



**ASIC**

Australian Securities & Investments Commission

# **Review of the small amount credit contract laws**

## **Submission by the Australian Securities and Investments Commission**

October 2015

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## A Executive summary

- 1 The Australian Securities and Investments Commission (ASIC) is Australia's national consumer credit regulator, with oversight of lenders, consumer lessors and credit assistance providers who offer consumer credit products (including small amount or payday loans<sup>1</sup>) to Australians.
- 2 This submission provides:
  - (a) information about the national consumer credit regime, payday lending industry and our outcomes in this area (see Section B);
  - (b) our feedback on the tailored rules that apply to payday loans, with suggestions for improvements (see Section C);
  - (c) our views on the potential for a mandatory, real-time database to help industry comply with a 'bright-line' test or objective rule that limits the situations in which small amount loans can be provided (see Section D);
  - (d) information about the consumer leasing industry and our outcomes in this area, as well as our feedback on the rules that apply to consumer leases with suggestions for improvements (see Section E and the appendix); and
  - (e) an overview of other proposals that are relevant to our regulation of payday loans and consumer leases (see Section F).

### Review of the small amount credit contract laws

- 3 The Government established this review on 7 August 2015 to consider the laws that apply to small amount loans and comparable consumer leases.
- 4 A consultation paper<sup>2</sup> was published to seek views on the effectiveness of the laws relating to small amount loans and whether a small amount loan database should be established. The paper also asked for submissions on whether the provisions that apply to small amount loans should be extended to comparable consumer leases and, if so, how this would be achieved.
- 5 In this submission we respond to the questions posed in the consultation paper and the terms of reference (TOR) of the review.

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<sup>1</sup> In this submission we refer to 'small amount credit contracts' as small amount loans or payday loans and the Australian credit licensees that provide these loans as 'payday lenders' or 'licensees'.

<sup>2</sup> Treasury, *Review of the small amount credit contract laws: Consultation on the regulation of small amount credit contracts and comparable consumer leases*, consultation paper, September 2015.

## ASIC, payday lending and consumer leasing

- 6 The payday lending and consumer leasing industries have been strong areas of focus for ASIC since we obtained responsibility for consumer credit in 2010. We have focused on these products because payday loans and consumer leases have particular risks for financially vulnerable consumers, who are often targeted by the marketing of these products.
- 7 We have focused on three areas of misconduct in the payday lending industry:
- (a) irresponsible lending;
  - (b) business models that attempt to circumvent the law ('avoidance models'); and
  - (c) misleading advertising.
- 8 Over the past five years, we have conducted two industry reviews and undertaken enforcement action that has resulted in close to \$2 million in refunds to more than 10,000 consumers who were overcharged when taking out a payday loan. In February 2015, the Federal Court imposed penalties of almost \$19 million on payday lender The Cash Store Pty Ltd and loan funder Assistive Finance Australia Pty Ltd for wholesale responsible lending failures and unconscionable conduct.<sup>3</sup> We have issued payday lenders with 13 infringement notices, totalling approximately \$120,000, in response to our concerns about their compliance with the credit laws.
- 9 We have also taken action to address misconduct by lessors, especially in relation to the responsible lending obligations. Between February 2013 and June 2015, we obtained 10 public outcomes, including enforceable undertakings, bannings and refunds for affected consumers.

## ASIC's recommendations

### Small amount credit laws

- 10 The rules that currently apply to payday lenders are a significant improvement over the previous state-based regulatory regime. However, we have identified a number of areas where there are options for change worthy of consideration.

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<sup>3</sup> *ASIC v The Cash Store Pty Ltd (in liquidation)* [2014] FCA 926.

### **Presumptions of unsuitability**

- 11 We support replacing the current ‘rebuttable presumptions’ that a payday loan is unsuitable if the consumer is in default under another small amount loan or has had two or more other small amount loans in the last 90 days.
- 12 In our view, a ‘bright-line’ test or objective rule would be a better way of preventing debt spirals and addressing recurrent use of payday loans than the current rebuttable presumptions, which do not appear to be working in the way Parliament intended.
- 13 One option that appears to have merit is a requirement limiting the number of small amount loans (or amount of credit provided under small amount loans) that can be obtained in a given period. Contracts or credit in excess of the specified number or amount would be prohibited.
- 14 This option is consistent with our general findings that compliance among payday lenders is greater in relation to objective, clear requirements than it is for more subjective obligations. As a result, a ‘bright line’ test may reduce uncertainty for industry.
- 15 We consider that any prohibition should be set at an appropriate level that balances the valid reasons why consumers may want to access small amount credit and ongoing industry viability against the risks associated with recurrent lending.
- 16 Our views on the presumptions of unsuitability, and our suggestions for improvement, are outlined in more detail at paragraphs 87–106.

### **Payday loans database**

- 17 If the rebuttable presumptions are replaced by an objective limit on payday loans, then our view is that a mandatory, real-time database of payday loans would assist lenders to comply with the new requirements.
- 18 Such a database could allow lenders to instantly determine whether the prohibition would prevent them from providing the loan the customer has sought, reducing the complexity associated with compliance. Where the loan is not prohibited, lenders would still need to comply with the general responsible lending obligations.
- 19 Focusing a database on an objective prohibition will allow concerns about borrower privacy and database cost to be mitigated.
- 20 Our views on a database for payday loans are outlined in more detail in Section D.

### **Anti-avoidance provision**

- 21 We have taken action where we have seen behaviour and business models that are intended to avoid consumer credit obligations. However, our experience has been that addressing avoidance under the current laws (i.e. on an ad-hoc basis) is resource intensive and does not have a broader deterrence effect in the payday lending and consumer leasing industries.
- 22 We support the enactment of a general anti-avoidance provision in the *National Consumer Credit Protection Act 2009* (National Credit Act). A rule that prohibits products or models that have the effect of avoiding some or all of the credit laws would assist our efforts to counteract avoidance and ensure that consumers receive appropriate protections. It would also address the disadvantages compliant lenders currently experience, where they may lose consumers to businesses that attempt to avoid the law.
- 23 We anticipate that an anti-avoidance provision may be useful in our efforts against business model and product avoidance. Such a provision may:
- (a) create a more significant deterrence effect than we have observed to date; and
  - (b) allow for judicial decisions on avoidance models that may have industry-wide impact.
- 24 Our work on avoidance, and the challenges we have faced, are outlined in more detail at paragraphs 182–203.

### **Warning statements**

- 25 We consider that there is scope for improvements to the current requirement for payday lenders to display a warning statement in their premises and on their websites. In particular, we recommend changes to address:
- (a) warnings being given insufficient prominence on websites;
  - (b) the inclusion of other text in the warning that dilutes the primary message;
  - (c) inconsistent practices around the use of hyperlinks; and
  - (d) the limited tools available to ASIC to address non-compliance with the warnings.
- 26 We also support moving the detailed rules for the warning statement into an ASIC-made legislative instrument. We anticipate that setting the requirements in a legislative instrument would allow for greater flexibility in the rules, and responsiveness to changing business models and consumer practices, than is currently available. Parliamentary oversight would be maintained and we would publish guidance on the rules we made.

27 Our views on the warning statements, and our suggestions for improvement, are outlined in more detail at paragraphs 129–146.

### **Consumer leases**

28 We consider that consumer leases are largely comparable to small amount loans. Both products are used by low-income and/or financially vulnerable consumers, as well as consumers who have low levels of financial literacy and limited knowledge of alternative forms of credit. In some instances the products may be substitutable.

29 Our views on the consumer leasing market, and our suggestions for improvement to the current laws, are outlined in more detail in Section E.

### **Cap on costs**

30 We support a cap on costs for consumer leases. We consider that a cap on costs would:

- (a) address the current incentives for licensees to structure their consumer credit arrangements as consumer leases to avoid the cap on costs for credit contracts;
- (b) lead to more consistent treatment for consumer leases and similar credit contracts; and
- (c) prevent the offering of very high-cost leases to vulnerable and disadvantaged consumers.

31 The cap could be set at a level that reflects the similarities between consumer leases and certain classes of credit contracts, such as payday loans or sale of goods by instalment.

### **Other obligations that currently apply to payday loans**

32 We issued Report 447 *Cost of consumer leases for household goods* (REP 447) in September 2015. This report outlined our findings that consumer leases can be a very expensive option for consumers seeking to access common household goods, and that the market for consumer leases is failing many low income consumers.

33 In light of our findings, as well as our experience with the tailored payday lending rules, we recommend that some of these rules be extended to consumer leases. In particular, we support the extension of:

- (a) the requirement to provide a warning statement; and
- (b) restrictions on the level of repayments from consumers who receive more than half their income in Government benefits.

**Other options**

- 34 We also note that there may be other options to address issues in the consumer leasing market, such as:
- (a) restrictions on the termination fees that can be charged;
  - (b) improved disclosure of the total cost of the lease; and
  - (c) limitations on the sale of add-on products to consumers where those products primarily benefit the lessor.



## B ASIC and payday lending

### Key points

Payday lending has been an area of focus for ASIC since we became the primary regulator of consumer credit in 2010.

We have conducted two industry-wide reviews of the conduct of the payday lending industry.

We have found that awareness of the obligations has increased, but that in many situations lenders may be at risk of non-compliance. This is particularly true for obligations with a degree of subjectivity.

We have achieved significant regulatory action, including record penalties awarded by the Federal Court against The Cash Store and Assistive Finance Australia and close to \$2 million in refunds to over 10,000 consumers who have been overcharged when taking out a payday loan.

## Regulation of consumer credit in Australia

- 35 ASIC took over the regulation of consumer credit on 1 July 2010 under the National Credit Act. Before 1 July 2010, consumer credit (including small amount lending) was primarily regulated by the states and territories under the Uniform Consumer Credit Code (UCCC).

### The National Credit Act

- 36 In 2008, the Council of Australian Governments agreed to transfer regulatory responsibility for consumer credit to the Commonwealth in two stages.
- 37 The first phase of the credit reforms was implemented by the National Credit Act and established the national consumer credit framework administered by ASIC as the single national regulator.
- 38 Central elements of the credit reforms include:
- (a) the introduction of a licensing regime that imposes minimum standards of conduct for credit industry participants, including requirements for competence, mandatory membership of an ASIC-approved external dispute resolution (EDR) scheme, compensation arrangements, and adequate compliance and risk management systems. The licensing regime provides mechanisms to cancel Australian credit licences and ban persons from engaging in credit activities; and
  - (b) responsible lending obligations, which mandate that credit licensees must make inquiries into a consumer's objectives and financial situation

and verify their financial situation. Credit licensees must assess this information and not provide or suggest credit to a consumer if that credit will not meet the consumer's objectives or the consumer will not be able to meet their financial obligations without substantial hardship.

- 39 Licensees must also comply with the National Credit Code (set out in Sch 1 to the National Credit Act), which largely mirrors the now-superseded UCCC, together with some key enhancements, including:
- (a) extended coverage (now encompassing lending to invest in residential property);
  - (b) regulation of brokers and other credit intermediaries;
  - (c) the power for ASIC to take representative action in relation to unjust transactions or unconscionable fees; and
  - (d) greater access to assistance for borrowers in financial difficulty.

### **Enhancements Act**

- 40 The second phase of the credit reforms was implemented in two legislative tranches. The second tranche of reforms was the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Enhancements Act).
- 41 The Enhancements Act contained a number of additional protections and obligations that apply to small amount loans to address particular risks with those loans. These protections include:
- (a) the presumptions of unsuitability,<sup>4</sup> which presume that a small amount loan will be unsuitable if either:
    - (i) the consumer is in default under another small amount loan (the default presumption); or
    - (ii) the consumer has had two or more other small amount loans in the last 90 days (the multiple loan presumption);
  - (b) a cap on the fees and charges of the loan (an establishment fee of 20% of the amount of credit and a monthly fee of 4%);
  - (c) a requirement that consumers who default under a small amount loan must not be charged an amount that exceeds twice the amount of the loan;
  - (d) protections for consumers who receive 50% or more of their income under the *Social Security Act 1991* (Social Security Act);
  - (e) a prohibition on charging an establishment fee if any of the credit is to refinance another small amount loan;

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<sup>4</sup> The presumptions of unsuitability are *not* equivalent to a prohibition or 'line' that cannot be crossed.

- (f) a requirement to obtain and consider account statements covering the 90 days prior to the assessment; and
- (g) a warning statement to be displayed advising consumers of the alternatives to a small amount loan; and
- (h) a prohibition on credit contracts for \$2,000 or less that have a term of up to 15 days (referred to as ‘short term loans’).

42 In June 2014 further provisions commenced, which in part sought to address specific schemes designed to avoid the cap on costs. The provisions clarified the particular fees and charges that are to be included in the calculation of charges to determine if the credit is regulated under the National Credit Code.

## Payday lending

43 Small amount credit contracts, or ‘payday loans’,<sup>5</sup> are loans for \$2,000 or less with a term of between 16 days and 12 months.

44 Payday loans have been recognised as having specific risks of financial detriment and harm for vulnerable and disadvantaged consumers. The Government sought to address these risks with the tailored rules in the Enhancements Act, outlined at paragraph 41.

### Changes in the payday lending industry

45 When ASIC became Australia’s consumer credit regulator in 2010, many payday lenders were operating out of shopfront premises that were situated in low socio-economic areas. At this time only a handful had an online presence.

46 When we undertook our most recent payday lending review, we found that the industry had consolidated, with some smaller lenders who were operating on the margins taken over by larger operators. Most operators had established an online presence and some lenders offered phone applications for consumers.

47 We also observed diversification in the industry, with many lenders providing other services along with payday loans, such as gold buying, cheque cashing, purchasing delinquent debts, pawnbroking and providing other types of credit.

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<sup>5</sup> We use the phrase ‘payday loans’ because that is the term consumers use. Industry promotes small amount loans to consumers using this term.

