consumer action law centre

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By email: consumercredit@treasury.gov.au

SACC Review Secretariat
Financial System and Services Division
Markets Group
The Treasury
Langton Crescent
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Dear Panel Members

Review of the small amount credit contract laws

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the review of the small amount credit contract laws and comparable consumer leases (**the review**).

We welcome the Federal Government's commencement of review, and the broad consultation that is underway. In our view, it is important that the review panel speak to real Australians who have used these products, and community organisations who assist them, in order to understand their circumstances and the harm these products can cause.

As one researcher described it, 'the payday lender is the epitome of a 'poverty industry' player who tailors products or services to a low-income individual for a marked up price.'[1] As the payday lending industry continues to boom in Australia, we ask the panel to question whether this form of high cost short term lending is a consumer product which we want to see become the 'norm' in our society. Unfortunately, this is the path we are currently walking down.

A brief summary of our responses to each question regarding small amount credit contracts (better known as 'payday loans') is set out below:

- **Question 1: Competition objectives**
    - We do not agree that high-cost short-term lending is a necessary or useful part of the consumer credit landscape. Nor do we agree that the provision of this kind of credit is a useful response for an Australian who already has insufficient income to meet basic needs, or is struggling with other debts.

[1] Marcus Banks et al, ''In a perfect world it would be great if they didn't exist': How Australians experience payday loans', International Journal of Social Welfare, 2014, p 37.

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- **Question 2: Complexity**
    - In our view, the easiest way to reduce complexity and improve consumer protection is to apply a comprehensive 48% cap on costs to all forms of consumer credit. A 48% cap would mean that many of the additional consumer protections under the current regulatory regime would probably be unnecessary.
    - A key goal of the 48% cap is to make very short-term loans unviable, unless they were low cost. Axiomatically, all form of high cost credit (above the cap) would be prohibited. It should not be cause for concern that consumers struggling to make ends meet will not have access to high cost credit that inevitably worsens their financial situation.
- **Question 3: Sanctions**
    - We explain the difficulties facing the Australian Securities and Investments Commission (**ASIC**) in enforcing the current regulations, particularly given the vulnerability of witnesses who use these loans.
    - We recommend a number of enhancements that could be made to the sanctions regime, including increasing ASIC funding and strengthening the licensing regime.
    - We suggest that requirements to provide certain information to the regulator, for example, the number of loans advanced, the sizes of loan books, and the level of defaults, could enhance compliance monitoring.
- **Question 4: Obligation to obtain and consider bank account statements**
    - We outline our experience that lenders generally comply with the obligation to obtain bank account statements, but do not sufficiently use the information on those statements to assist with responsible lending assessments.
    - We explain that a review of bank account statements will not solely satisfy a lender's obligation to obtain and verify all information relevant to making a suitability assessment. We also raise concerns about reports of lenders logging into bank accounts of borrower in store, and the use of account scraping technology.
    - However, we are reluctant to recommend that lenders no longer obtain bank statements without more robust protections for consumers in place.
- **Question 5: Restrictions on repeat borrowing**
    - We present evidence showing that the 'presumptions' of unsuitability have failed to stop harmful cycles of repeat borrowing. We argue that bright-line caps on the maximum number of loans per year are likely to be more successful at limiting the harm of repeat borrowing.
- **Question 6: Ban on short term credit contracts**
    - Based on our casework, it appears that loans of less than 16 days are generally no longer being offered to consumers.
    - There is no credible evidence that tighter regulation of the payday lending sector will push consumers towards illegal 'loan sharks', as often argued by industry.
- **Question 7: Warnings**
    - We query the usefulness of disclosure in this sector, given that consumers often take out payday loans when they are in financial stress and feel they have no other options. Disclosure will rarely be effective in this situation.
    - However, given the emerging trend of borrowers using payday loans for 'convenience', we believe warnings including the comparison rate of payday loans may be more effective for this group of consumers.

- **Question 8: Cap on costs**
    - The current cap on costs has led to a boom in the payday lending sector at the expense of consumers. We reiterate our call for a 48 % cap on costs charged by all forms of consumer credit, and compare this with cost caps implemented in other jurisdictions.
    - Any costs imposed for varying a credit contract during the term of agreement should be included in the cap.
- **Question 9: Protection for Centrelink customers**
    - We argue that the protected earnings amount should align with the Centrelink Code of Operations. Under the Code, if a Centrelink recipient overdraws their bank account, and subsequently receives a welfare payment, the bank can only use 10% of the recipient's fortnightly income payment toward repaying the overdrawn amount.
- **Question 10: National database**
    - We discuss the difficult policy question of whether a payday lending database or comprehensive credit reporting (**CCR**) regime is the best option to improve compliance with responsible lending obligations. On balance, we support the establishment of a payday lending database provided privacy concerns are appropriately addressed.
- **Question 11: Additional provision for SACCs**
    - We recommend additional provisions relating to payday lending marketing, single repayments, front-loading, blackmail securities and pawn broking. We also suggest further limitations on costs charged for default or enforcement.
- **Question 12: Anti-avoidance provision**
    - We recommend introducing a general anti avoidance provision, and provide advice from Brind Zichy-Woinarsky QC which sets out why such a provision could be introduced without further referrals of power from the states.
- **Question 13: Documentation of suitability assessments**
    - We draw the panel's attention to the systemic non-compliance issues in this sector in relation to record keeping, and emphasise the focus of record keeping should be on demonstrating actual compliance.

A brief summary of our responses to each question regarding consumer leases is set out below:

- **Question 14: Comparable consumer leases**
    - In our view, there is little to be gained from defining 'comparable consumer leases', which would add unnecessary complexity to the regulatory regime and encourage regulatory arbitrage.
    - We recommend that the National Credit Code (**the Code**) no longer distinguish between consumer leases and credit contracts based on whether they provide a right or obligation to purchase. Rather, consumer credit should be regulated based on its economic substance rather than form of contract.
- **Question 15: Applying SACC provisions to comparable consumer leases**
    - We recommend additional disclosure, including the cash price of the goods, the total price of the goods, the cost of credit as a comparative interest rate and the cost of additional services (such as delivery and repair).

    - These rules should apply not only to 'comparable' consumer leases (which we assume to be leases for appliances etc. up to the value of $2,000) but for leases of items greater than this amount (commonly vehicles).
- **Question 16: Cap on costs for consumer leases**
    - We recommend applying the 48% cap on costs to consumer leases. In calculating the cash price of the goods, the definition used for sales by instalment under the Code should be used.

Our comments are detailed more fully below.

About Consumer Action

Consumer Action Law Centre is an independent, not-for profit consumer organisation based in Melbourne. We work to advance fairness in consumer markets, particularly for disadvantaged and vulnerable consumers, through financial counselling, legal advice and representation, and policy work and campaigns. Delivering assistance services to Victorian consumers, we have a national reach through our deep expertise in consumer law and policy and direct knowledge of the consumer experience of modern markets.

General remarks

We are concerned by the premise in the consultation paper that there is a need to ensure the payday lending industry remains viable. This is a product which is profitable precisely because it creates a cycle of dependency amongst those who can least afford it. This is established by independent research and confirmed by the industry itself.[2] We do not believe that payday lending is a useful or necessary part of the consumer credit market. Australians and the Australian consumer credit market functioned before payday loans were introduced in Australia in 1998.[3] Numerous developed economies overseas impose interest rate caps which effectively limit payday lending without harm associated with reduced access to credit.[4]

The review should not be afraid to recommend reducing the availability of this product – it is inherently harmful and should be regulated as such. Product safety has long been a key consumer protection measure when it comes to consumer goods. The recent Financial System Inquiry recommended the introduction of a product safety-type regime for financial services – recommendation 21 proposed a new obligation on those that manufacture financial products with respect to design and distribution.[5] There is no reason why a product safety approach should not be taken with respect to high-risk payday lending.

The review also need not be concerned about filling a 'gap' in the market with other products, which assumes that demand is driven by an inherent 'need' for this product rather than the mere existence of the product itself. We have discussed these issues further under Question 1 below.

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[2] Marcus Banks et al, 'Caught Short: Exploring the role of small, short-term loans in the lives of Australians', August 2012, available at: http://www.uq.edu.au/swahs/news/CaughtShortFinalReport.pdf; Sandra McCullough and Chris Parks, 'Risks in payday lending and goods rental', CreditSuisse, 2015; Money3, 'Annual Report 2014', 2014, p 1, available at: https://web-dev.money3.com.au/reports-annoucements.html.
[3] Banks, above n. 2, p 1.
[4] Zac Gillam and the Consumer Action Law Centre, 'Payday loans: Helping hand or quicksand?', September 2010, p 185, available at: http://consumeraction.org.au/wp-content/uploads/2012/05/PayDayLendingReport-FINAL.pdf.
[5] Financial System Inquiry, 'Final Report', 7 December 2014, available at: http://fsi.gov.au/publications/final-report/.

The central problem with payday loans is that, where used other than as a one-off, they worsen a borrower's financial situation instead of improving it. Although these loans are marketed as a one-off solution to temporary problems, evidence indicates that repeat borrowing is the norm.

Payday loans are harmful because of a combination of five key factors:

1. They are extremely expensive;
2. They are predominantly issued to Australians on low incomes of those in financial stress;;
3. They are predominantly used to pay for basic recurrent expenses;
4. They prioritise repayment of the debt over other expenses by using direct debits; and
5. The growth in online lending is providing quick and easy access.

Below we also make general remarks about the growth of the payday lending sector since the introduction of the payday lending laws in 2013, and community attitudes towards payday loans.

The industry is booming

The 2013 regulations haven't seen the death of the industry. In fact, researchers estimate the market to be valued at more than $1 billion per annum. This is predicted to grow to $2 billion per annum by 2018.[6] Large operators have reported 'record breaking' lending performance, and overseas lenders are looking to move into the Australian market. Large payday lender, Money3, announced a profit before tax of over $10 million for the half year to 31 December 2014, a 126% increase on the prior year.[7]

Despite suggestions from the payday lending industry that the 2013 reforms had led to many payday lenders leaving the market, ASIC data suggests otherwise. While there may have been some initial contraction in the market with ASIC data showing a reduction in licence numbers for lenders operating in this sector (from 1,208 in December 2013 to 1,036 in December 2014), it also shows that new entrants to the payday lending industry continue to apply for credit licences in similar numbers over the last two years.[8]

Growth in online lending

Research by Digital Finance Analytics (**DFA**) has found that 43.6% of payday borrowers surveyed in 2015 had found out about payday lending online. By 2015, more than 68 % of households with payday loans used the internet to access their loans, making online lending now the primary access channel for payday lending. In comparison, only 3.1% of payday borrowers surveyed in 2010 used the internet to access payday lending.[9] DFA estimates that by 2018, more than 80% of

[6] Digital Finance Analytics, 'Payday Lending's Online Revolution', 1 June 2015, available at: http://www.digitalfinanceanalytics.com/blog/payday-lendings-online-revolution. These figures take into account broader factors other than just the value of loans written per year.
[7] Money 3, 'Media Release December 2014 Half Year Results', 2015, available at: http://www.asx.com.au/asxpdf/20150226/pdf/42wx5lyft7styg.pdf.
[8] Australian Securities and Investments Commission, 'REP 426: Payday lenders and the new small amount lending provisions', 17 March 2015, para 22, available at http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-426-payday-lenders-and-the-new-small-amount-lending-provisions/.
[9] Digital Finance Analytics and Centre for Commercial Law and Regulatory Studies at Monash University, 'The Stressed Finance Landscape Data Analysis', October 2015, section 2.1

loans will be taken out via online apps and web sites. A copy of DFA's research is attached at **Appendix 1.**[10]

Research by RMIT University in May 2014 found that payday loans were directly available through 65 websites.[11] Traditional shop front lenders are also seeing growth in online business. For example, in February 2015 Cash Converters reported that the value of online loans written increased to $31.3 million in the half year to December 2014, up 65.2% on the previous corresponding period.[12]

Financially stressed vs financially distressed borrowers

In recent years, there has been a shift in the mix of household segments that use payday loans. 'Financially stressed' households emerge as a growing payday lending sector, making up 41 % of payday borrowers. This is more than a ten-fold increase since 2010. Over the same period, the number of 'financially distressed' households using payday loans fell by 5 %, but still make up 59% of all payday borrowers.[13] DFA defines financialy stressed households as those that are generally 'coping' with their current financial situation, for example by short term borrowing from family, friends, or juggling multiple credit cards. This group could perhaps be best described as the 'working poor'. Distressed households are a subset of financially stressed households, and are defined as those not meeting their financial commitments as they fall due, exhibiting chronic repeat behaviour, and having limited financial resources.

These changing demographics reflect our concerns that these loans are now being marketed to a wider audience, often irresponsibly suggesting that payday loans can be used to pay everyday expenses like gas bills, rounds of drinks and telecommunications bills.[14] The ease of access through online channels is now making these loans easier than ever to take out, and arguably reduces the 'shame factor' of walking into a high street lender. However, while clever marketing may try to suggest otherwise, the online payday loan and the high street payday lender are still charging the same excessive costs.

Irresponsible lending is systemic

In many of our cases, clients are provided loans they simply cannot afford to pay. ASIC's report supports this conclusion, with the report finding that lenders are still failing to comply with basic record keeping and information-gathering requirements, and are structuring credit contracts to avoid regulation.[15] The report also demonstrates that the presumptions of unsuitability introduced in 2013 have not affected any real behavioural change in the industry.

