# Review of the small amount credit contract laws

## Submission by Credit Corp Group Limited

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# Submission by Credit Corp Group Limited (Credit Corp)

## Part 1 – Executive Summary

1.1 Credit Corp is an ASX200 listed public company and is Australia's largest provider of sustainable financial services in the credit impaired consumer segment. As a consequence of the July 2013 changes to the *National Consumer Credit Protection Act* 2009 (**Credit Act**), Credit Corp entered the Small Amount Credit Contract (**SACC**) segment and, uniquely in the sector, offers loans with minimum terms of four months and with consumer fees and charges well below legislated caps.

1.2 The SACC market is a very significant financial sector. Credit Corp has undertaken a comprehensive analysis revealing that in the 2015 financial year $1.2 billion of loans were issued, comprising of 2.2 million individual loans to 540,000 consumers.

1.3 The sector has been opened up to responsible, mainstream financial services companies, such as Credit Corp, to compete on the basis of price and sustainable product features as a result of the framework provided by the SACC legislation. Appropriately set fee caps mean that ethical providers with no tolerance for avoidance techniques can operate viably without risking adverse scrutiny. In addition, the use of the neutral term, 'small amount credit contract (or 'SACC'), to describe the sector, as opposed to more pejorative terms, has also assisted in encouraging the entry of responsible operators.

1.4 The SACC legislation has, however, failed to limit the offering of unsustainable loans with durations of less than three months and encourage longer term SACCs with more affordable repayments. Credit Corp's market analysis demonstrates that 85% of the SACCs issued in the 2015 financial year were for durations of less than three months and almost half (45%) of these showed repayments that accounted for more than 15% of the borrower's income and, as a result, may have been unaffordable. This is borne out by the high incidence of repeat borrowing, with SACC customers entering an average of four SACCs over the year.

1.5 Even more concerning is the large number of applications received by Credit Corp from consumers who have allocated more than 30% of their income to SACC repayment over the 90 days preceding their application. On an annualised basis Credit Corp receives more than 56,000 such applications and these consumers will be facing severe financial exclusion. This is an unsatisfactory outcome that implies shortcomings in both the legislation and the regulatory approach.

1.6 Primarily, the legislation fails to differentiate between shorter term SACCs with high repayments and longer term SACCs with more affordable repayments, which minimise repeat borrowing and the risk of a debt spiral. In March 2015, the Australian Securities and Investments Commission (**ASIC**) issued Report 426 and took the unprecedented step of applying the term 'payday loan' to all SACCs regardless of duration, affordability and pricing. Not only is this inconsistent with regulatory treatment in other jurisdictions but it has effectively marginalised responsible operators, jeopardising the support of their critical stakeholders.

1.7 Unaddressed, the logical consequence of using 'payday loan' to replace the term 'SACC' will be less participation in the segment by reputable operators and a reduction in competition. Specifically, for Credit Corp, the application of the pejorative term 'payday lender' has resulted in unacceptable corporate and social responsibility outcomes. Credit Corp is consulting with its stakeholders and will make a decision on its continued participation in the SACC segment shortly. The practical effect of a decision to withdraw from the segment will be to deny thousands of consumers a way out of the payday loan debt spiral through access to longer-term, sustainable and lower cost credit products.

1.8 This review provides an opportunity for the Government to address these regulatory shortcomings.

1.9 Credit Corp's submission describes the substantial economic disincentives to the provision of more affordable SACCs by individual providers. Credit Corp proposes that, in order to overcome these disincentives and promote longer duration SACCs, the term 'payday loan' be properly defined in the Credit Act to apply to loans with a maximum duration of 90 days. Credit Corp also proposes that additional limitations are imposed on such 'payday loans', that less restrictive controls are applied to longer duration SACCs and that some existing controls are relaxed.

# Part 2 – Company Profile

## 2.0 Introduction

2.1 Credit Corp is Australia's largest provider of sustainable financial services in the credit impaired consumer segment.

2.2 Credit Corp has been listed on the Australian Securities Exchange since 2000 and forms part of the S&P ASX 200 index. The company is an Australian success story employing in excess of 1,200 people with business operations in Australia, New Zealand, the USA and the Philippines. The face value of Credit Corp's total receivables is $5 billion across 700,000 consumers.

## 3.0 Core business

3.1 Credit Corp's core business is debt purchasing. Credit Corp purchases charged-off (defaulted) unsecured consumer debts from major banks, finance companies and telecommunication and utility providers. By providing lenders with higher and more timely returns on charged-off debts, Credit Corp helps to reduce the cost of credit and to promote its wide availability within the Australian economy.

3.2 We are a recognised leader in sustainable business practices and maintain certifications under ISO 9001:2008 (Quality Management System) and ISO 27001: 2013 (Information Security Management System). Financial services have become a basic need in the modern market economy,[1] and Credit Corp plays an important role in working with consumers who suffer from financial exclusion. Our objective is to improve the situations of our customers by establishing pathways to mainstream financial inclusion. By pursuing this objective, Credit Corp has led a revolution in the business of late stage debt collection to the benefit of consumers.

3.3 In our core debt purchasing business, we work with consumers who have, for various reasons, found themselves in default of their credit obligations. We agree affordable repayment plans and work with our customers over several years to improve their credit standing as a pathway to financial inclusion.

3.4 Credit Corp currently has a portfolio of more than one billion dollars of defaulted consumer credit obligations, restructured into sustainable ongoing repayment arrangements across 133,000 individual customer accounts. This is the most successful financial hardship program in the industry, with more than 75% of our total collections made pursuant to mutually-agreed ongoing payment arrangements.

3.5 At Credit Corp, we set operational standards at levels significantly above minimum legal requirements. We have a strong compliance culture supported by a control framework to ensure that we adhere to the standards we have set for ourselves. We openly engage with consumer stakeholders and regulators for ongoing feedback and assistance. This includes a long-term partnership with Kildonan Uniting Care to promote respectful engagement with consumers and the proactive recognition and management of financial hardship.

3.6 These commitments have established Credit Corp as an industry leader. Despite being the largest and longest-established debt purchaser in Australia, Credit Corp has never been the subject of a regulatory order or undertaking. We have one of the lowest rates of External Dispute Resolution (**EDR**) complaints in the debt purchasing industry, with only 1.2 complaints for each one million dollars collected. Credit Corp has never had a reportable EDR systemic issue.

3.7 Credit Corp commenced consumer lending operations with the objective of leading a similar revolution in the business of lending to the credit impaired consumer segment, by introducing competition on the basis of price and sustainable product features. This decision aligned with Credit Corp's existing commitment to increasing financial inclusion and leveraged its existing infrastructure and investment in sustainable and responsible business practices.

## 4.0 Lending

4.1 Financial exclusion is a significant issue in Australia, and it is not confined to the welfare-dependent. Many people are unable to access moderate amounts of credit from mainstream lenders to help them manage unexpected expenses. Approximately 40% of Australians with annual incomes of $50,000 or more do not have access to a credit card and this statistic rises to almost 60% for the population with annual incomes in range of $25,000 to $50,000.[2]

4.2 Credit Corp is supportive of government and philanthropic initiatives such as the No Interest Loan Scheme (**NILS**) to address financial exclusion. However, the reality is that only a small proportion of financially excluded Australians are able to access such initiatives.[3]

4.3 Our market comprises those consumers who fall within the gap between people who qualify for mainstream credit products and the vulnerable, mostly welfare dependent, consumers to whom government and philanthropic services such as NILS are rationed.

4.4 Credit Corp is committed to delivering the lowest cost financial products to this market. All of our products are priced to deliver the same modest rate of return targeted by all mainstream credit issuers. We have implemented a purely on-line and call centre lending model supported by automated technology to maximise efficiency. We leverage our existing infrastructure to marginally cost overheads to the lending business. All efficiency gains are returned to customers through lower pricing.

4.5 Credit Corp commenced lending to credit impaired consumers in 2012. Our core product has always been an instalment loan in amounts of $2,000 to $5,000 over terms of one to three years (this is not an SACC product). This market-leading product is priced at an Annual Percentage Rate (**APR**) which is between one half and five sixths of the applicable tiered cap under the Credit Act. Our pricing is highly attractive to consumers and we have gained significant share of the market from competitors who operate at the applicable legislative caps. Credit Corp has provided 41,000 consumers with affordable credit through this product.

4.6 Credit Corp has developed comprehensive responsible lending practices. Consumer objectives and requirements are obtained and are assessed to ensure that any loan is appropriately aligned with those objectives and requirements. Financial capacity is carefully examined through the verification of income and expenses, as well as by use of recognised cost of living benchmarks. Any inconsistences are resolved by discussion with applicants and the receipt of further substantiation where appropriate. The process results in a thorough assessment of the suitability of every loan for every customer's individual circumstances.

4.7 Our lending approach has placed Credit Corp in a unique position. We have a significantly lower incidence of complaints per 100,000 loans than either the credit card or personal loan averages reported by the EDR provider to mainstream credit product issuers and our lending business has never been the subject of an investigation by an EDR scheme or regulator.

4.8 Prior to the introduction of the legislated tiered fee and interest rate caps in July 2013, Credit Corp did not offer loans below $2,000 for terms of less than one year. Prior to the introduction of those caps, it was not possible to sustainably and economically offer such loans to credit impaired consumers below the 48% APR cap which applied in some States, and Credit Corp's commitment to responsible and transparent practices would not tolerate the various techniques used by other industry participants to avoid the cap in those States.

## 5.0 Credit Corp SACC

5.1 Credit Corp welcomed the July 2013 changes to the Credit Act. The introduction of a concessional cap on fees to SACCs provided an opportunity for Credit Corp to introduce competition in the SACC market. That competition was introduced through offering cheaper prices and more flexible product features than previously offered to consumers in the market.

5.2 Our decision to enter the SACC market was taken very carefully after consultation with consumer stakeholders and the Regulator. We looked to structure our lending to responsibly deliver a highly differentiated and affordable solution to consumers who might otherwise be users of unsustainable 'payday loans' (loans with a duration of less than three months).

5.3 Credit Corp consulted with both ASIC and Kildonan Uniting Care in formulating its entry into the SACC market. Both organisations recognised the benefits to consumers that would flow from the entry of a responsible and sustainable operator. ASIC encouraged Credit Corp's entry into the market, which it viewed as complementing its own regulatory objectives of delivering positive and competitive consumer outcomes.

5.4 We did not (and still do not) consider that true 'payday loans' (loans under three months) were affordable for consumers. Short durations lead to high repayments, which have the potential to push consumers into an immediate state of financial hardship and create the need for further borrowing, exposing consumers to debt spirals. We chose to focus on loans with longer durations, with more affordable repayments.

5.5 Our initial financial modelling on SACC lending suggested that we could achieve sustainable returns at a discount to the legislated caps and we set our monthly fee rate at 2% (rather than 4% as allowed by the legislation). We chose to reduce the monthly fee rate to ensure we were not motivated to unnecessarily extend the duration of loan contracts to charge additional fees, so that consumers maintained the flexibility of obtaining shorter loans where that best suited their purpose and particular circumstances.

5.6 Over time, we have further refined our SACC product. We now only offer loans with a minimum duration of 4 months and both our upfront and monthly fees are set well below the legislated caps, representing a substantial discount to the market. Our upfront fee is set at 15% (rather than 20% allowed by the legislation) and our monthly fee remains at 2%.