- 48 The number of lenders that disclosed to ASIC that they operate in the payday lending industry has declined by about 10% over the last financial year.<sup>6</sup> We continue to receive new applications from lenders wishing to enter the industry.
- 49 In August 2015, we sent a voluntary data survey to licensees who had advised ASIC that they may provide payday loan type products. We received responses from lenders that comprise the vast majority of the payday lending industry by volume. We received responses from all listed entities as well as a range of large internet providers, franchised operations and individual small licensees.
- 50 Based on these responses, the payday lending industry provided over \$831 million in credit in the 2014–15 financial year through close to 1.5 million loans.
- 51 Some lenders were unable to answer parts of the survey due to system limitations. However, based on the responses received, the average term of a payday loan was 50 days (small amount loans may have a term of between 16 and 365 days).
- 52 Our data collection also indicated that at least 15 authorised deposit-taking institutions (ADIs), such as banks, are now providing loans of less than \$2,000 to consumers.<sup>7</sup> Together, the 15 ADIs entered into 191 loans with a total of \$264,583.51 lent. The fees and charges levied were well below the maximum amounts allowable under the cap on costs for payday loans. Our data collection indicates there is some appetite among ADIs to offer loans of small amounts for a 12-month period.

## **Our focus on conduct and compliance**

- 53 Payday lending has been a strong focus for ASIC since the commencement of the National Credit Act. Addressing concerns about conduct and compliance in the payday lending industry is consistent with ASIC's strategic objective to promote investor and financial consumer trust and confidence.
- 54 As borrowers who take out payday loans are often low-income or vulnerable consumers, poor conduct by the payday lending industry may lead to substantial detriment, such as the creation of ongoing cycles of disadvantage that reduce the potential for financial and social inclusion.

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<sup>6</sup> We recently updated the self-reporting categories on our licensing forms, which has led to a recalculation of licensing figures provided in previous public reports.

<sup>7</sup> Loans provided by ADIs are exempt from the definition of a 'small amount credit contract'.

### **Report 264 *Review of micro lenders' responsible lending conduct and disclosure obligations***

55 Shortly after the National Credit Act commenced, we conducted a review of compliance with the responsible lending obligations by the payday lending industry. This review was undertaken because of:

- (a) existing concerns about practices in the payday lending industry; and
- (b) the targeting of financially vulnerable consumers by payday lenders.

56 We initially reviewed 28 lenders, and we then selected 168 files from 19 lenders for further, detailed review.

57 Our findings were published in Report 264 *Review of micro lenders' responsible lending conduct and disclosure obligations* (REP 264). We found that lenders had changed their practices and introduced new procedures to meet the responsible lending requirements.

58 However, the files reviewed indicated that procedures were not followed consistently for all loans. We observed instances of lenders not recording the actual purpose of the loan, undertaking very limited verification of a consumer's financial circumstances, and not taking steps to clarify conflicting information in loan applications. We reviewed files where:

- (a) the expenses listed in the loan application appeared to be understated relative to very basic living costs;
- (b) the consumer's stated expenses, together with the required repayments on the loan, exceeded the consumer's stated income; and
- (c) the bank statement provided with the application showed the consumer's account was overdrawn by the end of each pay cycle.

59 We made further inquiries with lenders about specific compliance issues identified during the review. We also continued our program of risk-based surveillance activities for payday lenders.

### **Report 426 *Payday lenders and the new small amount lending provisions***

60 Following the commencement of the Enhancements Act provisions and developments in industry practices, we decided to conduct another broad review of compliance by payday lenders.

61 We reviewed 288 consumer files from 13 payday lenders (who were collectively responsible for more than 75% of payday loans made to Australian consumers). Our findings were published in Report 426 *Payday lenders and the new small amount lending provisions* (REP 426) in March 2015.

- 62 We found that payday lenders were falling short in meeting important new obligations, such as the rebuttable presumptions regarding loan unsuitability, which must be considered when the consumer has multiple other payday loans or is in default under a payday loan.
- 63 The review also identified concerns where payday lenders set their loan terms at 12 months or more, thereby charging the consumer more fees, in circumstances where a consumer had requested a shorter term and paid the loan back in that shorter time.
- 64 Our review also found systemic weaknesses in documentation and record keeping, including around the issue of the consumer's requirements and objectives. There was little to no improvement in this area since our 2010 review.
- 65 Our review found better levels of compliance with some objective or 'bright-line' requirements, including the requirement to provide a warning about alternative credit options and the income protection rules for Centrelink recipients.
- 66 Where particular issues were identified, we commenced investigations and further follow-up work, and considered enforcement action or other regulatory action.
- 67 Our findings in REP 426 were based on consumer files from 2013. However, our findings from the review were consistent with what we have observed during current surveillances of payday lenders, including based on information obtained in 2015.

### **ASIC outcomes**

- 68 We have focused on three areas of misconduct in the payday lending industry:
- (a) irresponsible lending;
  - (b) business models that attempt to circumvent the law; and
  - (c) misleading advertising.
- 69 Since 2010, ASIC enforcement action has resulted in close to \$2 million in refunds to more than 10,000 consumers who have been overcharged when taking out a payday loan. Payday lenders have also been issued with 13 infringement notices, totalling approximately \$120,000, in response to our concerns about their compliance with the credit laws.

### **Responsible lending**

- 70 In addition to being a strong focus of our industry-wide reviews, we have achieved a number of significant enforcement outcomes in relation to the responsible lending obligations.
- 71 In February 2015, following ASIC action, the Federal Court awarded record penalties totalling nearly \$19 million against The Cash Store and loan funder Assistive Finance Australia for wholesale responsible lending failures and engaging in unconscionable conduct.
- 72 The court found that The Cash Store provided unaffordable loans to a large number of its customers who were on low incomes or receiving Centrelink benefits. In addition, the company acted unconscionably and unfairly in selling insurance for these loans to these customers when it was unlikely that they could ever make a claim on that insurance. The penalty awarded in this matter is the largest civil penalty obtained by ASIC.<sup>8</sup>

### **Avoidance**

- 73 We have taken action where we have seen behaviour and business models that are intended to avoid consumer credit obligations. Some of the challenges we face when dealing with avoidance behaviour are detailed at paragraphs 194–199. Our work in this area has included enforcement action where appropriate.
- 74 In October 2015, the Federal Court found that payday lenders Fast Access Finance Pty Ltd, Fast Access Finance (Beenleigh) Pty Ltd and Fast Access Finance (Burleigh Heads) Pty Ltd (collectively, the FAF companies) breached consumer credit laws by engaging in credit activities without holding a credit licence.<sup>9</sup>
- 75 Consumers who were seeking small value loans entered into contracts with the FAF companies that purported to be for the purchase and sale of diamonds in order to obtain a loan. The Federal Court found that the true purpose of the contracts was to satisfy the consumer's need for cash and the FAF companies' desire to make a profit from meeting such a need. The provisions in the contracts for the sale and resale of diamonds added nothing to the transaction. The intended effect of these contracts was to avoid the National Credit Act and charge interest well in excess of the 48% interest rate cap that applied to these loans.

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<sup>8</sup> Media Release ([15-032MR](#)) *Federal Court orders record penalty* (19 February 2015).

<sup>9</sup> Media Release ([15-278MR](#)) *Federal Court finds Fast Access Finance breaches National Credit Act* (1 October 2015).

## Advertising

- 76 We undertake regular reviews of payday lending advertisements. Marketing statements that do not accurately represent the financial product or its key features and risks can create unrealistic expectations that lead to poor financial decisions.
- 77 Since 2010, we have taken action in seven matters resulting in payday lenders changing and withdrawing their advertising to ensure consumers are not being misled. Our work has addressed concerns over the use of the following phrases:
- (a) ‘instant decisions’;<sup>10</sup>
  - (b) ‘loan approvals within minutes’;<sup>11</sup>
  - (c) ‘free \$100 loan’;<sup>12</sup>
  - (d) ‘short term’;<sup>13</sup> and
  - (e) ‘no application refused’.<sup>14</sup>
- 78 ASIC action has also addressed advertisements that listed an interest rate lower than what was charged,<sup>15</sup> as well as advertisements listing repayment amounts that didn’t disclose interest rates.<sup>16</sup>

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<sup>10</sup> Media Release ([14-065MR](#)) *Small amount lender pays 30600 dollar penalty for misleading online advertisements* (2 April 2014).

<sup>11</sup> 14-065MR.

<sup>12</sup> Media Release ([13-284MR](#)) *Small amount lender pays infringement notice penalty for ‘Free’ loan offer* (21 October 2013).

<sup>13</sup> Media Release ([13-112MR](#)) *ASIC concerns sees payday lender change advertising* (23 May 2013).

<sup>14</sup> Media Release ([12-136MR](#)) *ASIC takes action on car finance advertising* (25 June 2012).

<sup>15</sup> Media Release ([13-088MR](#)) *Fair Finance Australia pays infringement notice penalty* (24 April 2013) and Media Release ([13-190MR](#)) *Lender to refund consumers and pay financial penalty following interest rate errors* (24 July 2013).

<sup>16</sup> Media Release ([12-197MR](#)) *ASIC takes action on payday loan advertising* (17 August 2012).



## C ASIC's experience with the small amount credit contract laws

### Key points

Many of the Enhancements Act provisions are operating well. However, we have observed higher levels of compliance with prescriptive, 'bright-line' obligations than with more subjective requirements.

There is some scope to improve on the current laws for small amount loans. We suggest that:

- the current presumptions of unsuitability be replaced with a prohibition on repeat lending (supplemented by a mandatory, national database of payday loans);
- a general anti-avoidance provision be inserted into the National Credit Act; and
- the detailed requirements for the small amount credit warning statement be contained in a legislative instrument made by ASIC.

### General recommendations for small amount credit contract laws

- 79 The rules that currently apply to payday lenders are a significant improvement over the previous state-based regulatory regime.
- 80 However, the current regime does have limitations. Based on our experience, including our findings in REP 264 and REP 426 and our other dealings with industry and consumers, our view is that there are some options for change that are worthy of consideration. Our specific feedback on the Enhancements Act obligations is provided at paragraphs 85–203.

#### Objective obligations

- 81 Our general experience with the payday lending industry has been that compliance is greater in relation to objective, clear, 'bright-line' requirements than it is for more subjective matters, such as some elements of the responsible lending obligations. Examples of clear obligations that have led to a strong compliance response from industry include:
- (a) the 'protected earning amount' rules for people receiving Government benefits; and
  - (b) the restrictions on fees and charges that can be imposed on payday loans.
- 82 We note that Parliament's decision to include a specific obligation relating to bank account statements may be an acknowledgment of the need for objective obligations in this context.

- 83 Our suggestions for improvements are informed by this experience. We consider that objective, unambiguous obligations:
- (a) are more likely to achieve the desired outcome in this area;
  - (b) may reduce complexity and compliance costs for businesses; and
  - (c) could address current inconsistent practices that can lead to competitive disadvantages or an uneven playing field for lenders with more robust compliance processes.

### Other proposals

- 84 Other proposals more specific to ASIC that could affect how we regulate the payday lending and consumer leasing industries have been raised in other forums, such as the 2014 Financial System Inquiry and the Senate Economics References Committee's inquiry into the performance of the Australian Securities and Investments Commission (Senate inquiry). These proposals are outlined in Section F.

## Rebuttable presumptions (TOR 1.2)

- 85 The Enhancements Act introduced rebuttable presumptions that a small amount loan will be unsuitable if either:
- (a) the consumer is in default under another small amount loan; or
  - (b) the consumer has had two or more other small amount loans in the last 90 days.
- 86 Once triggered, the presumptions are intended to place a responsibility on the licensee to establish that the loan is not unsuitable for the consumer. These provisions seek to address concerns in relation to 'debt spirals' and recurrent use of small amount loans. The more small amount loans that the borrower takes out within a short period of time, the more likely it is that income is being continually diverted to meet the repayments. In these circumstances, there is a greater risk that the consumer may experience consequent hardship while living on a reduced income with increased financial pressures.

### ASIC feedback

#### Question 5: Restrictions on repeat borrowing (TOR 1.2)

*There is a presumption that a SACC is unsuitable if either the consumer is in default under another SACC or in the 90-day period before the assessment the consumer had two or more other SACCs.*

How do SACC providers determine whether a prospective customer has a SACC with another SACC provider or is in default under another SACC?

Is a restriction on repeat borrowing necessary to protect consumers?

Is a rebuttable presumption or a bright-line test (e.g., an outright ban or a limitation on the number of SACCs that a consumer can take out in a certain period of time) more effective? When responding, please consider:

- the degree of protection afforded to consumers;
- the complexity for SACC providers who are making a decision to grant a loan;
- the cost of complying with the requirement; and
- the flexibility afforded to SACC providers and whether this flexibility is desirable.

Would the objective of limiting a debt spiral through repeat borrowing be assisted by requiring SACC providers to rely on a recognised prescribed benchmark, such as the Household Expenditure Measure or Henderson Poverty Index (with or without an added margin)?

- If so, do stakeholders have any views on which benchmark should be used?
- How should a benchmark be used? For example, should the use of a benchmark replace the need to make inquiries about a consumer's expenses or the rebuttable presumption?
- What is the likely cost or saving of requiring SACC providers to use benchmarks?

87 Our view is that the effectiveness of the current rebuttable presumptions has been limited.

### **Concerns with the rebuttable presumptions**

88 During our recent review of compliance with the Enhancements Act requirements,<sup>17</sup> we asked the payday lenders to explain how they identified if a presumption applied. All 13 lenders stated that they asked the consumer to identify if a presumption had been triggered using an application form and verified this by reviewing the consumer's bank account statements.

89 Lenders identified three distinct ways in which they responded to the presumptions. Lenders either:

- (a) relied on their responsible lending practices and ignored whether a presumption was triggered;
- (b) used the presumptions as a trigger to make further inquiries; or
- (c) treated the presumptions as a prohibition.

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<sup>17</sup> REP 426.