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[10] The DFA survey is based on consumer responses to a telephone survey, and is limited in so far as those answers are not verified. Further consumers may misinterpret some questions. However, given its longitudinal nature, we believe the overall trends are reliable. Further, in our experience, consumers are more likely to understate their use of pay day lending rather than overstate it (through embarrassment or an element of self-delusion about their level of reliance) making it likely the results are quite conservative.
[11] Banks and Ali, 'Into the Mainstream: The Australian Payday Loans Industry on the Move', the Finsia Journal of Applied Finance, 2015.
[12] Cash Converters, 'Cash Converters Half-Year Result', 2015, available at: https://www.cashconverters.com/Investors/AsxAnnouncements
[13] Digital Finance Analytics, above n. 9.
[14] Clare Rawlinson, 'Payday lender Nimble Money under fire for ads offering help to people struggling to pay utility bills', 12 January 2015, available at: http://www.abc.net.au/news/2015-01-11/payday-lender-under-fire-for-utility-bill-assistance-ads/6011350.
[15] ASIC, above n. 8.

Consumers who are already struggling to make ends meet simply cannot afford to make repayments, and can become caught in a harmful cycle of repeat borrowing. ASIC's payday lending report found that 54.2% of the 288 files it had reviewed indicated that the payday lender had entered a loan with a consumer who had entered into two or more payday loans in the previous 90 days.[16]

Competition is failing to reduce costs

Payday loans continue to be excessively expensive, with competition between large lenders failing to reduce fees and charges. A number of payday lenders, including Nimble, Cash Converters and Payday 247, are charging the maximum amount permitted by legislation, indicating that price competition does not work in this market.[17] These findings are consistent with findings of the Competition and Markets Authority (**CMA**) in the United Kingdom, which found that customer demand responded weakly to prices and that competition between payday lenders on prices was largely ineffective.[18]

Payday loans typically attract comparison interest rates between 407.6% and 112.1%.[19] For a borrower already struggling to make ends meet, repayment of these excessive fees and charges can leave the borrower with another shortfall and encourage them to return to the lender. This is a financial product that is designed to create a cycle of dependency.

Australian attitudes towards payday loans

Recent polling data shows the vast majority of Australians are opposed to the lending practices of payday lenders.[20] According to the poll, less than 1 in 5 (17%) Australians view the payday lending industry favourably. Only 1 in 10 (10%) of Australians think that the interest and fees charged by payday lenders are reasonable, and almost 4 in 5 (77%) of Australians would support the Government to restrict the amount of interest and fees that payday lenders can change customers.

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[16] ASIC, above n. 8.
[17] See Nimble https://nimble.com.au/; Payday 247 https://www.payday247.com.au/; Cash Converters https://cashloans.cashconverters.com.au/.
[18] Competition and Markets Authority, 'Payday lending market investigation', 24 February 2015, para 35-37, available at: https://assets.digital.cabinet-office.gov.uk/media/54ebb03bed915d0cf7000014/Payday_investigation_Final_report.pdf.
[19] Comparison rate calculations completed using RiCalc software assuming maximum permitted fees and charges, and fortnightly repayments. 407.6% comparison rate calculated using a 30 day loan of $200 with total repayments of $248. 112.1% comparison rate calculated using a 12 month loan of $1,000 with total repayments of $1,680.
[20] The study was conducted online by Lonergan Research among 1,030 Australians aged 18 years and over. Surveys were distributed throughout Australia including both capital city and non-capital city areas between Tuesday, 24th March and Friday 27th March 2015.

Question 1: Competing objectives

How is the need to protect consumers balanced with the need to ensure that the industry remains viable and consumers can still access credit?

We reject the framing of the payday lending problem in the consultation paper, which states that there is a need to ensure that the payday lending industry remain viable and that consumers can still access credit.

Viability of the industry

As set out above, we do not agree that high-cost short-term lending is a necessary or useful part of the consumer credit landscape. We also do not believe that the provision of this kind of credit is a useful response for a consumer who already has insufficient income to meet basic needs or has serious debt problems. An approach which assumes that the payday lending problem is a solely a problem of financial exclusion, and that it is important that consumers can access credit of any type regardless of the cost or long term harm caused, will lead to inaccurate problem identification and inappropriate policy responses.

Drivers of payday lending

Often during the policy debate on payday loans there is an assumption that there is a 'gap' in the market that is being filled by payday loans, which implies that there is a market response to the payday lending problem. It is important to recall that payday loans only first appeared in Australia in 1998, and there was no widespread reports of problems caused by lack of access to short-term consumer credit prior to that time. Improving access to 'safe' alternatives will not replace the market currently exploited by payday loans, as the purpose of programs like the No Interest Loans Scheme (**NILS**) and StepUp is to create a net improvement in welfare (most commonly, the loan involves purchasing a basic asset base of household items). This is a completely different purpose to the typical payday loan, which is used to cover basic ongoing expenses like groceries or utilities bills.

The demand for payday loans is driven by the existence of payday lenders and desperate Australians who feel they have no other options other than payday loan, not the lack of access to 'safer' alternatives. The existence of payday lenders is in turn facilitated by a regulatory regime which validates and allows this particular type of irresponsible lending to be both available and profitable.

Financial exclusion and access to credit

It is important to note that many payday borrowers are not necessarily financially excluded, at least according to a narrow definition of that term.[21] DFA research indicated that 68.9% of financially stressed households that took out payday loans had credit cards, and 17.6% had a mortgage on their property. A large proportion of 81.5% had other loans.[22] Many of our clients have a range of debt problems of which payday loans are often one. It is largely insufficient income, not financial

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[21] Centre for Social Impact for National Australia Bank, 'Measuring Financial Exclusion in Australia', 2014, p 5, available at: http://cr.nab.com.au/docs/measuring_financial_exclusion_in_australia_2014_final.pdf
[22] Digital Finance Analytics, above n. 9.

exclusion, that is the driver for problematic payday lending. The most common purpose for taking out a payday loan is to pay for basic ongoing expenses. DFA research indicated that the majority of payday borrowers (35.6%) took out a payday loan to cover household expenses, such as food, clothing, medical bills and children's needs. A further 16.7% took out payday loans to pay for utility or communication bills.[23]

A person who, on an ongoing basis, is unable to afford their groceries, clothing or medical bills cannot be described as a person who needs credit. They need either an increased income or support services that can help them to get their finances under control. Provision of credit may provide short-term relief, but will ultimately compound the borrower's financial problems because it adds more expenses (loan repayments) without increasing income or wealth. Most other lenders (including NILS) refuse to provide loans to fund recurrent household expenditure like bills, simply because it would be irresponsible. It shouldn't be cause for concern that there is unmet demand for the kind of credit offered by payday lenders. Instead, governments should be increasing access to support services that actually improve the financial wellbeing of struggling Australians, and consider solutions to the underlying cause of much of the demand for payday loans: insufficient income.

Question 2: Complexity

Could the current regulatory regime be simplified in a way that provides consumers with the same, or a higher level of, protection while reducing the regulatory burden on industry?

The current regulatory regime could easily be simplified in a way that provides consumers with a higher level of protection while reducing the regulatory burden on industry: by implementing a 48% annual cost rate cap. This cap currently applies to credit over $5,000, and would be the most effective solution to the problems caused by payday lending. It would likely render many of the additional and complex consumer protections under the current regime unnecessary.

A key goal of the 48% cap is to make very short term loans unviable. Credit provided at interest rates of above 48% does nothing to improve the financial situation of borrowers, only the bottom lines of lenders. These loans are used to cover day-to-day essentials, and trap desperate borrowers in cycles of debt without improving their net welfare. The Government sets the boundaries within which private enterprise can operate, having regard to the harm that private enterprise, if left unchecked, can cause consumers. ASIC's recent report uncovering the exorbitant charges imposed by consumer lease providers, which are not subject to a cost cap, provide an example of harm where these boundaries are not properly set.[24] Given the harm that payday loans are causing Australia's most vulnerable consumers, it is not unreasonable to expect the Government to legislate accordingly by introducing a 48% cost cap.

Academics have noted that the complexity of the current regime potentially has three effects associated with it:

- greater complexity increases the risk of avoidance by some sections of the industry (our comments in relation to anti-avoidance measures are set out under Question 12);

[23] Digital Finance Analytics, above n. 9.
[24] Australian Securities and Investments Commission, 'REP 447: Cost of consumer leases for household goods', September 2015, available at http://download.asic.gov.au/media/3350956/rep-447-published-11-september-2015.pdf.

- it increases the costs of providing the loans, a cost that will presumably be passed on to borrowers; and
- it present challenges for enforcement by ASIC.[25]

As set out above, competition does not work in this market and has failed to reduce costs for consumers. In fact, the current regulatory regime gives payday lenders an unfair competitive advantage over other lenders. Other lenders that provide credit above $5,000[26] are required to abide by the 48% cost cap, but payday lenders are able to charge comparative interest rates up to 10 times this figure. Fairness and equity in the marketplace should be a key consideration for the panel.

Question 3: Sanctions

Is the current sanctions regime working?

We commend ASIC's recent enforcement work in the payday lending sector, which has seen the regulator achieve some significant enforcement outcomes. However, we note that we see little response from the broader payday lending market when lenders are successfully prosecuted for breaching payday lending laws. For example, *The Cash Store* decision, which was the first case under the new responsible lending laws and resulted in penalties of nearly $19 million,[27] does not appear to have had any discernible impact on the lending practices of payday lenders we regularly deal with.

There continues to be significant non-compliance with the 2013 laws, as demonstrated by ASIC's enforcement work, our casework and ASIC's payday lending report. In addition to *The Cash Store* case, ASIC has recently commenced proceedings against seven companies where it identified systemic non-compliance with the law.[28] The ASIC payday lending report also identified problematic practices where some lenders set loan terms that did not meet the requirements and objectives of borrowers, failed to include sufficiently prominent warning statements, and did not have sufficient records to rebut presumptions of unsuitability.[29]

The 2013 regulations introduced 'presumptions' of unsuitability, whereby a loan is deemed unsuitable if the consumer has had two or more payday loans in the preceding 90 day period, or is in default under another payday loan. These presumptions have been particularly difficult for ASIC to enforce, as it is difficult for lenders to obtain necessary information to determine whether a presumption applies. This makes it difficult for ASIC to prove critical elements of criminal offences such as knowledge and intent.

While there is an obligation to review the previous three months' bank statements, such a review might not necessarily help a lender obtain the relevant information because, for example:

- borrowers use multiple bank accounts;

[25] Ali et al, 'The politics of payday lending regulation in Australia', Monash University Law Review, 2013, p 39, available at: https://www.law.unimelb.edu.au/files/dmfile/201421.pdf.
[26] Excluding consumer lease providers, which are not subject to any cost caps.
[27] See ASIC's media release for more information - http://asic.gov.au/about-asic/media-centre/asic-responds/asic-response-significance-of-cash-store-decision-for-credit-industry/.
[28] ASIC, above n. 8.
[29] ASIC, above n. 8.

- repayments made through employer authorities won't be identified on bank statement;
- borrowers may use their partner's bank account;
- borrowers may obtain multiple loans in a short period of time such that repayments are not yet disclosed on bank statements; or
- bank statements can be irregular (and borrower may have to pay a fee to obtain it from their bank teller).

ASIC may face further barriers in successfully bringing enforcement action in respect of a presumption regarding responsible lending, for example:

- A consumer seeking a third loan in three months for everyday living expenses is likely to be somewhere between highly motivated and desperate to obtain the loan. This increases the likelihood they will say what they need to get the loan (truthful or not) and decreases the likelihood they will complain.
- Repeat borrowing is profitable so lenders are likely to be motivated to engage in a range of behaviour from 'tick-a-box' compliance to avoidance. ASIC's Report 426 'Payday lenders and the new small amount lending provisions' (**ASIC's payday lending report**) confirms this behaviour.
- Information about the relevant practices will need to reach the regulator, and will need to do so in a timely way.
- The regulator will generally need enough evidence to establish that behaviour is more than 'one-off' or isolated or attributable to a 'rogue' staff member. This will require similar evidence from multiple consumers.
- Where consumers' evidence can be attacked (for example, because they have been less than truthful in their loan application), additional and more substantial evidence will be needed.
- At least part of a case is likely to rely on evidence of what was said at the time of lending. This will often involve two conflicting versions of events—the consumer's and the trader's. This makes litigation riskier.
- Consumers' motivation and ability to participate in an enforcement action is likely to be impacted by some or all of:
    - shame
    - embarrassment
    - guilt
    - vulnerability
    - the stability of personal circumstances
    - the potential for adverse allegations to be made against them (e.g. fraud or dishonesty)
    - the potential for adverse findings to be made about them
    - lack of time
    - the lengthy period such actions take from investigation to hearing (commonly several years)
    - the fact that consumer redress may be a secondary consideration in the action - or in some cases not a feature at all
    - other priorities (e.g. work, family etc).

Some or all of these barriers may apply to each enforcement action a regulator wishes to take that involves consumer evidence. It will not be easy for a regulator to be able to effect systemic change across an industry in these circumstances.

Are there any enhancements that could be made to the sanctions regime to make it more effective?

In our view, there could be significant enhancements made to the regulatory system overall which would make the sanctions regime more effective. Improvements to the sanctions legislation will not have any significant impact unless the regulator is appropriately resourced, able to influence the market and able to overcome evidentiary burdens.

ASIC funding needs to be at a level that enables it to be a proactive regulator that responds promptly to evidence of misconduct. Currently, ASIC does not appear to be receiving adequate funding to enable it to carry out its consumer protection mandate. Additional funding is required to enable ASIC to enhance its enforcement activities and financial literacy and outreach work, and to take on cases that test the law and challenge large players in the market. ASIC has recently faced significant funding cuts, which ASIC Chairman Greg Medcraft has acknowledged have reduced its capacity to undertake proactive surveillance.[30] It is imperative that ASIC be provided with a level of funding that enables it to exercise its enforcement powers effectively to protect consumers and enhance confidence in the market. ASIC must also be able to offer remuneration comparable to the private sector in order to attract and retain experienced staff.[31]

In allocating resources to ASIC, it must be recognised that complaints from consumers are unlikely to brought forward and, if they are, it is unlikely these consumers will be willing to testify. ASIC requires funding for proactive surveillance and enforcement action, which reduces reliance on consumer complaints being made.

