers is probably two to eight, but the proportion of people who take only one loan versus people who take more than one loan—I would have to get those exact numbers for you.

**Mr GRIFFIN:** I would be interested in that. The other thing I am interested in is the average size of a loan.

**Mr Shteyn:** The average size of a loan ranges between $280 and $450. The bookmarks are someone who is known to us versus someone who is not.

**Mr GRIFFIN:** The reasons why people access lines from you in those circumstances—I am not sure if you were here before, but it has been suggested by the consumer movement that in fact there is no sensible reason why anyone would access this sort of loan facility, given the other choices that are available, and therefore people are making bad choices. So I am wondering what the reasons are.

**Mr Shteyn:** That would come as a surprise to me, given all the feedback I have received directly from our customers, and I monitor our phone lines. Every once in a while we run customer surveys. So while we do not have face-to-face contact we have our finger on the pulse. Just to repeat what I have said about our customer base: all are employed, the average income is probably about $45,000 to $46,000 gross per year, they have dependents and many own their own housing. It is very hard, if not impossible, for me to believe that all of these customers have no idea what they are doing. Plus, we are absolutely committed to providing a very transparent and obvious way for them to price a loan. We tell them exactly how much it will cost. Why do they do it? There are any number of reasons. One is a shortfall finances on an emergency basis; in some cases they have no access to credit, we refer to those as under banked, meaning they have bank accounts but they do not have access to credit or their credit cards are maxed out; they wish to avoid disconnection; they wish to avoid late charges; they need it for emergency expenses such as car repairs; or in some cases they believe that this is a superior product, relative to a bank loan. In other words: when the need is for several hundred dollars, the last thing people want to do is go to a bank and borrow $2,000 for two years. I am not sure if that answered your question completely.

**Mr GRIFFIN:** That is fine.

**Senator HANSON-YOUNG:** Seeing as you operate primarily online, is the phone contact just to verify identity? You said that you speak to customers on the phone as well. Can you apply online and over the phone or is the phone used just to confirm identity?

**Mr Shteyn:** Our phone lines are available for customers to start the application process, but they cannot fully complete the application process over the phone. We use the phone to support customers who are applying and to conduct customer service, which means people who want to double-check their due date or who are simply not able to go online. We also conduct verification of employment over the phone—in other words, we call the employer. We also call back customers to confirm their identity. So only in those cases.

**Senator HANSON-YOUNG:** While you have restrictions that require people to be employed, is the type of employment a concern to you?

**Mr Shteyn:** Yes, it is, very much so. The type of employment that we like lend against, so to speak, is customers who have been employed at a certain location for over a certain period of time. Generally, this is over a month. In other words, somebody who states that they have just started would not be eligible. We also do not lend to the part-time or casually employed and we do not lend to employed people when they are paid via cash or paper cheque.

**Senator HANSON-YOUNG:** If a loan is approved, how soon do people get their money?

**Mr Shteyn:** We have recently launched a same-day funding service so that in many cases, when people apply prior to a certain cut-off and they bank with the major banks here in Australia, they could receive their money as early as the same day.

**Senator HANSON-YOUNG:** You do a rapid deposit, do you?

**Mr Shteyn:** That is right. This is a feature which has recently become available in the Australian market. In other cases, our direct deposit would be received in the customer's accounts on the next business day.

**Senator HANSON-YOUNG:** Do you think the next-business-day deposits means you get different customers from those who walk into a shopfront?

**Mr Shteyn:** That is a very interesting question. I have no way to provide you with a certain answer. My best guess would be no. The reason I am saying that is that the online business model stresses privacy. In other words, you could complete your application process in your pyjamas. There is no need to actually walk into any given location. However, that said, there is probably not that much difference between an employed customer that we would fund and an employed customer that somebody else would fund. It is just that, generally, bricks-and-mortar locations also fund other types of customers, which we do not.

**Senator HANSON-YOUNG:** You do not have a shopfront, so where do you advertise your service?

**Mr Shteyn:** Online.

**Senator HANSON-YOUNG:** Where? What type of sites would you advertise on?

**Mr Shteyn:** Generally, in the e-commerce environment, the way that advertising and customer acquisition work is via organic searches and paid searches. The main search engine which hosts both organic and paid searches is Google. In the Australian market, I believe Google accounts for over 70 per cent of all searches in this particular market segment, with the rest being accounted for by Bing and other search engines. Is that helpful?

**Senator HANSON-YOUNG:** Yes. Do you pay for banner advertising on other people's websites?

**Mr Shteyn:** In some jurisdictions we do. In Australia we do not.

**Senator HANSON-YOUNG:** Okay. So you just pay for the placement up or down the page with Google?

**Mr Shteyn:** The way it works is that you have paid searches, which are generally at the top of any given search page and at the right, and sometimes at the left as well; and then the middle part is your organic search, which you cannot really pay for. This is a matter of Google ranking your website. There are also affiliates which advertise themselves and then pass on the customer application to another broker or a lender.

**Senator HANSON-YOUNG:** Do you participate in that?

**Mr Shteyn:** Yes.

**Senator HANSON-YOUNG:** Who would be your affiliates?

**Mr Shteyn:** There are probably 10 different affiliate networks operating in the Australian market. Are you looking for a specific listing?

**Senator HANSON-YOUNG:** Yes.

**Mr Shteyn:** Would you like me to provide it offline?

**Senator HANSON-YOUNG:** You could give it to us in writing if you have affiliates that you advertise through.

**Mr Shteyn:** Yes, absolutely.

**Senator HANSON-YOUNG:** Thank you. Can I just clarify: how long have you been operating online in Australia?

**Mr Shteyn:** Since May 2009.

**Senator HANSON-YOUNG:** What type of increase has the business had over the last 2½ years?

**Mr Shteyn:** If I were to look at practically any metric, the increase would be infinite, as we started at zero and now we are at a viable business level. I am not sure what metric I can give you. Presumably, the most relevant metric would be year-on-year growth, as opposed to two because then the nominator is not zero. I would say there has been year-on-year growth probably in the order of 25 per cent, but really this depends on the kind of metric that you use.

**Senator HANSON-YOUNG:** Twenty five per cent is pretty good though.

**Mr Shteyn:** I am not arguing with you. This is a matter of us taking market share from other lenders and brokers as well as the growth in the market itself.

**Senator HANSON-YOUNG:** In your applications, what type of extra information do you give people? Part of this legislation will be looking at giving people information on where else they could get quick money if they needed it. Do you offer any of those types of services currently?

**Mr Shteyn:** Currently we do not. We believe that if and when such an impact statement is legislated we will be happy to comply with all relevant provisions of the law, as we have in the past.

**Senator THISTLETHWAITE:** Mr Shteyn, does your organisation offer any other lending type services or is it just payday loan type services or products in Australia?