- 90 Of the 288 loan files we reviewed, 8% triggered the default presumption and 54% triggered the multiple loan presumption.<sup>18</sup> Our surveillance work has resulted in similar findings—in mid-2015, we reviewed 150 files from a large payday lender, 52% of which were for loans to consumers who triggered the multiple loan presumption.
- 91 Of the 13 lenders selected for our recent industry review, only one maintained files that contained evidence about how the presumptions had been rebutted. The files of the remaining lenders did not indicate how the presumptions of unsuitability had been rebutted.
- 92 If a lender enters into a small amount loan with a consumer where a presumption of unsuitability is triggered, and that lender has no information on file to indicate how the presumptions were rebutted, it is very unlikely that they will be able to establish that they have met their responsible lending obligations for the loan.
- 93 We have also identified situations where lenders have operated in contravention of their policies. For example, at least one lender had a policy to treat the presumptions as though they are prohibitions, but consumer files showed the licensee providing loans even though the presumptions were triggered.
- 94 Lenders that do not properly comply with the presumptions gain a competitive advantage and provide loans to consumers that would be declined by other lenders with more stringent compliance processes. There may be incentives for lenders to provide loans in situations where the presumptions indicate that a small amount loan is unsuitable (i.e. to maintain market share or a customer base).

#### **'Bright-line' alternatives**

- 95 In light of our findings about current industry practice, our view is that a 'bright-line' test or objective rule would be a better way of preventing debt spirals and addressing recurrent use of payday loans than the current rebuttable presumptions. As outlined at paragraph 81, our experience to date has been that there have been fewer compliance issues in this area with objective, 'bright-line' requirements.
- 96 One option that appears to have merit is a requirement limiting the number of small amount loans (or amount of credit provided under small amount loans) that can be obtained in a given period. Contracts or credit in excess of the specified number or amount would be prohibited.

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<sup>18</sup> We selected files that reflected the range of geographic locations, loan amounts and loan terms of the lenders' loan books. At the same time, we were also keen to examine compliance with the tailored rules that apply where the debtor receives Government benefits or is in default.

97 We consider that any prohibition should be set at an appropriate level that balances the valid reasons why consumers may want to access small amount credit and ongoing industry viability against the risks associated with recurrent lending and debt spirals.

98 A report by Digital Finance Analytics and Monash University Centre for Commercial Law and Regulatory Studies found that the average number of loans per borrower in the last twelve months is 3.64.<sup>19</sup>

*Consumer protection and flexibility*

99 A prohibition would be likely to increase the degree of protection afforded to consumers, particularly given our findings that many small amount loans have been provided in circumstances where the presumptions have been triggered and the basis on which they have been rebutted is unclear.

100 We acknowledge that a prohibition may lead to some consumers not being able to access small amount credit in circumstances where they are currently:

- (a) able to access that credit; and
- (b) adequately managing their financial affairs.

101 Our view is that the risks associated with debt spirals and recurrent use of short-term, high-cost credit apply to such a wide range of consumers that a prohibition set at a reasonable level is justified. Current industry practice in relation to the presumptions may indicate that loans are being provided in circumstances where Parliament's intention was for the presumptions to prevent the provision of credit.

102 We note that even if a prohibition is not triggered, licensees will still be required to comply with the general obligations that prohibit lending in situations where the loan would be unsuitable. We do not consider that a prohibition is an adequate replacement for those obligations—there may be situations where particular loans are unsuitable even though a prohibition has not been triggered.

*Compliance costs and complexity*

103 We consider that replacing the rebuttable presumptions with a prohibition should reduce complexity and compliance costs for payday lenders. These advantages will be maximised if a prohibition is supported by a mandatory, real-time database of payday loans.

104 A database could simplify compliance by giving lenders a prompt yes or no answer about whether they are prohibited from providing the credit a

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<sup>19</sup> Digital Finance Analytics and Monash University Centre for Commercial Law and Regulatory Studies, [The stressed finance landscape data analysis](#) (PDF, 675.2kb), report, commissioned by Consumer Action Law Centre, Good Shepherd Microfinance and Financial Rights Legal Centre, October 2015.

consumer has sought. Our views on a database, as well as our previous consultation on that topic, are at Section D.

#### *International comparisons*

105 A number of overseas jurisdictions have prohibitions of some form. In the Canadian state of Ontario, a lender cannot enter into a new payday loan with a borrower until any previous payday loan is repaid in full.<sup>20</sup> In the United States:

- (a) the state of Washington limits the number of loans a borrower may take out over the course of a 12-month period to eight. Before the law commenced in 2009, two-thirds of borrowers took out eight or fewer loans but two-thirds of all loans went to borrowers who took out nine or more loans. In other words, one-third of payday loan borrowers accounted for two-thirds of payday loans made in Washington. The state regulator reported in 2011 that only about 24% of borrowers had taken out the maximum eight loans over a 12-month period;<sup>21</sup>
- (b) Delaware limits consumers to a maximum of five payday loans in any one year (and no more than two payday loans with any one lender at the same time); and
- (c) Alabama limits consumers to one payday loan of up to \$5,000 at a time.

106 In the United States, the Federal Government is currently considering nationwide regulation of payday lending. One of the proposals being considered is a 60-day cooling-off period that would apply after a consumer has had three payday loans in succession. As part of the consideration of the new laws, the Consumer Financial Protection Bureau (CFPB) has released data that indicates:

- (a) 40% of borrowers take out only one loan;
- (b) about 15% take out two consecutive loans; and
- (c) the remaining 45% of borrowers take out three or more loans, with 14% of borrowers entering into more than 11 loans in a row.<sup>22</sup>

## **Special rules about bank statements (TOR 1.1)**

107 The Enhancements Act introduced a requirement that licensees obtain and consider bank account statements for the preceding 90-day period before they provide credit under, or credit assistance for, a small amount loan.

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<sup>20</sup> *Payday Loans Act 2008* (Ontario), s35(1).

<sup>21</sup> S Montezemolo, *Payday lending abuses and predatory practices: The state of lending in America and its impact on US households* (PDF, 403kb), report, Center for Responsible Lending, September 2013.

<sup>22</sup> CFPB Office of Research, *CFPB data point: Payday lending* (PDF, 543kb), report, CFPB, March 2014.

108 This rule applies in addition to the general responsible lending obligations, and does not limit the inquiries that a payday lender must make to meet their obligations. The rationale for this additional rule was outlined in Revised Explanatory Memorandum to the Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Revised Explanatory Memorandum):

This provision seeks to ensure that the licensee considers the income and expenses of the consumer as disclosed by their transaction history in the account statement. It could ordinarily be assumed that licensees would obtain this type of information in order to comply with the responsible lending obligations. However, a specific obligation has been introduced in relation to small amount credit contracts, given, first, the particular risks associated with this product, and, second, the evidence from reviews undertaken by ASIC since the commencement of responsible lending conduct obligations has found that there are inconsistent standards in this sector, resulting in a greater need for statutory direction.<sup>23</sup>

## ASIC feedback

### Question 4: Obligation to obtain and consider bank account statements (TOR 1.1)

*The law currently requires SACC providers to consider a consumer's bank account statements for at least the preceding 90 days.*

Is the requirement to obtain and consider bank account statements necessary given the broader responsible lending obligations?

- Are there more effective ways to obtain information about the financial situation of a SACC customer? If so, specify the alternative ways for obtaining information and whether the alternative is simpler, cheaper, or provides more useful information.

Is it appropriate for SACC providers to use bank account statements for purposes other than complying with the responsible lending obligations, such as for marketing?

109 Our view is that the requirement to obtain bank account statements continues to be necessary. As noted in REP 264 and the Revised Explanatory Memorandum, before the Enhancements Act there were inconsistent standards and practices across the payday lending industry in relation to the responsible lending obligations and information collection.

110 We consider that the specific obligation in relation to bank account statements has helped to raise awareness of the importance of collecting information about a consumer's income and expenses and has resulted in increased consistency across industry.

111 Our recent review found that payday lenders were aware of this requirement and generally had adequate systems in place to ensure they received the

<sup>23</sup> Revised Explanatory Memorandum, para 4.26.

necessary bank account statements. Of the 288 files we reviewed, 94% contained statements for the full 90-day period. We have taken action where our review identified non-compliance with this rule.<sup>24</sup>

112 Obtaining bank account statements covering a 90-day period is an effective and relatively simple way to obtain information about a customer's financial situation. However, compliance with this requirement alone will not satisfy a credit licensee's responsible lending obligations—lenders should have systems in place to make additional inquiries and deal with any conflicting information provided by consumers.

113 We have provided guidance to this effect in Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209), where we identify that the requirement to obtain statements is in addition to the usual verification obligations. It does not limit the steps that would otherwise be considered 'reasonable steps to verify the consumer's financial situation' according to the circumstances of the particular consumer.<sup>25</sup>

114 Further, lenders are required not only to obtain the account statements but to consider the information contained in the statements as well. Although lenders are generally meeting their obligations to collect statements, we have seen many instances where:

- (a) the information in the bank statements was not used when assessing the loan application; and
- (b) if the information had been used, the loan application should have been rejected.

### **Third-party 'account aggregation' software**

115 Our recent review found that many payday lenders were using third-party software providers to obtain bank account statements from customers.<sup>26</sup> These providers require customers to type in their internet banking log-in details to draw the statement from the banking portal.

116 The information provided to the lender may comprise the raw data from the bank statements and, in some cases, the software provider's analysis of the customer's statement. We are aware that some statements provided to lenders do not include an opening balance, leaving the lender unable to know if the consumer has any savings at the time their assessment commences.

117 Third-party software systems of this nature have existed for some time. We considered the use of similar products, known as account aggregation

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<sup>24</sup> REP 426, paragraphs 124–126; Media Release ([14-313MR](#)) *Payday lender penalised for breaching new responsible lending laws* (25 November 2014).

<sup>25</sup> RG 209.67.

<sup>26</sup> REP 426, paragraphs 201–213.



products, in 2001: see Consultation Paper 20 *Account aggregation in the financial services sector* (CP 20). At that time this technology was being used solely as a personal financial management tool—it was not used by payday lenders.

- 118 CP 20 identified that consumers using these software platforms to access their banking data may:
- (a) not be comfortable with the security standards of the third-party software provider;
  - (b) not understand and agree to the privacy policy of the third-party software provider;
  - (c) not understand that their information may be sent outside Australia,
  - (d) not understand that, by providing internet banking log-in information via a third-party software provider's system, the consumer may be breaching the relevant ADI's terms and conditions of using internet banking;
  - (e) not have access to EDR schemes if there is a complaint against the third-party software provider.
- 119 We note that third-party software providers are largely unregulated (with the exception of privacy legislation) and not subject to tailored rules about data handling and security.

#### *Interaction with ePayments Code protections*

120 It is unclear whether customers who disclose their internet login credentials to use account aggregation services may lose protections against fraud and unauthorised transactions that apply under the ePayments Code. Specifically, there is a chance that consumers may not be protected under the ePayments Code if they access their internet banking portal via a third-party software provider's system and the third party was not promoted, endorsed or authorised by the consumer's banking institution.

121 We have held discussions with software providers and banking institutions about account aggregation products, their use by payday lenders and implications for protections under the ePayments Code. We will continue to engage with stakeholders about this issue as we consider our approach.

#### **Use of customer data**

122 We are aware of situations where consumer data obtained during the loan assessment process is being used for purposes other than complying with the responsible lending obligations, such as for marketing (either by the lender or a third-party who has purchased the data from the lender).

123 We are concerned about these practices—in particular the on-selling of consumer data to third parties (including for marketing purposes). We have

- reservations about whether consumers have truly consented to the distribution of their information.
- 124 Attempting to address this issue through a requirement based around consumer consent may be challenging because:
- (a) many consumers do not read or understand mandated disclosures or fine print;<sup>27</sup> and
  - (b) there may be an overarching desire to obtain credit regardless of the precise terms and conditions.
- 125 Other laws have addressed similar practices via a prohibition—for example, the Australian Privacy Principles under the *Privacy Act 1988* (Privacy Act), which prohibits the use of personal data for direct marketing purposes.<sup>28</sup>
- 126 Our view is that similar restrictions on the use of consumer information for the purposes of the credit legislation should be considered.

## Warning statements (TOR 1.4)

- 127 The Enhancements Act introduced a requirement for payday lenders to provide a warning statement to their clients. Regulations 28XXA and 28XXB, along with schedules to the National Consumer Credit Protection Regulations 2010 (National Credit Regulations), currently specify the content and formatting requirements for the warning. The warning must be as set out below:
- Do you really need a loan today?\*
- It can be expensive to borrow small amounts of money and borrowing may not solve your money problems.
- Check your options before you borrow:
- For information about other options for managing bills and debts, ring 1800 007 007 from anywhere in Australia to talk to a free and independent financial counsellor.
  - Talk to your electricity, gas, phone or water provider to see if you can work out a payment plan.
  - If you are on government benefits, ask if you can receive an advance from Centrelink: Phone: 13 17 94.
- The Government's MoneySmart website shows you how small amount loans work and suggests other options that may help you.
- \* This statement is a Government requirement under the *National Consumer Credit Protection Act 2009*.

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<sup>27</sup> ASIC, *Financial System Inquiry: Submission by the Australian Securities and Investments Commission*, submission, April 2014, paragraphs 123–127.

<sup>28</sup> Sch 1 to the Privacy Act.

128 The warning statement requirements are included in the National Credit Regulations to allow for flexibility and ensure the warning maximises the impact of the information on the consumer.

## ASIC feedback

### Question 7: Warnings (TOR 1.4)

*The Credit Act requires SACC providers to provide a specific warning statement to consumers.*

Are the warning statements effective? Could the statements be improved? When responding, please consider:

- the content of the warning; and
- the manner in which it is displayed.

Should SACC providers be required to include a hyperlink to the MoneySmart website when warnings are displayed on webpages?

129 Our view is that the warning statements are effective, but that there is scope for improvements to the current requirements.