We also suggest replacing the presumptions of unsuitability with bright line rules, which will be easier for lenders to comply with and easier for ASIC to enforce. The current rebuttable presumptions lead to grey areas, and make enforcement work inherently riskier for ASIC.

We note that the consultation paper did not recognise the important role of administrative enforcement action in the sanctions regime.[32] These important powers enable ASIC to cancel, suspend and amend credit licences, and ban problem players from the industry. The standard of proof is the 'Briginshaw standard', which is lower than the criminal burden of proof, and enables ASIC to take significant enforcement action without the burden of taking a matter to court. We encourage ASIC to continue its work in this area.

ASIC's licensing regime is a critical 'gatekeeper', which has a very significant role to play in addressing the payday lending problem. In our view, it is critical that ASIC strengthens its licensing regime to ensure that only ethical and compliant players are able to enter the market. Section 37 of the *National Consumer Credit Protection Act 2009* (**NCCP Act**) provides that ASIC must grant

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[30] Georgia Wilkins, 'You're on your own: Watchdog ASIC's warning after budget cuts', Sydney Morning Herald, 4 June 2014, available at: http://www.smh.com.au/business/youre-on-your-own-watchdog-asics-warning-after-budget-cuts-20140604-39i4s.html.

[31] For further information, see our response to the Financial System Inquiry Final Report: http://consumeraction.org.au/submission-financial-system-inquiry-final-report/.

[32] For example, see Part 2-4 of the *National Consumer Credit Protection Act 2009* (Cth).

an application for a credit licence if it has 'no reason to believe that the applicant is likely to contravene the obligations that will apply under section 47 if the licence is granted'. In our view, as part of the licence application assessment process, ASIC might more widely use section 47(a) in particular, which requires licensees to 'do all things necessary to ensure that the credit activities authorised by the licence are engaged in efficiently, honestly and fairly'. These are broad powers and we urge ASIC to use them more often to keep problem players out of Australia's consumer credit market, particularly given the interest of overseas lenders in Australia's payday lending market.

We also reiterate our support for providing ASIC with product intervention and rule-making powers, similar to the Consumer Finance Protection Bureau (**CFPB**) in the United States which recently released payday lending rules.[33] This power recognises the limited function of disclosure as a consumer protection mechanism. The power also responds to lessons from studies into consumer behaviour, recognising that consumers commonly exhibit predictable behaviours that do not accord with rational assumptions. This power would enable ASIC to be more responsive to market conditions and to take a more proactive approach to reducing the risk of significant detriment to consumers. Please see our submission to the Financial System Inquiry Final Report for further information.[34]

Question 4: Obligation to obtain and consider bank account statements

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

Our casework experience suggests that most lenders obtain three months' bank statements as part of loan application processes. However, lenders do not effectively use the information to determine whether advancing a loan is responsible. In a recent case which has been taken to the Federal Circuit Court, our clients alleges that Cash Converters failed in its obligation to lend responsibly by repeatedly offering her payday loans over the course of six years. The case alleges that the lender only assessed income and ignored significant warning signs which should have been apparent from considering the bank account statement information, including gambling issues.[35] In our view, there must be a stronger obligation to record information about a decision that a loan is suitable, including demonstrating consideration of the information on bank account statements.

However, even if a lender does fully consider information on a loan applicant's previous three month's bank statements, such a review might not necessarily help a lender obtain and verify all information relevant to making a suitability assessment. As set out above, there are various circumstances which will mean that additional information would be required.

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[33] Dimity Kingsford Smith and Marina Nehme, 'Product Intervention Powers: a Legal, Comparative and Policy Analysis', University of New South Wales, April 2015, available at: http://clmr.unsw.edu.au/sites/default/files/product_intervention_powers_final_2April2015_Kingsford_Smith_and_Nehme.pdf; Consumer Finance Protection Bureau, 'CFPB considers proposal to end payday debt traps' 26 March 2015, available at: http://www.consumerfinance.gov/newsroom/cfpb-considers-proposal-to-end-payday-debt-traps/.

[34] Consumer Action Law Centre, above n. 31.

[35] Consumer Action Law Centre, 'Media release: Cash Converters taken to court after reforms fail to protect vulnerable', 24 September 2015, available at: http://consumeraction.org.au/cash-converters-taken-to-court-after-reforms-fail-to-protect-vulnerable/.

We also have concerns about reports of lenders logging into borrowers' internet banking in store and the use of 'account scraping' technology to access to bank accounts via online portals during the application process. This raises serious privacy concerns and may mean that borrowers are not protected under the ePayments Code for unauthorised transactions.[36] We think that this should be investigated further, and appropriate consumer protections considered should 'account scraping' become an accepted method to obtain bank account information.

Despite the above concerns, we are reluctant to recommend that lenders no longer be required to obtain bank statements to determine a borrower's financial situation. In our view, many of the additional consumer protections under the regulatory regime, particularly the presumptions of unsuitability, would probably be unnecessary if an effective 48% cap on costs was introduced, meaning that the analysis of bank statements would be less complex. Later in this submission we have also supported the introduction of a payday lending database, which we believe will also assist lenders to more effectively assess a borrower's financial situation in conjunction with their bank statements.

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?

We reject any suggestion that it is appropriate for payday lenders to use bank account statements for purposes other than complying with responsible lending obligations. Bank statements contain highly sensitive personal information, and are provided for a specific purpose. They should not be used for any other purpose, especially marketing. We make further comments about unsolicited marketing of payday loans later in this submission.

Question 5: Restrictions on repeat borrowing

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

In our experience, lenders generally rely on the consumer disclosing whether one of the presumptions of unsuitability apply. This was supported by findings in ASIC's payday lending report, where all 13 lenders reviewed 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. However, as discussed under Question 3 above, there are significant limitations with the information that can be obtained from bank account statements. Of the lenders reviewed by ASIC, three also obtained the consumer's credit report. Two lenders stated that if they identified that the consumer had another payday loan, they would request the consumer's permission to contact the other lender to confirm the consumer's position.[37]

ASIC's review found approximately 52 % of the 288 files indicated that the payday lender had entered into a loan with a consumer who triggered one of the presumptions of unsuitability. Importantly, the majority of files reviewed by ASIC indicated that each consumer had taken out two or more payday loans with the same lender within the review period. Some consumers had

[36] Clause 12 of the *ePayments Code*, 1 July 2012, available at: http://asic.gov.au/for-consumers/codes-of-practice/epayments-code/.
[37] ASIC, above n. 8.

as many as five or six loans with the same payday lender. The majority of lenders did not have records that supported the rebuttal of the presumptions. At best, this indicates a serious failure of payday lenders in reviewing their own records. At worst, it shows a blatant disregard for the presumptions of unsuitability and compliance with the law.

Is a restriction on repeat borrowing necessary to protect consumers?

We recommend that repeat lending be addressed through a system which:

- caps the number of loans that can be advanced to a person to no more than two loans per year (which could potentially replace the current presumptions of unsuitability); and
- has a mandatory payday loans register so lenders can easily access a borrowers' lending record (discussed further under Question 10).

Many borrowers take out payday loans to provide short term relief from an income shortfall and in doing so simply get further into debt. The recurrent use of payday loans has been found to be a key factor leading to unmanageable debt, debt spiralling and, ultimately in the most extreme cases, bankruptcy.[38] However, consumers caught in repeat borrowing are extremely profitable for the industry. This cycle is so profitable that, as an industry representative said to the Parliamentary Joint Committee in 2011, large parts of the industry may not exist without it:

> *The focus has been on the interest and cost cap. The reality is that… at least 28 % of the payday lenders will go because at least that number are dependent, in part – whether good or bad; but this is an economic fact – on some form of rollover or refinancing opportunity.*[39]

The industry's reliance on repeat borrowing is not unique to Australia. An Office of Fair Trading study found that rolled over loans account for 50% of lenders' revenues in the UK. Borrowers who receive five or more payday loans in a year account for 91% of payday lender revenues in the United States.[40]

Research has shown that repeat payday borrowing is the norm in Australia, and that the presumptions of unsuitability in the NCCP Act have failed to curb this destructive lending pattern. In fact, one payday lending website states:

> *It is not uncommon for payday loan customers to be repeat customers. Lenders become more comfortable providing payday loans to repeat customers who have established a record of repayment.*[41]

Research by DFA indicates that the average number of payday loans taken out by borrowers during the 12 month period to 20 July 2015 was 3.64, an increase from 2.50 in 2010. Thirty-eight% of payday borrowers had more than one payday loan in the same period, an increase from 22.9%

[38] Ali, above n. 25, p 15.
[39] Phillip Smiles, cited at Parliamentary Joint Committee on Corporations and Financial Services, 2011, paragraph 5.149.
[40] Banks, above n. 1, p 42.
[41] Speedy Money, 'Repeat Payday Loan customers', accessed 11 October 2015, available at: https://www.speedymoney.com.au/Payday-Loan.

in 2010 and 17.2% in 2005. Almost 30% of households also had more than one payday loan concurrently.[42]

Other studies have shown even more shocking rates of repeat borrowing. The RMIT's Caught Short report found more than half of respondents (53% of men and 59% of women) were heavy borrowers, having taken out more than ten loans in the previous two years. Most of the heavy borrowers in this study (75%) had taken out more than 20 loans.[43] The Financial Counselling Report found that 92% of financial counsellors surveyed had clients who had multiple payday loans within the last 12 months. Of the counsellors surveyed, 79% reported that payday loans had 'never' improved the financial wellbeing of their clients.[44]

Repeat borrowing is also prevalent in other jurisdictions, with the CFPB finding that '[f]or many borrowers, what starts out as a short-term loan turns into an unaffordable, long-term cycle of debt.'[45] A number of US jurisdictions have introduced caps on the number of loans that can be taken out per year,[46] or have effectively banned payday lending through effective interest rate caps[47] in order to address problems with repeat borrowing. The CFPB also recently released proposed payday lending rules, which feature a requirement that a consumer could not be more than 90 days in payday loan debt over a 12 month period.[48] The rules are still under consultation.

These cycles of debt cause considerable harm to payday loan customers. In our experience it is scenarios like this, demonstrated in the case studies below from our service delivery, paint the most realistic picture of consumers who borrow repeatedly from payday lenders.

Laura's story

Laura lives in public housing and receives a Centrelink pension. She has a mild intellectual disability and suffers from mental illness. Laura has two young children one of which has a mild intellectual disability. Laura is in severe financial hardship and is due to have her electricity disconnected.

Laura fell into a debt spiral in 2013 and 2014 after she received multiple, successive loans from three different payday lenders. Laura used her Centrelink income to cover the loan repayments and fell into arrears with the rent and energy bills. Laura is currently on a payment plan for her rent after the Department of Housing tried to evict her for failing to pay her rent.

Laura complained to the Energy and Water Ombudsman Victoria about her energy debt. She was too embarrassed to disclose her payday loans so she told them that her Centrelink payments had been reduced. Laura eventually entered into a payment plan with the energy

[42] DFA, above n. 9.
[43] Banks, above n. 1 and above n. 2.
[44] Ali, above n. 25, p 15.
[45] CFPB, above n. 33.
[46] For example, in Washington capped the number of payday loans per year to a maximum of 8 – see Washing State Department of Financial Institutions, 'Payday loans', accessed 15 October 2015, available at: http://dfi.wa.gov/financial-education/information/payday-loans.
[47] In Georgia, payday lending is explicitly prohibited and a violation of racketeering laws. New York and New Jersey prohibit payday lending through their criminal usury statutes, limiting loans to 25 % and 30 % annual interest, respectively - see http://www.paydayloaninfo.org/state-information for further information.
[48] CFPB, above n. 33.

provider, however she fell into arrears for a few weeks during the plan. Consumer Action is currently assisting Laura to resolve her dispute.

Jenny's story

Jenny has a history of gambling addiction. Jenny took out 63 payday loans between July 2009 and June 2014. Jenny says that she was gambling for much of this time. Jenny sometimes had multiple payday loans at once. She says she was in a spiral of debt and would often look forward to the next loan as it would give her a chance to pay her immediate debts and get temporary relief. Jenny says that that lender did not make proper enquiries as to her expenses, and that she was often put in a position of significant financial hardship trying to make her repayments.

Payday lenders do not oppose restrictions on repeat borrowing out of concern for their customers. It opposes them because such a ban will harm its profitability. An argument previously raised by the industry is that introducing restrictions on repeat borrowing would force people to borrow more, and that this would increase default rates. We have seen no evidence to support this proposition, nor any explanation as to how issuing an unaffordable high cost short term credit to cover a low income borrower's unforseen liabilities would meet the lenders' responsible lending obligations under the NCCP Act.

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?

It is clear from ASIC's report, our casework and research by DFA that the rebuttable presumption regime has not curbed repeat borrowing. In fact, according to DFA's research, the level of repeat borrowing is actually increasing. The presumptions are difficult for lenders to comply with, and even more difficult for ASIC to enforce.[49] A bright line restriction on the number of loans per year would offer better protection to consumers, be easier for lenders to comply with, and reduce the number of borrowers being caught in dangerous debt spirals.

As shown above, the business model of payday lending is premised on repeat borrowing, and there are strong financial incentives for payday lenders to trap customers in debt spirals. The complexity and 'grey areas' created by the rebuttable presumptions has increased the risk of avoidance and non-compliance by the industry.[50] A bright line test would offer far greater protection to consumers, as it is clear that the presumptions have failed to curb repeat borrowing as intended.