**Mr Shteyn:** In Australia we offer a pure cash advance type of service, otherwise known as payday loans. Like I said, it is generally a product that ranges between $250 to $450 and the term ranges between several weeks to several months.

**Senator THISTLETHWAITE:** There is a study, which the committee has been provided with from the University of Queensland and another university in that state, that looked at some of the statistics associated with payday loans and the profiles of the types of people that utilise these services in Australia. They found that many of them were commonly unemployed or received government assistance. It said that 78 per cent were receiving Centrelink payments. All of the other organisations that have appeared before you expressed the view that they did not lend to people who were not employed. Based on these statistics are you aware of where these people are sourcing these loans if organisations such as yours do not lend to people who do not have paid employment?

**Mr Shteyn:** Just to repeat the question to make sure I properly understand, you are asking where non-employed beneficiaries would get loans funded online?

**Senator THISTLETHWAITE:** Yes, are there any online competitors that you are aware of that are providing these loans to people who are unemployed—you do not have to name them—or are there non-online providers?

**Mr Shteyn:** I believe among the online players, who are licensed in the Australian market, to the best of my understanding, they generally require employment as a prerequisite for a loan being underwritten. Accordingly Centrelink beneficiaries I believe are not eligible.

**Senator THISTLETHWAITE:** They could still be a Centrelink beneficiary and hold employment in some circumstances.

**Mr Shteyn:** Senator, I unfortunately I am unable to shed too much light on the underwriting practices of other lenders. I do however know that there is some illegal lending going on in Australia online. Equally there is legal, licensed lending provided by storefronts such as the honourable gentleman and lady who appeared here before me. They do accept, in some cases, customers who are not employed. In other words they have funds from a source other than pure employment.

**Senator THISTLETHWAITE:** You are saying that your organisation will not lend to someone who is not employed.

**Mr Shteyn:** We have found that that is the optimal course of affairs both for our own business purposes as well as for the customers involved.

**Senator THISTLETHWAITE:** What sort of proof is required? Do you ask for a letter from an employer or a payslip?

**Mr Shteyn:** We have a very extensive underwriting process which has been developed in several different countries across quite a few years of operation. We have a room full of PhDs and masters and statistical scientists who devise credit models. We also have a pretty exhaustive loan underwriting process where people are required to submit some sort of documentation, typically a payslip or sometimes bank statements as well. Then we verify this information by calling back and speaking to employers.

**Senator THISTLETHWAITE:** Does your organisation operate in other jurisdictions where there are caps on interest charges and fees?

**Mr Shteyn:** Yes. We operate in a variety of different jurisdictions. For instance, the UK on numerous occasions has rejected rate caps as being unworkable and counterproductive. Other jurisdictions in the US have seen fit to impose such rate caps, given the fact that regulation is a state-by-state matter in the United States.

**Senator THISTLETHWAITE:** So you do operate in some jurisdictions where there are caps?

**Mr Shteyn:** Right. Obviously not all rate caps are created equal. There are many jurisdictions where rate caps are set at levels which are ridiculously low, such as a 36 per cent APR cap for instance, where we are unable to operate. In other jurisdictions we are able to.

**CHAIRMAN:** Mr Shteyn, thank you very much for your time and thank you for your submission. If you could provide the extra bits of information we would be more than happy to accept them.

**CORRIE, Ms Tanya, Senior Project Worker, Good Shepherd Youth And Family Service**

**ANDERSEN, Ms Felicia, Community Care Sustainable Living Coordinator, Anglicare Sydney**

**McDONALD, Mr Paul, Chief Executive Officer, Anglicare Victoria**

**PATSIKA, Mr Shungu, Financial Counsellor, Anglicare Victoria**

[15:46]

*Evidence was taken from Anglicare witnesses via teleconference—*

**CHAIRMAN:** I now welcome witnesses from Good Shepherd Youth and Family Service here in person, and from Anglicare Sydney and Anglicare Victoria by teleconference. While we wait for Anglicare to come online, Ms Corrie, do you have any opening remarks?

**Ms Corrie:** The main things I wanted to speak to were our position on the changes overall and our position in terms of fringe lending and the caps on the rates, because that is of particular interest to us. Good Shepherd Youth and Family Service administers one of the largest microfinance networks in Australia. We have quite an intimate knowledge of the consumer issues that come about as a result of fringe loans.

I would like to say from the outset that we do not advocate for the end of the industry and we are not suggesting that we need to see an end to the payday lending industry. We see a market, unfortunately, but we also believe that people needed to be provided with the appropriate options and that the role of the fringe market should be restricted to a tertiary one. We do not believe an under-regulated fringe market is best to fill the gap.

We think that often people are pushed to take out these loans in certain circumstances. I am not suggesting this is always the case, but in certain circumstances people do not feel they have many other options. If those options are made available and are made explicit at the outset then we believe there would be a decreased financial vulnerability. We are not supporting the end of the industry, but we do think there needs to be protections in place to protect those consumers when they get to the pointy end where they are struggling to make their repayments. In terms of the changes to the legislation we are very supportive of anything that is in place that helps people to access hardship provisions. Our practice experience is not just microfinance; we also run financial counselling services. We often see people in quite a lot of financial stress. So we are fully supportive of allowing them to access hardship provisions and also making them more flexible and increasing the protection of people when they are going through that process so they cannot be pursued for their debts. We do realise that that time in the interim is quite critical for a lot of people when they are financially stressed. So we support any of those changes that allow that. We also support the caps on rates and the caps on costs and, as mentioned earlier, that is not an attempt to wipe out the industry, but we think it is important to make sure people are protected and are offered things like microfinance. We also understand that microfinance is not necessarily going to be the most appropriate option for people who are accessing payday loans or small short-term loans. But we do think that is an option that should be made available as well as a whole suite of support programs that are required to really meet those needs.

**CHAIRMAN:** In terms of you providing microcredit, how much do you provide and under what conditions do you provide the finance?

**Ms Corrie:** There are two different schemes. One is the No Interest Loan Scheme, which is primarily community driven. The capital is provided by a range of different sources. National Australia Bank provides a large chunk of the capital for us as well as that provided by a whole range of different local government and philanthropic organisations. So there is quite a range of different pools of capital. It is managed on a basis of circular credit, so any payments made are recycled and then lent back. There is no interest or charges applied to the loan.

**CHAIRMAN:** What is the default rate?

**Ms Corrie:** It depends on the program. The programs are very diverse. We have some specialised programs that have quite high default rates, so a certain amount of capital is put aside for those programs, fully expecting that they are riskier. Generally, on the whole, it is about five per cent. There are some programs that have never had a default and there are some that have slightly higher defaults, but generally it is about five per cent.