5.7 Our exception fees are also market-leading. Credit Corp does not profit from customer arrears and does not exacerbate the impact of any hardship a defaulting borrower may be suffering. Credit Corp charges a single cost-recovery late payment fee of $10 for each payment reversal, and this can only be charged across two payment cycles for a maximum of $20 for each instance of arrears. We encourage customers to contact us in advance of a missed payment and will not apply any charges when this occurs. We do not charge any fees for early repayment and waive monthly fees for the unused portion of the original term.

5.8 Credit Corp's SACC is significantly more sustainable than a 'payday loan'. Credit Corp's analysis of the SACC market shows that 180,000 SACCs are issued each month and 153,000, or 85%, of these are issued for a duration of up to three months and could accurately be described as a 'payday loan'. The analysis shows that the average such 'payday loan' is for an amount of $479 for 37 days, repaid by an average of 2.6 repayments of $229. Such high repayments are less likely to be affordable for consumers on lower incomes and in 45% of instances absorb greater than 15% of a borrower's after tax income. This will produce a high incidence of repeat borrowing leading to a debt spiral.

5.9 In contrast, Credit Corp's average SACC is for $835 over six months with 13 fortnightly repayments of $85. Credit Corp's fortnightly repayments (which on average absorb less than 5% of a borrower's after tax income) are manageable for consumers on lower incomes and effectively minimise the need for repeat borrowing and the risk of a debt spiral, being one of the main public interest considerations driving the 2013 reforms. To date, 35,000 consumers have successfully avoided higher cost and unsustainable 'payday loans' through Credit Corp's SACC product.

5.10 Credit Corp believes it is impacting the SACC segment to the benefit of consumers. We have introduced competition on the basis of price and sustainable product features to a market where the only differentiators to date have been ease of access and speed of disbursement.

# Part 3 – Competition and incorrect use of *'payday loan'*

## 6.0 Competition

6.1 It is axiomatic that competition on price and product features in any market is more effective in improving consumer outcomes than regulation alone. It is important that that any regulatory activity provides an environment where ethical and responsible operators are encouraged and are not dis-incentivised to enter or remain in markets to promote such competition.

6.2 One of the common arguments for regulation of the SACC sector is the absence of competition.[4] Commentators have recognised a need for increased competition to traditional operators and have called for the expansion of government and philanthropic lending programs,[5] and the introduction of regulatory incentives such as tax breaks to encourage competition.[6] However, key to enabling competition is to establish an environment in which sustainable and responsible lenders can operate. This would also minimise any need for government funding or incentivisation.

6.3 The inaccurate application of pejorative terms such as 'payday loan' to describe all SACCs effectively marginalises responsible operators seeking to stimulate competition, leaving consumers with only higher cost and less sustainable alternatives. Credit Corp has made a strong commitment to sustainability across all of its business activities and will not be able continue as an agent for positive change in the SACC sector unless there is some clarification of the term 'payday loan'. This is a fundamental concern for Credit Corp and represents a significant road block to improving consumer outcomes and financial inclusion.

6.4 There are significant economic incentives for lenders to provide shorter duration SACCs over terms of less than three months. Cost structures for SACC providers are relatively fixed per customer. They are lower for lenders providing shorter duration loans as a consequence of higher rates of new customer loan approval. High repeat rates for shorter term SACCs increase revenue per customer, through the ability to charge an additional establishment fee for each repeat loan. These very short term, lower value and high repeating loans put less capital at risk at any time. The combination of these factors mean that returns on capital for longer duration loans are a fraction of those available for 'payday loans' (loans over terms of terms of less than three months).

6.5 The economic disincentives to offer longer term loans and charge lower rates can only be offset with the support of our business partners and stakeholders. Credit Corp's commitment to sustainability provides us with access to efficient debt and equity capital, as well as access to lower cost administrative facilities.

6.6 The support of Credit Corp's stakeholders and business partners has been jeopardised by the unjustified and unprecedented use of the pejorative language 'payday lending' to characterise all SACC providers,[7] discussed below.

6.7 Credit Corp is not arguing for government funding or incentives, just a fair opportunity to maintain the support of its stakeholders so that it may continue to deliver on the public policy objectives of the SACC legislation and introduce competition on price and product features to improve consumer outcomes and financial inclusion.

## 7.0 ASIC Report 426 and the definition of a *'payday loan'*

7.1 ASIC's adoption of the term 'payday loan' to describe all SACCs in Report 426 published in March 2015[8] is entirely without precedent and will serve to defeat the public policy objectives of the SACC legislation. It is also the first time, of which Credit Corp is aware, that any government body has sought to apply the term in this way.

7.2 A 'payday loan' is a borrowing to fund living expenses until the next pay day and should not be used to describe any loan with a duration of more than three months, particularly given employers in Australia are legally required to pay employees at least monthly.

7.3 ASIC's own methodology to estimate the size of the SACC market in Report 426 is stated to be based on a 2010 Consumer Action Law Centre (**CALC**) study that limited its scope to consideration of loans with durations of less than 8 weeks.[9] The methodology used by CALC also extrapolated from Cash Converters published cash advance (less than 8 weeks) loan data to estimate market volume.[10] Perversely, ASIC's own approach to estimating market size demonstrates that it is erroneous to describe all SACCs as 'payday loans', yet this is what the Regulator is now doing.

7.4 Credit Corp has performed an exhaustive survey of the large body of academic and other research work over the last 15 years in Australia in relation to payday lending to review use of the term 'payday loan' or 'payday lender'. A summary of those findings is contained in **Appendix A**. While no uniform definitions of these terms exist, the views and findings expressed by researchers, academics, lenders and consumers show that a definition specifying a maximum loan amount of $2,000 for a maximum duration of three months would cover the field.

7.5 The term 'payday loan' emanates from the United States of America and the use of the term in that market is relatively consistent and specifies loan durations much shorter than three months. The vast majority of State-based legislation defines such loans as between 7 and 90 days and Federal legislation defines such loans as loans up to USD $2,000 up to 91 days in duration.[11]

7.6 The US Federal Regulator, the Consumer Financial Protection Bureau (**CFPB**) refers to 'payday loans' as:

> *typically structured as a closed-end single payment loan with a due date that coincides with the borrower's next payday or receipt of other income. Because the due date is timed in this manner, the loan term is typically two weeks.*[12]

7.7 For the purposes of legislative reform, the CFPB recently proposed that a definition of short term loans be introduced into Federal consumer credit laws that focuses on a loan duration of up to 45 days:

> *'Covered Short-Term Loan' means a credit product, other than those explicitly excluded from the proposals under consideration, with a contractual duration of 45 days or less.*[13]

7.8 Further, academic literature and industry stakeholders in the US 'payday loan' market characterise 'payday loans' in that country as: unsecured loans for US$250-US$500 and terms of 14 to 18 days,[14] short-term loans made for 7 to 30 days for a small amount,[15] loans from $100 to $1,000 and an average term of two weeks,[16] and financial instruments that immediately provide customers with small amounts to be paid back on an agreed date that typically coincides with the customer's next receipt of income within two to four weeks.[17]

7.9 In Canada, all provinces have effectively adopted a uniform definition of payday loans as loans up to CAD $1,500 up to 62 days in duration.[18]

7.10 Similarly, use of the term 'payday loan' in the United Kingdom (UK) focuses on loan durations of much less than three months. A UK report on the topic defines a 'payday loan' as:

> *A small, short-term unsecured loan with both principal and interest scheduled to be repaid on a single date* [19]

7.11 In support of this definition, it cites figures published by the Office of Fair Trading (OFT) that:

> *The average loan is between £265 and £270 and is borrowed over 30 days.*[20]

7.12 In our discussions with ASIC on its use of the term 'payday loan' to describe all SACCs in Report 426, ASIC has justified its position on the basis that it is a term commonly used by consumers. Credit Corp agrees that the term is commonly used by consumers but this merely reflects the fact that 85% of all SACCs issued in Australia are for durations of less than three months and can, therefore, be accurately described as 'payday loans'. Consumers have been conditioned by an industry which focuses on such short durations as part of a business model that relies on repeat borrowing. Consumers do not expect to be offered more sustainable loans over longer durations, nor would they identify such longer term loans as 'payday loans'.

7.13 ASIC has also pointed out that the term 'payday loan' continues to be used by providers of SACCs of various lengths in their Google AdWords advertising. This is correct but it does not mean that all such providers are offering 'payday loans'. Nor does it mean that any providers consider that SACCs of more than three months duration are 'payday loans'.

7.14 It is commonplace in on-line advertising to purchase a keyword in Google AdWords to promote an alternative to the product denoted by the keyword. Credit Corp buys the keyword 'payday' to encourage consumers to visit its website to take out longer-term loans at lower rates. Credit Corp has reviewed the AdWord copy and websites of all the underlying credit providers advertised on the first page of Google search results for the term 'payday loan' and not one credit provider uses the term 'payday loan' to describe loans with a duration of more than three months.

## 8.0 Incorrect use of *'payday loan'* stifles objectives of the SACC legislation

8.1 The *Consumer Credit Legislation Amendment (Enhancements) Bill* 2012 (**Bill**) introduced the system of tiered fee and interest rate caps and the small amount lending provisions into the Credit Act.

8.2 The scheme and background to the Bill explicitly recognises the risk of harm associated with high cost, small amount loans over durations of less than three months and the need to encourage loans over longer durations with more affordable repayments.

8.3 The Regulation Impact Statement (**RIS**) to the Bill correctly defines 'payday loans' as a discrete subset of short term, small amount loans with a duration of less than three months:

> *This RIS uses the term 'payday loan' to refer to a loan of under $1,000, and for a duration of less than three months.*[21]

8.4 The Digest to the Bill published on 9 November 2011 by the Department of Parliamentary Services also adopted the following definition of 'payday loans':

> *'pay-day' loans marketed to 'tide the borrower over' until payday, often of two to four weeks duration and are designed to meet unexpected expenses.*[22]

8.5 Primary research papers which form the basis for the analysis in the RIS adopt a similar position in setting parameters for 'payday loans'.

| Paper | Parameters of 'payday loan' |
|---|---|
| G Marston and L Sheveller, 'The Experience of Using Fringe Lenders in Queensland: A Pilot Study', July 2010 | A loan of under $1,000 and for a duration of less than three months. |
| National Australia Bank ('NAB'), 'Do you really want to hurt me: Exploring the costs of fringe lending – A report on the NAB small loans pilot', 2010 | A loan of up to the vicinity of $1,000 with a duration of up to eight weeks. |
| Z Gillam and Consumer Action Law Centre, 'Payday Loans Helping Hand or Quicksand', 2010 | Defines a high-cost short-term loan as up to $2,000 for a period up to eight weeks |
| N Howell, T Wilson, J Davidson for Consumer Credit Legal Centre 'Interest Rate Caps, Protection or Paternalism', December 2008 | A loan of up to $1,000 and for a duration of up to eight weeks. |
| D Wilson, Consumer Law Centre Victoria, 'Payday Lending in Victoria – A research report', 2002 | Short term, high interest loans, usually unsecured, and for amounts under $1,000 for periods of less than 62 days. |

8.6 The tiered system of fee and interest rate caps is critical to a proper understanding of the legislative intention of the loan definitions adopted in the Bill and can be summarised in the following table:

| Loan type | Definition | Cap |
|---|---|---|
| 'Short Term Credit Contract' ('STCC') | Amount of less than $2,000 for a duration of less than 16 days | N/A. Such loans are prohibited. |
| 'Small Amount Credit Contract' ('SACC') | Amount of up to $2,000 for a duration of between 16 days and one year | Establishment fee of 20% and ongoing fee of 4% per month ('20/4 cap') |
| 'Medium Amount Credit Contract' ('MACC') | Amount of between $2,001 and $5,000 for a duration of between 16 days and two years | Establishment fee of $400 plus an APR of 48% |
| All other loans | All other loans | An APR of 48% |

8.7 STCCs are prohibited. This is a recognition that loans with a single 'bullet' repayment pose an unacceptable risk of harm to consumers. The size of the repayment on such loans often represents such a high proportion of an individual's income over the period that it can only be met by either foregoing essential items resulting in an immediate state of substantial hardship or through further borrowing leading to a 'debt spiral'.[23] This prohibition should be retained.