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)?

We support setting prescribed benchmarks as a mandatory minimum standard for assessing expenses. The benchmarks should include an added margin, as responsible lending should not occur where borrowers are on the brink of being in poverty. Further, as ASIC has indicated in its

[49] For further information, see our comments under Question 3 above.
[50] For further information, see Ali above n. 25.

responsible lending analysis, additional buffers are needed for other expenses (such as other loans repayments which may be subject to interest rates rises).[51]

Benchmarks, however, should not replace the need to make reasonable inquires about a consumer's actual financial situation. The benchmarks should set the minimum amount of expenses in the suitability assessment. Actual expenses should be increased accordingly based on the lender's inquiries into the customer's financial position. This recommendation is in line with guidance in ASIC's Regulatory Guide 209 (**RG 209**) in relation to benchmarks, explained further below.

Currently, some payday lenders use their own benchmarks, which often significantly underestimate expenses. See 'James' story' below for an example.

Other lenders may use benchmarks such as the Henderson Poverty Index (**HPI**) to test the reliability of information provided, or simply use benchmarks instead of collecting information about actual expenses. For example, recently ASIC required to Bank of Queensland to improve its lending practices as it was concerned that the bank was using a benchmark figure to estimate the living expenses of consumers applying for home loans, rather than asking borrowers about their actual expenses.[52]

ASIC's RG 209 makes it clear that the use of benchmarks is not a replacement for making inquiries about a particular consumer's current income and expenses, nor a replacement for an assessment based on that consumer's verified income and expenses. The need to make inquiries about a consumer's actual financial situation was confirmed in *The Cash Store* decision, where Justice Davies said:

> *Assessing whether there is a real chance of a person being able to comply with his or her financial obligations under the contract requires, at the very least, a sufficient understanding of the person's income and expenditure. It is axiomatic that 'reasonable inquiries' about a customer's financial situation must include inquiries about the customer's current income and living expenses.*[53]

In terms of which benchmark should be used, we generally prefer the HPI over the Household Expenditure Measure (**HEM**) mainly because when compared with the HEM, the HPL is more generous towards singles and single parents, which are the main users of payday loans.[54] The HPL is also free of charge, which would reduce costs for lenders and ensure community organisations (such as financial counsellors) would have access to the relevant benchmark. A HEM subscription costs approximately $1,500 per annum for businesses with a loan book of less than $100 million.

[51] For example, see Australian Securities and Investments Commission, 'REP 445: Review of interest-only home loans', 20 August 2015, available at: http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-445-review-of-interest-only-home-loans/.

[52] Australian Securities and Investments Commission, "15-125MR ASIC concerns prompt Bank of Queensland to improve lending practices', 25 May 2015, available at: http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-125mr-asic-concerns-prompt-bank-of-queensland-to-improve-lending-practices/.

[53] *Australian Securities and Investments Commission v Cash Store Pty Ltd (in liquidation)* [2014] FCA 926, [42].

[54] DFA research indicates that sole male households are significantly more likely to use payday loans than sole female or family groups. See DFA, above n. 9.

Question 6: Ban on short term credit contracts

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

Based on our casework, it appears that loans with a term of 15 days or less are no longer being offered to consumers. However, we have still seen examples of avoidance (discussed further below under Question 12) whereby a consumer entered into a loan of less than 16 day, which purported to be a Medium Amount Credit Contract (**MACC**), despite MACCs being defined as 16 days or more in length.

Blair's story
Blair works with computers, and has a variable income and says he has no attachable assets. Blair entered into four small amount loans with the same lender within six months. One of these loans purported to be a MACC, but had a term of only 13 days. The loan amount for approximately $2,200 with a $400 establishment fee and 48% interest rate. The contract provided that the loan would be repaid in a single repayment after 13 days, amounting to over $2,600. We are unaware of the outcome of Blair's dispute with the lender.

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.

Apart from the avoidance mentioned above, we have not seen any unintended negative consequences from the prohibition on short-term lending. One of the industry's main arguments against this kind of strict regulation is that it will push consumers towards illegal 'loan sharks', but we have seen no evidence of this being the case.

Despite rate caps (and in some cases outright bans) on payday loans existing in many jurisdictions both in Australia (prior to the 2013 reforms) and elsewhere, there is simply no credible evidence to suggest that increased regulation leads to increased illegal lending. It is highly doubtful that all or even a significant majority of current borrowers would turn to 'loan sharks' if payday loans were no longer available. Even if increased regulation were to cause an increase in illegal lending, that market would be subject to criminal law enforcement, which would constrain the market and render it far smaller than the previously legitimate market.

The claim that increased regulation will lead to increased illegal lending is often based on research commissioned by Cash Converters that was conducted by a UK consultancy firm Policis in 2004, the findings and methodology of which have since been widely questioned by consumer groups in the UK, Germany and Australia.[55] In fact, a majority of former payday loan borrowers in North Carolina reported that a 36% rate cap (which effectively banned payday loans) had either no effect on their household's financial security or improved financial security.[56] The 'substitution

[55] Gillam, above n 4, Chapter 5.

[56] Colin Morgan-Cross and Marieka Klawitter, 'Effects of State Payday Loan Price Caps & Regulation', University of Washington, available at:

hypothesis' (i.e. that borrowers will simply shift to other forms of high cost credit) is not correct: a large %age of payday borrowers will not, when payday loans are withdrawn, switch to other sources of credit such as credit cards, illegal loans and bank overdrafts. Rather, they will make do without credit (no doubt at some personal stress) and avoid a larger debt burden that will put them under even greater financial stress in the future.[57]

Question 7: Warnings

Are the warning statements effective? Could the statements be improved?

Broadly, we support improving disclosure to warn consumers of the risks and costs of payday loans to draw their attention to better alternatives. ASIC's payday lending report found that the number of consumers who clicked through to MoneySmart from payday lenders' websites has dramatically increased since the introduction of the warning statement requirement. The report found that the majority of lenders had made genuine efforts to introduce a warning statement for consumers, although five of the 13 lenders did not have an appropriately prominent statement.[58]

ASIC's report indicates that, despite problems with compliance, the warning statements have been effective in part, although the report did not comment on whether the warnings had changed consumers' borrowing behaviour. We note that some of our financial counsellors have reported than when consumers have read the warning in store or online and called 1800 007 007, they often think that this is a contact number for the lender, or that we are an organisation that can provide loans.

Feedback from MoneyHelp financial counsellors – payday loan warnings

- *"Sometimes we can help them. But what they think is that this is an alternative source for the loan. Sometimes we can divert them to other options like NILS,[59] but they often think we are the payday lender."*
- *"It is harder to explain what financial counsellors do because the payday lenders don't explain anything to the clients. It's not like the banks. The clients are focussed on getting the loan."*
- *"Most have no idea what the line actually is. They just think it is an alternative source for another loan."*
- *"You start the call apologising for not being who they think it is. It is not a strong place to start."*

https://evans.uw.edu/sites/default/files/public/STATE%20PAYDAY%20LOAN%20PRICE%20CAPS%20%26%20REGULATION.pdf.

[57] For further information, see Consumer Action Law Centre, 'Payday lending report – draft literature review', pp 24-26, available at http://consumeraction.org.au/wp-content/uploads/2012/05/AttA-Draftpaydaylendingliteraturereview100608.pdf.

[58] ASIC, above n. 8, p 11.

[59] Good Shepherd Microfinance's No Interest Loans Scheme.

While we broadly support improving disclosure, it is important to recognise that disclosure of any type will not prevent the harm caused by payday loans. Consumers generally take out payday loans because they have insufficient income to meet basic expenses. Consumers in this position are generally in financial distress and see no other option. DFA research indicates that 78% of financially distressed households that take out payday loans do so because they see it as their only option, while 17% take out a payday loan due to 'desperation'.[60] Disclosure will rarely be effective in this situation.

We note that one of the defining features of the Financial System Inquiry (**FSI**) final report has been an explicit shift in focus from consumer protection regulation based on disclosure to one focusing on fair treatment of consumers. Implicit in that change is an acceptance that consumers are not necessarily capable of absorbing all of the information presented to them in financial services disclosure and, even if they do, various cognitive limitations and biases limit the ability of people to make rational product choices. We strongly support this shift and focus and the rational that the FSI panel advanced to support it.[61] We agree that we need to move from a disclosure-based consumer protection regime to one which recognises that consumers can only protect their interests if we treat them fairly.

We note in particular Paul O'Shea's research on consumer credit disclosure, which found that 'consumers do not understand important features of consumer credit contract transactions' even after reading compliant disclosure documents for those products. For example, O'Shea found that only 6% of participants understood the true cost of a home loan, 15% understood how long it would take to pay off a credit card at the minimum monthly payment, and 29% understood the total interest charges on a car loan.[62]

To be effective, disclosure must not only share information but positively influence consumer behaviour. Designing effective disclosure will start with a consideration of how consumers actually use disclosure and how they make decisions, rather than a focus on compliance and risk avoidance. It will be designed with an understanding of what kind of information will be useful to consumers, and when and how to present it for maximum effect. We strongly recommend consumer testing of the payday loan warning to improve its content, timing and placement. Consumer testing of disclosure will ensure that the disclosure does what it is intended to do, that is, help consumers understand products and make informed decisions. This is especially important given the current movement towards permitting providers to use more innovative disclosure.[63]

Importantly, in our view payday lenders should be required to disclose the comparison rates of their loans in advertisements and during the application process. Comparison rates are an industry standard method of measuring the annual cost of credit. It includes the interest rate, and most fees and charges relating to a loan, reduced to a single percentage figure. By making costs more transparent to a consumer at the point of sale, comparison rates allow consumers to objectively compare the relative cost of competing credit products.

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[60] DFA, above n. 9.

[61] Consumer Action Law Centre, above n. 5.

[62] Paul O'Shea, 'Simplification of Disclosure Regulation for the Consumer Credit Code: Empirical Research and Redesign - Final Report', Uniquest Pty Ltd, University of Queensland, 2010, p 4.

[63] See Australian Securities and Investments Commission, 'Consultation Paper CP 224 – Facilitating electronic financial services disclosures', 14 November 2014, available at: http://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-224-facilitating-electronic-financial-services-disclosures/.

Payday lenders reject the use of comparison rates, mainly on the basis that comparison rates are apparently not appropriate for short term loans. However, industry practices have compared interest rates on an annual basis for centuries, whether the loan is scheduled to be paid off in less than one year or more than one year. Other types of credit such as personal loans and mortgages disclose comparison rates, and this figure is much more readily understood by consumers than the 20% (of the amount borrowed) establishment fee and 4% (of the amount borrowed) monthly fee, which disguises the true cost of a payday loan. In some mainstream media commentary of the payday lending sector, this is described as a 24% interest rate – which of course vastly under-estimates the actual cost. For example, payday lender Ferratum's website states that:

> *We are direct about what your short term loan will cost and will not charge any hidden fees, all fees and charges excluding direct debit costs are 24% of loan amount regardless of term.*[64]

In discussing the costs of payday loans, we commonly resort to explain the actual cost in comparison to credit cards. Taking a credit card cash advance of $300 on a high-rate (18%) credit card will cost $4.50 in interest charges after 30 days. A 30-day payday loan of $300 imposing the maximum charge will cost $72. Borrowers should be able to compare these loans with other options, such as a credit card or personal loan. Disclosure of the comparison rate also shows consumer, policy makers and regulators that payday loans are unreasonably expensive.

Example comparison rates[65]

- If you borrow $300 from a payday lender for 30 days, your total repayments will equal $372. This is a comparison rate of 407.6%.
- If you borrow $1,000 from a payday lender for 12 months, your total repayments will be $1,680. This is a comparison rate of 112.1%.

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

We are not opposed to payday lenders including a hyperlink to the MoneySmart website when warnings are displayed on webpages. However, while MoneySmart is a very useful resource, a person struggling with debt will usually be better served by speaking to a financial counsellor. Financial counsellors are equipped to provide immediate, tailored advice that a person in financial distress requires. If referral to an online service is warranted, it might be better to refer consumers to websites established to provide advice specific to credit and debt. We note that the National Debt Helpline (the new national name for the services that deliver the 1800 007 007 telephone financial counselling hotline) will have a new website shortly, which may be appropriate.

[64] Ferratum, 'Our charges explained', accessed 14 October 2015, available at: https://www.ferratum.com.au/our-charges.
[65] Comparison rate calculations completed using RiCalc software assuming maximum permitted fees and charges, and fortnightly repayments.

Question 8: Cap on costs

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?