**CHAIRMAN:** How much would you typically lend?

**Ms Corrie:** For NILS I believe the average loan out is about $800. The typical repayment period is longer than you would probably get with a fringe loan; that is to make sure it is affordable for people. Off the top of my head, I think it is about 12 to 18 months.

**CHAIRMAN:** Do people access NILS programs and what you offer in other programs and also get payday loans? Do you know that?

**Ms Corrie:** I have not got anything empirical that I can tell you, but I can tell you from my experience in speaking with people through some of the more qualitative research that we have done that, yes, people do sometimes have both. It is rare, because we are quite careful to make sure people are not further marginalised by taking out an additional loan. If we can see that there is no capacity in their budget to pay it back—and chances are that if they have got a fringe loan, often that does restrict their capacity, but there are occasions.

**CHAIRMAN:** When you say you are careful, how do you check? How do you know?

**Ms Corrie:** To qualify for a NILS loan, you do require a healthcare card. Generally speaking, we are talking to people on lower incomes. A Centrelink statement or payslip, depending on their work circumstances, is required. Often the loan workers will go through bank statements, utility bills, anything that would indicate what their ongoing expenses are as well as their earnings. Then they will sit down and work out a budget and basically work out, in consultation with the client, what they can afford to pay back.

**Senator HANSON-YOUNG:** How long would it take to do that assessment process?

**Ms Corrie:** It is very variable.

**Senator HANSON-YOUNG:** Could you do it in 45 minutes?

**Ms Corrie:** For certain clients it is a very straightforward process. They are very aware and able to just come in, as long as they have got the right paperwork. There is quite a lot of paperwork that is required in making sure someone can afford it. Generally speaking, if the right information is provided at the inquiry stage, then it can take up to about 45 minutes.

**Senator HANSON-YOUNG:** So in terms of time it is comparable to a payday loan?

**Ms Corrie:** Yes, I think so.

**CHAIRMAN:** Do you do credit checks as well?

**Ms Corrie:** It depends. For the NILS loans, no. The NILS loans are based on the person's capacity. For the second type of loan that we do in partnership with National Australia Bank a credit check performed.

**CHAIRMAN:** Does that take longer and cost more?

**Ms Corrie:** It takes longer—not a great deal—but it does take a little bit longer. I cannot speak to the costs, though.

**CHAIRMAN:** You do not know that.

**Ms Corrie:** National manage most of those things.

**CHAIRMAN:** Could you just give us some idea of who it is that you see? Who is your client base?

**Ms Corrie:** Primarily, the people we see are on Centrelink payments. We do have some people who are working on either a casual or a part-time basis and are, generally, supplementing that income with a Centrelink payment. On the whole, off the top of my head, 80 or 90 per cent of people we speak to are on Centrelink payments. The majority of the borrowers are women—

**Senator HANSON-YOUNG:** The majority are women?

**Ms Corrie:** Yes, a lot of the borrowers are women—about 60 per cent, from memory.

**Senator HANSON-YOUNG:** Is there any weighting on whether or not they have dependants?

**Ms Corrie:** In terms of whether or not they are more likely to be approved if they have dependants? No, each application is based on its own merit. Our mission is very much about supporting women and girls, but the microfinance programs themselves are run through a whole range of different organisations, including Anglicare. They do tend to have their own ways of working them within the frameworks that we have established.

**CHAIRMAN:** Would you know whether they had previously applied for a loan somewhere else and been rejected?

**Ms Corrie:** Microfinance only, or just generally speaking?

**CHAIRMAN:** Just generally speaking. Is that something that you would know or would ask?

**Ms Corrie:** It is likely it would be asked, but it is not something that I can speak to with any certainty.

**Senator HANSON-YOUNG:** Do you have clients who come in asking to loan money to pay off outstanding debts with payday loans or Cash Converters?

**Ms Corrie:** All the time. Unfortunately, the purposes of the microfinance loans are more restricted, so it is not used for refinancing, for example, and it cannot be used to pay bills or ongoing expenses. In that sense, I guess what I was saying before is that it is not a replacement for short-term loans because the aim is really asset

building or to improve someone's financial situation. The loans are more restricted and very often we do get inquiries from people wanting to refinance some of the payday loans but also trying to consolidate their bills, which is another thing that comes up a lot, which we cannot unfortunately assist with.

**CHAIRMAN:** Can I just check: do we have Anglicare Sydney or Victoria by telephone? Yes. Thanks for joining us. Starting with Anglicare Victoria, I invite you to give us a very brief statement on your submission.

**Mr McDonald:** Yes, thank you Chair. I apologise to the committee for not being able to be there in person but, unfortunately, we had a board meeting today.

We welcome the opportunity to submit in writing as well as orally to the committee in relation to this new legislation. We welcome the legislation, because we feel it gives the borrower more scope to deal with a creditor, it is a good start to regulating the issues around payday lending behaviour and it does start to capture the conduct that may avoid obligations. Within our submission we have outlined particular points in relations to schedules 1, 3, 4 and 5 in relation to the amendments being sought. We also do have some comments in relation to some issues within the current legislation, which we are happy to attend to later on, if you like, and also to pose some minor additional inclusions into the legislation if there is an ability to do that. In principle we are very supportive of the directions the legislation is headed. We would like to see the payday lending industry decreased in the sense of exposure to low-income people who come and seek our services. Anglicare Victoria would see about 10,500 people through our financial counselling services and we provide a range of NILS and StepUP programs to our customers. In relation to our views on the regulation or otherwise of payday lenders, we are seeing the results of many families in high debt and high financial stress. The opportunities to take on or accept some of our microfinancing of NILS and StepUP were not picked up in the legislation, but certainly we see these as viable alternatives for many of the consumers that we see come in to seek our financial counselling. I am happy to talk more in detail to each of the schedules if the committee would like.

**CHAIRMAN:** Sure. Just before I move on, Mr McDonald, could I just ask you about the people you see with high-debt, high-finance problems. Could you explain what those problems are. Are they a direct result of a payday loan, or were they existing problems and is the payday loan just another slice on top of that?

**Mr McDonald:** There are two types. There would be people on the payday loan. We would certainly see people coming in in great difficulty, being tied up in a payday loan, particularly in relation to direct debit repayments of these payday loans that are not capped. A high percentage of their income would be going across. For example, we had someone on a disability pension, and $300 a fortnight of that total disability pension was being direct-debited straight into a payday lending account. Sometimes we would find that the payday lending behaviour was that they would get into the account the day before the pension was going to hit the account to ensure that that payday lending direct debit was actually achieved, thus incurring further fees for drawing on accounts that did not have income in them; the income went in the next day.