8.8 The definition of a SACC is foremost a recognition that loans of amounts up to $2,000 for durations of up to one year cannot be viably provided under the comprehensive APR of 48% applicable to all other loans. The RIS cited a NAB study which concluded that it was not possible to make a profit and legally operate within the 48% APR cap for loans of $1,700 or smaller.[24] At the time of introducing the reforms in July 2013, the Government could have chosen to apply the concessional 20/4 cap only to loans for durations of less than three months to reflect both the very short term nature of 'payday loans' and the evidence presented by the industry at the time about the typical characteristics of 'payday loans' or parameters by which small loans common among the industry are to be distinguished from other loans (namely $200-$500 with durations of one to six weeks)[25]. The Select Committee noted this industry evidence in its December 2011 report, which recognised that lenders drew a distinction between 'payday lenders' and 'micro lenders', with the former covering loans for a maximum of $1,500 and for a duration of up to 12 weeks.[26] However, applying the concessional 20/4 cap only to loans for durations of less than three months would have had the consequence of discouraging more affordable longer term lending above three months.

8.9 The Government explicitly recognised the need to encourage loans of longer durations in excess of three months in setting the 20/4 cap for SACCs. The Revised Explanatory Memorandum to the Bill (**Memorandum**) explains the reasons for the cap as follows:

> *Setting the cap at this level would allow for a viable small amount lending industry to continue while meeting the Government's objective of indirectly encouraging longer term loans.*[27]

8.10 The Memorandum goes on to compare the 20/4 cap fee structure to various alternatives suggested by industry through a table of returns at different durations. In explaining the preference for the 20/4 cap fee structure, the Memorandum notes that the table shows that this structure provides the lowest relative returns to lenders on a single loan for periods up to three months, an equivalent return at four months and a better return from five months:

> *Table 5.2 demonstrates the '20/4 model' provides a higher return than the other models after a period of time between five and nine months.*[28]

8.11 The identification of particular risks associated with loans of less than three months' duration is reflected in the Government's decision to introduce a presumption of unsuitability that applies where a consumer has had two or more SACCs in the last 90 days. That decision reflects the evidence that existed at the time of the reforms that risks associated with repeat borrowing are concentrated in lending at terms of less than three months. In that regard, both the RIS and the Memorandum identify the risk factors as follows:

> *The term of the loan – the shorter the loan the less income the borrower can expect to receive, so there is little or no opportunity for a borrower to put aside sufficient income to repay the principal plus associated charges, so that the impact will be greater in relation to loans with terms between one week and one month.*
>
> *The number of loans – the more loans that the borrower takes out within a short period of time, the more likely it is that income is being diverted to meet repayments, rather than ongoing expenses.*[29]

8.12 The primary protection in the Bill targets borrowing over periods of less than three months through a presumption of unsuitability where the consumer has been a debtor under two or more other SACCs in the preceding 90 days.

8.13 The protection was set as a presumption, rather than a prohibition, to encourage responsibly delivered loans of more than three months' duration. In that regard, the Memorandum notes:

> *The use of presumptions, rather than a prohibition, allows for greater flexibility and acknowledges that there may be situations where a refinance would not result in financial hardship (such as where it results in lower repayments which the consumer can afford).*[30]

8.14 It is clear from the above analysis of the background to the previous reforms that SACCs with a duration of more than three months are not 'payday loans', and that the Government's intention was to encourage longer term SACCs with more affordable repayments. The analysis shows that the SACC definition is a framework for a concessional cap to encourage loans of durations of more than three months and cannot be construed as recognition that all lending over a term of less than one year poses a disproportionate risk of harm.

8.15 There is compelling public policy rationale and a pressing need to clarify what is meant by a 'payday loan' vis a vis a SACC, and to clearly establish that the two concepts are not interchangeable. Credit Corp submits that the term 'payday loan' ought to be defined as a loan of up to $2,000 and for a duration of between 16 and 90 days – in other words, distinct from SACCs with loan periods of longer than three months.

# Part 4 – Effectiveness of SACC legislation

## 9.0 Summary

9.1 The SACC legislation has succeeded in providing a framework for the entry of responsible operators into the SACC segment to compete on the basis of price and sustainable product features. An appropriately set fee cap means that ethical providers with no tolerance for avoidance techniques can operate viably without risking adverse scrutiny. The application of the neutral term, ‘small amount credit contract’, to describe the sector has been important in encouraging the entry of responsible operators.

9.2 The SACC legislation has, however, failed to limit unsustainable loans with durations of less than three months and encourage longer term SACCs with more affordable repayments. Credit Corp’s comprehensive analysis of the market is set out in **Appendix B**. This analysis reveals that in the 2015 financial year, $1.2 billion of SACC loans were issued, comprising 2.2 million individual loans to 540,000 consumers. 85% of these SACCs were issued for durations of less than three months and almost half (45%) of these showed repayments which accounted for more than 15% of the borrower’s income and may have been unaffordable. This led to a high incidence of repeat borrowing of approximately four SACCs per customer over the year.

9.3 Even more concerning is the large number of applications received by Credit Corp from consumers who have allocated more than 30% of their income to SACC repayment over the 90 days preceding their application. On an annualised basis Credit Corp receives more than 56,000 such applications and these consumers will be facing severe financial exclusion. This is an unsatisfactory outcome that implies shortcomings in both the legislation and the regulatory approach.

9.4 These failures are a consequence of both the legislation and the regulatory approach. The legislation fails to differentiate between shorter term SACCs, namely 'payday loans’ with high repayments, and longer term SACCs with more affordable repayments, which minimise repeat borrowing and the risk of a debt spiral. Regulatory activity has failed to provide an environment where ethical and responsible operators are encouraged to enter or remain in the segment to promote competition.

9.5 The risk factors contained in the Bill provide a useful framework for assessing the success of the SACC legislation. The Memorandum identifies four risk factors at paragraph 5.7:[31]

1. ***the term of the contract*** *– the shorter the term the less income the borrower can expect to receive from other sources while they need to repay it, so that there is less opportunity for a borrower to receive sufficient income to either repay the debt or avoid an immediate need for additional credit to meet expenses temporarily deferred in order to make that repayment.*

2. ***the borrower’s income*** *– the lower the income the greater the reduction in income that will result from having to meet repayments under a credit contract (noting that a significant percentage of borrowers who use these products will have very low incomes).*

3. ***the number of credit contracts*** *– the more credit contracts that the borrower takes out within a short period of time (whether concurrently or successively), the more likely it is that income is being diverted to meet repayments, rather than ongoing expenses.*

4. ***the level of costs being charged by the credit provider*** *– there can be significant differences in the level of costs being charged by credit providers, part reflecting the difficulties some debtors have in being able to obtain credit from other credit providers (with the result that they enter into contracts irrespective of the costs being charged)* (this was the case prior to enactment of the Bill – presently, almost all operators charge the 20/4 cap, comment added).

## 10.0 The term of the contract

10.1 2.2 million SACCs are being written each year, with 85% of SACCs, or 153,000 SACCs per month, being written for loan terms of less than three months. The market share by volume of loans is distributed as follows:

| Credit Provider | 0 – 3 month loans | 4 – 12 month loans | Share of total SACC market |
|---|---|---|---|
| Cash Converters | 28% | 8% | 36% |
| Nimble | 18% | 0% | 18% |
| Money 3 | 9% | 1% | 10% |
| Credit Corp Financial Services | 0% | 2% | 2% |
| Others | 30% | 4% | 34% |
| **Total** | **85%** | **15%** | **100%** |

(See Appendix B)

10.2 The typical loan term for loans with durations less than three months is four to six weeks, with the average loan term of all such loans originated by industry from January to June 2015 being 37 days (an average of 2.6 fortnightly repayments). This is markedly different to Credit Corp's SACCs, for which the average loan term in the period January to June 2015 is six months (or 13 fortnightly repayments). Further, industry participants offering 'payday loans' with durations of less than three months do not always offer loans at Credit Corp's minimum duration of four months.

| SACC terms based on Jan-15 to Jun-15 originations | Credit Corp SACC | 0 – 3 month SACC |
|---|---|---|
| Minimum term | 4 months | 16 days |
| Maximum term | 12 months | Typically 8 weeks |
| Average term | 6 months | 37 days |
| Average loan amount | $835 | $479 |

(See Appendix B)

10.3 Loan term is a particularly relevant factor and is a proxy for affordability, as shorter loan terms absorb a far greater portion of a borrower's pay and thereby materially increase the risk of a debt spiral.

## 11.0 The borrower's income

11.1 The analysis presented in Appendix B indicates that 45% of SACCs with terms of less than 90 days have repayments which absorb more than 15% of a borrower's after tax income. This level of repayment for an individual SACC has the potential to create dependency and expose a borrower to the risk of a debt spiral.

11.2 To assess the risk associated with the level of income of the borrower, it is instructive to compare borrowers of less than three month SACCs with Credit Corp's SACC borrowers and more vulnerable consumers serviced by NILS. Schemes such as NILS are, by necessity, available only to consumers in more severe categories of financial exclusion. Credit Corp's SACC cannot assist such consumers but does provide a sustainable alternative for the more populous segment of consumers in less severe categories of financial exclusion.

11.3 Credit Corp's SACC borrowers have an average validated income equivalent to a gross annual salary of $57,500 and receive on average $1,773 per fortnight after tax.

| | NILS[32] | Credit Corp SACC | 0 -3 month SACC |
|---|---|---|---|
| Average loan amount | $930 | $835 | $479 |
| # fortnightly repayments | 39 | 13 | 2.6 |
| Average fortnightly repayment | $24 | $85 | $229 |
| Average fortnightly after tax income | $857 | $1,773 | $1,659 |
| Repayment as a % of income | 2.8% | 4.8% | 13.8% |

(See Appendix B)

11.4 Whilst Credit Corp's borrowers are generally earning as much as users of 0 - 3 month 'payday loans', the repayments are on average an affordable 4.8% of each borrower's after tax income and are much more akin to a NILS loan in relative affordability for those borrowers. Loans with terms of less than three months are absorbing an average of 13.8% of a borrower's after tax income and 45% of these loans absorb more than 15% of a borrower's after tax income. Appendix B contains additional detail on borrower income and SACC affordability, including stratifications of borrower income and loan affordability by product type and loan term.

11.5 There is little or no overlap between the NILS customer base and the customer base of the SACC industry. The average equivalent pre-tax salary of a Credit Corp SACC borrower exceeds $57,500 per annum and applicants are rarely holders of a concession card. Such customers do not qualify for a NILS loan. At present, 180,000 SACCs totalling over $100m are being written to customers every month. It is impossible for schemes such as NILS, which by necessity are available only to consumers in more severe categories of financial exclusion, to service this demand. This means there is significant consumer demand that will need to continue to be met. Credit Corp's SACC complements programmes such as NILS by providing a sustainable and affordable alternative for consumers excluded from mainstream credit products.