In our view, the current cost cap has certainly achieved the latter objective, as shown by the huge growth in the payday lending industry since the introduction of the 2013 regulations. Unfortunately, this has been at the expense of the former objective – providing adequate protection to consumers. DFA research estimates that the average value of outstanding loans has increased from approximately $391 million in 2013, to approximately $670 million in 2015. DFA predicts the average value of outstanding loans will increase to over $1 billion by 2018.[66] Researcher Marcus Banks also notes that 'the industry is progressively moving from the fringe into the mainstream of consumer finance in Australia' and that 'the online Australian SACC market appears to be dynamic and growing'.[67]

As set out under Question 2, in our view a 48% comprehensive cap on costs is required to properly protect consumers. A key goal of this cap is to make short term, high cost payday loans unviable. We do not want to see a society where extremely high cost lending becomes the norm, at the expense of the welfare of ordinary Australians struggling to make ends meet. This is not a problem that can be addressed by responsible lending alone (which we strongly support) – those type of laws are simply not well adapted to the particular threat posed by short term credit contracts, particularly given the systemic non-compliance and avoidance techniques we have seen the industry engage in over the years.[68]

Payday loans can attract comparison interest rates between 626.2% and 112.1%.[69] Repayments create a large financial burden for borrowers on low incomes, particularly due to the short term nature of the loans. Up to 25% of payday borrowers have incomes below the Henderson Poverty Line.[70] Research by DFA indicates that the average income of a payday borrower is $35,702 (or $686.58 per week). This is approximately 40% less than the average Australian's income.[71]

Where the loan is for a short term, it must be repaid over a small number of relatively large installments, which has a much greater impact on a borrower's budget than if the same loan is repaid over a longer period. For example, assume a typical payday borrower earning $686.58 per

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66 DFA, above n. 9.
67 Banks, above n. 11.
68 Gillam, above n. 4, p 18; The Treasury, 'The Regulation of Short Term, Small Amount Finance: Regulation Impact Statement', June 2011, pp 36-39, available at: http://ris.dpmc.gov.au/files/2011/09/RIS-Short-term-small-amount-finance.pdf.
69 Comparison rate calculations completed using RiCalc software assuming maximum permitted fees and charges, and fortnightly repayments. 626.2% comparison rate calculated using a 16 day loan of $200 with total repayments of $248. 112.1% comparison rate calculated using a 12 month loan of $1,000 with total repayments of $1,680.
70 The Treasury, 'Review of the small amount credit contract laws: Consultation on the regulation of small amount credit contracts and comparable consumer leases', September 2015, p 12, available at: http://consumercredit.treasury.gov.au/content/downloads/Review-of-SACC-laws/Review_of_SACC_laws_CP.pdf.
71 Australian Bureau of Statistics, 'Average Weekly Earnings Australia', May 2015, available at: http://www.abs.gov.au/ausstats/abs@.nsf/mf/6302.0/.

week borrows $300 over a term of 28 days, with two fortnightly repayments of $186.[72] These repayments would amount to 13.5% of the borrower's fortnightly income, leaving even less (or no) money available for essentials like food, utilities and housing.

The situation is even more dire for consumers living on under the poverty line. As noted in the consultation paper, 25% of payday borrowers have incomes below the Henderson Poverty Index.[73] For a single person in the workforce, this is only $510.16 per week. If a person living on the poverty line borrows $300 over a term of 28 days, with two fortnightly repayments $186, repayments would amount to 18.2% of the borrower's fortnightly income.

If a borrower earning the minimum wage borrowers a slightly higher amount, it is clear they will suffer a shortfall.

A payday borrower's tough fortnight[74]

Income: $1,313.80
Living expenses: $1020.32
Amount repayable on a 28 day $500 loan: $310

Balance: - $16.52

Even with direct debits prioritising repayments, many payday borrowers are in behind in their payments. DFA research indicates that 19.6% of payday borrowers are more than 30 days in default with their payday lender.[75] Almost 39 % of distressed households taking out payday loans were refinancing another debt, and 36.8% already had a payday loan.

A 48 % cost cap has previously applied in New South Wales, Queensland and the Australian Capital Territory.[76] Even more stringent cost caps have been applied in overseas jurisdictions, particularly in the United States. States with caps on payday interest rates 36% or lower include North Carolina, New York, New Jersey and Ohio.[77] Applying a 48% cap to payday lenders in Australia is therefore not an unprecedented step. In fact, at least five US states have banned payday loans altogether.[78]

As noted under Question 2 above, competition does not work in this market to reduce costs. This is a similar to the situation in other jurisdictions. Research in the US indicates that a state's limit

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72 Calculated using ASIC's payday loan calculator – available at: https://www.moneysmart.gov.au/tools-and-resources/calculators-and-apps/payday-loan-calculator.
73 The Treasury, above n. 70, p 12.
74 Income calculated as minimum wage - Fair Work Australia, 'Awards and agreements – national minimum wage orders', accessed 15 October 2015, available at: https://www.fwc.gov.au/awards-and-agreements/minimum-wages-conditions/national-minimum-wage-orders. Living expenses calculated in accordance with the Henderson Poverty Lines for a employed single person including housing – Melbourne Institute of Applied Economic and Social Research, 'Poverty Lines: Australia – March Quarter 2015', accessed 15 October 2015, available at: https://melbourneinstitute.com/downloads/publications/Poverty%20Lines/Poverty%20lines%20Australia%20March%202015.pdf; Repayments calculated using ASIC's payday lending calculator – available at: https://www.moneysmart.gov.au/tools-and-resources/calculators-and-apps/payday-loan-calculator.
75 DFA, above n. 9.
76 Gillam, above n. 4, p 168 onwards.
77 Morgan-Cross, above n. 56.
78 National Conference of State Legislatures, 'Payday lending state statutes', 14 January 2015, available at: http://www.ncsl.org/research/financial-services-and-commerce/payday-lending-state-statutes.aspx.

on interest rates is the key factor driving loan pricing. The four largest payday lenders in the United States charge similar prices within a given state, with rates set at or near the maximum allowed by law. In states with higher or no interest rate limits, the same companies charge comparable borrowers far more, for essentially the same small-loan product.[79] In short, policy makers cannot expect competition to drive prices down in this market. Government intervention will be required if costs to consumers are to be lowered.

ASIC Class Order 13/818 granted temporary exemption from the cap for certain MACCs and allowed SACC 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?

We support an outright ban on lenders requiring or suggesting repayment by direct debit. Direct debit authorities reduce the risk of default for the lender, as the lender has taken first stake in the borrower's income so the borrower is more likely to default on other essentials. Lenders would be more alive to the risk of non-payment, and may therefore make very different lending decisions, if a consumer was required to initiate each repayment, rather than repayment being automated through direct debits. In many markets, direct debits provide consumers and traders with convenience. However, the high risks associated with payday lending necessitates a different approach.

The common practice of requiring repayment by direct debit is part of the reason why payday loans are both harmful for consumers and profitable for lenders. Lenders generally obtain direct debit authorities from borrowers as part of the application process. Lenders then debit a borrower's bank account as soon as pay or benefits are deposited, securing the loan. When a borrower is already on a limited income and unable to afford basic needs, this impinges on their capacity to pay for essentials like food or rent, prompting additional financial stress and further borrowing. Requiring direct debits allows for a relatively low risk of default on payday loans, even though a typical payday loan for a typical client is likely to create financial stress.

In relation to direct debit fees, we note that the purpose of the ASIC Class Order was to 'minimise disruption to the business of credit providers and direct debit companies under these kind of contracts."[80] Unfortunately, while it may have minimised disruption to payday lenders and direct debit companies, it is yet another fee that consumers must pay for an already excessively expensive product. In our view, the cap on fees should include fees charged for direct debit processing. Processing direct debits is part of many businesses' costs, and there is no reason that this cost should not be borne within the total costs allowed to be charged by lenders pursuant to legislation.

Question 9: Protection for Centrelink customers

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

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[79] The Pew Charitable Trusts, 'How state rate limits affect payday loan prices', April 2014, available at: http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs/content-level_pages/fact_sheets/stateratelimitsfactsheetpdf.pdf.

[80] ASIC Class Order [CO 13/818] Explanatory Statement, available at https://www.comlaw.gov.au/Details/F2013L01262/Explanatory%20Statement/Text.

We reiterate our view that a comprehensive 48% cap on costs would be the most effective consumer protection in regards to payday loans. Many of the additional protections under the NCCP Act, including the protected earnings amount, would probably be unnecessary if this cap was introduced.

The NCCP Act allows payday lenders to take up to 20% of a fortnightly welfare recipient's income. This is a huge proportion of such a low income consumer's fortnightly payments. For example, for a single Disability Support Pensioner who receives $867 per fortnight,[81] this regulation enables a payday lender to take $173.40 of this amount in repayments. Given that the poverty line is $1020.32 per fortnight (meaning the welfare recipients expenses are likely to already to exceed their income by $153.32 per fortnight), this amount is outrageous and harmful to the consumer.

Should a 48 % cost cap not be introduced, we recommend that the protected earnings requirement be in line with the Centrelink Code of Operations, which is a voluntary agreement between banks and the Government. Under the Code, if a Centrelink recipient overdraws their bank account, and subsequently receive a welfare payment, then the bank can only use 10% of the recipient's fortnightly welfare payment to repay the overdrawn amount. This recognises that the recipient must have access to the other 90% to pay for basic living expenses.[82] There is a case that the Code and the NCCP Act should be aligned – in our view, there is no compelling reason why banks should only be able to recover 10% of a welfare payment while payday lenders can recover 20%. We recommend reducing the payday lending protected earnings amount to 10%.

Do any additional groups of consumers need to be subject to specific protection in relation to SACCs?

We would also encourage consideration be given to applying this a protected earnings rule to consumers beyond welfare recipients. There are many low-income workers, including those on traineeships, apprentices or those working in low-skill jobs, who require the vast majority of their income to pay for their day-to-day living expenses. It is only fair that these consumers benefit from the same protection, that is, that the majority (90%) of their fortnightly income be available for living expenses, and only up to 10% towards repaying high cost payday loans.

Question 10: National database

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

In our view, there is insufficient information currently available for payday lenders to meet the responsible lending obligations. As set out under Question 2 above, it will not always be possible for lenders to know whether one of the presumptions of unsuitability is triggered, or a person's genuine financial circumstances. There is presently no absolutely reliable way for lenders to verify all necessary information such as whether a borrower has had previous payday loans, or whether

[81] Department of Human Services, 'Payment rates for Disability Support Pension', accessed 15 October 2015, available at: http://www.humanservices.gov.au/customer/enablers/centrelink/disability-support-pension/payment-rates.

[82] Department of Human Services, 'Code of Operation', 1 March 2015, available at: http://www.humanservices.gov.au/corporate/publications-and-resources/code-of-operation.

an existing loan is in default (for example, default or non-repayment will not show up on a bank account statement).

Given the precarious financial situation of many borrowers and the potentially urgent need for funds, we think it is unrealistic to expect that consumer disclosure will always provide full information. Further, there is an obligation for lenders to verify information provided by consumers. While the lender may take steps to verify the information a borrower provides about their financial situation, a review of the borrower’s bank account statements will not necessarily provide a full picture of their financial situation for a number of reasons. For example, borrowers may use multiple bank accounts or may obtain multiple loans in a short period of time such that repayments are not yet visible on bank statements.

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

We support the development of a payday lending database to assist lenders to comply with responsible lending obligations, provided that privacy concerns are addressed. The database provided must be designed to minimise risks of misuse or disclosure of personal information.

In our view, the database would be a simple and effective means of determining whether presumptions of unsuitability apply (or if a hard cap on the number of loans is introduced, as we have recommended, whether the lender has breached this cap). This will be a far more reliable record of loans than bank statements, and will assist both lenders and community organisations assisting borrowers to determine the true financial situation of a borrower. Our lawyers report that sometimes clients are unable to even remember the number of loans they have taken out, as they have been borrowing continuously for some time.

We have provided further comments below.

<u>The cost of a database</u>

The experiences of databases in the US[83] suggest that these systems can cost as little as $1 for each entry made on the database, which is then be passed on to the borrower. If a similar cost applied to an Australian system and lenders were required to record only minimal information (as recommended below) the burden to lenders would be very small.

However, we accept that the Australian and US regulatory environments are different and that further costing would need to be done to ensure the database was affordable.

<u>Privacy concerns</u>

A number of our colleagues in the community sector, including the Australian Privacy Foundation, have raised concerns about the use of personal information held in a database.[84] While the privacy

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[83] Australian Securities and Investments Commission, ‘CP 198 Review of the effectiveness of an online database for small amount lenders’, 25 January 2015, available at: http://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-198-review-of-the-effectiveness-of-an-online-database-for-small-amount-lenders/.

[84] Australian Privacy Foundation, Submission to ASIC: Review of the effectiveness of an online database for small amount lenders’, February 2015, available at: https://www.privacy.org.au/Papers/ASIC-SmallLoansDB-130221.pdf.

concerns held by our colleagues are legitimate, we believe that many of the privacy concerns can be ameliorated by careful design. Given the harm caused to vulnerable consumers by irresponsible payday lending, and that in order for responsible lending obligations to be enforceable in order to effect behaviour change, on balance we support a well-designed database which places strict limits on how information is collected, held, used and disclosed.

The advantages and disadvantages of having multiple databases operating in parallel

We acknowledge that a payday lending database would, to some extent, duplicate the infrastructure that already exists for the comprehensive credit reporting (**CCR**) regime. However, we prefer a payday lending database to CCR for a number of reasons:

- Consumer Action has for many years expressed concerns about the impact of comprehensive credit reporting on consumers,[85] and also raised issues with the Australian Retail Credit Association's proposed Principles of Reciprocity and Data Exchange, which aims to make credit reporting mandatory for signatories.[86]
- We have previously argued that CCR will only increase risk-based pricing for consumers, and will increase consumer debt overall. Risk-based pricing already operates in Australia and it is expected to increase over time. This means consumers that live pay check to pay check and sometimes pay bills late will be charged higher interest rates by mainstream lenders, causing them to be more excluded from mainstream lending and other financial products.[87]
- There are three main credit reporting bodies, meaning payday lenders would have to report to all – a significant compliance cost for lenders. Otherwise, the Government would need to designate a certain credit reporting body to collect and hold this information. Given that Veda controls the majority of the credit reporting market, it is likely that they would be provided this data. We have previously raised concerns about Veda's treatment of personal information with the Office of the Australian Information Commissioner[88] and consider that this arrangement would present an inherent conflict of interest.
- If this information were to appear on a borrower's credit report, it is likely that this would affect other lenders' assessments of their credit worthiness. For those borrowers who are already financially excluded, or close to it, this could further push them out of mainstream finance.
- Payday lenders are not generally using CCR in any case (for example, only two lenders in ASIC's payday lending report obtained credit reports to assess the credit worthiness of borrowers[89]), as these loans are often targeted at those with poor credit histories.