The second main group are people tied up in utility bills, with high bills and high commitments. In fact, we gave a profile—a breakdown—of the client debt related problems in our submission. Of all our client cases coming in to see financial counsellors, 72½ per cent related to client debt problems, and of these debt problems 50 per cent resulted from creditor issues and creditors not being willing to negotiate payment rearrangements, or creditor harassment.

There are also those one-off debts, such as car repairs, whitegoods, children being sick or children needing to be taken to hospital if they are in regional Victoria. We certainly see that group as a third group that is seeking our assistance.

**CHAIRMAN:** Thanks for that. I will just go quickly over to Anglicare Sydney, if you want to make a few short remarks.

**Ms Andersen:** Thank you. Anglicare Sydney welcomes the introduction of the proposed reforms, which aim to provide greater protection for consumers in relation to consumer leases and short-term amount loans and reverse mortgages. We hope that these reforms will contribute to a greater level of accountability and transparency in the credit services industry. We believe that will generally benefit consumers over the long term. We can also acknowledge that short-term credit loans are sometimes a necessary source of income for consumers that are unable to access the mainstream credit market. For this reason, it is also important that the credit services industry be financially sustainable in the long term so that consumers do not have to resort to loan sharks when there is an exchange of things like household goods involved.

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 that people understand, and we would like there to be alternatives provided to them such as microfinance and financial counselling. When things are brought into place to hopefully improve the system as it now stands, we would like these things to be followed up so that it is not just a statement that is made or a policy that is brought but payday lenders are actually held accountable to uphold any changes that are brought into place.

I would just reiterate what Tanya said: we work closely with Good Shepherd and can support the examples that she gave. My microfinance worker was sitting here nodding as she spoke about the clients that they see.

**CHAIRMAN:** Thanks. Mr Griffin?

**Mr GRIFFIN:** I have just a couple of questions. Ms Corrie, you mentioned that you saw a role for a market in short-term lending. I want to examine that for a second because it has become fairly clear from the evidence from the industry—and it has been supported, I think, by the consumer movement—that the result of the capping that is proposed will be fairly large scale exiting from the industry over the number of companies that provide products. That will effectively make the products more affordable but make the supply of those products much less available. Do you agree with that?

**Ms Corrie:** The best sort of evidence I have in terms of being able to make that a sustainable cap is that you need sufficient scale, and so I imagine that may mean smaller lenders will leave the market. But I think, if you look at a more comprehensive response to that, you will find—as some of the research that we have says—that about 50 per cent of loans are for large expenses, such as fridges or a car breakdown, which microfinance can assist with in many circumstances. I do appreciate that it may reduce the supply of small, short-term loans, but I think the way to meet the extra demand that may be created, which I think is being dealt with, is by increasing microfinance provision. There are also some other strategies such as financial counselling and emergency relief services. I think, once those are exhausted, there is a role for the market, and it will be a more limited role, given the other reforms and the other sorts of programs that are put in place. I also do not necessarily support the idea that there is going to be—

**Mr GRIFFIN:** You still think there will be a market there?

**Ms Corrie:** I do.

**Mr GRIFFIN:** The point about a market is you need demand and you need supply.

**Ms Corrie:** Yes.

**Mr GRIFFIN:** So you still think there will be a market provided there? Because that is not what the response has been from industry and, frankly, it is not what the response has been from some of the other consumer groups.

**Ms Corrie:** In other states that have introduced caps, there has not been a mass exodus from the market. I think there will be some players that leave. Our point probably speaks to working on how we do meet that demand, because I do not think demand will go away. I think supply might drop off—I think that is what I said before—but there are other ways you can meet that demand without people resorting to the fringe market.

**Mr GRIFFIN:** Do either of the Anglicare witnesses want to make a comment on that point?

**Mr McDonald:** From our observation of any lower socioeconomic suburb, there are a bevy of payday lenders in most shopping malls and strips within those communities. Now, there may be a trimming of payday lenders. Some may get out of the market because they do not find it cost-effective. But I think there will be, from the consumers, some demand still for payday lending that they will choose. I think it is an overreaction to say—

**Mr GRIFFIN:** Can I just stop you there for a second. I think there will be an increase in demand for payday lending as a result of the changes that are being proposed, because they will actually make it cheaper. The question is whether there will be a supply of organisations that are prepared to provide it.

**Mr McDonald:** Do you mean payday-lending organisations?

**Mr GRIFFIN:** Basically, in this context we are talking about demand as in: who are the people who will wish to access payday lending? If the reforms go ahead as proposed, as I understand it they will make payday lending cheaper because the cap would operate to make it cheaper. On that basis, you would expect demand for payday lending to go up—no question. The question is: would the supply be there to meet that demand?

**Mr McDonald:** I am not seeing that the supply will not be there to meet that demand. I am not sure supply will shrink, that there will be a whole heap of demand that will be unable to be fulfilled.

**CHAIRMAN:** You are saying both that it is going to be cheaper and that there is going to be supply as well, so more people will access it?

**Mr McDonald:** Yes, more people will access it. Also, I think we have to continue not only in relation to these amendments but also in growing the NILS and StepUPs and those types of models. I think it will find an equilibrium, but I do not think supply will reduce.

**Mr GRIFFIN:** Let us be clear that supply in this case is companies being prepared to provide the product.

**Mr McDonald:** In relation to some trimming or reduction through the industry saying, 'This won't be a business model we feel will meet our interests, we'll bail out,' and thus there will not be enough of these types of options for consumers, I would not witness that that would be the result of this legislation.

**Mr GRIFFIN:** That is not what some of the other consumer advocates have said earlier today. I want to ask about the sorts of people that your organisations are seeing. How many cases are we talking about over, say, the last year or two? For each of your organisations, how many actual cases have you had of people coming forward who have had problems with payday lending?

**Ms Andersen:** My microfinance worker would say at least 50 per cent of the clients that she sees have had issues with payday lenders. We also see that through—

**Mr GRIFFIN:** Fifty per cent of how many—of one, of 20, of 100, of 1,000?

**Ms Andersen:** Out of 180 interviews that we did through microfinance in the last 12 months.

**Mr GRIFFIN:** So out of 180 in the last 12 months you found 90 were payday lending issues?

**Ms Andersen:** Yes.

**Mr GRIFFIN:** That is with Anglicare in Sydney?

**Ms Andersen:** Yes, through the microfinance program.

**Mr GRIFFIN:** What are the figures for Melbourne?

**Mr McDonald:** 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.

**Mr GRIFFIN:** So most of the three-and-a-bit thousand that you reckon were credit issues would be payday lending?

**Mr McDonald:** Yes.

**Mr GRIFFIN:** Do you have any more exact figures than that or can you get them?

**Mr McDonald:** Yes, we can supply further detail in relation to that data.

**Ms Andersen:** Anglicare Sydney could gather more accurate information. We see about 16,000 clients through ER across our seven programs a year. 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.