11.6 Credit Corp's loan application data shows that most large SACC lenders regularly advance to their customers three or more loans within a 90 day period. The data also shows that for almost one in every five applications the applicant has had five or more SACCs in the previous 90 day period and that for these applicants, there is a high probability of a debt spiral. All of this data strongly suggests that the risk of debt spirals amongst consumers of SACCs has not been effectively addressed by the previous reforms and the presumption of unsuitability that was adopted in the Credit Act, for example section 131(3A), is routinely being rebutted by the majority of industry players and therefore has little or no practical effect. As discussed later in this submission, Credit Corp proposes that the presumption be replaced with a prohibition for SACCs less than 90 days in duration.

11.7 The repayments under Credit Corp's SACCs as a percentage of income differ markedly from the average SACC being offered by the industry:

| Repayments as a % of after tax income | <5% | 5% - 10% | 10% - 15% | 15% - 20% | >20% |
|---|---|---|---|---|---|
| Credit Corp | 40% | 48% | 10% | 2% | 1% |
| 0 – 3 month SACC | 11% | 22% | 21% | 15% | 30% |

11.8 88% of SACCs written by Credit Corp absorb less than 10% of a borrower's after tax income and less than 3% absorb more than 15% of that income. Of concern is that 45% of less than three month SACCs absorb greater than 15% of a borrower's after tax income and almost one in three absorb more than 20%.

## 12.0 The number of credit contracts

12.1 64% of Credit Corp SACC applications show at least one SACC in the 90 days immediately prior to the application. Half (49%) of Credit Corp SACC applications show that the applicant has been a debtor under two or more other SACCs in the 90 days immediately prior to the application, triggering the presumption of unsuitability (e.g. in section 131(3A) of the Credit Act). 36% of applications present with a third or further SACC within 90 days, which suggests that the presumption is being rebutted in a large proportion of instances.

12.2 These statistics are cause for significant concern when observed in light of the fact that 85% of all SACCs being written at present are for loan terms averaging 37 days. The data shows that income is being used to meet repayments rather than ongoing expenses, by taking out multiple loans of less than three months duration in any 90 day period. This is precisely the risk that was identified in the Bill and against which the SACC reforms sought to militate. Credit Corp sees this as particularly alarming given that repayments under such loans are typically three times the repayments under Credit Corp's SACC over the same pay period, and the amount advanced is typically half the amount advanced under a Credit Corp SACC.

12.3 Appendix B contains detail on SACC repeat rates in total and by individual borrowers. Credit Corp has concluded that the average SACC borrower enters four SACCs within a 12 month period.

## 13.0 The level of costs being charged by the credit provider

13.1 Credit Corp cannot identify another significant industry participant who, since the Credit Act was amended in 2013, has charged establishment or monthly fees below the caps prescribed by the Credit Act. Credit Corp's fees are substantially differentiated from the rest of the industry, operating sustainably at three-quarters of the cap for establishment fees and half the cap for monthly fees.

13.2 Credit Corp's fee structure also compares well to the caps advocated by consumer groups during the consultation phase leading up to the 2013 legislative amendments.

| | Consumer Groups' Proposed Cap | Credit Corp SACC | SACC Cap under Credit Act |
|---|---|---|---|
| Establishment fee (Flat) | 10% | 15% | 20% |
| Monthly fee (Flat) | 2% | 2% | 4% |

13.3 Credit Corp's fees are transparent. As outlined above, Credit Corp does not profit from customer arrears and does not exacerbate the impact of any hardship to a borrower who falls into arrears. Credit Corp charges a single cost-recovery late payment fee of $10 for each payment reversal and this can only be charged across two payment cycles for a maximum of $20. We encourage customers to contact us in advance of a missed payment and will not apply any charges when this occurs. By comparison, the industry's largest online lender charges $15 per reversal and $5 per day whilst ever an account is in arrears, which is only limited by the cap under the Credit Act on total repayments of no more than 200% of the amount borrowed.

| | Credit Corp SACC | Largest online lender |
|---|---|---|
| Late payment fee | $10 per debit reversal | $15 per reversal plus $5 per day |
| Late payment cap | Maximum 2 reversals ($20) | Cap of 200% of amount borrowed |
| Two week arrears total late fee | $20 (nil if advance contact) | $100 |

(See Appendix B)

# Part 5 – Answers to Questions

## 14.0 Question 1

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

14.1 It is Credit Corp's view that the balance between consumer protection and the need to ensure a viable industry which provides consumers with access to credit is best achieved through the creation of an environment which encourages competition on price and product features from responsible lenders. Key elements of the previous reforms, including an interest rate cap in excess of a 48% APR for certain loans with a duration of up to one year, and the application of the neutral term ‘small amount credit contract’ to identify such loans, has provided a framework for competition from responsible lenders. Obviating the need for avoidance techniques to overcome an unviable interest rate cap has facilitated the entry of responsible lenders who have no tolerance for such techniques and are committed to sustainable consumer outcomes.

14.2 It is critical that responsible lenders with a strong commitment to sustainability are encouraged to either enter or remain in the sector, as there is a substantial level of ongoing consumer demand for small amount credit. In order to achieve this objective, the legislation and its administration by the Regulator ought to avoid the untargeted use of pejorative language and there should be a clear differentiation between ‘payday loans’ (loans with a duration of less than three months) and longer-term SACC loans. Sustainable lenders need the support of stakeholders providing efficient debt and equity capital as well as efficient administrative facilities. Pejorative language jeopardises the support of mainstream stakeholders capable of providing these facilities.

14.3 It is important that policy makers properly appreciate critical product features which have the potential to harm consumers. The critical product feature of some SACCs which creates the potential to cause harm is the term of the loan. The shorter the term the higher the repayment and the less income the borrower can expect to receive while they need to make repayments, which ultimately creates the need for additional credit in order to meet expenses temporarily deferred and can lead to a ‘debt spiral’. This risk is concentrated in loans with durations of less than three months, which are properly described as ‘payday loans’.

14.4 Regulation which encourages competition, while minimising the potential for consumer harm, must be set with an appreciation of the economic incentives facing segment participants. There are significant economic disincentives to the provision of longer duration SACCs with terms in excess of three months. These disincentives mean that only 15% of SACCs are for durations of more than three months. Regulatory and supervisory activity must focus on reducing the barriers to providing these more sustainable loans, while appropriately controlling loans with durations of less than three months. At present, there is no differentiation in the treatment of these two distinct categories of loan and the objective of encouraging loans over more sustainable durations is not being achieved.

## 15.0 Question 2

***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?***

15.1 The current regime incorporates a heavy focus on controlling repeat borrowing, rather than addressing the underlying drivers of repeat borrowing. When a consumer takes out an initial SACC for a duration of less than three months, the repayments are likely to account for such a large proportion of the consumer’s income over the repayment period that the individual must ultimately return for a further loan, creating the risk of a ‘debt spiral’. Broadly speaking, lender economics are geared towards issuing such short duration loans, in part to encourage repeat borrowing. A basic affordability test, in addition to general responsible lending obligations, will address the issue of repeat borrowing at its source.

15.2 Credit Corp suggests that consideration be given to a cap on repayments for individual SACCs as a percentage of borrower disposable income. This would need to be complemented by some anti-avoidance provisions to ensure that concurrent SACCs from the same lender are taken into account and that any collusive arrangements with other lenders are also taken into account. Income is readily verifiable and a percentage of income test provides a simple ‘bright-line’ threshold. Based on our experience and analysis of the sector, we would suggest that a cap on repayments equal to 15% of income should be considered.

## 16.0 Question 3

***The Credit Act imposes three types of sanctions - civil penalty breaches, criminal breaches and infringement notices. Is the current sanction regime working and are there enhancement that could be made to make them more effective?***

16.1 Credit Corp makes no comment on this question.

## 17.0 Question 4

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

17.1 Credit Corp considers that this requirement is positive. Bank statements provide substantial data to be used for verification purposes and to trigger further enquiry.

17.2 Credit Corp utilises bank statement data for verification purposes. By way of example, 19% of bank statements we receive evidence loan repayments in excess of those declared by the applicant at the time of application and 38% of bank statements received evidence income materially below what is declared by the applicant. Any such inconsistencies trigger further enquiry and/or a recalculation of the affordability of the loan using verified data.

17.3 Credit Corp utilises bank statement data to identify potential addictions or regularly recurring ongoing expenditures, such as online gambling. Online gambling is detected in 12% of applications received by Credit Corp, and 76% of such applications are promptly declined.

17.4 Further, receipt of electronic bank statement data is superior to manually provided bank statements (e.g. by fax, scan, photograph or photocopy) as electronically provided data is less prone to potential fraud and can be processed by a series of algorithms rather than manually reviewed, which reduces the possibility of error. Electronic statements also facilitate statistical interrogation to identify new or emerging affordability indicators.

17.5 Bank statements are a very effective and efficient way of verifying relevant information about a customer. Credit Corp is not aware of any superior alternatives for meeting verification obligations.

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

17.6 It is appropriate for SACC providers to make use of bank account statements for purposes other than complying with responsible lending obligations. These are used for credit risk assessment as well as to meet responsible lending requirements. Credit Corp does not use bank statements for marketing purposes.

17.7 Many lenders, financial services and other providers make use of bank statements for various purposes, regardless of any specific regulatory requirement to obtain such material. There is no basis for placing specific restrictions on SACC providers without applying such restrictions to all parties obtaining and utilising such data.

17.8 Credit Corp takes extensive steps to preserve the privacy and security of all customer data. Credit Corp is subject to regular external audits of its privacy and security protocols and maintains certifications under ISO 9001:2008 (Quality Management System) and ISO 27001:2013 (Information Security Management System).

## 18.0 Question 5

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

18.1 Credit Corp utilises specific application questions, bank statement data including loan repayments, repayment reversals and SACC deposits and enquiries with credit reporting bureaus to determine whether an applicant has had any other SACCs in the previous 90 days and/or is in default under another SACC.

18.2 Credit Corp notes the following comment on page 22 of the Consultation Paper for this review:

> *The report (ASIC Report 426) noted that SACC providers often determined whether a consumer had a SACC with another SACC provider by asking the consumer. SACC providers appeared to experience difficulty verifying a consumer's assurance that the customer did not have another SACC.*

Credit Corp cannot identify any explicit basis in ASIC Report 426 for the second sentence above.

18.3 Credit Corp is confident that its verification procedures are operating effectively.

***Is a restriction on repeat borrowing necessary to protect consumers?***

18.4 It is clear from data gathered by Credit Corp from SACC applicants that repeat borrowing is commonplace. Almost two-thirds (64%) of applications show that applicants have had at least one other SACC in the previous 90 days and 85% of those SACCs are for terms of less than 90 days. For almost half (45%) of such less than 90 day SACCs the repayments account for more than 15% of the borrower's income and may be unaffordable. Half (49%) of SACC applications show that applicants trigger the multiple SACC loan presumption and 36% have evidence of at least three SACCs in the previous 90 days (See Appendix B).

18.5 Credit Corp believes that repeat borrowing is a symptom of an underlying cause. The driver of repeat borrowing is the fact that 85% of SACCs are for durations of less than three months. Such short durations are accompanied with high repayments which can create the need for further borrowing and the potential for a 'debt spiral'. As stated above and demonstrated in this submission, much more focus needs to be applied to encouraging longer duration SACCs with affordable repayments. Longer duration loans with affordable repayments represent a solution to the risk of a 'debt spiral'. Credit Corp believes that consumers should be encouraged to take out these more sustainable loans in the first instance and, where they have already taken out unsustainable 'payday loans' (shorter than three months) and seek further credit, they should be prevented from taking out a further 'payday loan' but should retain the flexibility to resolve their difficulty through a more sustainable loan with more affordable repayments.