130 We have analysed website traffic data from 21 payday lenders who include a hyperlink to the MoneySmart website in their warning statement. We have observed a significant increase in consumers accessing our webpages from the relevant payday lending website: see Table 1.

**Table 1: Growth in number of MoneySmart referrals from payday lending websites**

Time period	Number of referrals
2012 (1 July to 30 September)	153
2013 (1 July to 30 September)	2,563
2014 (1 July to 30 September)	4,075
2015 (1 July to 30 September)	5,358

131 The website traffic data we analysed indicated that 81.7% of the 5,358 consumers who clicked through to MoneySmart between 1 July and 30 September 2015 were new visitors to ASIC's website. Over 70% of referrals were consumers using a mobile or tablet device.

132 The number of referrals from each of the 21 websites was not reflective of that lender's current market share. This indicates that other factors, such as the way in which the warning statement is displayed, may influence whether a consumer clicks on a link to the MoneySmart website.

- 133 Our analysis suggests that the warning statements have been effective at facilitating access to key consumer protection information by a greater range of consumers.
- 134 We acknowledge that the impact of warning statements may be limited. By the time a consumer views the warning statement, they may have already made a decision to apply for a payday loan. However, the warning statement complements our broader work in relation to financial literacy and other consumer protections not based on disclosure.
- 135 During our recent review, we identified concerns about how the warnings are displayed in some situations.<sup>29</sup> These include:
- (a) warnings being given insufficient prominence on websites (e.g. at the bottom of the home page, requiring consumers to scroll down to access it, or being the same colour as the background of the webpage on which the warning appears);
  - (b) the inclusion of other text in the warning, which may remove focus from the information about alternatives to a small amount loan;
  - (c) confusion among lenders about the requirement for a ‘boxed icon’;<sup>30</sup> and
  - (d) inconsistent practices around the use of hyperlinks, such as failures to include a hyperlink to MoneySmart or Centrelink websites, or linking to the MoneySmart home page instead of the specific payday lending page.
- 136 We understand that most of these concerns have been address in draft regulations. Those regulations also propose to update the list of infringement notice offences to include the warning statement provisions to simplify ASIC enforcement action and encourage compliance with the warning statement requirement. The regulations are yet to be made.
- 137 Under the current rules, consumers who use a mobile application to apply for a payday loan may not have an opportunity to actively engage with the warning before they enter into the loan. Going forward, technological developments and new business channels are likely to mean that the rules about the content, formatting and provision of the warning statement will require amendments over time.

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<sup>29</sup> REP 426, paragraphs 149–155.

<sup>30</sup> The intention of the requirement is that both the icon and the phrase be surrounded by a box to maximise its visibility to users of the website. However, some lenders are just placing a box around either the icon or the phrase not both.

### Potential improvements

- 138 We consider that Parliament's intention for flexibility in the setting of the detailed warning requirements could be better achieved by providing ASIC with a power to specify requirements in a legislative instrument.
- 139 We anticipate that setting the requirements in a legislative instrument would allow for greater flexibility and responsiveness to changing business models, technology and consumer practices than is currently available. In making this suggestion, we consider that:
- (a) guidance could be published on any ASIC-made rules (we have already published a number of regulatory guides about legislative instruments that we have made); and
  - (b) although the rules may require amendment from time to time in response to technological and market developments, repeated change would not be desirable.
- 140 Parliamentary oversight would be maintained because ASIC legislative instruments are subject to disallowance and are regularly reviewed as part of existing processes.
- 141 Our view is that the rules should be amended (either through substantive changes to the National Credit Regulations or detailed requirements established under an ASIC-made legislative instrument) to address the issues noted in paragraph 135. We suggest that the rules:
- (a) require the warning to be displayed in a manner reasonably likely to come to the attention of a consumer; and
  - (b) prohibit the inclusion of other material not related to the specific disclosures.
- 142 In light of our findings on traffic to our webpages, we also support including a requirement to link to the MoneySmart website in the warning statement. We are currently reviewing the content and structure of our payday lending page to ensure it is providing consumers with important information in a readily accessible format.
- 143 Consideration should be given to including a requirement to link to the Centrelink website in the warning statement. We note that some payday lenders already include this hyperlink in their warning statements.

### *ASIC's toolkit*

- 144 The tools currently available to ASIC to respond to breaches of the warning statement requirements are limited. Although a breach of the warning statement provisions is a criminal offence or may attract civil penalties, these options are unlikely to be commensurate to the nature of the misconduct and do not allow ASIC to address relatively minor breaches effectively.

145 We can issue infringement notices for strict liability offences and alleged  
contraventions of some civil penalty provisions.<sup>31</sup> We consider that the  
expansion of the infringement notice regime to include the warning  
statement provisions would facilitate more timely responses to industry  
misconduct.

146 We understand that draft regulations have been prepared to address this  
issue.

#### **Other disclosure options**

147 Additional tailored disclosure to potential debtors could also address  
concerns about repeat borrowing in circumstances where alternatives exist.

148 One option may be to introduce an additional disclosure alerting repeat  
borrowers to the amount they have spent on fees and charges. It could  
include information such as:

In the last 12 months, you have borrowed a total of \$X from this lender and  
paid \$Y in fees and interest.

### **Small amount credit contract fees and charges (TOR 1.5 and 1.6)**

149 Before the National Credit Act was introduced, Government-funded reports  
identified issues with the affordability of payday loans and the level of  
competition on price within the industry.<sup>32</sup>

150 The low level of price competitiveness in part reflected the difficulties some  
consumers faced obtaining credit from other lenders, with the result that they  
enter into loans irrespective of the costs being charged.

151 The reports found that the risk to a consumer of financial detriment increases:

- (a) the lower the consumer's income;
- (b) the shorter the term of the loan;
- (c) the higher the number of loans they take out; and
- (d) the higher the level of costs charged by the payday lender.

152 The combination of these factors can result in such a reduction in income  
that the consumer may, in a very short period, be placed in a position where  
the debt cannot be repaid, or can only be repaid through a significant drain  
on the consumer's financial resources.

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<sup>31</sup> An infringement notice may be issued where we have reasonable grounds to believe that the person has committed an offence or contravened the provision: see Pt 6-2 of the National Credit Regulations.

<sup>32</sup> D Wilson, *Payday lending in Victoria: A research report*, report, Consumer Law Centre Victoria, July 2002; Z Gillam, *Payday loans: Helping hand or quicksand? Examining the growth of high-cost short-term lending in Australia, 2002–2010*, report, Consumer Action Law Centre, September 2010.

- 153 The restrictions on fees and charges introduced in the Enhancements Act were intended to address these issues, while allowing for a viable payday lending industry. The general cap on costs of 48% that applies to other credit contracts was considered to be too low to support a viable payday lending industry, given the small size of each loan.
- 154 The only fees or charges that can be collected in relation to a small amount loan are:
- (a) an establishment fee of up to 20% of the adjusted credit amount<sup>33</sup> (so long as the credit is not being used to refinance another payday loan);
  - (b) a monthly fee of up to 4% of the adjusted credit amount;
  - (c) default fees, so long as the total amount recovered under the contract does not exceed twice the adjusted credit amount;
  - (d) Government fees and charges; and
  - (e) in some situations, direct debit fees.

### Direct debit fees

- 155 Before the Enhancements Act commenced, lenders identified that the cap on costs would prevent the collection of fees charged by third parties to process direct debt requests. At that time many lenders used the services of agencies for collection of loan repayments through direct debits; these agencies typically charged fees to process these transactions.
- 156 Treasury was preparing regulations to allow for the collection of amounts to cover direct debit fees. As regulations were not finalised by 1 July 2013, ASIC made Class Order [CO 13/818] *Certain small amount credit contracts* at Treasury's request to exempt credit providers on an interim basis from the cap on costs in relation to direct debit fees charged by third parties.

### ASIC feedback

#### Question 8: Cap on costs (TOR 1.5 and 1.6)

*The Credit Act currently caps establishment fees at 20 per cent of the credit amount, monthly fees at 4 per cent of the credit amount and the total fees payable in default to twice the credit amount.*

The policy intention in respect of the rate at which the cap on cost was set was to provide adequate protection to consumers and continue to allow the SACCs industry to operate. Do stakeholders think the cap has broadly met this objective?

<sup>33</sup> 'Adjusted credit amount' is the first amount of credit that is, or is to be, provided under the contract.

- When providing a submission, please provide data, such as evidence that it is not viable for businesses to operate or evidence as to how the amount of the cap is causing financial hardship to consumers.
- ASIC Class Order 13/818 granted temporary exemption from the cap for certain medium amount credit contracts (MACCs) and allowed small amount credit contracts (SACCs) providers to exclude fees charged for direct debit processing from the caps. Should the temporary exemptions provided by Class Order 13/818 be made into regulation?

157 Our view is that the caps on fees and charges payable have broadly met their objectives of providing adequate protection to consumers while allowing the payday lending industry to operate. We do not have evidence to suggest that the current caps should be significantly altered.

158 Our recent review of compliance with the Enhancements Act provisions found that the payday lending industry generally has a good understanding of the caps and appears to be applying them in accordance with the legislation.

159 We have seen lenders starting to compete on price (by charging a reduced establishment fee or monthly fee), which is a sign of a functioning marketplace. It is interesting to note that these lenders are not currently advertising price as a point of difference with their product, which may reflect that price is not a consideration for consumers looking for a small amount loan.

### **Avoidance**

160 Although industry has generally adapted to the new cap-on-costs provisions, and the majority of lenders have ceased using previous avoidance schemes, we have identified some instances where lenders are acting in a way that is inconsistent with the intent of the restrictions on fees and charges: see paragraphs 192–193.

### **International comparisons**

161 The United Kingdom and South Africa both have restrictions on the fees and charges that can be collected from borrowers under short term credit contracts. These caps allow the collection of very similar amounts of fees to the current arrangements under the National Credit Act.

#### *United Kingdom*

162 During 2014, the Financial Conduct Authority (FCA) implemented a cap on interest, fees and charges for high-cost, short-term credit in the United Kingdom. Under that cap:

- interest and fees charged must not exceed 0.8% of the amount borrowed per day;
- default fees must not exceed £15 (approximately A\$32) and interest rates cannot be increased once a consumer is in default; and



- (c) borrowers must never pay more in fees and interest than 100% of what they borrowed.<sup>34</sup>

#### *South Africa*

- 163 South Africa's credit legislation limits the fees and charges that can be levied on consumers. For 'short term loans' of up to six months of no more than R8000 (approximately A\$840), lenders may charge:
- (a) a maximum interest rate of 5% per month;
  - (b) a maximum initiation fee of R150 (approximately A\$16) plus 10% of any amount over R1,000 (approximately A\$105);
  - (c) service fees that do not exceed R50 (approximately A\$5) a month; and
  - (d) default administration and collection fees, subject to limits set by South African courts.

#### **Other specific issues**

##### *Prohibition on establishment fees when refinancing*

- 164 We note that it is difficult to determine whether this prohibition is working well, as it may not always be clear whether a loan is used to refinance another credit contract.
- 165 We are aware of lenders who ask consumers whether they are applying for credit to refinance another payday loan. Verifying this information may pose challenges, as bank account statements that show the existence of other loans may not provide evidence that the those loans have been paid off.
- 166 We note that there may be consumers who are charged an establishment fee in circumstances where the prohibition was intended to apply.

##### *Exemption for direct debit fees*

- 167 We have observed a greater level of reliance on [CO 13/818] than we had expected. We have also observed:
- (a) lenders purporting to rely on this class order in situations other than those envisaged when the exemption was provided (e.g. lenders who do not use a third party to process direct debits);
  - (b) direct debit agreements that do not specify the repayments the debtor is authorising (i.e. leaving the frequency and amount of repayments at the lender's discretion); and

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<sup>34</sup> Policy Statement (PS14/16) [Detailed rules for the price cap on high-cost short-term credit: Including feedback on CP14/10 and final rules](#) (PDF, 3.02MB), FCA, November 2014.

- (c) direct debit fees that may be significantly above the cost of processing the direct debit request.

168 We have been unable to ascertain the basis on which consumers are being charged substantially differing amounts for direct debit services. We have seen examples of consumers paying up to \$3.50 per transaction: see Table 2.

**Table 2: Examples of direct debit fees charged by payday lenders**

Lender	Direct debit fee
Lender A	\$0
Lender B	\$1.25
Lender C	\$3.00
Lender D	\$3.50

169 Accordingly, we suggest that it may be appropriate to review this exemption (and the underlying policy rationale) before any regulations are made.

## Rules for persons receiving Government benefits (TOR 1.7)

170 The Enhancements Act ensures that consumers who receive the majority of their income under the Social Security Act who take out a small amount loan will not have repayments that would exceed 20% of their income (the protected earnings amount rule).

171 This rule is intended to provide additional protection for a group of consumers who are more likely to be financially vulnerable.

### ASIC feedback

#### Question 9: Protection for Centrelink customers (TOR 1.7)

*The Credit Act caps the amount of repayment for consumers who receive 50 per cent or more of their gross income from Centrelink payments to 20 per cent of the consumer's gross income.*

Is the protection for consumers who receive 50 per cent or more of their income under the *Social Security Act 1991* working effectively?

Do any additional groups of consumers need to be subject to specific protection in relation to SACCs? For example, should the provisions be extended on a similar basis to other persons whose income is less than a specified amount or recipients of payments under the *Veterans' Entitlements Act 1986*?

172 Our view is that the ‘protected earnings amount’ rule is working effectively. Our recent review found that lenders have responded positively to this rule and have implemented systems to comply with these requirements.

173 The systems we observed varied from lender to lender, but included:

- (a) relying on existing responsible lending policies;
- (b) ceasing to offer small amount loans to consumers who receive the majority of their income from Centrelink;
- (c) adopting a 20% repayment ceiling for all consumers, regardless of the source of the consumer’s income; and
- (d) excluding any income received from Centrelink in the calculation of a consumer’s income.