There is another issue that was raised when we were talking about reducing interest rates. As I said, I do not think it will decrease the supply, but more people will try and access it because the interest rates are lower. Our concern is that clients can face those charges in other ways, such as through administration fees or something called a 'financial information package' or 'financial education'. They will call it something else and it could be a $200 or $300 fee that they will then tack onto the loan. So they will meet the interest rate cap but they will find some other way around it.

**Mr GRIFFIN:** Yes, thank you. Ms Corrie?

**Ms Corrie:** I do not have any statistics on hand but I can certainly get some numbers on how many of our financial counselling clients have presented with payday lending issues.

**Mr GRIFFIN:** I would appreciate that, so I can be clear about this. We are getting a complete disconnect between what industry is saying and, to be blunt, what the consumer movement is saying. I am not quite sure we are looking at the same things and I am keen to see if we can at least get some understanding about why there is such a graphic difference. The other point I would like to know is how many of your clients are on Centrelink benefits.

**Mr McDonald:** We at Anglicare Victoria estimate that 75 per cent would be on Centrelink benefits, with the rest made up of people in either part-time or insecure work or casual working arrangements.

**Ms Andersen:** At Anglicare Sydney we would say over 90 per cent of our clients are in receipt of some form of Centrelink benefits.

**Mr GRIFFIN:** The reason I make that point is that at least some of the witnesses today in their particular businesses—and I am not saying that that is necessarily representative of the overall lender industry here—only cover people in full-time work, or they have stated that as much as 60 per cent plus of their clientele are in full-time work, which therefore is again an example of the disconnect that I am pointing to.

**Mr McDonald:** We would not be seeing many of those in full-time work with debt related problems with payday lenders coming in to see us.

**Mr GRIFFIN:** I understand that. I am saying that from the committee's point of view it is difficult to try and work out to a sufficient degree whether we are looking to legislate covering a particular area in a situation where the areas that are being described to us are quite different.

**Senator HANSON-YOUNG:** I have a question for Anglicare. I do not think Good Shepherd would necessarily—though you may, Ms Corrie—be able to answer this. One of the comments that was made by representatives from the industry was that the hardship programs run by utilities and other companies are not necessarily either accessible or used, and they quoted the numbers of people who had been cut off electricity and gas. What is your response to that?

**Ms Andersen:** I think our services are extremely well accessed by people. The issue is that we cannot provide services to the number of people who need help, which leaves people out there, very vulnerable, who still do get disconnected from their services. There has been vast improvement in working with utility providers over the last five to 10 years to try and prevent people being disconnected. For my office alone, which is Mount Druitt, one of the poorest suburbs of Sydney, we turned away 4,000 people last year simply because we did not have the staff or the means to provide a service to them. And then that also excludes the people you talk about who may well be on a full-time income which could still be a low income. They are then accessing the payday lenders, and they probably would not even think of coming to a service like Anglicare for help because they are just not aware that the services exist, whereas recipients of Centrelink get provided that information by Centrelink. Utility companies will provide that information to them as well. So there is almost a pocket of people, in a sense, who may be struggling financially because of payday lenders, whom we cannot access through our services. I am not sure if it is the same for Anglicare in Victoria.

**Mr McDonald:** Here in Victoria—sorry, could you just repeat the question again?

**Senator HANSON-YOUNG:** There was some criticism from people in the lending sector around accessibility and how usable the hardship programs are. Figures for the utility companies were quoted about the numbers of people being cut off electricity and gas, and therefore perhaps the hardship programs run by those companies are not particularly accessible to people.

**Mr Patsika:** For the clients who present to our service with utilities problems, there are mechanisms that they can access in order to engage with the hardship department if there is a problem. In Victoria, we have the industry ombudsman. If a complaint is lodged with the ombudsman, it means that things like disconnection can be put on hold until the client is able to engage with the hardship department. That is usually the case in such a situation. To say that a client has to then turn to a payday lender for assistance in that situation I think ignores diverse avenues that some of those clients have in order to prevent disconnection, access our service if need be and also contact their energy provider's hardship department.

**Ms Corrie:** Am I able to comment briefly on that also?

**CHAIRMAN:** Yes.

**Ms Corrie:** I think what that speaks to in my mind is again getting back to that demand-supply type of discussion. These reforms in isolation are not necessarily going to solve the demand problem. Other parts of that, as I spoke to earlier, are better hardship provisions for people. Their financial stress will manifest itself in a variety of ways. That can be through needing to access energy hardship programs. It could be needing to access hardship programs with a credit provider. It could be needing to access emergency relief.

Good Shepherd Youth and Family Service do not provide ER but we do financial-counselling services. Once a client is actually in a utility company's hardship program they are quite well protected in terms of being worked with to make sure that they cannot have their power and things disconnected. Getting people into those programs can be challenging. I am not suggesting it is that simple but I do think that, again, this requires a more comprehensive response than just capping interest rates. It requires that demand to be met somewhere else—

*Witness interjecting—*

**Ms Corrie:** Yes, I think so. To me, this is what that speaks to.

**CHAIRMAN:** That probably explains part of the issue, in that maybe the gap or discrepancy in discussion around this legislation is not about solving the demand side; it is really about reforming the supply side.

**Ms Corrie:** Yes.

**CHAIRMAN:** The demand side is a completely separate question in terms of other policy areas and other programs. Thanks very much to all three agencies. Good Shepherd Youth and Family Service, thanks for appearing here, and thanks also to Anglicare Sydney and Anglicare Victoria, appearing via teleconference. We appreciate your time and your submission. Thanks very much.

**MANCE, Ms Paula, Section Manager, Money Management Branch, Department of Families, Housing, Community Services and Indigenous Affairs**

**MIKULA, Mr Christian, Manager, Consumer Credit Unit, Retail Investor Division, Department of the Treasury**

**MILLER, Dr Paul McLean, Section Manager, Innovation and Design, Money Management Branch, Department of Families, Housing, Community Services and Indigenous Affairs**

**VROOMBOUT, Ms Sue, General Manager, Retail Investor Division, Markets Group, Department of the Treasury**

[16:22]

**CHAIRMAN:** Welcome. Maybe Treasury could start by making some opening remarks.

**Ms Vroombout:** I have some brief opening statements. I would like to thank the committee for the opportunity to appear before you. I will begin by just briefly talking about the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 generally and then talk a little bit about the small-amount-lending provisions in the bill. Then I will hand over to Mr Mikula, who might respond to some of the issues that have been raised throughout the course of today before we then open up to questions.

The enhancements bill, more generally, addresses a number of topics as part of phase 2 of the national credit reforms—namely in relation to small amount lending, reverse mortgages, consumer leases and enhancements that were deferred from the phase 1 reforms. I will briefly outline the underlying drivers of reform as a whole so that you can get a sense of what the bill is seeking to achieve.