18.6 Credit Corp supports the retention of restrictions on repeat borrowing with certain amendments detailed below.

***Is a rebuttable presumption or a bright-line test more effective?***

18.7 85% of SACCs being written at present have loan terms of less than three months, with the average loan term of these SACCs being 37 days. Such loans are most commonly repaid by two or three fortnightly payments and almost half of these (45%) absorb more than 15% of a borrower's after tax income (See Appendix B). Loans of this type expose consumers to the risk of debt spirals. Credit Corp recommends that amendments be made to the Credit Act, which amendments are set out in **Appendix C** (**Proposed Amendments**). In summary, they are:

18.7.1 the inclusion of a definition of *'payday loan contract'* which defines such contracts by reference to durations of 16 to 90 days;

18.7.2 where the consumer is in default under another SACC, the presumption of unsuitability should be amended to a prohibition on any further SACC;

18.7.3 where in the 90 day period before the assessment the consumer had two or more SACCs:

- the presumption of unsuitability should be changed to a prohibition on the granting of any 'payday loan' contract; and
- the presumption of unsuitability should be retained for the granting of a non-'payday loan' SACC and, in addition to existing requirements, any new loan should be capped such that repayments cannot exceed 5% of a borrower's after tax income.

18.8 This recommendation recognises that loans with durations of less than three months are less likely to be sustainable. It converts the existing rebuttable presumption to a prohibition on issuing a 'payday loan' (correctly defined as a loan with a duration of less than three months) and increases consumer protection.

18.9 The retention of the presumption for a longer duration SACC provides the flexibility to move the consumer into a more sustainable position. This provides the consumer with an alternative to defaulting on their existing SACC obligations. SACC defaults are a significant derogator in the calculation of credit scores and will have an adverse impact on the consumer's ability to obtain credit for a period of at least five years, perpetuating their financial exclusion. Denying the consumer the opportunity to affordably avoid long-term financial exclusion is at odds with the public policy intent of the 2013 legislation.

18.10 The additional protection of a cap on repayments of 5% of disposable income ensures that the consumer will be placed in an improved position. As noted above, income is easily verified and the test is uncomplicated for lenders to administer. Income verification is an existing requirement under the Credit Act, so there will be no additional cost to the provider. There is also precedent for a 5% of income test, from the Consumer Financial Protection Bureau (**CFPB**) in the USA.[33]

18.11 Further, and importantly, such a change would encourage lenders to compete in offering more affordable, longer term loans more generally.

***Would the objective of limiting a debt spiral through repeat borrowing be assisted by requiring SACC providers to rely on a recognised prescribed benchmark?***

18.12 Existing responsible lending guidance applicable to all lending stresses the importance of individual inquiry. Benchmarks are presented as a tool for assessing the reasonableness of consumer responses and can be used to prompt additional inquiry and verification. In light of these requirements, the mandatory use of specified benchmarks is unlikely to simply and effectively limit a debt spiral through repeat borrowing. There would also not appear to be a case for mandatory use of certain benchmarks within one segment of the lending market, without broad application to all segments.

18.13 Credit Corp uses both the Household Expenditure Measure ('HEM') and the Henderson Poverty Index ('HPI') within our credit assessment processes. We are satisfied that our approach in the use of these benchmarks is appropriate and supports our assessments of affordability. Credit Corp recognises that other lenders may utilise alternative approaches. Mandating a particular approach may have the effect of stifling competition and innovation which might otherwise benefit consumers.

18.14 The data we have presented in this submission identifies the increased risk associated with loans of less than three months' duration. Credit Corp's recommendation of a prohibition on granting a 'payday loan' in the situation where a consumer has had two or more SACCs within the preceding 90 days, and retaining the rebuttable presumption with the introduction of an income-related repayment cap on any third or more 3 to 12 month loan will provide far greater protection to consumers than mandating use of particular benchmarks. It is also likely that industry would find the requirement to use prescribed benchmarks significantly more burdensome than a simple repayment as a proportion of validated income test.

## 19.0 Question 6

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

19.1 Yes. Our data suggests this prohibition is generally being complied with.

***Has the prohibition on short-term lending had any unintended consequences that mean it should be changed?***

19.2 Yes. Defining contracts by reference to 1-15 days (STCC) and 16 days to 12 months (SACC) fails to reflect the market and the issues associated with short term, high cost loans, namely 'payday loans', as that term should properly be understood. The Regulation Impact Statement defined the term 'payday loan' with reference to a duration of up to three months.[34] The data presented by Credit Corp shows that 85% of SACCs are for durations of less than three months and 45% of such loans may be unaffordable because repayments account for more than 15% of the borrower's after tax income.

19.3 This current definitional framework has resulted in a lack of differentiation in the legislation between high-risk 'payday loans' and longer, more affordable loans. It has led to the unprecedented application of the term 'payday loan' to longer duration loans in ASIC Report 426. This presents a barrier to responsible lenders being able to enter or remain in the sector, to the immediate and long term detriment of consumers and the market. Credit Corp's recommendation is to introduce a definition of the term 'payday loan' as a loan with a duration of 16 to 90 days. Additional protections should apply to such loans and some existing provisions should be relaxed for longer duration SACCs to encourage competition from providers offering these more sustainable loans.

## 20.0 Question 7

***Are the warning about borrowing statements effective? Could the statements be improved? Should SACC providers be required to include a hyperlink to the MoneySmart website when warnings are displayed on webpages?***

20.1 Credit Corp already provides a hyperlink to the MoneySmart website within the warnings presented on our website. Our concern in relation to these warnings is that when consumers are redirected to the MoneySmart website in its present form, it is not an appropriate resource for consumers, and has a number of critical weaknesses.

20.2 The MoneySmart website publishes a definition of the term ‘payday loan’ which equates the term with all SACCs. This definition is without precedent and has the potential to limit competition from responsible operators seeking to provide consumers with more affordable loans over longer durations.

20.3 The MoneySmart website fails to make any mention of the risk associated very short duration SACCs with a term of less than 90 days, as opposed to longer term SACCs. These ‘payday loans’ comprise 85% of the SACC market and are associated with a significantly increased incidence of high repayments which account for more than 15% of the borrower’s income. The website makes no mention of the risk of unaffordable repayments and the potential for a ‘debt spiral’, which is associated with such loans.

20.4 Rather than encouraging longer duration SACCs with more affordable repayments to minimise the risk of the consumer becoming trapped in a ‘debt spiral’, the website seems to specifically target such loans. Perversely, the case study presented on the site features a loan of $1,000 to be repaid over six months. Such loans represent only 15% of the market and most consumers visiting the site will be considering a loan of around $500 over four to six weeks.

20.5 The case study does not genuinely assist consumers to understand the risks of different alternatives and make informed decisions. The case study is positioned as a comparison to the option of a NILS loan. The vast majority of SACC applicants diverted to the MoneySmart website are unlikely to qualify for a NILS loan and will be considering taking out a very short duration ‘payday loan’. The NILS product is more readily an alternative for a consumer lease than an SACC in terms of factors such as the consumer demographic, loan purpose and duration.

20.6 The site makes no effort to encourage consumers to look for SACCs with lower repayments at lower fee rates. There is no mention of fee rates other than the caps. The website seems to erroneously presuppose that competition and innovation does not exist and provides no encouragement to lenders to differentiate on price and sustainable product features. For example, the loan calculator provided on the site does not allow the user to enter alternative establishment fee rates or monthly rates, in the same way as calculators for other products are presented. This discourages potential SACC applicants from investigating and searching for alternatives.

20.7 In light of the very specific risks associated with very short duration SACCs, the loan calculator should provide for the consumer to enter their level of income and provide warnings as to affordability where repayments exceed 15% of after tax income. The other shortcomings identified on the MoneySmart website should also be addressed.

## 21.0 Question 8

***Do stakeholders think the establishment fee and monthly fee caps have met the objective of protecting consumers and allowing the SACC industry to operate?***

21.1 There are significant economic incentives for lenders to provide shorter duration SACCs over terms of less than three months. Cost structures for SACC providers are relatively fixed per customer. They are lower for lenders providing shorter duration loans as a consequence of higher rates of new customer loan approval. High repeat rates for shorter term SACCs increase revenue per customer, through the ability to charge an additional establishment fee for each repeat loan. These very short term, lower value and high repeating loans put less capital at risk at any time. The combination of these factors mean that returns on capital for longer duration loans are a fraction of those available for ‘payday loans’ (loans over terms of terms of less than three months).

21.2 Credit Corp has implemented a highly-developed operating model to enable it to provide longer duration SACCs. We have implemented a purely on-line and call centre lending model supported by automated technology to maximise efficiency. We leverage our existing infrastructure to marginally cost overheads to the lending business.

21.3 The support of business partners and stakeholders plays an important role in our economic model. Our commitment to sustainability provides us with access to efficient debt and equity capital, as well as access to lower cost administrative facilities.

21.4 Efficiency from our highly-developed operating model and the support of stakeholders enables us to address the economic disadvantages associated with longer term loans and offer an establishment fee of 15% and a monthly fee of 2%, while still providing our shareholders with an adequate return.

21.5 Our view is that the Government and Regulator could do more to encourage other sustainable product offerings and business models which will serve to increase competition within the sector and benefit consumers. In our view, increased competition will serve to further protect consumers and improve consumer outcomes. A key element of this is the introduction in the legislation of a definition of the term 'payday loan', which will restrict its application to loans with a duration of less than three months.

21.6 Credit Corp does not advocate a reduction in the fee caps. We recognise that other operators may have different operating models which deliver an alternative consumer experience and may not be able to continue at our pricing structure. Credit Corp's lending business has been refined over several years' operation and with considerable investment. Applying reduced caps may stifle the ability of new entrants with more innovative models to commence in the SACC sector to the ultimate long-term benefit of consumers.

## 22.0 Question 9

***Is the protection for consumers who receive 50% or more of their income from Centrelink payments working effectively?***

22.1 Yes. Our view is that lenders understand and attempt to adhere to this requirement.

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

22.2 Credit Corp has not been able to identify any other groups of consumers who need to be the subject of specific protection.

## 23.0 Question 10

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

23.1 Yes. With access to bank statement data and credit reporting bureau data, adequate information exists to respond to all SACC specific and general responsible lending obligations. ASIC's Report 426 indicates that SACC lenders have processes in place to identify when the presumptions of unsuitability have been triggered.[35]

***Considerations in relation to an SACC database***

23.2 Credit Corp does not support the introduction of another source of data to be utilised in meeting responsible lending obligations. It is clear that identifying the presence of other

SACCs is not an issue at present. Rather, the issues are the affordability of very short duration SACCs and the approach to the presumptions of unsuitability. Adding another source of SACC data will not assist in dealing with these matters.

23.3 An additional reporting requirement can only serve to create cost and complexity for lenders to the detriment of consumers. Costs will need to be passed on to consumers. Credit reporting bureaus report that credit enquiries from SACC lenders are already factored as a derogator in a consumer's 'credit score' – this will only worsen if another database is implemented.

23.4 In other jurisdictions, notably some states of the US, where such registers are used they are used because it is far more common for 'payday loan' applicants not to have bank accounts.[36] The existing requirement to obtain and utilise bank statement information in Australia is an effective solution.