174 We found no evidence of non-compliance with the protected earnings amount rule, although some lenders did deviate from their internal policies in a small number of circumstances.

175 We consider that these rules have had the intended effect of limiting the risk of debt spirals by providing additional cost restrictions for consumers receiving benefits under the Social Security Act. The protected earnings amount rule has set clear, unambiguous expectations for lenders.

#### **Extension of the rule to other benefit recipients**

176 The ‘protected earnings amount’ rule only applies to consumers who receive more than 50% of their income under the Social Security Act. However, persons who receive more than half of their income from the Government under other laws, such as the *Veterans’ Entitlements Act 1986*, may also be at risk of debt spirals.

177 Based on the effectiveness of the protected earnings amount rule to date, we support the extension of this rule to other Government benefit recipients.

### **Short term credit contracts (TOR 1.3)**

178 The Enhancements Act introduced a prohibition on ‘short term credit contracts’, which are credit contracts:

- (a) for less than \$2,000;
- (b) issued by non-ADIs; and
- (c) with a term of 15 days or less.

179 The prohibition was intended to address the consumer risks associated with the repayments required under short term credit contracts. There were concerns that:

- (a) the repayments for these contracts were dictated by the need to repay the loan within a short period (rather than the borrower's capacity to meet those repayments); and
- (b) the extremely short period of the loan meant that the repayment would consume a disproportionate amount of the borrower's income, resulting in risks of repeat use or financial hardship.<sup>35</sup>

### ASIC feedback

#### Question 6: Ban on short term credit contracts (TOR 1.3)

*The Credit Act prohibits loans with a term of 15 days or less.*

Has the prohibition on short-term lending been effective in preventing lenders from offering loans with a term of 15 days or less?

Has the prohibition on short-term lending had any unintended consequences that mean it should be changed? If so, please provide examples of these consequences.

- 180 We continue to support the ban on short term credit contracts. We consider that the rules prohibiting these contracts have been effective in preventing lenders from offering loans with a term of 15 days or less.
- 181 However, our recent review identified that some payday lenders enter into loans for 16 days or more that require repayment via a single lump sum. In these circumstances, a high percentage of a consumer's fortnightly or monthly income may be required to meet their obligations. These arrangements may increase the chances that repaying the loan would cause a consumer substantial hardship.

## Anti-avoidance provisions (TOR 2.2)

### ASIC feedback

#### Question 12: Anti-avoidance provisions (TOR 2.2)

Are stakeholders aware of any avoidance practices in relation to the Credit Act? If so, provide details of these practices and the scope (if known).

Should any additional anti-avoidance provisions be included in the Credit Act?

- If so, should there be any distinction between business model avoidance and internal avoidance?

<sup>35</sup> Revised Explanatory Memorandum, paras 4.19–4.20.

182 Elements of the payday lending industry have created avoidance models to  
circumvent credit laws for many years. This includes avoidance of the  
previous state-based interest rate caps, as well as regulation under the  
National Credit Act. We have taken action to stop avoidance models,  
including enforcement action.

183 Our experience has been that avoidance conduct falls into three general  
categories:

- (a) business model avoidance;
- (b) product avoidance; and
- (c) law intent avoidance.

#### **Business model avoidance**

184 Business model avoidance is where lenders structure their business  
operations—including through the existence of related party entities—to  
attempt to avoid the credit regime in its entirety.

185 An example of business model avoidance is the ‘diamond selling model’  
operated by the FAF companies. Under this model, consumers who were  
seeking a loan entered into contracts purportedly for the sale and purchase of  
diamonds. The Federal Court recently held that the FAF companies were  
engaging in credit activities without a licence: see paragraphs 74–75.

186 We also commenced court proceedings against Teleloans Pty Ltd in relation  
to our concerns that they were attempting to avoid the National Credit Act:  
*ASIC v Teleloans Pty Ltd* [2015] FCA 648 (*ASIC v Teleloans*). The Federal  
Court found in favour of Teleloans.

#### **Product avoidance**

187 We have seen product avoidance where lenders provide offerings that are  
substantially similar to a defined product but with minor modifications to  
purport to avoid tailored rules that apply to those products.

188 We are aware of entities that advertise in a similar manner to payday lenders  
and offer loans that are very similar to small amount credit except for the  
fact that the loan amounts are slightly over \$2,000. As a result, the small  
amount lending provisions may not be triggered, even though both the  
consumer and lender treat the contract like a payday loan.

189 Product avoidance is also a particular problem in the consumer leasing  
sector. Many consumer leases arrange to provide the goods to a consumer at  
the completion of a fixed term consumer lease without actually providing  
them with a right or obligation to purchase the goods (which would make the  
arrangement a sale of goods by instalment and subject to a 48% all-inclusive  
interest rate cap). Typically, lessors arrange for the consumer to retain

possession of the goods at the end of the lease contract, using two approaches:

- (a) a rent-to-buy model, under which there is an expectation, but not a contractual right, that the consumer will be able to buy the goods at the end of the lease for a token or nominal amount (sometimes \$1); and
- (b) a gift model, under which the lessor agrees that the leased goods can be gifted to a third party nominated by the consumer.

190 The distinction in the credit legislation between consumer leases (with no cost cap), and contracts for the sale of goods by instalment (with a 48% cost cap), has led to regulatory arbitrage and created an uneven playing field for businesses in this area.

### **Law intent avoidance**

191 Some licensees have engaged in conduct that may be legal, but clearly inconsistent with the intent of the Enhancements Act provisions. In particular, we have seen examples of this behaviour in the context of the restrictions on fees and charges.

192 We are aware of one payday lender who offers a 12-month term on loans with the repayment rate for the first six months set at a significantly higher level than the repayments for the last six months. If consumers continued to make the higher repayment amount, the loan would be paid out within seven months. Extending the loan term in this way results in consumers paying an additional five months' worth of fees.

#### **Example**

A consumer borrows \$600 for a 12-month term with fortnightly repayments. The consumer makes 13 repayments of \$58.15 and then 13 repayments of \$19.38. The total amount repaid is \$1,008.

If the consumer made equal repayments of \$59.20 each fortnight (an increase of just \$1.05) they would pay out the contract in seven months and repay \$888, saving \$120.

193 We have also observed one payday lender who requires the establishment fee and all monthly fees for the term of the contract to be paid when the loan commences. This enables the lender to turn over their loan book quicker and gain full fees in circumstances where the consumer may repay early. This practice may encourage consumers to continue to take out additional payday loans as they may receive less of the amount borrowed than anticipated, and may not be able to fund the expense for which they sought the loan.

### Challenges to dealing with avoidance

- 194 Addressing avoidance under the current legislative framework is particularly resource intensive for ASIC. Our experience has been that once one avoidance business model has been stopped, another soon takes its place.
- 195 For example, in October 2014 we intervened to stop a business model where a consumer purported to sell a household good to the lender and then lease it back.<sup>36</sup> Shortly after, in early 2015, we observed a new model where lenders attempted to avoid the small amount lending rules by offering a loan with a term of two years, even though the repayments are such that the loan is paid out within one year.
- 196 Our experience has been that addressing avoidance models on an ad-hoc basis does not have a significant broader deterrence effect in the payday lending and consumer leasing industries. In the absence of a strong deterrence effect or a general anti-avoidance provision, the regulatory effort required to address one avoidance model is unlikely to lead to broader changes in practice. Under the current laws, court decisions on a particular avoidance situation are likely to turn on the individual circumstances of the business model and may not impact other lenders.
- 197 In *ASIC v Teleloans*, the court favoured a narrow construction of the term ‘credit contract’, in part based on the lack of a general anti-avoidance provision. In his judgement, Logan J stated:
- [N]either the Act nor the Code prevents the making of choices. And some of those choices may, as a matter of ordinary language, fall outside the reach of the Act and the Code.
- ... [E]ven though there is no general anti-avoidance provision in either the Act or the Code, s 6(2) of the Code contains some particular anti-avoidance measures. The presence of these would make it difficult to conclude that some more general doctrine ought to be imported. It is to be remembered, too, that the Act and the Code were enacted after *Australian Finance Direct* and *Bahadori*. Had Parliament wished further to extend the definition of ‘contract’ or the anti-avoidance measures found in earlier State consumer credit models so as to extend to ‘helpers’, it could have done so.<sup>37</sup>
- 198 Although the laws on which *ASIC v Teleloans* was decided have since been amended, the Federal Court’s preference for narrow constructions based on the absence of an anti-avoidance provision poses challenges for ASIC when seeking to address business model avoidance.
- 199 We also note that changes to the National Credit Act intended to address limitations or problems with the current laws may increase incentives to avoid the consumer credit obligations.

<sup>36</sup> Media Release ([14-278MR](#)) *ASIC continues crackdown on payday lending avoidance models* (22 October 2014).

<sup>37</sup> *ASIC v Teleloans* [40–42].

### **Introducing a general anti-avoidance provision**

- 200 In light of the challenges experienced to date, we support the enactment of a general anti-avoidance provision in the National Credit Act.
- 201 We consider that a rule that prohibits products or models that have the effect of avoiding some or all of the National Credit Act would greatly assist our efforts to respond to avoidance and ensure that consumers receive appropriate protections in relation to credit.
- 202 We anticipate that an anti-avoidance provision may be particularly useful in our efforts against business model and product avoidance. Such a provision may:
- (a) create a more significant deterrence effect than we have observed to date; and
  - (b) allow for judicial decisions on avoidance models that may have industry-wide impact.
- 203 We note that a general anti-avoidance provision may be outside the scope of the current referral of powers from the states and territories to the Commonwealth that partly underpins the National Credit Act. However, we consider that:
- (a) a provision based on other Constitutional heads of power (such as interstate trade and commerce or corporations) would apply to a significant majority of credit licensees; and
  - (b) the current referral of powers could be amended.



## D Small amount loan database

### Key points

During 2013, we consulted on the effectiveness of an online database for small amount loans. We received submissions with a range of different views on the desirability of a database.

In Section C we indicated our support for a rule limiting the number of small amount loans (or value of small amount credit) that can be obtained in a given period. Our view is that a mandatory, real-time database of payday loans with a narrow scope would support such a prohibition.

Many overseas jurisdictions have mandatory payday lending databases to support lending prohibitions.

### ASIC consultation on a small amount loans database

- 204 In November 2012, the then Minister for Financial Services and Superannuation requested that we undertake a review addressing:
- (a) the effectiveness or otherwise of an online database or similar system that would assist providers of small amount loans to determine whether consumers applying for such loans have any outstanding small amount debts, and whether the contracts offered by the provider are consistent with regulations;
  - (b) the existence of any limitations in the provisions applying to small amount loans in the Enhancements Act that would prevent ASIC from taking court action against payday lenders, or severely restrict our capacity to do so (including the inability to obtain evidence, either documentary or from debtors, to establish the requirements necessary to prove an offence); and
  - (c) any recommendations for amendments to the Enhancements Act arising from our review of the matters listed above.
- 205 In January 2013 we published Consultation Paper 198 *Review of the effectiveness of an online database for small amount lenders* (CP 198) in response to the first part of the then Minister's request. CP 198 sought comments on:
- (a) whether it should be mandatory for payday lenders to register loans in a database and check the database for the purposes of considering the rebuttable presumptions;
  - (b) what information should be recorded on a database;
  - (c) whether consumers should have access to a database;

- (d) how privacy issues could be addressed; and
- (e) whether a database could assist lenders to meet other regulatory obligations (and, if so, which ones).

206 We received 14 submissions from a range of stakeholders. Seven submissions were supportive of a database for one or both of the presumptions, three had mixed views and four did not support the introduction of a database. We have considered the feedback we received in response to CP 198 in developing this submission to the review (noting the time that has elapsed since CP 198 was issued).

## International experience with small amount loan databases

### United States

207 In the United States, the laws regulating payday lenders are state-based and therefore vary across the country. Over 14 states mandate the use of centralised databases of payday loans.

### Florida

208 Florida was the first jurisdiction in the United States to implement a database. In 2001, a database system was introduced to help regulators enforce new regulations on payday lending. These regulations included imposing a maximum loan amount of US\$500, limiting transaction fees to 10% of the amount borrowed (up to a maximum of US\$5), banning the rolling over of loans, restricting loan terms to a period of between 7 and 31 days, and imposing a cooling-off period of 24 hours between loans.

209 The database is a real-time database of all outstanding payday loan transactions. Licensed payday lenders are assigned a password-protected login to access the database. When a consumer applies for a loan, the lender enters the database to verify that the consumer has no current payday loans and has not terminated a payday loan in the previous 24 hours.

210 A database inquiry will result in the lender being given a response about whether the consumer is eligible or ineligible for a new loan, and a brief description of the reason. Only the consumer can request a more detailed reason about why they are ineligible for a new loan.

211 The Commissioner of the Florida Office of Finance Regulation administers the database, which can only be accessed by the Florida Office of Finance Regulation (the regulator) or lenders. Data is deleted three years after a transaction is closed or any action relating to a dispute is resolved, whichever is later.

212 Consumer complaints about information held in the database are assessed by the regulator and, if it is unable to confirm the details of the information (e.g. the lender fails to reply or has ceased operations), the regulator administratively updates the information held in the database.

#### **Washington state**

213 A database operates in Washington in a similar manner to the system used in Florida. In Washington, payday lending laws requiring information to be registered in a state-wide database to ensure lenders have up-to-date loan information commenced in 2010. These laws include a prohibition on taking out more than eight payday loans in a 12-month period.

214 The state regulator, the Department of Financial Institutions, has noted that state-wide database has made regulating under the new laws considerably easier.<sup>38</sup> There has also been some reduction in the number of borrowers taking out the maximum number of loans available: see paragraph 105(a).