In looking at the reforms holistically, there are four key policy drivers that sit behind them. The first is around moving away from generic regulation to more product-specific regulation. This reflects a concern to address particular risks associated with a range of products including small amount loans, reverse mortgages and consumer leases. The other driver sitting behind the reforms in the bill is a move to a more flexible approach to disclosure to engage consumers to encourage them to make better decisions. That is illustrated in the provisions, firstly, in relation to reverse mortgages that use website scenarios to illustrate the potential impact of those products on borrowers and, secondly, in relation to requiring small amount lenders to inform consumers of alternatives. A number of the reforms also reflect a government commitment to protecting consumers who are disadvantaged—for example, because they are elderly, have a low income or have limited access to mainstream credit products. The final driver behind the reforms in this bill is that they reform to some reforms that were already underway in the states and territories prior to the Commonwealth taking over responsibility for consumer credit.

In relation to the small amount lending provisions in the bill, the bill, as you know, introduces specific obligations in relation to this class of credit contract because of the particular risks that arise for consumers from their use. In particular, as I think you have heard from consumer groups today, there are risks that the repeated or continued use of this form of credit can result in consumers entering into multiple contracts where their overall level of indebtedness increases over time such that an increasing proportion of their income will need to be used to meet their repayments and their capacity to use the credit for purposes that can improve their standard of living is diminished.

The government's policy is primarily based on equity considerations and the desirability of maximising the possibility of social inclusion for low-income or marginalised debtors. To put it another way, the purpose of the reforms is to reduce the negative financial and social impacts of the relatively high cost, in dollar terms, of access to credit by those who can least afford it.

The government has introduced a comprehensive package of reforms in relation to small amount lending, not simply the cap on costs. The restriction on the amount that can be charged is supplemented by other reforms, including prohibitions on consumers being provided with multiple loans and a requirement for lenders to inform consumers about the alternatives to small amount lending. It is proposed to implement the disclosure requirements through regulations that will oblige licensees to include on their website a short, high-impact statement disclosing the availability of sources of assistance such as financial counselling services and specialist consumer legal advice services—many of those organisations that you have heard from today—and alternative and cheaper sources of credit. I will now hand over to Mr Mikula, who will respond to some of the things he has heard here today.

**CHAIR:** Before we do that, we will get some opening remarks from FaHCSIA.

**Dr Miller:** FaHCSIA approaches this very much as a financial exclusion issue. Our main concern is with low-income and vulnerable households and the key issue of access to fair and affordable credit. We are very much into the complementary side that was mentioned before, particularly on the money management side of things. From our point of view, overall our 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, as I think was mentioned, and in a sense that is what the legislation is designed to do. As well is that, we are very strong supporters of providing alternatives to payday lending. In our financial management program, we support various micro-finance options that you have already heard about—NILS, StepUP and those kinds of things. We are running a community development finance institution pilot and we also run Emergency Relief. So there are a couple of areas there that you might say are alternatives to payday lending. Finally, the other thing our program does is assist consumers who might fall into payday lending or any other debt trap cycle through our Commonwealth Financial Counselling program.

**CHAIRMAN:** Treasury, you wanted to make some responses to a number of issues that have been outlined?

**Mr Mikula:** In view of the time, I thought it might be helpful to initially run through a number of the matters that have already received significant discussion today. I will begin by talking about the distinction between borrowers who might be on Centrelink payments and those who might be in employment. The research consistently shows that, irrespective of the source of income, the majority use of credit is for living expenses, basic needs, utilities and emergencies. Very little is for discretionary spending. Those observations have been repeated today.

**CHAIRMAN:** Is that an issue in itself though? Rather than looking at where they get the money from, let us start by looking at why people are desperate to find some money, somewhere, to pay for day-to-day expenses. What is that the result of?

**Mr Mikula:** It is an issue. There might be an argument that they have a choice, but in most cases, at the end of the day, they do not.

**CHAIRMAN:** That is exactly my point. If that is the case—and all the research shows it—then they need to go somewhere. I assume that people are aware that there are programs. In fact, I am more than convinced that they first seek out a whole range of areas where they can get finance as cheaply as possible or free. If the last resort is payday lending, what is the alternative?

**Mr Mikula:** The research does not necessarily show that they are aware of those programs or that they actively seek out cheaper sources of payday lending amongst the options that are available to them. In fact—

**Mr GRIFFIN:** Sorry to interrupt, but that is at odds with some of the what has been said today, so I think it is very important that we address it. When asked about the reasons for the various loans, a number of witnesses have put forward a number of reasons which seemed to be at odds with what you have just said. What is the status of that research? Can you outline that briefly?

**Mr Mikula:** It is largely covered in the regulation impact statement, which reviewed Australian research. But I am happy to develop that on notice.

**Mr GRIFFIN:** Thank you. It is at odds with what has been said, so I think it is important to address that question.

**CHAIRMAN:** There are two things that people talk about which creates a very difficult field to discuss in terms of the particular legislation that we have. FaHCSIA is raising a number of organisations around the root causes in the first place, whether it be bills or having some other debt or other problem, rather than dealing with the legislation that is before us, which is about how we regulate properly a market which will in some form or other continue and be maintained. So it is not a case of either or; it is a case of trying to separate for the committee the specific issue that FaHCSIA raises about there being needs et cetera. I accept all of that. But really it is a case of how we distinguish that from what is being done now. I appreciate that Treasury and FaHCSIA have not made a submission, as it is legislation that is already on the table, but is there specific modelling that demonstrates why people end up their or on the impact the caps have on the market people or the sector itself?

**Mr Mikula:** There is research on the needs—and I will take your question on notice and develop that. But if you accept the proposition that there are people who need small and affordable sums of credit then the question is how you design a cap that meets that objective. 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.

**CHAIRMAN:** So you have got a model?

**Mr Mikula:** The model that was in the act—that is trying to explain the approach as to what it was trying to achieve and why it differed from others. It also differed from the New South Wales cap of a strict 48 per cent cap, which we saw as too tight. There needed to be some slight easing relative to the New South Wales position.

**Mr GRIFFIN:** I have one quick question on Centrelink versus employed. Do you know what percentage of the payday lending market are on Centrelink payments and what percentage are employed? Do you have the numbers?

**Mr Mikula:** We have looked at all the Australian research, but I would not want to try to summarise it here.

**Mr GRIFFIN:** Sure. If you can take that on notice as well.

**Mr Mikula:** Sure.

**CHAIRMAN:** So what Treasury is saying is that modelling has been done and you have put forward a model. Is it based on an economic analysis of what is a viable commercial-economic proposition or is it one that is a mixture of social and economic outcomes? I ask the same question of both Treasury and FaHCSIA—that is, the underlying principles in trying to determine a position.