23.5 A simple and cost-effective improvement would be for the publication of a register of direct debit and direct credit identifiers for each SACC provider. This could be maintained and published as part of ASIC's credit licensee registry. SACC providers would be required to apply the identifiers to all transactions processed to consumer bank accounts. This would substantially eliminate the potential for error in identifying SACC loans.

23.6 Credit Corp does not support mandatory comprehensive credit reporting for SACC providers. A more practical solution would be a mandatory negative listing for all SACCs where the loan is in default and there has been no payment for 180 days. This accords with the practice adopted for mainstream credit products and, accordingly, does not discriminate against SACC users. At the same time, it complements bank statement verification by identifying defaulted SACC obligations where there has been no payment during the statement period.

## 24.0 Question 11

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

24.1 Credit Corp has already recommended that a definition of the term 'payday loan' be incorporated in the Credit Act, specifying that it applies to loans with a duration of 16 to 90 days. Credit Corp recommends that this definition be applied to change the presumption to a prohibition against the granting of a 'payday loan' in circumstances where the consumer has had two SACCs in the preceding 90 days. The presumption would be retained for longer duration SACCs, subject to a simple income affordability test.

24.2 Applying similar rationale, Credit Corp suggests that the prohibition on charging an establishment fee where any part of the SACC is to refinance an existing SACC should be changed so that it only operates as a prohibition in respect of the issuance of a 'payday loan'. An additional establishment fee could be charged for longer duration SACCs, subject to the repayments on the longer duration SACC not exceeding 5% of the borrower's after tax income over the period. This would assist in achieving the objectives of the legislation in encouraging the provision of longer duration SACCs and providing consumers with the ability to refinance into a more affordable loan in order to avoid the potential for a 'debt spiral'.

## 25.0 Question 12

***Are stakeholders aware of any avoidance practices in relation to the Credit Act? Should any additional anti-avoidance provisions be included in the Credit Act?***

25.1 Credit Corp is not aware of any specific avoidance tactics.

25.2 However, Credit Corp notes that there exists a practice of 'front-ending'/'accelerating' SACC repayment schedules, which is used in 50% of all SACCs above 90 days in duration. This practice appears to be designed to needlessly inflate charges levied on the consumer, while minimising the risk of loss to the lender. To prevent this practice, Credit Corp recommends that additional provisions be included in the Credit Act which mandate that SACCs must be offered with equal repayments throughout the term of the loan.

## 26.0 Question 13

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

26.1 Credit Corp undertakes a robust process to make a suitability assessment for SACC applicants. SACC applications are only accepted online and the application form is a detailed set of questions about the consumer, their personal living situation, income, liabilities, and living expenses. To assist in making a suitability assessment, Credit Corp also asks the consumer to declare whether or not they have been a party to another credit contract in the preceding 90 days and if they are in default. Before commencing the assessment, statements covering at least the immediately preceding 90 days are obtained and bureau checks are also performed. The consumer's loan purpose is recorded and all appropriate consents are received to permit Credit Corp to perform any further enquiries to complete the assessment.

26.2 Once an application is completed, Credit Corp verifies the information supplied by the consumer against the bank statements, bureau reports and other checks when required. In addition, where the statements are electronically submitted, the process is supplemented by a series of automated checks designed to alert the assessing officer to any inconsistencies that may require further investigation. For the purposes of performing a serviceability assessment, Credit Corp uses a combination of HEM and HPI benchmarks to ensure that the higher of the consumers declared or benchmarked living expenses is used. Additional conservatism is added in a number of areas including allocating surplus buffers and assuming that credit card repayments will always be the monthly repayment at the credit limit of the card to ensure that the consumer will not suffer hardship in the repayment of a Credit Corp SACC.

26.3 Additional tests are applied and documented in circumstances where the presumption of unsuitability applies because the consumer has had two or more SACCs in the preceding 90 days.

26.4 A copy of all of the items checked, documents received, and verification calls are retained and the assessing officer will summarise their assessment in a log note before making their decision.

***What is the most efficient and effective way to document suitability assessments and should SACC providers be required to document the assessment? Is it possible to use the same steps for actual compliance and demonstrable compliance?***

26.5 Yes, actual and demonstrable compliance is able to be achieved by utilising a robust technology framework which records all application information and all relevant factors considered in the credit assessment process, together with the decision/outcome.

## 27.0 Questions 14 -16

***Consistency between SACCs and consumer leases***

27.1 Credit Corp notes that the retail value of the goods financed and the term applicable to the majority of consumer leases will not conform with the definition of either a SACC or a MACC under the Credit Act. Most consumer leases are for goods with a retail value of less than $2,000 and are for a term of more than one year. Accordingly, the appropriate cap applicable to such arrangements will be a 48% APR.

27.2 To the extent that a higher cap is proposed for such consumer leases, a new definition should be inserted into the Credit Act to ensure that cash loan alternatives are afforded an equivalent cap.

27.3 Credit Corp also notes the considerable difficulty that may be encountered in determining the retail price of leased goods. This may be exacerbated in the case of second hand goods, including vehicles, and 'house-branded' appliances which are not generally marketed for outright purchase.

## Part 6 – Conclusion and recommendations

27.4 The 2013 reforms provided a framework for the entry of responsible operators into the SACC sector. The reforms have however failed to deliver several key policy objectives which were intended to be achieved by the reforms, namely (a) encouraging longer term lending which would make SACCs more affordable to consumers and (b) addressing the industry's reliance on a business model focussing on repeat borrowing which would in turn reduce the risks of consumers being exposed to a debt spiral.

27.5 In addition, the legislation does not sufficiently differentiate between the concept of a 'payday loan' and other, longer term loans. This, coupled with the recent incorrect application of the pejorative term 'payday loan' to all SACCs (even those that 2013 legislative amendments sought to encourage), creates an urgent need for clarification in the legislation. The legislation needs to distinguish between 'payday loans' (16 to 90 days), which have been identified as an area where there is a concentration of risk for consumers, and other SACCs (91 days to 12 months), which are to be encouraged as they present less risk, greater affordability and opportunity for consumers to break the cycle of repeat borrowing, leading to long term financial inclusion.

27.6 Without such changes, the current situation presents a barrier to responsible lenders who can provide much needed competition on price and product features from entering or remaining in the SACC sector.

27.7 Credit Corp recommends a small number of specifically targeted amendments in the form of the Proposed Amendments to address these issues (see Annexure C). These are in addition to the proposals that we have put forward for consideration elsewhere in this submission, for example the cap on repayments for individual SACCs as a percentage of borrower disposable income and necessary anti-avoidance provisions.

27.8 Credit Corp would greatly welcome the opportunity to meet with panel members to discuss the issues raised in this submission and is committed to engaging extensively with the panel and the Government in relation to this review to ensure improved consumer outcomes in the SACC sector.

15 October 2015

[1] The Centre for Social Impact, ‘Measuring Financial Inclusion in Australia’ (Report, National Australia Bank, April 2014) 8.

[2] Roy Morgan Research (2013), cited in The Centre for Social Impact, ‘Measuring Financial Inclusion in Australia’ (Report, National Australia Bank, April 2014) 18.

[3] The Centre for Social Impact, ‘Life Changing Loans at No Interest: An Outcomes Evaluation of Good Shepherd Microfinance’s No Interest Loan Scheme (NILS)’ (Report, Good Shepherd Microfinance, March 2014) 37.

[4] Consumer Action Law Centre, Submission to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, 14 October 2011, 5-6.

[5] Paul Ali, Cosima McRae and Ian Ramsay, ‘The Politics of Payday Lending Regulation in Australia’ (2013) 39(2) *Monash University Law Review* 411, 450.

[6] Sally Andersen, ‘The Phenomenon of Payday Lending’ (2013) 21(1) *Australian Journal of Competition and Consumer Law* 20, 34; Sally Andersen, ‘Mapping the Terrain: The last decade of payday lending in Australia’ (2011) 39(1) *Australian Business Law Review* 5, 27; Anglicare, Submission to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, October 2011, 6 [5.3].

[7] See Australian Securities and Investments Commission, ‘ASIC Report 426: Payday lenders and the new small amount lending provisions’ (Report, Australian Securities and Investments Commission, March 2015) 4, 42.

[8] Australian Securities and Investments Commission, ‘ASIC Report 426: Payday lenders and the new small amount lending provisions’ (Report, Australian Securities and Investments Commission, March 2015) 4, 42.

[9] Australian Securities and Investments Commission, ‘ASIC Report 426: Payday lenders and the new small amount lending provisions’ (Report, Australian Securities and Investments Commission, March 2015) 7; Zac Gillam, ‘Payday Loans: Helping Hand or Quick Sand? An examination of high-cost short-term lending in Australia, 2002-2010’ (Research Report, Consumer Action Law Centre, September 2010) 2.

[10] Zac Gillam, ‘Payday Loans: Helping Hand or Quick Sand? An examination of high-cost short-term lending in Australia, 2002-2010’ (Research Report, Consumer Action Law Centre, September 2010) 88.

[11] *Military Lending Act* 2006, section 232.3.

[12] Consumer Financial Protection Bureau, ‘Payday Loans and Deposit Advance Products’ (White Paper, 24 April 2013) 8.

[13] Small Business Advisory Review Panel For Potential Rulemakings for Payday, Vehicle Title, And Similar Loans, ‘Outline of Proposals under consideration and alternatives considered’ (Proposals Outline, Consumer Financial Protection Bureau, 26 March 2015) 7-8, 57 <http://files.consumerfinance.gov/f/201503_cfpb_outline-of-the-proposals-from-small-business-review-panel.pdf>.

[14] Paul Ali, Cosima McRae and Ian Ramsay, ‘Payday Lending Regulation and Borrower Vulnerability in the United Kingdom and Australia’ (2015) 3(1) *Journal of Business Law* 25 <http://ssrn.com/abstract=2597393>

[15] Michael Stegman, ‘Payday Lending’ (2007) 21(1) *Journal of Economic Perspectives* 169, 169.

[16] Consumer Federation of America, *Payday Loan Consumer Information* (2015) <http://www.paydayloaninfo.org/>.

[17] Community Financial Services Association of America, *What Is a Payday Advance?* (2015) <http://cfsaa.com/what-is-a-payday-advance.aspx#sthash.p1Fbo8jo.dpuf>.

[18] For example Nova Scotia *Consumer Protection Act*, May 2013 (R.S.N.S. 1989) section 18A(b), British Columbia *Business Practices and Consumer Protection Act* [SBC 2004] section 112 and Alberta *Fair Trading Act Payday Loans Regulation, Alberta Regulation* 157/2009 section 1(f).

[19] Sarah Beddows and Mick McAteer, 'Payday Lending: fixing a broken market' (Report, Association of Chartered Certified Accountants, May 2014) 7.

[20] Office of Fair Trading, 'Report 1481: Payday Lending Compliance Review Final Report' (March 2013) 9 <http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.oft.gov.uk/shared_oft/Credit/oft1481.pdf>, cited in Sarah Beddows and Mick McAteer, 'Payday Lending: fixing a broken market' (Report, Association of Chartered Certified Accountants, May 2014) 7.

[21] Department of Treasury, 'The Regulation of Short-Term, Small Amount Finance' (Regulation Impact Statement, Department of Treasury, Australian Government, June 2011) 8.

[22] Department of Parliamentary Services (Cth), *Bills Digest*, No 71 of 2011-12, 9 November 2011, 17-18.

[23] Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 56 [4.20].