Whether a database would assist SACC providers to discharge the responsible lending obligations

As set out above, there may sometimes be insufficient information currently available for payday lenders to meet the responsible lending obligations. In our view, the database would be a simple

[85] Consumer Action Law Centre, 'Credit reporting and responsible lending', 2008, available at: http://consumeraction.org.au/wp-content/uploads/2012/11/Fact-Sheet-credit-reporting-and-responsible-lending-Dec-08.pdf.
[86] Consumer Action Law Centre, 'Submission: Proposed Principles of Reciprocity and Data Exchange', 1 April 2015, available at: http://consumeraction.org.au/submission-proposed-principles-of-reciprocity-and-data-exchange/.
[87] Ibid.
[88] John Collett, 'Furore over fees for free credit reports', Sydney Morning Herald, 17 July 2015, available at: http://www.smh.com.au/money/borrowing/furore-over-fees-for-free-credit-reports-20150716-gidri3#ixzz3gNyE0T1g.
[89] ASIC, above n. 8.

and effective means of determining whether presumptions of unsuitability apply (or if a hard cap on the number of loans is introduced, whether the lender has breached the cap). This will be a more reliable record of loans than bank statements, and will assist both lenders and community organisations assisting borrowers to determine whether responsible lending obligations have been complied with.

The effect of the CCR regime, including whether or not additional information could be obtained through a SACC database that would not be available through CCR

Participation in the CCR regime is voluntary, and many payday lenders choose not to participate in this regime. Therefore, we believe the CCR regime will have a limited effect on a payday lending database. Payday loans are often marketed towards consumers who have poor credit histories, meaning many lenders often do not obtain credit reports before issuing loans in any case. Non-payday lenders may prefer that all loans were listed on a consumer's credit report, but given the system is voluntary this is unlikely to become a reality in any case.

We have recommended that a limited amount of information be available on the payday lending database below.

What information should be included in the database?

A response to this question depends on what we want the database and the regulation of payday lending more generally to achieve. The main problem with payday lending is that this business model encourages problematic repeat borrowing which leads borrows into a debt spiral. In our view, the database should therefore be designed to ensure compliance with, and enforcement of, regulations that limit repeat borrowing. Currently, this is the presumptions of unsuitability but we have recommended elsewhere that these presumptions be replaced by a hard cap on the number of loans per year.

At a minimum, the database must at least record:

- The identity of the borrower;
- The loan amount;
- The loan start date; and
- The loan contracted completion date.

We also recommend including the actual loan completion date and whether the payday loan is in default, although we would still support a database that did not record these two items.

Who should manage the database (a third party or government agency)?

As noted above, we have significant concerns about private corporate entities controlling this information through the CCR regime. We have similar concerns about the database. Ideally, we would like to see the database managed by ASIC, however would still support a database operated by a private entity provided that privacy concerns are addressed.

How should the database be funded?

In our view, the database should be funded by a proportionate increase to the Annual Compliance Certificate lodgement fee. The lodgement fee is already scaled depending on the size of the licensee's loan book, which would ensure that increases in fees are shared proportionately across payday lenders of different sizes. This fee should allow a licensee unlimited access to the database.

Should reporting of key information be mandatory or voluntary?

Yes, reporting of key information should be mandatory. Without mandatory reporting, the database will fail to fulfil its purpose – which is to ensure compliance with, and enforcement of, responsible lending laws.

Should SACC providers be required to check the database and, if so, when should this obligation be triggered?

Yes, payday lenders should be required to check the database as part of their responsible lending obligations. The databases should be checked during the assessment of suitability (i.e. before the loan is issued).

Should SACC providers be charged a fee for accessing the database and, if so, should the fee be included in the cap?

As noted above, in our view the payday lending database should be funded by a proportionate increase to the Annual Compliance Certificate lodgement fee, which would provide unlimited access to the database. This fee would not be included in the cap, as it is an annual fee payable by the business rather than a fee applied per loan.

Who should be permitted to access and amend information on the database?

Access to and correction of information on the database should be similar to that of credit reporting information under the *Privacy Act 1988.* There is no question that consumers should be able to access the information about them listed on the database. Payday lenders and ASIC should also have access, along with persons authorised by the consumer to access their information on the database (similar to 'access seekers' under the *Privacy Act 1988*). There should be a simple process for consumers to request correction and removal of incorrect or incomplete information, and for payday lenders to correct this information if it is not accurate or up to date. This should be based on the process set out in section 20U of the *Privacy Act 1988.*

What mechanism should be available to ensure that the database was accurate?

As set out in Question 3, we believe ASIC needs significantly increased resources to undertake proactive surveillance and enforcement action in this sector. This would include surveillance to ensure that payday lender files correspond accurately to the database. There should also be a simple process for consumers to access information held about them, and request correction of this information.

The accuracy of the database could also be maximised by making penalties available for failing to update the database, and providing access to External Dispute Resolution (**EDR**) to resolve disputes regarding accuracy of the database.

How should the database interact with the other responsible lending obligations?

Discussed above.

Question 11: Additional provisions for SACCs

Are there any additional provisions relating of SACCs that should be included in the Credit Act taking into account the objective of the legislation?

Marketing of payday loans

Since the introduction of the 2013 regulations, we have seen a proliferation of television and online advertising for payday loans, suggesting consumers take out payday loans for rounds of drinks to children's birthday parties. For example, Nimble recently ran a television advertisement that suggested consumers take out payday loans to pay for a gas bill– this is not unlawful, but is completely irresponsible, particularly given that gas providers have a legislative obligation to provide hardship assistance to those that are having trouble paying their gas bill. In our view, no consumer should be required to resort to a payday loan to pay for electricity, gas, water or telecommunications. Providers of these services have obligations to provide assistance to those experiencing financial difficulty. The Nimble advertisement was later withdrawn after a complaint was made by Consumer Action to the lender.[90]

DFA research indicates that 22.6% of payday borrowers surveyed found about payday lending from a television or radio advert in 2015, an increase from 2.3% in 2005. 43.6% of borrowers found out about payday lending from the internet and social media, an increase from 3.1% in 2010 and 0% in 2005.[91] We see these advertisements particularly targeting young consumers via Facebook and during specific television programming. We have also seen examples of payday lenders text messaging clients asking them to return.

Richard's story

Richard is 41 years old. His gambling problem began with a visit to the casino when he turned 18. Richard is now addicted to playing poker machines. When he has blown his money, he sometimes needs money for rent and other expenses so takes out payday loans. Richard says he always has at least two payday loans on the go, and couldn't count how many he has in a typical year. Richard says his payday lender knows him by name, and knows about his gambling addiction. Richard pays the loans back within 4 to 6 weeks, but just before his current loan is paid off the lender will SMS him to offer him a new loan. When Consumer Action spoke to Richard he was in default as he needed to pay for his car registration fees and couldn't afford his repayments. He says it is difficult to contact the lender to ask for hardship arrangements.

[90] Frank Chung, 'Consumer groups slam 'irresponsible' payday lending ads on youth channels', News Corp, 23 April 2015, available at: http://www.news.com.au/finance/money/consumer-groups-slam-irresponsible-payday-lending-ads-on-youth-channels/story-fnagkbpv-1227316636592.

[91] DFA, above n. 9.

There are no specific regulations applying to the advertising of payday loans. Given these products are inherently harmful to borrowers, and currently do not even advertise the comparison rates of the loans offered, we believe further regulation of payday lending advertisements is warranted. There should be appropriate limits on the timing and content of these advertisements, with appropriate warnings and comparison rates included (see our comments under Question 7 for further details). In our view, amendments to ASIC Regulatory Guide 234 in relation to the advertising of financial products would be a step in the right direction. However, it is likely that legislation would also need to be amended to ensure these advertisements are regulated appropriately.

Single repayments

Loans required to be repaid through a single repayment increase the risk of financial stress for borrowers. Single repayments are relatively uncommon since the 2013 regulations were introduced. While we support a prohibition on lenders requiring borrowers to pay off the whole loan in a single repayment, we believe a better solution would be to require a minimum term for payday loans. We suggest the regulations should require a minimum term of three months and minimum of six approximately equal repayments.

In our view, three months is the minimum repayment period necessary to ease pressure on low income borrowers. As the table below shows, a minimum three month term will create less strain on a budget of a typical borrower even though under the 20+4 cap will mean a three month term will attract more monthly fees than a shorter term.

Table 1: Impact on budget of typical borrowers of repaying a $300 payday loan under the 20+4 cap over 1 to 6 fortnights

Term (fortnights)	**1**	**2**	**3**	**4**	**5**	**6**
Total to be repaid	$372	$372	$384	$384	$396	$396
Repayments per fortnight	$372	$186	$128	$96	$79.20	$66
% of income assuming $1373.16 per fortnight[92]	27%	13.5%	9.3%	7%	5.8%	4.8%

Front-loading

Requiring approximately equal repayments will also effectively ban the practice of front-loading. Front-loading is where a lender charges more fees during the first half of the loan and less during the final half. According to the Pew Trust, it is important to prevent front-loading of fees as 'experience shows that front-loading practices make the early months of the loan disproportionately more profitable for lenders than the later months, creating incentives for them to maximise profit by encouraging borrowers to refinance loans before they are fully paid off.'[93]

[92] DFA, above n. 9.
[93] The Pew Charitable Trusts, "Payday Lending in America: Policy Solutions', October 2013, available at: http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydayoverviewandrecommendationspdf.pdf.

Phillip's story

Phillip works full time and his household had recently gone from a double to single income. Phillip, his partner and child live in rental accommodation. Phillip contacted MoneyHelp as he and his partner were struggling to pay the bills and were negotiating hardship arrangements with one of his creditors. Phillip had been provided with two payday loans, one of which was a \$2000 loan for a term of 12 months. Phillip's repayments under the \$2,000 loan contract were nearly \$100 per week for the first 26 weeks of the contract, and less than \$35 for the remaining 26 weeks. It did not appear that this step down in payments met Phillip's requirements and objectives – instead, it served to increase the total monthly fees the lender would be able to recover.

Blackmail security

We are becoming increasingly concerned by MACC loans that purport to take security over high value items, such as cars or homes. Particularly in circumstances where it is known the borrower is unlikely to be able to repay the loan, these securities are known as 'blackmail securities'. The benefit to credit providers of taking security over these items is vastly disproportionate to the immense psychological burden placed on consumers by the knowledge that these essential goods could be repossessed. In our view, MACC providers should not be allowed to take security over an item that is not purchased with the funds.

Felicity's story

Felicity called MoneyHelp after she was contacted by lawyers acting for debt collectors. Felicity said she had took out a MACC loan of approximately \$4,000 to send money to her mother for medical expenses, but had fallen behind in payments. The lender had secured the loan over Felicity's house. Felicity said she was under financial stress and that she had been putting off calling the lender. Felicity said when she called the lender, they said it was too late too late and that if she did not pay \$1,500 by the following Monday, they would take her house. Felicity was very upset during the call, and said she did not know if she would get the money together.

Default and enforcement costs

A number of lenders charge significant and, sometimes, multiple fees for default. There may be also charges associated with enforcement. These fees appear to outweigh the actual costs incurred by the lender.

For example, Nimble charges \$15 as a dishonour fee, charged if a direct debit fails. It also charges \$5 per day as a default fee. This appears to be a doubling of fees.

Given inconsistent practices in this area, and the lack of competition in the sector generally, there is a case for regulating these fees further.

Pawn broking

We acknowledge that pawn broking is outside the terms of reference for the review, but believe it is important to comment on this predatory business models as there is an inextricable link between payday lending and pawn broking. A number of payday lenders have shopfronts that offer both pawn broking and payday lending services. In the case below, one consumer told us he was provided with a payday loan to repay a pawn broking loan at another counter within the same store.

James' story

James says he has had approximately 8 to 12 payday loans from a payday lender (that also operates as a pawnbroker) in the last 12 to 18 months, but he's lost count. James says that he was recently provided a loan from one counter, which he then used to pay off his pawn broking loan at another counter of the same store. The payday lender listed his monthly expenses (excluding rent) as less than $550 per month, based on a default calculation of expenses that equals just 15% of borrowers' income. James says that his monthly expenses are much higher. James says that he generally used the loans for groceries and living expenses, such as rent.

James says that he had trouble paying back the loans, and that he got caught in a cycle where he had cash flow problems. The default fees were significant so when he defaulted on one contract about 3-4 times, he was left with little money to make ends meet.

Pawnbrokers are regulated by state and territory legislation. Pawnbrokers are expressly excluded from the operation of most of the national credit laws under the NCCP Act, including the requirements around responsible lending, limits on fees and charges of small loans, and the requirement on providers to be members of external dispute resolution scheme.

We regularly receive complaints from vulnerable and disadvantaged consumers who have pawned goods to pay for basic necessities. These goods often hold relatively little monetary value, but significant sentimental value. Unable to repay the entire loan, debtors can be encouraged to extend a pawn broking agreement if they pay monthly interest payments. This means that the most marginalised Australians can end up paying significant amounts of interest to avoid having their goods sold, and become stuck in a dangerous debt spiral.

One such story was recently reported by the ABC. Kirsten, a single mother and disability pensioner pawned her late mother's jewellery when she was in desperate need of cash. The Melbourne pawnbroker involved charged her the equivalent of 420 % interest per annum. If the pawnbroker was subject to the national credit laws, it would have had to comply with responsible lending obligations and an interest rate cap.[94]

Pawn broking is subject to the unjust transaction provisions of the Code. However, this protection is largely illusory for vulnerable borrowers because there is no accessible forum where a consumer can make a complaint. As noted above, pawnbrokers are not required to be members of an external dispute resolution scheme.