**Ms Vroombout:** I think the answer is that it seeks to achieve a balance between both of those, addressing the social concerns as well as the economics of the industry. I think the minister has said his objective is to continue to have a viable industry whilst addressing the concerns for consumer protection in this space.

**Mr GRIFFIN:** Maybe we could let Mr Mikula go through those issues that he noted, if we have time.

**CHAIRMAN:** Yes, please keep going.

**Mr Mikula:** In relation to the New South Wales cap that was discussed, I will briefly outline that we think the formula works in the sense that it is understood and it has been in place. The argument is around its implementation: if you have a formula that cannot easily be avoided—or, rather, legislation that addresses the potential loopholes—then you will have a greater impact than one that can be avoided, necessarily.

**CHAIRMAN:** That is still your view, even though you have heard evidence from a whole range of people, including about stuff that we know happens in practice—that not only can it be avoided but there is also avoidance happening now?

**Mr Mikula:** Yes, and we would not guarantee that the approach we have taken is completely avoidance proof. But we have looked to address some of those practices around avoidance for the 48 per cent cap and applied those lessons to the small-amount cap as well, to make it as rigorous as possible, because if the legislation is going to be in place it really should be as effective as it can be.

**Mr GRIFFIN:** Sure, Mr Mikula, but your argument, I thought—and correct me if I am wrong—was that the New South Wales cap had been working. We have evidence that the legislation needs to be as clear as possible to ensure that it operates properly. The evidence that we have had today—at least, it has been said—is that it is not working.

**Mr Mikula:** Perhaps I can put it another way. We think you do not need to change the existing formula. The issue is how various fees that might be artificial might be taken into account. For example, one avoidance technique is lenders requiring borrowers to purchase a DVD on budgeting, which increases the amount borrowed.

**Mr GRIFFIN:** What you are really saying, though, is that you believe the formula as it is intended in New South Wales is reasonable, allows people the opportunity to make a commercial return and therefore should not endanger the viability of the industry. I am not trying to put words into your mouth, but I am trying to get out of here before midnight.

**Mr Mikula:** We accept that it is a problem for small-amount loans, and that is why we have drawn a two-tier system—but, otherwise, yes.

**CHAIRMAN:** I would like to ask FaHCSIA: have you looked at the impact of this model proposed in the legislation? The idea is that it reforms the supply side, but to a point where there may be fewer operators. If customers can no longer access that particular segment of the payday-lending market, they are going to come back to you as a department. How does the department then deal with those people who need some assistance?

**Dr Miller:** We have not done any specific modelling to work out exactly what the impact would be; but, if that did happen, yes, it potentially could increase demand for some of our services, such as the microfinance

products we have been mentioning, or Emergency Relief. Indeed, if there is no way to access funds, it could increase the burden of financial counselling. On the other hand, it could also reduce the burden on financial counselling. As you have heard, a lot of the not-for-profits would certainly say that some of that burden comes from the very practice of payday lending. It depends which way it goes and how much it affects the supply side.

**CHAIRMAN:** Which one do you put first? I am trying to understand how the market works here. Do people get into some sort of trouble first—and we have heard that utilities is the most common—and then need to go and find some finance to cover those debts and then get in trouble with those debts and other debts? Or does it start with the payday loan? Let us say that a person has not debt problems at all, gets a payday loan and then finds that they have a problem. Is that more common?

**Dr Miller:** I would suggest that the evidence is that it is a bit of both. There is a general need for short-term credit at various points in times, such as when there are unexpected expenses—for example, high utility bills, a car breaking down or various other expenses, as has been previously mentioned. That then necessitates the demand for some kind of short-term credit. Payday lenders are one such source. People, though, who access that payday lending—depending on their specific situations—may have their financial hardship or difficulty exacerbated by that loan. Not all, but definitely some.

**CHAIRMAN:** Has FaHCSIA done any modelling or have any data that gives the numbers on these things?

**Dr Miller:** In terms of the number of people who seek Commonwealth Financial Counselling and the kinds of presenting problems, we have some data on that. I should say that we do not go down to the level of asking the question of whether the problem was caused by a payday loan. But, for example, with Commonwealth financial counselling, during 2010-11 about 40,935 people sought Commonwealth financial counselling. Approximately 38 per cent of those new clients presented with credit debt issues in general as a concern. I would not say that that is all attributable to payday lending by any means but—

**CHAIRMAN:** It is a general thing.

**Dr Miller:** It is general category.

**CHAIRMAN:** There could be credit cards or whatever in there.

**Dr Miller:** The other problem area that is reported is utilities. Quite a high percentage of people who have money problems cite them as the cause. It is not quite as clear as 'It is because of payday lending,' or 'It is not because of payday lending.' But that issue of people needing to access small amounts of credit and then getting in trouble through various debts is certainly a common issue.

**CHAIRMAN:** Is there any clearer picture in terms of people who are unemployed or employed?

**Dr Miller:** As was mentioned, our providers report that between 70 per cent and 90 per cent of people who attend Commonwealth financial counselling and our emergency relief services are on Centrelink payments. The vast majority of the people who we see are Centrelink clients.

**CHAIRMAN:** Mr Mikula, you had some other responses to some of the things that we heard today. Do you want to continue with those?

**Mr Mikula:** In relation to the lending of small amounts, there was some earlier discussion about enforcement expenses and whether there should be a cap on enforcement expenses. 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. We think that that is a satisfactory position for now.

**CHAIRMAN:** So effectively what that means is that the total amount in terms of borrowings under this legislation cannot exceed the 200 per cent mark. That is well understand. But third party expenses in terms of trying to recover the money could be an additional charge.

**Mr Mikula:** They do not necessarily have to be third party. They can be in house, but they have to be attributable to debt collection.

**CHAIRMAN:** So it is specific to debt collection.

**Mr Mikula:** In relation to civil penalties, there was a deliberate decision made in the bill to not apply civil penalties but to simply impose—given that these are relatively small contracts—loss of amounts over the amount of credit as a sanction. We think that that is sufficient. That can be enforced by ASIC or by the debtor or by the guarantor if there is one. We do not see any need for further reform in that space.

**CHAIRMAN:** You do not see any need for what?

**Mr Mikula:** Extending the civil penalty regime any further.

**CHAIRMAN:** To these contracts. I see. One of the submissions that we received referred to a Treasury figure. It said, 'For all people who are not classified as vulnerable, the proposed rate cap should be increased from 10 per cent to $30 per $100 lend. This 30 per cent is the lowest number at which some people can continue to do business or provide this service.' They said that this was something that Treasury had agreed on or had a view on—the $30 in $100.