#### **Alabama**

215 On 10 August 2015, a mandatory payday lending database commenced operation in Alabama.

216 Lenders are required to use the database, which is intended to help enforce Alabama's laws that limit consumers to one payday loan of up to \$5,000 at any given time. Recent media reports indicate that during the first two months of the database's operation, over 385,000 payday loans totalling in excess of \$120 million were provided.<sup>39</sup>

## **ASIC feedback**

### **Question 10: National database (TOR 2.1)**

*The review is required to consider whether a SACC database would enhance the capacity of SACC providers to meet the responsible lending obligations by providing them with access to more comprehensive and accurate information.*

Is there sufficient information currently available for a SACC provider to meet the responsible lending obligations?

If not, would a database or alternatives such as comprehensive credit reporting be a more effective way to meet the responsible lending obligations?

<sup>38</sup> Correspondence from Mr Scott Jarvis, Director, Department of Financial Institutions, to Mr David Burtzlaff, Chartered Financial Analyst (CFA), 21 July 2011.

<sup>39</sup> A Henry, '[Alabama payday loan database showing big numbers in short time](#)', *Tucson News Now*, 7 October 2015.

If a SACC database is considered an effective method to meet the responsible lending obligations, please comment on:

- the cost of a database;
- any privacy concerns;
- the advantages and disadvantages of having multiple databases operating in parallel;
- whether a database would assist SACC providers to discharge the responsible lending obligations; and
- the effect of the comprehensive credit reporting (CCR) regime, including whether or not additional information could be obtained through a SACC database that would not be available through CCR.

If a recommendation was made to introduce a database:

- What information should be included in the database?
- Who should manage the database (a third party or government agency)?
- How should the database be funded?
- Should reporting of key information be mandatory or voluntary?
- Should SACC providers be required to check the database and, if so, when should this obligation be triggered?
- Should SACC providers be charged a fee for accessing the database and, if so, should the fee be included in the cap?
- Who should be permitted to access and amend information on the database?
- What mechanism should be available to ensure that the database was accurate?
- How should the database interact with the other responsible lending obligations?

217 We consider that there is sufficient information available to payday lenders to enable them to meet their responsible lending obligations. However, we have identified concerns with the way in which some lenders are complying with the law in this area—in particular, around the rebuttable presumptions: see paragraphs 87–94.

218 We support the replacement of the rebuttable presumptions with an objective rule limiting the number of small amount loans (or amount of credit provided under small amount loans) that can be obtained in a given period.

219 We consider that there is potential for a mandatory, real-time, national database of payday loans to facilitate compliance with a prohibition. Such a database could allow lenders to instantly determine whether the prohibition would prevent them from providing the loan the customer has sought,

reducing compliance complexity relative to the current rules. We note that the benefits of a database would be significantly diluted if:

- (a) the database is non-mandatory; or
- (b) there are multiple competing databases, each with partial market share.

## Scope and operation

### Privacy concerns

220 We understand that industry and consumer advocates have concerns about the privacy implications of a small amount loans database. The level of concern increases with the amount of personal information about a consumer that may be collected for the database.

221 For example, there is less concern about the information needed for a database to provide responses about the multiple loan presumption than there was about information about obligations such as the protected earnings amount rule.

222 These concerns may be capable of being addressed by ensuring the scope of the database is limited (i.e. only obtaining data needed to provide a yes or no answer to lenders on whether a prohibition would be breached). Our experience does not suggest that a database is required to assist lenders to comply with obligations such as the protected earnings amount rule.

223 There may be advantages to a database that also assists lenders to comply with the prohibition on establishment fees for refinancing loans (e.g. by advising lenders whether the prospective borrower currently has another payday loan). However, these advantages would need to be weighed against the additional cost and privacy concerns associated with a database of that nature.

224 A database would not assist a payday lender to meet its responsible lending obligations where the prohibition is not triggered. We note that lenders should still be subject to the requirement to obtain bank statements covering 90 days, which would assist them to verify consumer income and expenses.

### Operation

225 We note that some payday lending databases in other jurisdictions are administered by the relevant regulators.

226 The Government announced in the 2014–15 Budget that it would commission a scoping study into future ownership options for the operation and ownership of ASIC's registry functions. In the context of this, along with the active and growing private market for operating sophisticated data services including databases of business information, we note that a payday lending database could be operated by a specialist third party.

227 Like regulators in other jurisdictions, we would seek access to information from the database to assist with our compliance monitoring responsibilities.

### Cost

228 The cost of the database to lenders would depend on:

- (a) whether the process of interacting with the database is automated or manual; and
- (b) the amount of information that must be entered and at what stages in the loan process.

229 We understand that the databases used in the United States provide credit providers with three interface channels to interact with the database:

- (a) *browser-based application system* (i.e. access to the system via an internet connection)—if the lender already pays for such a connection, there is no additional cost;
- (b) *non-browser based automated interface* (i.e. interfaced with point of sale software providers and company software systems)—a database provider in the United States has advised that the typical cost to integrate a lender's software system with a payday lending database is a one-off internal software development cost of approximately 40 hours or less; and
- (c) *toll-free interactive voice response system and/or customer service representative*—this mode is provided at no cost to the lender.

230 The information we received in response to CP 198 suggested that online payday lending databases overseas have a minimal cost to lenders, typically less than 0.5% of the average fee charged to a consumer for the average loan. The highest fee charged in the United States at that time was US\$1.24 per inquiry in Virginia. We are mindful that the cost to lenders of online databases may have changed since we received submissions in response to CP 198.

231 In any event, a small amount loans database in Australia may be able to operate in a similar manner to comparable overseas offerings. This could potentially include several channels for connection to provide payday lenders with the opportunity to adopt the most cost-effective model for their businesses.

232 We anticipate that the cost to lenders for a database supporting a prohibition may be lower than a database supporting the rebuttable presumptions. This is because a database that captured data about the default presumption would need to be updated during the course of a loan where consumers miss repayments.

## Accuracy

- 233 For a small amount loans database to operate successfully, it must be accurate, complete and contain up-to-date information in real-time. If the database does not have these features, there is a risk the credit provider will make a decision about the consumer's financial situation without current information that should influence that decision.
- 234 To ensure accuracy of the information in the database, there must be some means of identifying consumers to ensure duplicate files are not held.
- 235 We have been advised by a credit reporting agency that inquiries of their database using name and date of birth only have a match rate of 80–85%. To achieve a higher match rate, other sources of information are used.
- 236 To maximise the accuracy of information in the small amount loans database, there should be measures supporting the database, including:
- (a) regular audits of the information provided to the database;
  - (b) complaint processes (internal and external dispute resolution) so that incorrect information in the database can be promptly corrected; and
  - (c) penalties for failure to provide information to the database.
- 237 These measures are used to support overseas databases.
- 238 Any small amount loans database should also include mechanisms to permit individuals to gain access to the personal information stored about them in the database, as well as ability to seek correction of that information at no cost.

## Compliance monitoring

- 239 Together with providing assistance to credit providers offering small amount loans, a database may also assist ASIC in our role as regulator.
- 240 A database would allow ASIC to access data relevant to compliance by payday lenders, informing our approach to enforcement and providing a cost-effective tool for monitoring industry developments.
- 241 The Florida Office of Finance Regulation advises that the database in their jurisdiction allows it to understand the volume and demographics of payday lending usage within the state, and to ensure that excessive fees are not charged. The database also provides them with advance information about the use of payday lending when conducting an examination or investigation.
- 242 Similarly, a small amount loans database would provide ASIC with the ability to quickly access raw data on small amount lending usage in Australia. This would complement our existing sources of information, such as consumer reports of misconduct and data provided by industry and EDR schemes.

## E Consumer leases

### Key points

Different rules apply to consumer leases and credit contracts. Lessors currently structure their contracts as consumer leases to avoid the cost caps that apply to credit contracts.

The amounts charged by different lessors for comparable goods vary significantly. Additionally, the same lessors often charge significantly different amounts for the same goods; Centrelink consumers often pay more than advertised prices.

We support changes to the law to address these issues, including a cost cap for consumer leases and the extension of Enhancements Act requirements such as warning statements and protections for persons receiving Government benefits.

### Background to concerns about consumer leases

- 243 ASIC is responsible for the regulation of consumer leases under the National Credit Act. A consumer lease is a contract for the hire of goods for a fixed term of more than four months, where the consumer has no contractual right or obligation to purchase the goods at the end of the lease term.
- 244 If there is a right or obligation to purchase the goods at the end of the lease term (e.g. a sale of goods by instalments arrangement), the contract is considered a credit contract rather than a consumer lease.
- 245 The obligations that apply to consumer leases are different to those that apply to credit contracts. A notable difference is that there is no statutory limit on the maximum amount that consumers can be charged under a consumer lease (unlike credit contracts, which are subject to restrictions on the maximum amount that can be charged): see Table 3.

### Consumer leasing market

- 246 A 2014 report by IBISWorld estimated the value of the leasing industry in Australia as around \$570 million for rentals of electronic goods (including televisions, stereos, DVD players and computers) and household appliances (including fridges, ovens, microwaves, toasters and blenders).<sup>40</sup>
- 247 There is a high use of consumer leases by financially vulnerable consumers, such as Centrelink recipients. The *Report of the independent review of*

<sup>40</sup> IBISWorld, *Home appliance rental in Australia* (OD5467), IBISWorld industry report, 2014.



*Centrepay* stated that, as at March 2013, there were approximately 118,700 deductions for consumer leases for household goods and the average fortnightly rental payment was just under \$76.<sup>41</sup> The total payments under these leases were expected to exceed \$200 million in 2013.

**Table 3: Regulatory obligations under the National Credit Act for different types of contracts**

Type of contract	Contract definition	Maximum costs	General responsible lending obligations	Additional obligations
Small amount credit contract (payday loan)	Amount borrowed: Less than \$2,000  Term: Between 16 days and 1 year	The provider cannot charge interest. The provider may charge an establishment fee of up to 20% of the amount of credit and a monthly fee of up to 4% of this amount.  No establishment fee can be charged where the contract refinances a payday loan.  On default: The consumer cannot be charged more than twice the amount of credit (including the amount already paid).	The provider must assess whether the consumer can afford the repayments, on the basis of reasonable inquiries.  The product must meet the consumer's requirements and objectives.	Bank statements must be obtained for 90 days.  The contract is presumed to be unsuitable if the consumer: <ul style="list-style-type: none"> <li>• is already in default under an existing payday loan; or</li> <li>• has been a party to two or more payday loans in the last 90 days</li> </ul> There must be a warning statement on the provider's website.  Repayments cannot exceed 20% of income for Centrelink recipients.
Medium amount credit contract	Amount borrowed: Between \$2,001 and \$5,000  Term: Between 16 days and 2 years	The amount charged must not exceed a maximum cost calculated as the sum of interest charged at 48% and a fee of \$400.	As for a small amount credit contract	No additional obligations
All other credit contracts	All other credit contracts.	The amount charged must not exceed a maximum cost calculated as the sum of interest charged at 48%.	As for a small amount credit contract.	No additional obligations.

<sup>41</sup> A Buduls, *Report of the independent review of Centrepay*, report to the Secretary of the Department of Human Services, Australian Government, June 2013.

Type of contract	Contract definition	Maximum costs	General responsible lending obligations	Additional obligations
Consumer leases	<p>Fixed term contracts of greater than 4 months.</p> <p>The consumer pays more than the cash value of the goods.</p> <p>There is no right or obligation to purchase the goods.</p>	No limit on costs.	As for a small amount credit contract.	No additional obligations.

### ASIC findings about the cost of consumer leases

- 248 In light of the use of consumer leases by vulnerable consumers, along with our concerns about the low standard of conduct by some lessors, we conducted a review of costs charged by providers of leases of household goods. Our findings were published in Report 447 *Cost of consumer leases for household goods* (REP 447) in September 2015.
- 249 We found that:
- (a) the amounts charged by different lessors for comparable goods vary significantly;
  - (b) the total cost paid by the consumer under a consumer lease increases as the lease term increases (i.e. the financial benefits of choosing a longer term lease over a shorter term lease are questionable—consumers who could afford higher rental payments under a shorter term lease could retain ownership of the goods at the end of that lease for a lower total cost);
  - (c) the same lessors often charge significantly different amounts for the same goods—in particular, Centrelink recipients were charged more than the advertised costs; and
  - (d) Centrelink recipients were often charged significantly more under a consumer lease than the maximum amount they would have been liable to pay if they had financed the purchase of the item under a small amount loan (see Table 4).

**Table 4: Cost comparison—Centrelink recipient leases compared to maximum cost under a payday loan (12-month term)**

Product	Retail price	Total cost of consumer lease	Interest rate	Maximum cost of payday loan	Additional cost of lease
7 kg washing machine	\$700.00	\$2,175.94	292.18%	\$1,176.00	\$999.94
5 kg dryer	\$345.00	\$3,042.00	884.34%	\$579.60	\$2,462.40
253 L fridge	\$498.00	\$1,690.00	324.35%	\$836.64	\$853.36
145 L chest freezer	\$319.00	\$1,092.00	327.65%	\$535.92	\$556.08

- 250 Table 4 compares four high-cost leases to Centrelink recipients with the maximum amount payable under a small amount loan for the value of the leased goods. The consumers in question were charged:
- in dollar terms, up to \$2,462 more than a payday lender could charge; and
  - between two and five times more than the maximum amount payable under a small amount loan.
- 251 Table 4 also lists the effective interest rates paid by those consumers, using the annual cost rate formula at s32B of the National Credit Code. By way of comparison, the maximum amount payable under a small amount loan with a 12-month term is 112.15% where repayments are made fortnightly.
- 252 The high relative costs of consumer leases may be indicative of the information asymmetries that exist in the consumer lease market. Lessors have access to information about the retail cost of the items and the additional amount that they are charging to the consumer, which is not available to consumers. For instance:
- lessors are not required to disclose the retail price of the leased goods—so the consumer cannot, without making further inquiries, assess the total amount payable relative to the retail price;
  - lessors are not required to disclose a comparative cost—there is no obligation to disclose the cost of a lease as an interest rate, which would otherwise enable consumers to compare the cost of different leases;
  - lessors are not required to provide consumers with a comparison of how changing the lease term affects the total cost; and
  - lessors are required to inform consumers of the total cost in the lease agreement—however, this typically occurs just before entering into the contract, once a consumer has already made a purchasing decision and is largely committed to entering into the lease.