[24] Department of Treasury, 'The Regulation of Short-Term, Small Amount Finance' (Regulation Impact Statement, Department of Treasury, Australian Government, June 2011) 42, citing National Australia Bank, 'Do you really want to hurt me: Exploring the costs of fringe lending – A report on the NAB Small Loans Pilot' (Report, National Australia Bank, March 2010) 13.

[25] See eg Cash Doctors, Submission to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, 13 October 2011, 2; Financiers' Association of Australia/Smiles Turner Delegation, Submission to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, 14 October 2011, 4; Evidence to Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, Canberra, 24 October 2011, 63 (Daniel Shteyn, DollarsDirect);

[26] Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Inquiry into Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011* (2011) 60 [5.41].

[27] Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 68 [5.34].

[28] Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 69 [5.38].

[29] Department of Treasury, 'The Regulation of Short-Term, Small Amount Finance' (Regulation Impact Statement, Department of Treasury, Australian Government, June 2011) 35-36; Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 268 [11.97].

[30] Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 58 [4.31].

[31] Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 62 [5.7].

[32] The Centre for Social Impact, 'Life Changing Loans at No Interest: An Outcomes Evaluation of Good Shepherd Microfinance's No Interest Loan Scheme (NILS)' (Report, Good Shepherd Microfinance, March 2014).

[33] Small Business Advisory Review Panel For Potential Rulemakings for Payday, Vehicle Title, And Similar Loans, 'Outline of Proposals under consideration and alternatives considered' (Proposals Outline, Consumer Financial Protection Bureau, 26 March 2015) 20-21, 27-28 <http://files.consumerfinance.gov/f/201503_cfpb_outline-of-the-proposals-from-small-business-review-panel.pdf>.

[34] Department of Treasury, 'The Regulation of Short-Term, Small Amount Finance' (Regulation Impact Statement, Department of Treasury, Australian Government, June 2011) 8.

[35] Australian Securities and Investments Commission, 'ASIC Report 426: Payday lenders and the new small amount lending provisions' (Report, Australian Securities and Investments Commission, March 2015) 12 [51], 31 [159].

[36] Stephen Corones, Denise McGill and Rebecca Durant, 'Phase Two of the National Credit Reforms Examining the Regulation of Payday Lenders' (Report, Queensland University of Technology, March 2011) 19.

## Appendix A - Payday Loan Definitions Table (Australia)

| Year | Author | Work | Definition Used | Payday Loan Profile |
|---|---|---|---|---|
| 2001 | Karen Sampford | 'Regulating Pay Day Lending : The Consumer Credit (Queensland) Amendment Bill 2001' Research Brief 14/01 June 2001 1. | **Payday Lending**<br>The practice of lending money to a consumer until their next payday in exchange for a fee<br>**Payday Loan**<br>The amounts loaned are typically small, with the average loan term one or two weeks and the lender's fee generally set at $20 to $25 for each $100 advanced | **Term**<br>1-2 Weeks |
| 2002 | Chris Field | 'Payday Lending – An Exploitative Market Practice' (2002) Alternative Law Journal 27(1) 36, 36. | **Payday Lenders**<br>Short term credit providers<br>**Payday Loan**<br>Typically a consumer taking out a loan for a small amount (for example $200) to be repaid by their next payday (within a fortnight) for a service fee | **Term**<br>2 Weeks / next payday |
| 2002 | Dean Wilson | 'Payday Lending in Victoria – A research report' (Research Report, Consumer Law Centre Victoria, July 2002) 11, 33. | **Payday Lending**<br>The practice of a lender advancing money to a consumer in exchange for a fee<br>**Payday Loan**<br>Typically two to four weeks and the average sum at around $250<br>Short-term high interest loans, usually unsecured, that are under $1000 and last less than 62 days | **Term**<br>2-4 Weeks<br>Less than 62 Days<br>**Amount**<br>$250<br>Less than $1,000 |

| Year | Author | Work | Definition Used | Payday Loan Profile |
|---|---|---|---|---|
| 2006 | Rosanna Scutella<br>Genevieve Sheehan | 'To their credit: Evaluating an experiment with personal loans for people on low incomes' (Report, Brotherhood of St Laurence, May 2006) 4. | **Payday Lenders**<br>Lenders that provide loans until the next pay day in exchange for a fee<br>**Payday Loan**<br>Typically two to four weeks for amounts around $250<br><br>Note: In relation to the definition of payday loans, the authors reference Dean Wilson, 'Payday Lending in Victoria - A research report' (Research Report, Consumer Law Centre Victoria, July 2002 | **Term**<br>2-4 Weeks<br>**Amount**<br>$250 |
| 2008 | Nicola Howell<br>Therese Wilson<br>James Davidson | 'Interest Rate Caps: protection or paternalism?' (Research Paper, Centre for Credit and Consumer Law, December 2008) 41, 43. | **Payday Loan**<br>Short term, high interest loans for small amounts which escape precise definition<br>All forms of short term lending for personal, domestic or household purposes of up to 2 months duration<br>**Non-Payday Loan**<br>Usually for periods in excess of two months<br><br>Note: In relation to the definition of payday loans, the authors reference Working Party (2000), Payday lending - A Report to the Minister for Fair Trading, Queensland Office of Fair Trading, Brisbane | **Term**<br>8 Weeks (2 Months) |
| 2010 | National Australia Bank | 'Do you really want to hurt me: Exploring the costs of fringe lending – A report on the NAB Small Loans Pilot' (Report, National Australia Bank, March 2010) 9. | **Payday Loan**<br>Small, short term loans that are usually 2 to 4 weeks in duration. They are not suited for long-term borrowing or continuing financial needs, and are best reserved for temporary cash flow problems. Their principals range up to several hundred dollars, with the average payday loan being around $250<br>**Non-Payday Loan (Microloan)**<br>Loans of two months to two years. They are generally for amounts of $500 or more, with an industry average principal of $1,000. These loans are generally used to meet larger expenses such as replacing | **Term**<br>2-4 Weeks<br>**Amount**<br>$250 |

| Year | Author | Work | Definition Used | Payday Loan Profile |
|---|---|---|---|---|
| | | | whitegoods, car registration, rental bonds, dental expenses and unexpected travel<br>Note: This definition is attributed to the National Financial Services Federation. | |
| 2010 | Gregory Marston<br>Lynda Shellevar | 'The Experience of Using Fringe Lenders in Queensland: A Pilot Study' (Report, Social Policy Unit, University of Queensland, July 2010) 5, 11. | **Payday Loan**<br>High cost short-term loans<br>Loans of less than $1000 that usually last two weeks, are marketed as short-term advances on the borrower's pay, attract a fee that is usually 25% of the loan amount and must be paid off in full<br>Note: The authors acknowledge that some payday lenders also specialise in larger amounts. | **Term**<br>2 Weeks<br>**Amount**<br>Less than $1,000 |
| 2010 | Zac Gillam | Zac Gillam, 'Payday Loans: Helping Hand or Quick Sand? An examination of high-cost short-term lending in Australia, 2002-2010' (Research Report, Consumer Action Law Centre, September 2010) 1. | **Payday Loan**<br>Small loans advanced to consumers, range from $200 to $500 and are designed to be paid back within a short period of time, typically 2 to 4 weeks | **Term**<br>2-4 Weeks<br>**Amount**<br>$200-$500 |
| 2011 | Stephen Corones<br>Denise McGill<br>Rebecca Durant | 'Phase Two of the National Credit Reforms Examining the Regulation of Payday Lenders' (Report, Queensland University | **Payday Lending**<br>The practice of lending small amounts of cash to consumers for short periods of time (less than 62 days, and typically 2-4 weeks until the borrower's next payday) in exchange for a fee<br>Note: The definition taken from Karen Sampford, Regulating Pay Day Lending: The Consumer Credit (Queensland) Amendment Bill 2001(QPL June 2001) 1; Dean Wilson, 'Payday Lending in Victoria – A research report' (Research Report, Consumer Law Centre Victoria, July 2002) 11; Government of South Australia: Office of | **Term**<br>2-4 Weeks<br>Less than 62 Days |

| Year | Author | Work | Definition Used | Payday Loan Profile |
|---|---|---|---|---|
| | | of Technology, March 2011) 6. | Consumer and Business Affairs, Payday lending in South Australia - options to increase consumer protection, Discussion Paper (2006) 1. | |
| 2011 | Sally Andersen | Sally Andersen, 'The Phenomenon of Payday Lending' (2013) 21(1) *Australian Journal of Competition and Consumer Law* 20, 5, 7. | **Payday Loan**<br>Small, unsecured loans that attract flat fees and are given to borrowers until their next payday or for a short period of time.<br>Typically a loan for $100 to be repaid in full on the borrower's next payday or at least within 31 days, for a fee of $25<br>Payday loan is typically a small, unsecured loan given to a consumer until their next payday or for a short period of time. The consumer is usually charged a flat fee | **Term**<br>Less than 32 Days<br>**Amount**<br>$100 |
| 2011 | Department of Treasury | 'The Regulation of Short-Term, Small Amount Finance' (Regulation Impact Statement, June 2011) 7-8. | **Payday Loan**<br>Loans of less than $1000 for periods of less than three months<br>Note: This definition is expressly taken from the Marston and Shellevar report produced in 2010 (see above entry).<br>Note: This definition is taken from 'The Experience of Using Fringe Lenders in Queensland: A Pilot Study' (Report, Social Policy Unit, University of Queensland, July 2010) 5. | **Term**<br>Less than 12 Weeks (3 Months)<br>**Amount**<br>Less than $1,000 |

| Year | Author | Work | Definition Used | Payday Loan Profile |
|---|---|---|---|---|
| 2011 | ASIC | ASIC REPORT 264 'Review of micro lenders' responsible lending conduct and disclosure obligations' November 2011 9. | **Payday Loan**<br>Typically last 2 to 4 weeks<br>**Non-Payday Loan (Microloan)**<br>Micro loans last on average 3 to 12 months<br>Note: This definition is taken from the National Financial Services Federation (2008), Submission to Financial Services and Credit Reform Green Paper, Redcliffe. | **Term**<br>2-4 Weeks |
| 2011 | Department of Parliamentary Services<br>Paula Pyburne | Bills Digest, No 71 of 2011-12, 9 November 2011 | **Payday Loan**<br>Small, short term loans that are usually 2 to 4 weeks in duration. They are not suited for long-term borrowing or continuing financial needs, and are best reserved for temporary cash flow problems. Their principals range up to several hundred dollars, with the average payday loan being around $250<br>**Non-Payday Loan (Microloan)**<br>Loans of two months to two years. They are generally for amounts of $500 or more, with an industry average principal of $1,000. These loans are generally used to meet larger expenses such as replacing whitegoods, car registration, rental bonds, dental expenses and unexpected travel<br>Note: This definition is taken from 'Do you really want to hurt me: Exploring the costs of fringe lending – A report on the NAB Small Loans Pilot' (Report, National Australia Bank, March 2010). | **Term**<br>2-4 Weeks<br>**Amount**<br>$250 |
| 2012 | Denise McGill<br>Stephen Corones<br>Nicola Howell | Denise McGill, Stephen Corones and Nicola Howell, 'Regulating the Cost of Small Loans: Overdue or Overkill?' (2012) 30(3) *Company and Securities Law Journal* 149 | **Payday Loan**<br>Loans between $200 and $2,000 that must be repaid within a short period of time, such as the borrower's next payday<br>Note: This definition is taken from Shorten MP, the Hon Bill, "Reforms to Payday Lending", *Media Release* (25 August 2011). | **Amount**<br>$200-$2,000 |