**Mr Mikula:** The $30 per $100 is not a figure that Treasury has publicly endorsed and is a slight misdescription of some information that was in the RIS as to possible—

**Ms Vroombout:** It was used by way of example. It was an example of the sort of thing that you could put in place. We were looking at the model rather than that specific number.

**Mr Mikula:** On the topic of reverse mortgages, the first witness today discussed an issue in relation to default clauses. We are certainly happy to go back and have another look at that one. There is probably a simple answer to that issue.

**Mr GRIFFIN:** This will go over what you have already said a little bit, but I want to make sure that I have it absolutely clear. There was a degree of concern raised about the operation of the New South Wales. Treasury's point of view is that you do not believe that that is an issue and therefore you are confident that the economics of what is being proposed makes it viable for people to remain in the industry to provide the products.

**Mr Mikula:** Yes, that is consistent. At least one of the witnesses today from the lenders said something to that effect. The issue with the New South Wales cap was that it applied across the board irrespective of the size of the loan. Under this model, it only applies to loans over $2,000 or for a term of two years or more. We think that that probably resolves the issue and that it can be viable at that level. The larger the loan, the more viable it will be. But we still think it provides a satisfactory model.

**Mr GRIFFIN:** The sense that I got was that people were basically saying that for loans under $3,000 the circumstances were that the industry would walk. You are saying that that is not Treasury's view in the circumstances.

**Mr Mikula:** That is correct.

**Mr GRIFFIN:** Okay.

**Ms Vroombout:** I would like to clarify a point. Mr Mikula was saying that the formula, the 48 per cent cap, works well in the New South Wales model. But what we have done in the bill is put in place some further provisions and address the avoidance concerns that were identified in New South Wales.

**Mr GRIFFIN:** I understand. But my point on that, though, is essentially that when we say that the New South Wales system works well the concern expressed in the evidence today with respect to that is that there has been large-scale effective avoidance of the intention of the New South Wales cap. That has not been refuted. If that is the case, then I have to ask whether it has worked well. If the answer is, 'Because it's been avoided, no, it hasn't,' then that raises questions about what sort of success putting in place better measures to ensure that there is less avoidance while rolling the system out nationally is likely to be. I do not pretend that I am an expert in this area; I am far from it. But I worry about that. When elements of the consumer movement seem to be of the view that the end result of this approach is likely to be that there will be less product in the system because people will get out, it would seem that to some extent there is agreement between elements of the consumer movement and significant elements of the industry. That seems to be at odds with what you guys are saying, unless I have missed the point.

**Mr Mikula:** What we would say, though, is that we would not accept the proposition that there has to be a loan-for-loan dollar-for-dollar equivalent. The existing demand for credit does not necessarily have to be met. If loans were cheaper then you would have less problems with repeat borrowing, and if people make greater use of alternatives or if there is a greater ability to access—

**Mr GRIFFIN:** I do not have a problem with the alternatives argument. Again the question is, in layman's terms, that if you have a level of demand—and demand will vary according to the cost and the options that are available—and if you have a series of commercial products—which, effectively, we are seeking to regulate the conditions around by virtue of this legislation—but you also have other sources, for example, through some of the other programs that were mentioned by FaHCSIA or in a situation where through better counselling and advice services people make better decisions sometimes about what they might do, then you have other sources. That is an argument.

One issue here is: will there continue to be a commercial product or products? And what impact will this legislation have on that? If the argument is that it will have a significant impact and that that is a good thing, I can accept that. But I am getting differing views about that, and that always concerns me.

That is one point. The second point I have, which goes to FaHCSIA as well, is that if we say there are alternative products available, then we go to the question of what the size of that availability is. And is it likely to meet the misplaced demand that comes out from the basis that there are no other products available? Does that make sense?

**Dr Miller:** Yes, it does. On the alternative side, I do not know what the level of displacement et cetera is going to be, but I suspect there would need to be some work done on developing alternatives further. Our Community Development Financial Institutions pilot is a case in point, where we are actually looking at combinations of organisations with social purpose—that is, trying to get people included financially—running along the business model line. In a sense, they are somewhere between welfare or no-interest loans, that are clearly not self-sustaining, through to the business model, say, that some of the small loans providers are marketing.

**Mr GRIFFIN:** I think that is a great idea, I really do.

**Dr Miller:** We are in a trial stage with that at the moment. It is a year's trial and we have five organisations that are delivering loans of various sizes, some of which compete with the very small loans end of things and some which go up to higher amounts. That is due to be evaluated in March next year. I guess we will have a better idea then as to the type of issue you are getting at, as to what level of interest rate is actually going to give you a viable business, taking out the 'big P' profit side of things.

**Ms Manse:** Can I just add that the interest rates for those pilot organisations go between about 12 per cent APR and 35 per cent APR?

**CHAIRMAN:** Just following on from that theme, because this does pose some contradictory questions and elements: for one thing, everyone accepts that if there is a problem that exists within this particular market then the problem is around the very high cost of the loan itself. Yet demand is obviously very strong and high, as we have evidenced, and I think everyone agrees on that. But if the intent and if the outcome—and this is probably a question—of this is to make it more affordable by reducing that high cost, demand would naturally go up unless there is something to replace it. Given that the demand is already so high at a very expensive price, how could you possibly reduce that demand just by making it cheaper? It almost resembles something else that I will not say, but you can imagine that in economic terms it resembles other products where you are trying to limit access through making it cheaper. I am just not sure; there are some contradictions, and I am trying to understand how that works from a Treasury perspective in terms of modelling.

**Ms Vroombout:** Reducing the cost reduces the potential disadvantage suffered by people entering into these loans. The fact that there is demand at quite high prices suggests that this is a product that is quite price inelastic, so reducing the price is not necessarily going to lead to a massive increase in demand, I would argue.

**Mr GRIFFIN:** I agree with that. My question is basically what happens to the supply. That is the issue—to me, anyway. The point there is: if there is a demand and the demand needs to be met, and an element of how that demand is met is through a commercial product, and that commercial product vacates the field, then what do you do with that demand? You do not have to have an increased demand to have an increased problem with meeting demand if you have a problem with the supply side. If the argument is that you have had a look at the figures and you are pretty confident that in fact there is a bit of commercial bluff and counterbluff going on here and there will still be products in the field, fine, if that is your argument.

**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.

**Mr GRIFFIN:** That is fine.

**CHAIRMAN:** Was there anything else, Mr Mikula, that you wanted to add in terms of other observations?

**Mr Mikula:** No. Were there any other questions that you had on any of the other matters covered or that you might want to address on notice?

**CHAIRMAN:** No. That is fine. Thank you very much for your presentation today. I declare closed this public hearing and thank everybody for participating. I particularly thank all the witnesses who have travelled—some from very far, as we heard. Thank you also to Hansard, the committee and the secretariat.

**Committee adjourned at 16:57**