## ASIC feedback

### Question 14: Comparable consumer leases (TOR 3)

*The Credit Act applies different obligations to transactions according to whether or not the product is structured as a credit contract or a consumer lease.*

Which leases could be considered comparable with SACCs?

Should there be greater consistency in the regulatory requirements that apply to SACCs and comparable consumer leases? Please consider:

- the similarities between the consumer bases for SACCs and comparable consumer leases;
- the similar economic outcomes of SACCs and comparable consumer leases;
- ASIC evidence which suggests that the effective interest rate for some consumer leases is substantially greater than the maximum allowed for SACCs under the caps;
- the effect of introducing new regulatory requirements on the viability of the consumer leasing market and the availability of consumer leases; and
- the impact of the distinction based on whether or not the consumer has a right or obligation to purchase the leased goods.

Please provide data, such as evidence as to the effect of any cap on the viability of businesses currently providing comparable consumer leases or evidence of where the absence of any cap is causing financial hardship to consumers.

### Question 15: Applying SACC provisions to comparable consumer leases (TOR 3)

As SACC and comparable consumer lease providers market to a similar consumer base, should the same provisions apply?

Should there be additional disclosure requirements for comparable consumer leases, such as a requirement to disclose:

- the purchase or cash price of the leased good;
- the amount the consumer will pay in excess of the purchase or cash price;
- the cost of credit in dollar terms;
- the cost of credit as an interest rate; and
- the cost of other services financed through the rental payments (apart from the cost of hiring the goods, such as a warranty or delivery)?

Please consider the cost of complying with any such additional disclosure requirements against the benefit of providing additional information to consumers.

If greater consistency between SACCs and comparable consumer leases is considered warranted, which SACC provisions should be extended to those leases?

- Would the SACC provision need to be modified when applied to consumer leases?

### Question 16: Cap on costs for consumer leases (TOR 3)

If a cap on consumer leases that are comparable to SACCs was introduced, how should the cap apply?

- The cash price of the good is used as the basis for applying the cap on costs. Should the approach for sales by instalment also be used as a basis for applying the cap to leases that are comparable to SACCs? If so, how should the cash price of the good be defined?
- If not, what alternative approach could be used to determine a cap on costs for leases?

- 253 Our view is that consumer leases are largely comparable to small amount loans. In reaching this view we note that:
- both products are used by similar consumer bases, which includes low-income and/or financially vulnerable consumers, as well as consumers who have low levels of financial literacy and limited knowledge of alternative forms of credit;
  - consumers using both products are likely to be excluded, or may perceive that they are excluded, from mainstream forms of credit, either because of their low income or because of a poor credit history; and
  - consumer leases are frequently used to hire goods with a value less than the \$2,000 threshold for a small amount loan (e.g. the products may be substitutable in some circumstances).<sup>42</sup>
- 254 In practice, many consumer leases bear a strong resemblance to a sale of goods by instalment, in that lessors typically allow the consumer to:
- retain the goods at the end of the contract for a nominal amount (sometimes \$1); or
  - gift the goods to a nominated third party.
- 255 Lessors who engage in this conduct typically draft their contracts so that they have discretion about whether to offer the goods to the consumer at the end of the contract. If the contracts included a right or obligation for the consumer to purchase the goods, they would be sales of goods by instalment credit contracts and a cost cap of 48% would apply.

<sup>42</sup> We note the consumer leases are also frequently used to hire motor vehicles, many of which have a value in excess of \$2,000. Although these leases may not be substitutes for small amount loans, we have concerns about the conduct of entities involved in the lease of motor vehicles, particularly used motor vehicles, where the value or cash price of the vehicle is very low but consumers pay a high cost for the lease of the vehicle.

- 256 Our observations about industry practice suggest that:
- (a) significant regulatory arbitrage is currently taking place, with lessors structuring their contracts as consumer leases to avoid the 48% cost cap; and
  - (b) the current distinctions, based on whether or not there is a right or obligation to purchase the goods, may lead to similar products and contracts receiving different treatment.

257 We support greater consistency in the regulatory requirements that apply to consumer leases and comparable credit contracts, including greater consistency in the costs to consumers for similar products. We consider that this will lead to a more even playing field for providers of payday loans, consumer leases and other credit contracts.

### **A cap on costs**

- 258 We support changes to the National Credit Act to establish a maximum cap on costs for consumer leases. We consider that a cap on costs would:
- (a) lead to more consistent treatment for consumer leases and similar credit contracts; and
  - (b) prevent the offering of very high-cost leases that we identified in REP 447.

- 259 The cap could be set at a level that reflects the similarities between consumer leases and certain classes of credit contracts. For example, the cap could limit the amount payable under the consumer lease to the amount payable under:
- (a) a payday loan (i.e. a maximum annual cost rate of 112.15%); or
  - (b) a sale of goods by instalment (i.e. a maximum annual cost rate of 48%).

260 Our experience has been that the cap on costs for payday loans has significantly reduced the cost to consumers of these types of loan. We expect a similar outcome would be the result of any cap on costs for consumer leases.

### **Calculating the cap**

- 261 Cost limits for consumer leases would require there to be rules around the base amount on which the cap is calculated. The National Credit Code defines the 'cash price' of goods or services as:
- (a) the lowest price that a cash purchaser might reasonably be expected to pay for them from the supplier; or
  - (b) the market value of the goods or services, if the goods or services are not available for cash from the supplier or are only available for cash at

the same price as, or a reasonably similar price to, the price that would be payable for them if they were sold with credit provided.

262 This definition is a component of the definition of a sale of goods by instalment contract. In light of the similarities between consumer leases and credit contracts, our view is that this definition should also be used for consumer leases (i.e. as the basis on which a cap on costs is applied).

263 We have observed that lessors often offer consumers additional benefits and services to lessees, such as free delivery and free maintenance and repair of goods. We consider that the cap on costs should also extend to these services. Our view is that provision of these benefits is a business decision for individual lessors. If a lessor decides to charge for these services, we consider that those charges should be included in the cap on costs.

264 In reaching this view, we noted that some benefits offered in relation to maintenance and repair may overlap with the Australian Consumer Law (set out at Sch 2 to the *Competition and Consumer Act 2010*), which provides for a statutory guarantee that supplied items are of acceptable quality.<sup>43</sup> The Australian Consumer Law specifies criteria for assessing whether items are of acceptable quality, including that they are fit for all the purposes for which items of that kind are commonly supplied, and as durable as a reasonable customer would regard as acceptable given the price of the items.

265 Including limits on the maximum costs for consumer leases may reduce the total amounts collected by lessors. However, we consider that the current significant price dispersion in the consumer leasing market may suggest that:

- (a) the current regulatory settings are resulting in poor outcomes, particularly for financially vulnerable consumers; and
- (b) the current fees paid by some consumers may be able to be reduced without affecting the overall viability of lessors.

266 Additionally, we note that it is unlikely that lessors will pay the cash price of the leased item. We understand that some lessors can negotiate to pay lower retail or even wholesale prices for goods based on their volume of purchases. Any discounts below the 'cash price' result in additional revenue for the lessor (in addition to the amount that could be charged to consumers under a cap).

### **Enhancements Act requirements**

267 Given the similarities between consumer leases and payday loans, and the financially vulnerable consumers that these industries focus on, we support the extension of some of the Enhancements Act provisions to consumer leases.

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<sup>43</sup> Australian Consumer Law, s54.

### **Warning statements**

268 We consider that credit licensees that engage in credit activities in relation to consumer leases should be subject to a warning statement requirement similar to the one that applies for payday loans. The warning statement for small amount credit is intended to provide consumers with information about the alternatives to obtaining a loan. We are of the view that the same policy rationale also applies to consumer leases because:

- (a) the alternatives to payday loans and consumer leases are similar (e.g. advances from Centrelink or no-interest loans); and
- (b) payday loans and consumer leases are marketed at similar types of consumers, including vulnerable and disadvantaged persons.

269 We note that the warning statement requirement would need to be tailored to the particular features of consumer leases. For example, the disclosure in the current warning statement about contacting utilities providers would not be appropriate for consumer leases. It may be advantageous for the warning statement to include a hyperlink to the consumer lease calculator on our MoneySmart website.

270 We consider that our recommendations for the payday lending warning statement could also inform the development of a tailored statement for consumer leases: see paragraphs 138–145.

### **Protections for persons receiving Government benefits**

271 Consumers who receive the majority of their income under the Social Security Act may only pay a maximum of 20% of their income in repayments for a small amount loan.

272 We consider that similar protections should also apply to these persons when they enter into a consumer lease.

273 The rationale for the protection in the context of payday loans is that additional protections are justified for a group of consumers who may be financially vulnerable. In our view, this rationale also applies to consumer leases, particularly given our recent findings that Centrelink recipients who enter into a consumer lease:

- (a) consistently pay more than the advertised price for consumer leases;<sup>44</sup> and
- (b) pay more than the maximum amount payable under a payday loan.

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<sup>44</sup> REP 447, paragraphs 55–64.



## Other issues

### Avoidance conduct

274 We consider that any tightening of the rules that apply to consumer leases may create an increased incentive for some lessors to engage in avoidance conduct.

275 For this reason (and in light of our general experience in relation to avoidance), we suggest that the anti-avoidance provision discussed at paragraphs 200–203 also cover arrangements that have the effect of avoiding obligations that apply to consumer leases.

### Additional disclosure requirements

276 In REP 447, we noted that consumers may be entering into consumer leases as a result of behavioural biases—for example, ‘myopia’, where the consumer may be focusing on the amount or affordability of fortnightly or monthly payments, rather than the total cost, to determine the value of the lease. Improved pre-contractual disclosure of the total cost of a lease may assist consumers to make an informed decision about the suitability of the lease.

277 Currently, most lessors only disclose the total cost of a lease in the lease contract. By that stage, the consumer has largely committed to the lease and is unlikely to change their mind based on the price of the product.

278 We consider that existing component pricing rules should be extended to consumer leases. Component pricing rules require the total amount payable for products, such as airline tickets and mobile phone contracts, to be disclosed before the products are purchased.

### Restrictions on early termination fees

279 Our experience has been that lessors charge substantial fees to consumers who seek to terminate a consumer lease. One lessor we reviewed charges a fee equivalent to the present value of all remaining lease payments discounted by the Reserve Bank of Australia’s cash rate.

280 We accept that a lessor may incur costs when a lease is terminated, including costs associated with recovering, refurbishing, storing and re-advertising the items for re-lease. However, we have concerns that these costs do not justify the current levels of early termination fees that we have observed, particularly when the lease is terminated early in the contract when the residual value of the goods remains high.

281 We suggests that the review panel consider:

- (a) a cap on the early termination fee payable under a consumer lease; or
- (b) a formula for determining the early termination fee.

### Sale of add-on products with consumer leases

- 282 Many lessors require consumers to purchase add-on insurance or similar products as a condition of entering into the lease. Examples include damage liability reduction cover or debt waiver products.
- 283 Research into add-on products in other jurisdictions indicates that consumers can be sold products that they do not need or understand.<sup>45</sup>
- 284 While it is difficult to assess the value of these products to a consumer, we understand that the claims ratio is low. One lessor had advised ASIC that only 95 claims were paid in relation to over 77,000 debt waiver products sold during one calendar year.
- 285 We are concerned about the sale of these products at the time the lease is entered into, particularly where purchasing add-on products is a condition of entering into the lease. We have concerns because of:
- (a) the overlap of some products with the statutory guarantees provided by the Australian Consumer Law (such as the guarantee that supplied items are of acceptable quality under s54), with the distinction between the statutory guarantees and any additional benefits not being obvious to consumers;
  - (b) the limited benefits to consumers who already hold other products that may provide similar benefits, such as home contents insurance; and
  - (c) the risk of poor or unfair practices at the point of sale that can have a higher impact on low-income consumers who may be less likely to negotiate the terms of the transaction.<sup>46</sup>
- 286 In light of these issues, our view is that the majority of add-on products are likely to be sold for the lessor's benefit or protection. We suggest that the review panel consider restrictions. These could include:
- (a) rules to make the sale of these products an opt-in process; or
  - (b) including the cost of any mandatory (or opt-out) products within a cap on costs for consumer leases.

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<sup>45</sup> Market Study (MS14/1) [General insurance add-ons: Final report—Confirmed findings of the market study](#), report, FCA, July 2014.

<sup>46</sup> For example, the sale of unemployment insurance to consumers who are never eligible to claim under the policy: see *ASIC v The Cash Store Pty Ltd (in liquidation)* [2014] FCA 926.

## F Other proposals relevant to small amount lending and consumer leases

### Key points

The Senate inquiry and the Financial System Inquiry considered a number of proposals relevant to ASIC's role as consumer credit regulator.

These inquiries have recommended changes to ASIC's regulatory toolkit, including broader and more flexible regulatory tools and a range of penalties that act as a credible deterrent to misconduct.

Our view is that these changes would assist ASIC to regulate the payday lending and consumer leasing industries while minimising the need for new or additional regulations.

### Other responsible lending issues

- 287 Like other credit licensees, payday lenders are subject to the standard responsible lending requirements. This includes an obligation to, on request, provide a consumer with a copy of the assessment of whether the contract or lease is unsuitable.<sup>47</sup>
- 288 The National Credit Act does not prescribe the information that must be included in the written assessment given to a consumer. We have provided guidance on these obligations in RG 209, at RG 209.141–RG 209.146.
- 289 The intent of this provision is to allow consumers to understand the assessment that has been made (including in the context of a dispute). As a result, we expect that written assessments will:
- (a) be concise and easy for consumers to understand;
  - (b) refer to the relevant factual information used to assess the credit contract or consumer lease as 'not unsuitable'; and
  - (c) allow consumers to check the factual basis of the assessment and raise concerns if this is not accurate.
- 290 We have observed inconsistent practices in industry in relation to written assessments given to consumers. We have seen examples of written assessments that do not include all of the information on which the assessment was based. Our view is that not including information of this nature means that the written document may not assist the consumer to understand the assessment the licensee has made.