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[94] Clare Rawlinson, 'Pawnbrokers charging 420 % interest in unregulated industry, 'profiting from misery' say low income earners', ABC, 16 July 2015, available at: http://www.abc.net.au/news/2015-07-16/pawnbrokers-profiting-from-desperation/6622310.

There are strong similarities between pawn broking and payday lending and these products should be similarly regulated.

Question 12: Anti-avoidance provisions

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).

The payday lending industry has a long history both in Australia and overseas of developing schemes to avoid consumer protection regulation. Even when legislators draft law with known avoidance techniques in mind[95] payday lenders still find weaknesses to exploit. Payday lenders are subject to additional cost caps and responsible lending regulations. Some less scrupulous businesses structure their loans to avoid compliance with these additional regulations.

We are aware of a number of different avoidance strategies. One such strategy involves requiring a borrower to make the first loan repayment immediately while paying fees and interest calculated on the full amount of the loan. In this scenario, a borrower seeking $500 might have to pay back $160 immediately and walk away with only $340 – yet they would be charged as if they borrowed the full $500. Another strategy involves a borrower being required to have their loan amount paid by cheque. A Bill of Exchange is then issued by a bank and a large fee is charged to the borrower to use a 'cheque cashing service' provided by another business that appears to be related to the lender.

Julie's story

Julie is a single mother who subsists on Centrelink payments. She was recently involved in a family breakdown and suffers from mental health issues. She has had her Centrelink reduced and as a result of extreme financial hardship relies on multiple payday loans.

Between February 2013 and October 2014 Julie entered into 20 loans with various payday lenders. Seventeen loans were from a single lender, with 12 of these loans provided while Julie was a debtor in two or more other payday loan contracts within the previous 90 days. Julie was unable to make repayments without suffering significant financial hardship.

While assisting Julie, we identified a number of avoidance practices by three of the lenders:

- Lender 1 – Lender 1 advanced a 'loan' of $270.48 to our client plus an establishment fee of $13.50. The net amount of $270.48 was allegedly paid by cheque. The cheque is then exchanged by an associated business for a cheque cashing fee of $70.48. The result is that $83.90 is taken in fees.
- Lender 2 – Lender 2 provided Julie with $200.00, but she was charged an additional establishment fee of $10.00 and interest of $3.68. Should Julie wish to be paid 'cash today', then a cheque cashing fee may be charged. If a cheque cashing fee is not charged, this loan structure appear unprofitable and unsustainable, unless the client defaults on the loan.

[95] For example, the *National Consumer Credit Protection Amendment (Small Amount Credit Contracts) Regulation 2014.*

- Lender 3 – Lender 3's contract stated that the term of the loan is 16 months, but the lender arranged for debits from Julie's account at a rate that ensured that the loan was repaid within four months. By restructuring the loan in such a way, Lender 3 was able to charge 16 months' worth of fees but recover them in only 4 months.

We've seen one of the biggest players in the market providing 12 month loans under which repayments are reduced to a third of the initial repayments after six months. This reduction in payments appears to have no relationship to the borrower's financial needs, in apparent breach of responsible lending requirements. Instead, the reduced payments mean that the loan runs for longer and, consequently, the lender receives more fees. On a $2000 loan, by reducing repayments, the lender can get the loan to run for an extra five months and collect an additional $400 in fees above what it would have received had the repayments not reduced.

We have also seen instances of potential 'loan splitting':[96]

Joanne's story

Joanne is a personal carer with two children. Joanne has been obtaining payday loans since 2007. She has a gambling addiction and has had 19 loans from the same payday lender since July 2013. Joanne says the payday lender always gives her the amount she wants, and sometimes even offers to lend her more.

Joanne is caught in a cycle of repeat borrowing. She gambles her money, then needs money for bills. It would appear that she uses payday loans as part of her monthly budget. She has rarely if ever defaulted. On one occasion, Joanne says she was told that she could get two separate loans for $1,200 and $2,000, which raised concerns of potential loan splitting. We believe that this is an avoidance technique used to ensure the maximum fees under the SACC regime can be charged. Joanne was confused as to why the lender gave her two loans instead of one.

In another recent case, ASIC took action against a payday lending business where borrowers were signed up to an arrangement where the borrower 'sold' a household item such as a washing machine or fridge to the business, in return for a sum of money, and simultaneously 'leased' the goods back from the business. In practice, the goods never changed hands, and the business never actually saw the household goods, or confirmed the current market value before 'purchasing' them from the consumer.[97]

ASIC was recently unsuccessful in challenging a Gold Coast-based payday lender which it alleged was engaging in fee cap avoidance by using a broking arrangement.[98] According to ASIC, the two companies involved were breaching the National Credit Code because separate agreements that they entered into with a borrower were "in reality" a single "credit contract", and

[96] This is despite prohibitions on loan splitting under Reg 28XXF of the *National Consumer Credit Protection regulations 2010.*
[97] Australian Securities and Investments Commission, '14-278MR ASIC continues crackdown on payday lending avoidance models', 22 October 2014, available at: http://asic.gov.au/about-asic/media-centre/find-a-media-release/2014-releases/14-278mr-asic-continues-crackdown-on-payday-lending-avoidance-models/.
[98] *Australian Securities and Investments Commission v Teleloans Pty Ltd* [2015] FCA 648.

the total fees collected from the customer under those two agreements exceeded the National Credit Code's cap on charges that may be recovered.[99] Interestingly, the Court said (at [42]) that:

> *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.*[100]

The problem with payday lenders using avoidance strategies such as these is that consumers who obtain payday loans from these businesses are not being afforded the additional protections provided by the NCCP Act. These businesses are avoiding compliance with cost caps and additional responsible lending requirements that were introduced to protect our most vulnerable and disadvantaged consumers from predatory behaviour by payday lenders.

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?

We strongly support the inclusion of a general anti-avoidance provision in the NCCP Act, which we believe would obviate the need to distinguish between business model avoidance and internal avoidance. Even assuming Government tries to close the loopholes with specific legislation, it is likely that lenders will continue to find more ways of avoiding the law. We would like to see a general anti-avoidance provision introduced that would enhance ASIC's ability to respond to avoidance as it occurs, making it less likely that we will need further regulatory fine tuning in future. The benefit of this approach is that it enables courts and regulators to identify and react to avoidance schemes before consumer detriment occurs.

The exposure draft of the *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012* proposed the introduction of, amongst other things, a general anti-avoidance provision in the NCCP Act. However, following the change of government at the 2013 election, the proposed Bill did not progress beyond the submission of public comments on the exposure draft.

Subsequently, Consumer Action has been informed by Treasury that such an anti-avoidance provision would require an additional referral of powers from the states. Treasury advised that the relevant Council of Australian Governments (**COAG**) agreement expired on or around 1 July 2012, and that without a further referral of power an anti-avoidance provision would have to be based on a patchwork of constitutional powers (such as the interstate trade and commence or corporations powers). This would end up with credit providers 'avoiding the avoidance provision'.

However, we have received advice from Brind Zichy-Woinarksy QC, which sets out how a comprehensive anti-avoidance provision could be introduced without additional referrals of power from the states (**Appendix 2**).

Question 13: Documentation of suitability assessments

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[99] We note that on 13 June 2014 (before the hearing date), Reg 50A of the *National Consumer Credit Protection Regulations 2010* amended the fees and charges that must be included for the purposes of the section 6 exemption in the National Credit Code.
[100] *Australian Securities and Investments Commission v Teleloans Pty Ltd* [2015] FCA 648, [42].

How do SACC providers currently meet the requirement to make a suitability assessment and what records of the decision-making process are maintained?

ASIC's payday lending report provides evidence that a large number of payday lenders are not currently meeting the requirement to make a suitability assessment. This finding accords with our casework experience, and findings by the Federal Court in *The Cash Store* decision. ASIC's report found that, in particular, there is a serious problem with a lack of documentation recording suitability assessments. According to ASIC's report, 12 of the 13 lenders reviewed did not have any records that indicated how the presumptions of unsuitability were rebutted.[101] The report went further, saying:

> *Overall, we found that the record keeping by lenders in the review was inconsistent and incomplete. There were examples of lenders not maintaining copies of important documents (such as a consumer's application form) on file, no evidence that Credit Guides had been supplied to consumers and no records to show how conflicting information on the file had been reconciled.*[102]

ASIC noted that it had previously highlighted the risk of poor record keeping in its guidance and in our first review of the payday lending industry,[103] and said it was 'disappointing to see compliance in this area has not improved.'[104] In our experience, some assessments of suitability merely state than an assessment was completed, rather than demonstrating the decision-making process and actual compliance. We have attached a de-identified Cash Converter's assessment of suitability by way of example at **Appendix 3.** We note the 'income and expenditure statement' attached to the assessment used a default 15% of income to calculate living expenses (excluding rent), which equated to less than $420 per month.[105] Despite the assessment stating that the lender assessed the borrower's expenses, it appears from the use of the default that the lender does not consider actual expenses in practice.

What is the most efficient and effective way to document suitability assessments? Is it possible to use the same steps for actual compliance and demonstrable compliance?

We are concerned that the framing of this question suggests that the focus of policy response to the issue of record keeping should be on efficiency and effectiveness, rather than avoiding the harm caused by these products from the outset and demonstrating compliance with the law. As ASIC's report shows, attempts to be 'efficient' have perhaps led to the inadequate record keeping we see across the industry and non-compliance with responsible lending laws. Instead, the focus should be on appropriate record keeping that stems from actual compliance with responsible lending laws, which can be easily recovered in the event of a dispute or enforcement action.

Should SACC providers be required to document the assessment? Please consider whether such a requirement could lead to great transparency.

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[101] ASIC, above n. 8, para 55.
[102] ASIC, above n. 8, para 67.
[103] Australian Securities and Investments Commission, 'Report 264 Review of micro lenders' responsible lending conduct and disclosure obligations', November 2011, available at: http://download.asic.gov.au/media/1343786/rep264-published-22-November-2011.pdf.
[104] ASIC, above n. 8, para 68.
[105] We have not attached the income and expenditure statement in order to protect our client's privacy.

Yes, SACC providers should be required to document the assessment. As set out in ASIC's payday lending report, 'If a payday lender does not make appropriate inquiries into the consumer's requirements and objectives and record these inquiries, it is clear the lender will not be able to establish the purpose of the loan'.[106] However, as discussed above, in our view a 48% comprehensive cap would reduce much of the complexity required by these assessments currently as the presumptions of unsuitability would arguably be unnecessary.

Question 14: Comparable consumer leases

General remarks

A consumer lease, as defined by the Code, is a contract for the hire of goods where:

- the hire is for domestic or household purposes;
- the person hiring the goods does not have a right or obligation to purchase the goods; and
- the total amount paid by the consumer is greater than the value of the goods being rented.

Many companies use this model nationally (Radio Rentals being the best known) to rent electronics, whitegoods and furniture to consumers. Motor vehicles are also provided through consumer leases, including through businesses such as Motor Finance Wizard and Carboodle (owned by Cash Converters).

Community legal centres and financial counsellors have years of experience assisting clients who have suffered harm after entering consumer leases where:

- misleading representations have been made in marketing and at point of sale;
- the total price of the transaction was obscured and vastly exceeded the cash price; and
- leases were provided without complying with responsible lending requirements, including proper consideration of whether the customer could meet payments without hardship.

ASIC recently released a report on consumer leases, which found one lease provider charging the equivalent to 884% for a clothes dryer. The ASIC report followed our 2013 report, *The Hidden Cost of Rent-to-Own*, which similarly demonstrated that consumer leases regularly charged 3-5 times the retail cost of goods, and two or more times the cost of a high rate credit card. [107]The ASIC report found that people receiving Centrelink payments are being charged much higher prices than the prices advertised by consumer lease providers. For two year leases, half the Centrelink recipients in ASIC's study paid more than five times the retail price of the goods. ASIC said that there is a high use of consumer leases by financially vulnerable consumers, and that it continues to be concerned about low standards of conduct by some lessors, despite multiple enforcement actions undertaken by ASIC.[108]

Reforms to the regulation of consumer leases introduced through the 2013 Enhancements Act made inroads to solving these problems, but much is left to do.

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[106] ASIC, above n. 8, para 61.

[107] Australian Securities and Investments Commission, 'Report 447 Cost of consumer leases for household goods', September 2015, available at: http://download.asic.gov.au/media/3350956/rep-447-published-11-september-2015.pdf.

[108] Australian Securities and Investments Commission, '15-249MR ASIC finds the cost of consumer leases can be as high as 884%', 11 September 2015, available at: http://www.asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-249mr-asic-finds-the-cost-of-consumer-leases-can-be-as-high-as-884/.

Which leases could be considered comparable with SACCs?

The Code imposes higher consumer protection standards on credit contracts. Where there is confusion over whether a transaction is a consumer lease or a credit contract, the deciding factor is usually whether the contract gives the customer a right or obligation to purchase the goods. If it does not include this right or obligation, it is regulated as a consumer lease.

Lease providers commonly avoid being classified as credit contracts through clever drafting of their contract terms. Terms generally state that the consumer does not have a right or obligation to own the goods being leased, but that the lease provider has the option to sell the goods at the end of the lease period for $1. A similar term in other lease agreements provides that the consumer has the right to gift the goods to a family member or friend at the end of the contract period. In practice, most consumers keep the goods at the end of the rental period, with the same outcome as a purchase by instalments (which would be regulated as a credit contract).[109] In this way, we view the practices of many lessors as engaging in regulatory avoidance mechanisms. In the worst cases, we see consumers continuing to pay fortnightly or monthly repayments beyond the term of the lease, because the options or 'gift' provisions in the contract have not been exercised. This can mean that consumers continue to pay perhaps indefinitely for products they have paid the retail value for many, many times over.