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<sup>47</sup> National Credit Act, s132 and 155. Similar obligations apply to licensees who provide credit assistance: s120 and 143.

291 We note that this issue could be addressed by increased prescription in the form of written assessments, such as regulations made for the purposes of the relevant sections.

292 Another option may be more detailed guidance in RG 209. However, we consider that many of the practices we observed do not comply with the guidance we have provided to date.

## Recommendations about ASIC from other inquiries

293 During 2013 and 2014, the Senate Economics References Committee undertook an inquiry into the performance of ASIC. The Government also established the Financial System Inquiry, which released its final report in December 2014. The Government responded to this report in October 2015.

294 These inquiries have made a number of proposals for ASIC and the legislation we administer that are relevant to how we regulate the payday lending and consumer leasing sectors.

295 Our initial submission to the Financial System Inquiry advocated improvements to ASIC's toolkit to:

- (a) provide ASIC with more flexible regulatory tools; and
- (b) ensure that there are a range of adequate penalties available for contraventions of ASIC-administered legislation.

### Broader and more flexible tools

296 Our view is that a broader and more flexible regulatory toolkit would enhance our ability to foster effective competition and promote investor and financial consumer protection.<sup>48</sup>

297 ASIC's current regulatory toolkit has a number of limitations, including that:

- (a) we can only take action to rectify consumer detriment after a breach or suspected breach of the law; and
- (b) we can only take enforcement action against conduct that causes consumer detriment on a firm-by-firm basis, even where the problem is industry-wide.

298 While disclosure, such as through credit guides and specific warnings for small amount loans, remains a central tool, in some situations other tools would address the limitations outlined at paragraph 297 and allow for more targeted and effective responses from ASIC.

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<sup>48</sup> ASIC, *Financial System Inquiry: Submission by the Australian Securities and Investments Commission*, submission, April 2014, paragraphs 122–162.

299 One such tool is a ‘product intervention power’, which allows a regulator to  
make temporary rules where there are significant problems with a product or  
market.

300 The Financial System Inquiry recommended that Government amend the law  
to provide ASIC with a product intervention power. This would allow ASIC  
to take a more proactive approach to reducing the risk of significant  
detriment to consumers through a new power that allow for more timely and  
targeted interventions. For example, we could require or impose:

- (a) amendments to marketing and disclosure materials;
- (b) warnings to consumers, and labelling or terminology changes;
- (c) distribution restrictions; and
- (d) product bans.

301 We support a broad and flexible regulatory toolkit, including a product  
intervention power. We anticipate that:

- (a) a product intervention power would only be used in limited  
circumstances where existing regulatory tools were not appropriate; and
- (b) interventions using the new power would be targeted and tailored to the  
risk of significant, widespread consumer detriment (e.g. product bans  
would be extremely rare).

302 The Government intends to review ASIC’s enforcement regime, including  
penalties, in 2017.

### **Penalties for corporate wrongdoing**

303 In March 2014 we published Report 387 *Penalties for corporate wrongdoing*  
(REP 387), which compared criminal and civil penalties under the laws we  
administer with comparable international and domestic regimes.

304 Our research in REP 387 found that non-criminal monetary penalties—  
including administrative penalties and disgorgement—are not as widely  
available and are lower in Australia than in the other jurisdictions surveyed.

305 Our research also found that in the jurisdictions of other Australian  
Government regulators, the maximum civil penalties available are higher  
than those available under ASIC’s legislation. Some other regulators also  
have the ability to seek penalties linked to the value of benefits obtained  
through the wrongdoing.

306 The final report of the Financial System Inquiry recommended that:

- (a) civil and criminal penalties for contravening ASIC legislation should be  
substantially increased to act as a credible deterrent for large firms; and

- (b) we should also be able to seek disgorgement of profits earned as a result of contravening conduct.

307 The Government intends to review ASIC's enforcement regime, including penalties, in 2017.

## ASIC licensing and banning decisions

308 We administer the credit licence regime; in the absence of an exemption, lenders are unable to engage in credit activities without a licence from ASIC.

309 We think that the law should set a presumption that a licence is a privilege to be earned and retained, rather than a right. However, there are gaps in the current Australian financial services (AFS) and credit licensing frameworks that prevent them from operating in this way. In particular, we have limited ability to:

- (a) refuse or remove a licence;
- (b) direct licensees to undertake compliance, remediation and compensation actions;<sup>49</sup> and
- (c) prevent a person from managing a credit business.

310 The Financial System Inquiry recommended that ASIC's AFS and credit licensing regimes be strengthened so that we:

- (a) can consider all relevant factors in determining whether or not a licence should be granted;
- (b) have more capacity to impose conditions requiring licensees to address concerns about serious or systemic non-compliance with licence obligations (including expert reviews); and
- (c) can deal more effectively with poor behaviour and misconduct.

311 The Government has agreed with the Financial System Inquiry's recommendation that ASIC's AFS and credit licensing regimes be strengthened.

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<sup>49</sup> For example, see the FCA's 'own initiative' requirements under s55L of the *Financial Services and Markets Act 2000* (UK).

## Appendix: ASIC's enforcement outcomes in relation to consumer leases

312 We have taken enforcement action against a number of lessors, largely in relation to responsible lending. A summary of matters where we have obtained an enforcement outcome is set out in Table 5.

**Table 5: ASIC enforcement actions and outcomes in relation to consumer leases**

Entity	Date	Details of outcome
Green Light Auto Group Pty Ltd	October 2015	<p>We imposed conditions on the credit licence of Green Light Auto Group Pty Ltd (which trades as Carboodle) after uncovering that their systems and procedures were not sufficient to ensure compliance with the National Credit Act, including the responsible lending obligations.</p> <p>The licence conditions require Carboodle to appoint an independent compliance consultant to review its compliance arrangements. Carboodle is required to provide a copy of the consultant's report to ASIC, as well as addressing any deficiencies identified by its review.</p>
Amazing Rentals Pty Ltd	June 2015	<p>We entered into an enforceable undertaking following an ASIC investigation into concerns about Amazing Rentals' compliance with the credit legislation, including the responsible lending obligations under the National Credit Act. The enforceable undertaking requires:</p> <ul style="list-style-type: none"> <li>• closure of the Darwin store for at least one year;</li> <li>• consumer refunds;</li> <li>• donations to the North Australian Aboriginal Justice Agency and the Top End Women's Legal Service; and</li> <li>• the appointment of an independent external compliance expert to conduct an assessment of, and report to ASIC on, Amazing Rentals' policies and procedures for compliance with its responsible lending and documentation obligations, and make any recommendations about required changes.</li> </ul>
Make It Mine Pty Ltd	May 2015	<p>The Federal Court found that this lessor had breached disclosure and responsible lending obligations under the National Credit Act. The decision followed ASIC launching civil action against the company in November 2014, and Make It Mine voluntarily issuing its own proceedings before the court. A hearing on penalty was heard in September 2015 and a decision is pending.</p>

Entity	Date	Details of outcome
Rent the Roo Pty Ltd	November 2013	<p>We issued an infringement notice and entered into an enforceable undertaking after finding deficiencies in Rent the Roo's operating and compliance practices.</p> <p>The enforceable undertaking required an independent compliance consultant to be appointed to review Rent the Roo's policies and make recommendations to increase its compliance with the National Credit Act. The consultant's recommendations included:</p> <ul style="list-style-type: none"> <li>• verifying third-party income where this is used to assess suitability; and</li> <li>• that Rent the Roo have flexibility in its hardship and dispute resolution procedures to address financial hardship as a result of a change in a consumer's financial circumstances.</li> </ul>
Ray Rentals Pty Ltd	August 2013	<p>An ASIC investigation found that Ray Rentals was providing regulated credit without a credit licence and was promoting this activity on its website. Ray Rentals was found to be largely targeting consumers living in remote Indigenous communities. We banned this unlicensed Victorian-based lessor and its sole director from offering credit for four years.</p>
Mr Rental Port Augusta	October 2013	<p>Our surveillance resulted in consumers being released from their contracts because we found that consumers were asked to sign several documents together with a lease agreement, none of which were explained to them and included a 'customer declaration' indicating they understood all the paperwork and that they were not intoxicated.</p>
Zaam Rentals Pty Ltd and franchisees	February 2013 and August 2013	<p>We banned the director and former director of Zaam Rentals from engaging in credit activities for six years and four years, respectively. We also cancelled Zaam Rentals' credit licence for failing to comply with the responsible lending obligations.</p> <p>Zaam Rentals was found to be targeting vulnerable consumers in remote Indigenous communities in Mildura, Victoria, and surrounding areas in New South Wales.</p> <p>We subsequently also excluded the directors of Zaam Rentals' franchisees from the industry by requiring them to enter into written undertakings with ASIC stating they will not engage in credit activities for three-and-a-half years. This followed an ASIC surveillance into the franchisees' responsible lending practices.</p>



Entity	Date	Details of outcome
Mobile Rentals Pty Ltd and franchisees	February 2013 and September 2013	<p>We banned the director of Mobile Rentals from engaging in credit activities for five years and cancelled its credit licence for failing to comply with the responsible lending obligations.</p> <p>Mobile Rentals was found to be targeting vulnerable consumers in Victoria.</p> <p>We subsequently also took action against Mobile Rentals' franchisees for failure to meet their responsible lending obligations. We imposed licence conditions against one franchisee, which operated under its own credit licence. This required the licensee to appoint an external independent expert to report to ASIC on whether the business was complying with its obligations in the future.</p> <p>The remaining franchisees entered into written undertakings with ASIC stating they would not engage in credit activities for three-and-a-half years. Consumers were also released from their obligations under the contracts and were given ownership of their goods.</p>
Mr Rental Australia Pty Ltd	February 2013	<p>We entered into an enforceable undertaking with Mr Rental, under which the lessor was required to refund consumers and amend the standard rental contract used by the 52 franchisees operating under the Mr Rental banner.</p> <p>This followed an ASIC investigation into Mr Rental's standard rental contract, which raised concerns that a term allowing Mr Rental to charge a 'calculation period adjustment' (i.e. an additional fee charged to consumers who terminated their rental agreements early) was an unfair contract term under the <i>Australian Securities and Investments Commission Act 2001</i> and the Australian Consumer Law.</p>

## Key terms

Term	Meaning in this document
14-313MR (for example)	An ASIC media release (in this example numbered 14-313)
ADI	Authorised deposit-taking institution
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services  Note: This is a definition contained in s761A.
<i>ASIC v Teleloans</i>	<i>ASIC v Teleloans Pty Ltd</i> [2015] FCA 648
Australian Consumer Law	Sch 2 to the <i>Competition and Consumer Act 2010</i>
Centrepay	Centrepay is a payment system operated by the Department of Human Services, which allows Centrelink consumers to make payments for leases to Centrepay registered providers, through regular deductions from their benefit payment
CFPB	Consumer Financial Protection Bureau (US)
consumer lease	A consumer lease to which the National Credit Code applies  Note: See s169–171 of the National Credit Code.
[CO 13/818] (for example)	An ASIC class order (in this example numbered 13/818)
CP 198 (for example)	An ASIC consultation paper (in this example numbered 198)
credit licence	An Australian credit licence under s35 of the National Credit Act that authorises a licensee to engage in particular credit activities
credit licensee	A person who holds a credit licence under s35 of the National Credit Act
EDR scheme	External dispute resolution scheme
Enhancements Act	<i>Consumer Credit Legislation Amendment (Enhancements) Act 2012</i>
FAF companies	Fast Access Finance Pty Ltd, Fast Access Finance (Beenleigh) Pty Ltd and Fast Access Finance (Burleigh Heads) Pty Ltd

Term	Meaning in this document
FCA	Financial Conduct Authority (UK)
Financial System Inquiry	2014 Financial System Inquiry
lessor	A lessor under a consumer lease
MoneySmart	ASIC's financial consumer information website at <a href="http://www.moneysmart.gov.au">www.moneysmart.gov.au</a>
National Credit Act	<i>National Consumer Credit Protection Act 2009</i>
National Credit Code	National Credit Code at Sch 1 to the National Credit Act
National Credit Regulations	National Consumer Credit Protection Regulations 2010
payday lender	A credit provider that provides small amount loans
payday loan	A small amount credit contract
Privacy Act	<i>Privacy Act 1988</i>
protected earnings amount	The amount of money a lender cannot access for the purposes of loan repayments, according to reg 28S(3) of the National Credit Regulations
REP 426 (for example)	An ASIC report (in this example numbered 426)
Revised Explanatory Memorandum	Revised Explanatory Memorandum to the Consumer Credit Legislation Amendment (Enhancements) Bill 2012
RG 209 (for example)	An ASIC regulatory guide (in this example numbered 209)
s132 (for example)	A section of the National Credit Act (in this example numbered 132), unless otherwise specified
sale of goods by instalment	A credit contract of the kind described in s9 of the National Credit Code
Senate inquiry	Senate Economics References Committee's inquiry into the performance of the Australian Securities and Investments Commission (ASIC)
small amount credit contract	Has the meaning given in Sch 3 to the <i>Consumer Credit Legislation Amendment (Enhancements) Act 2012</i>
small amount loan	A small amount credit contract
Social Security Act	<i>Social Security Act 1991</i>

<b>Term</b>	<b>Meaning in this document</b>
TOR	Terms of reference for the review of the small amount credit contract laws
UCCC	Uniform Consumer Credit Code
warning statement	Statement required by Pt 3.5 of the National Credit Regulations