Ian's story[110]

Ian leased some TV and stereo equipment on a four year rental contract about 10 years ago and had a direct debit arrangement in place. Ian was a victim of the 2009 Black Saturday fires, lost the equipment and suffered post-traumatic stress. This year a financial counsellor discovered the direct debits were still being made, on the basis of a tiny, illegible 'hold-over' clause in the contract. Ian had overpaid some $14,000, which we were successful in getting refunded. This case highlighted unfair terms in goods lease contracts, and the value of working with financial counsellors to assist vulnerable clients. Together we made a real difference to our client's financial position.

Consumer leases target a similar demographic to payday loans – often low income and disadvantaged consumers who feel they have no other options other than to resort to high cost lenders. However, in our view there is little to be gained from defining 'comparable consumer leases'. Regulating 'comparable consumer leases' more tightly (as opposed to the industry as a whole) would make the regulatory regime more complex, encourage regulatory arbitrage, be more difficult for ASIC to enforce and allows consumers to fall through the gaps.

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

In our view, there should be greater consistency in the regulatory requirements that apply to credit contracts over $5,000 and all consumer leases. In effect, this would apply a 48% cost cap to consumer leases and other disclosure requirement, including interest rates.

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109 *National Consumer Credit Protection Act 2009*, Schedule 1 - National Credit Code s 9.
110 Case study from Consumer Action Law Centre's 2013/14 Annual Report, available at: http://consumeraction.org.au/wp-content/uploads/2014/10/CALC_Annual_Report_2014_web.pdf.

The absence of the cap is causing significant hardship to consumers, as evidence by the case studies below:

Hilary's story

We were contacted by Hilary after she had entered into a number of consumer leases. Hilary's income is sourced through a disability support pension and a modest wage earned working part time. Hilary has an intellectual disability, and experiences difficulties learning, reading and spelling. Hilary says has no assets other than some essential household items.

Hilary entered into her first consumer lease for a mattress, bedroom suite, and cabinet in March 2013. The total payments under the lease would have been more than $8,900. The cash price of the goods was less than $3,000. Hilary entered into her second consumer lease with the same provider for a washing machine in October 2013. Total payments under the lease to amounted to more than $2,300. The cash price for the washing machine was less than $800.

Hilary was also required to purchase 'add on' insurance. We are instructed that Hilary did not know what the insurance was when she entered the lease agreements. Hilary says that she thought she would own the goods at the end of the leases, although this was not the case.

Sarah's story

Sarah, a single parent relying on Centrelink payments, entered into a number of consumer leases agreements for a laptop, washing machine, refrigerator, television and entertainment unit. Sarah has a young child who has medical needs.

Each agreement was for an effective period of 36 months, and payments were made via Centrepay. Sarah says that she did not understand the legal or practical consequences of the agreements, including that she would have no right to own or buy the goods and that an early termination fee may be payable. Sarah says that she also did not know the cash price of the goods, or that she would be paying an amount significantly in excess of the cash price. Based on our calculations, Sarah would have paid the consumer lease provider more than $7,000 in excess of the cash price of the goods by the end of her contract.

At the time of entering into the contracts, Sarah's income barely covered her expenses. Her financial position was worsened when she separated from her partner. Sarah contacted the consumer lease provider to tell them that she could not afford the repayments. The lease provider said that she could not terminate the agreements without paying significant termination fees.

Consumer leases are subject to considerably lighter regulation than credit contracts. Melbourne University research has found that the uneven regulation of consumer leases and credit contracts has resulted in significant consumer harm.[111] The distinction in regulation is based solely on the

[111] For further information, see Paul Ali, Cosima McRae, Ian Ramsay and Tiong Tjin Saw, Consumer Leases and Consumer Protection: Regulatory Arbitrage and Consumer Harm, *Australian Business Law Review* (2013) Vol. 41, pp. 240-269.

presence or absence in the contract of lease of a right or obligation to purchase the leased goods. This can created an ample incentive for lease providers to enter into agreements with consumers that are in substance credit contracts, but are regulated only as consumer leases.

While the 2013 reforms did much to harmonise regulation of credit contracts and consumer leases, there are still significant incentives for lease providers to engage in regulatory arbitrage. Businesses achieve this by drafting contracts that do not explicitly give a 'right or obligation to purchase', but in practice allow the consumer to keep the goods. As noted above, this can be done in many ways. For example, some contracts currently on the market:

- give customers a right to purchase 'similar goods' to those goods being rented;
- give customers the right to require the business to give the rented goods as a 'gift' to a person nominated by the customer, for example, the customer's spouse; or
- allow the customer to make an extra payment to enter a new 'indefinite lease' of the goods.

There have been numerous instances of lease providers actively misleading consumers about whether they would obtain ownership of the goods at the end of the lease.[112] Many of our clients expect they have a right to own the goods and are shocked to find they do not. Others think they are merely renting the product and can return it at any time, only to later find they are locked into making repayments over several years.

Section 171 of the Code also exempts short term leases (those for four months or less) and indefinite leases from regulation altogether. This encourages lease providers to artificially structure their agreements to fall under these exemptions, leaving their customers without protection under the Code. We are aware of at least one well known firm that structured their offer as an indefinite term lease as a way of avoiding regulation under the Code.

In our view, Code should no longer distinguish between consumer leases and credit contracts based on whether they provide a 'right or obligation to purchase'. This distinction encourages regulatory arbitrage. Contracts should be regulated on substance over form. We endorse the solution proposed by Melbourne University to remove the 'right or obligation' distinction and instead categorise leases either as a 'finance lease' (which would be regulated in the same way as a credit contract) or a 'true lease' (which would not be regulated by the Code at all).[113]

A finance lease would be one in which the term of the contract is long enough to take up the useful life of the goods, and where the consumer bears the risks that come with owning a good, like depreciation. A true lease would be short term, and wouldn't last the life of the product. The customer would be free to return the goods whenever it suits them (rather than being bound to a long term contract). For example, a true lease would include a lease for a laptop that only lasted two weeks, where the customer does not pay more than the price of the laptop. A financial lease might be where the contracts lasts for three years, after which time the laptop is obsolete and the customer has paid much more than the value of the product.

The exemptions for short term and indefinite leases should also be removed. These exemptions allow avoidance without creating any discernible benefit. Consumer Action has been unable to establish why these exemptions (which pre-date the current Code) were created, and it makes

[112] Ibid, p. 241.
[113] Ibid, p. 240.

no sense to keep them. A proposal to remove the short term and indefinite term exemptions was included in an exposure draft *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012*, and we understand the Government is currently developing a regulatory impact statement to address this issue. We urge the Government to maintain the momentum and complete this reform.

Question 15: Applying SACC provisions to comparable consumer leases

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

See our response to Question 14 above.

Should there be additional disclosure requirements for comparable consumer leases?

Our report *The Hidden Cost of Rent to Own* found consumer leases can cost at least twice retail price, usually three times and sometimes more. However, consumers often are not aware of this because advertisements are not upfront about the total rental price of the goods.

The cost of a consumer lease is usually expressed as a low 'per week' amount, but no lease providers properly disclose the full cost of making many years of payments in advertisements. Credit providers, by comparison, would be required to indicate an interest rate and comparison rate if they made the same representations about 'per week' price. Failure to explain total cost entices consumers to enter overpriced contracts they would otherwise avoid, and limits price competition between lease providers.

Margaret's story

A financial counsellor in regional Victoria contacted us about Margaret, who had entered into multiple consumer leases with a consumer lease provider.

Margaret is in her sixties and relies on a disability support pension. She suffers from multiple, chronic illnesses. Margaret visited the consumer lease provider with the intention of purchasing an inexpensive laptop on lay-buy. She had recently lost her husband, and was struggling to recover from her loss. She wanted the laptop for recreational purposes. While she was looking at the laptops, she was approached by a staff member. Margaret advised the representative that she wanted to lay-by a laptop. The staff member told her it would be better to rent the laptop, and that she could rent the laptop for as long as she liked and then just "buy it at the end".

Margaret told the staff member that she was on a disability support pension, and so was unlikely to get approved by the lease provider. The representative encouraged her to "give it a try" and assisted her to complete the forms. The total cost of the laptop over the 60 month term of the contract was around $3,270. The tax invoice from the retailer shows that the insurable value of the laptop was $1,318 including an amount for a three year warranty.

Margaret was never told that the total amount payable was so much higher than the retail price. She says she would not have entered into the contract if she had known that. Margaret feels she was misled about how much she had to pay.

We believe that lease providers should be upfront about the total cost of their products. If they choose to advertise the amount of a repayment, they should also have to prominently disclose the total cost of the goods. Lease providers would then be subject to the same disclosure obligations as credit providers, and consumers would be empowered to make a more informed decision about whether a lease is the right deal for them.

We also recommend the review consider whether consumer lease providers should be required to advertise the cash price of the goods, and the cost of credit as an interest rate (as being considered by the Department of Human Services for consumer lessors using Centrepay).[114] We also recommend that the cost of other services, such as delivery and servicing, be clearly disclosed and optional. The cost of these services should not be able to be financed (i.e. should not be included in the cost cap).

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

See our response to Question 14 above.

Other issues - Centrepay

We note that we have particular concerns about consumer lease providers having access to Centrepay, the Government's bill paying service for welfare recipients. It allows customers to authorise payments to be made automatically out of their Centrelink payment before it reaches their bank account. It effectively prioritises payments made by Centrepay ahead of any other expenses. Centrepay is not available for all types of transactions, and notably it cannot usually be used to repay a credit contract. However, it can be used to rent household goods. Lease providers are making huge profits from access to Centrepay. For example, Radio Rentals' total revenue last financial year was $197 million, and $90 million of that came from Centrepay payments.[115] In effect, this means that almost half of Radio Rentals' revenue came directly from the Department of Human Services.

We object to Centrepay being available to pay off consumer leases because, as explained above, these transactions are effectively credit contracts, which are not permitted access to the Centrepay for good reason. It is also inconsistent with the purpose of Centrepay (assisting low income consumers gain financial stability) to allow access to a product with a history of creating such significant consumer detriment. Allowing access to Centrepay gives a stamp of approval to this business model and prioritises their payments above other essential expenses—they receive repayments every fortnight from Centrelink even if the payments are unaffordable.

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[114] Senator the Hon Marise Payne, Minister for Human Services, 'Media release: Changes to Centrepay deductions', 22 May 2015, available at: http://www.canberraiq.com.au/downloads/2015-5-21-9.pdf.

[115] Credit Suisse, 'Australian ESG/SRI - Risks in payday lending and goods rental', published 3 March 2015. See also the ABC's report on Radio Rentals here: http://www.abc.net.au/news/2015-03-20/radio-rentals-reaps-90-million-in-centrelink-payments/6333690.

In August 2015, the Senate passed a bill designed to remove access to Centrepay by consumer lease providers.[116] The bill is yet to be considered by the House of Representatives. We encourage the review panel to support the enactment of this Bill.

Other issues – motor vehicle leases

The consultation paper give consideration to ‘comparable consumer leases’. We believe there is very similar consumer harm associated with consumer leases for items worth greater than $2,000 (the limit for small amount credit contracts). The problems are most starkly associated with motor vehicle consumer leases, with providers targeting consumers that cannot access mainstream motor vehicle finance due to their financial position or credit history. As noted above, we have received many complaints in relation to Motor Finance Wizard[117]and Carboodle.[118]

Probably the most instructive explanation of this business model was undertaken by TV consumer affairs show, The Checkout.[119] Similar to the harm incurred with ‘appliance’ consumer leases, these products generally charge very highly inflated prices and contracts can lock consumers into long-term arrangements. Returning the vehicle may impose a termination fee, which is unaffordable to the average consumer attracted to these products.

Our view is that should the distinction between consumer leases and consumer credit contracts be abolished, this should equally apply to motor vehicle lease. This would mean that motor vehicle consumer leases would be required to comply with the suite of protections that apply to car finance, including disclosure about the cost of credit.

Question 16: Cap on costs for consumer leases

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

In our view, the cash price of the good should be used as the basis for applying the 48% cap on costs. We believe that the approach for sales by instalment should be used as a basis for applying the cap to all consumer leases.

Under the Code, the *cash price* of goods or services to which a credit contract relates means:

a) the lowest price that a cash purchaser might reasonably be expected to pay for them from the supplier; or

b) if the goods or services are not available for cash from the supplier or are only available for cash at the same, or a reasonably similar, price to the price that would be payable for them if they were sold with credit provided—the market value of the goods or services.

[116] *Social Security (Administration) Amendment (Consumer Lease Exclusion) Bill 2015*
[117] Consumer Action Law Centre, ‘Motor Finance Wizard - general information’, 27 September 2012, available at: http://consumeraction.org.au/motor-finance-wizard-general-information/
[118] Consumer Action Law Centre, ‘ASIC raises concerns about Carboodle’s ‘potentially misleading representations’, 9 April 2013, available at: http://consumeraction.org.au/asic-raises-concern-about-carboodles-potentially-misleading-representations/.
[119] The Checkout, ‘The Car Genie – Episode 23’, http://www.abc.net.au/tv/thecheckout/clips/.

If subsection b) applies, the market value of the goods could be calculated as the price paid by the supplier for the goods, or a reasonable estimate based on the cash price of the same (or similar) goods being sold by other retailers.

We would be very happy to discuss the issues raised in this submission with the review panel further. Please contact Katherine Temple on 03 9670 5088 or at katherine@consumeraction.org.au if you have any questions about this submission.

Yours sincerely
CONSUMER ACTION LAW CENTRE

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