| Year | Author | Work | Definition Used | Payday Loan Profile |
|---|---|---|---|---|
| 2012 | Marcus Banks<br>Greg Marston<br>Howard Karger<br>Roslyn Russell | 'Caught Short: Exploring the Role of Small, Short-Term Loans in the lives of Australians' (Research Report, Social Policy Unit, University of Queensland, August 2012) 1. | **Payday Loan**<br>The practice of lending small amounts of cash for short periods of time, typically less than $1000 for two to four weeks, in exchange for a fee | **Term**<br>2-4 Weeks<br>**Amount**<br>Less than $1,000 |
| 2013 | Paul Ali<br>Cosima McRae<br>Ian Ramsay | Paul Ali, Cosima McRae and Ian Ramsay, 'The Politics of Payday Lending Regulation in Australia' (2013) 39(2) *Monash University Law Review* 411, 411, 416, 420, 424. | **Payday Loan**<br>Colloquial term used to describe small amount, high interest, short-term loans<br>Fringe credit products provided by non-mainstream lenders at a very high cost to borrowers relative to mainstream products<br>Typical loan is a small cash amounts of between $100 to $300, borrowed for a length of time between two weeks to one month<br>Note: In relation to the definition of payday loans, the authors reference 'Caught Short: Exploring the Role of Small, Short-Term Loans in the lives of Australians' (Research Report, Social Policy Unit, University of Queensland, August 2012) 1 and Consumer Action Law Centre, Submission to Treasury, *Discussion Paper: Strategies for Reducing Reliance on High-Cost, Short-Term, Small Amount Lending*, 8 June 2012. | **Term**<br>2-4 Weeks (1 Month)<br>**Amount**<br>$100-$300 |

| Year | Author | Work | Definition Used | Payday Loan Profile |
|---|---|---|---|---|
| 2013 | Sally Andersen | Sally Andersen, 'The Phenomenon of Payday Lending' (2013) 21(1) *Australian Journal of Competition and Consumer Law* 20, 20. | **Payday Loan**<br>Form of predatory lending<br>Small, high-cost, unsecured loans given to a customer for a short period of time or until their next payday for which a flat fee is typically charged | |
| 2014 | Good Shepherd Microfinance | 'Life Changing Loans at No Interest: An Outcomes Evaluation of Good Shepherd Microfinance's No Interest Loan Scheme (NILS)' (Report, Good Shepherd Microfinance, March 2014) 39. | **Payday Loan**<br>Operate on a 4-6 week basis depending on the provider<br>Figures employed for the purpose of comparison with other finance options suggest that a loan of this type will typically last 15-30 days unless extended (comprising 2 to 4 repayments depending on the borrower's pay schedule) and remain under $2000<br>**Non Payday Loan (Personal Finance Loans)**<br>Operate over a longer period of 6 to 12 months are referred to as personal finance loans. The comparison figures for this class of product will typically last 6-12 months (comprising 13 fortnightly or 26 weekly repayments) and range from $2000 to $5000 | **Term**<br>4-6 Weeks<br>15-30 Days<br><br>**Amount**<br>Under $2,000 |
| 2015 | Andrew Serpell | 'Protecting the Desperate: The Regulation of Payday Lending' *Federal Law Review* (2015) 43(1) 147, 147, 148-149. | **Payday Loan**<br>Small-amount, short-term, unsecured, high-cost credit contracts provided by non-mainstream credit providers<br>Typical amount is less than $500 and the typical term is a couple of weeks (although research shows that these can vary considerably) | **Term**<br>2 Weeks<br>**Amount**<br>Under $500 |
| 2015 | ASIC | 'ASIC Report 426: Payday lenders and the new small amount lending provisions' | **Payday Loan**<br>Small Amount Credit Contracts<br>Loans of up to $2000 and for periods of between 16 days and 1 year | **Term**<br>Less than 52 Weeks<br>(1 Years)<br>**Amount** |

| Year | Author | Work | Definition Used | Payday Loan Profile |
|---|---|---|---|---|
| | | (Report, Australian Securities and Investments Commission, March 2015) 4, 42. | | Less than $2,000 |

# Appendix B – Market Analysis

To support our submission and provide genuine insight into the SACC industry, Credit Corp has undertaken a comprehensive data gathering and analysis exercise. We have sought to quantify the size of the SACC industry, identify the various product offerings within the industry and their characteristics and investigate affordability by assessing loan repayments against a borrower's after tax income.

## Part 1 – Summary outcomes

1. 2.2 million SACCs are being written each year, with 85% of this loan volume being for loans with a term of less than 90 days (typically four to six weeks in duration). These 2.2 million SACCs comprise a total of $1.2 billion in loan funds advanced to 540,000 consumers who enter an average of four SACCs per year.

2. 45% of SACCs with terms of less than 90 days have repayments which absorb more than 15% of a borrower's after tax income. This level of repayment for an individual SACC has the potential to create dependency and expose a borrower to the risk of a debt spiral.

3. Whilst a large portion of SACCs with terms of less than 90 days are potentially unaffordable, sustainable alternatives do exist and, relative to borrower income, are not dissimilar to the affordability of a NILS loan. These alternatives presently represent a very small proportion of the SACC market by volume.

4. Over 75% of the SACC industry's customer base would be immediately excluded from consideration for a NILS loan based on income. This percentage would increase further when considering loan purpose. There is little overlap between the potential NILS customer base and the customer base of the SACC industry and NILS customers are not highly represented within SACC applicant or borrower data.

5. Half (49%) of all SACC applications trigger the multiple SACC presumption of unsuitability. 36% of applications present with a third or further SACC within 90 days, which suggests that the presumption is being rebutted in a large proportion of instances.

## Part 2 - Data gathering and analysis methodology

### SACC market size

To estimate the volume of SACC lending undertaken in Australia we have utilised public statements made by the three largest market participants. As comparable data is available for the period FY2015 H2 (January 2015 to June 2015 inclusive) we have focused on this date range as it is both meaningful in duration and proximate to the review.

The sources of our data for these lenders includes:

- data in relation to Cash Converters International Limited (CCV) available at http://www.cashconverters.com/Investors/AsxAnnouncements; specifically
  - CCV 2015 FY 4E – Chairman & MD's Report published on 28/08/2015
  - CCIL Half Year Result 2014 published on 16/02/2015
    (together, these reports can be used to calculate activities in the FY2015 full year and each Half of FY2015)
- data in relation to Nimble Australia Pty Ltd available at https://nimble.com.au/; specifically
  - Volume of approved loans which is published here daily
- data in relation to Money3 Corporation Limited (MNY) available at https://www.money3.com.au/reports-annoucements.html; specifically
  - The Investor Presentation published on 9/09/2015
  - The Investor Presentation published on 2/03/2015
    (together, these reports can be used to calculate activities in the FY2015 full year and each Half of FY2015)

Credit Corp has then utilised verified application data collected from applicants to our loan products during the eight month period to August 2015 to identify SACCs from other lenders and estimate the size of the balance of the market. The analysis covered 138,000 loan applications and identified 275,000 SACCs. Verified application data shows SACC borrowing where:

- there is evidence of a deposit of up to $2,000 made to a consumer by a lender known to be part of the SACC industry followed by the commencement of repayments to that lender; and/or
- there is evidence of direct debits or other payments made by a consumer to a lender known to be part of the SACC industry, and these payments reconcile with the frequency and amount which would indicate an SACC is being repaid.

We have determined the relationship between the number of SACCs appearing in verified application data for the three largest lenders in the industry to the published total volume data for those lenders. We have then applied this proportion to the number of SACCs from other, smaller lenders appearing in verified application data to estimate the balance of total industry volume.

### SACC characteristics and repeat borrowing

To determine the duration and amounts of SACCs offered by industry participants, Credit Corp has utilised product feature information published on the websites of industry participants and reconciled that product detail with loan disbursement amounts, payment amounts and payment frequencies in verified application data. Credit Corp has also analysed the frequency of repeat SACC origination by lender and by product type to inform insights into repeat borrowing.

For the purposes of this analysis, Credit Corp utilised verified application data collected from applications for our loan products during the fourteen (14) month period to August 2015, which comprised a total of 209,000 loan applications.

SACC borrower income

Credit Corp has analysed SACC applicant and borrower income to provide useful insight into the affordability of SACC products presently being advanced.

Data used to analyse SACC borrower income includes applicant income verified during the application process. This methodology ensures the integrity of the analysis as it does not utilise income information declared by applicants during their application process, which we have determined is materially (at least 15%) inaccurate in 38% of cases and requires validation as part of the credit assessment process.

There is a material difference between median SACC borrower incomes and average SACC borrower incomes, however the majority of published material on borrower incomes (including NILS borrowers) presents averages rather than medians. We have sought to address this by using average incomes for our comparative analyses and provide income and affordability stratification tables to accurately evidence SACC borrower incomes and the proportion of income being absorbed by SACC repayments.

Sample biases

While we consider that the data analysis approach outline above is comprehensive and the quantity of data utilised provides for an accurate statistical representation of the industry, there are some shortcomings.

This approach is based on SACC borrowers who have applied for a loan with Credit Corp, and it provides limited visibility of any SACC borrowers who maintain relationships with SACC lender shop-fronts and do not apply for loans online. Further, our data set provides limited visibility of any SACC borrowers who maintain an exclusive relationship with a single non-Credit Corp lender.

As a result, the industry may be slightly larger than we have calculated and borrowers using SACC lender shop-fronts or with exclusive single lender relationships may differ in terms of average income and SACC borrowing and repeat habits to the borrower characteristics identified from our data.

Finally, our analyses of customers with non-Credit Corp SACC loans will, by definition, be biased towards customers who are attempting to repeat borrow, because it is formed solely from that portion of competitors' customers seeking a further loan.

Having said this, we have assessed this analysis to be comprehensive, statistically valid and representative of the SACC industry and borrower characteristics. It is based on the interrogation of a large data set and it leverages or reconciles with other data points quoted by industry participants, government, academics and consumer groups.

## Part 3 - Analysis findings

### Market size by duration band and market share of major participants

Our analysis suggests that between 1,050,000 and 1,100,000 SACCs were originated during H2 of FY2015. This equates to a monthly average volume of 180,000 SACCs. In terms of market participants, the market is led by Cash Converters International Limited and the market is heavily dominated by lenders offering loans with durations of less than 90 days.

Table 1 – Proportion of total market by volume of loans

| Credit Provider | < 90 day duration SACCs | 3 month – 12 month SACCs | Share of total SACC market |
|---|---|---|---|
| Cash Converters International Limited | 28% | 8% | 36% |
| Nimble Australia Pty Ltd | 18% | 0% | 18% |
| Money3 Corporation Limited [See 4] | 9% | 1% | 10% |
| Credit Corp Group Limited | 0% | 2% | 2% |
| Others | 30% | 4% | 34% |
| **Total** | **85%** | **15%** | **100%** |

1. 85% of all SACCs, or approximately 153,000 loans per month, are written with durations of less than 90 days.

2. The three largest industry participants comprise 64% of the entire SACC industry and originate 65% of loans with durations of less than 90 days.

3. Based on loan volumes, the second tier industry participants other than Credit Corp Group Limited include Cash Stop Financial Services Pty Ltd, Ferratum Australia Pty Ltd, Loan Ranger Pty Ltd, MoneyMe Financial Group Pty Ltd, Sunshine Loan Centres Pty Ltd and Teleloans Pty Ltd. In aggregate, these first and second tier industry participants originated 90% of SACCs advanced in Australia during FY2015 H2.

4. The volume reported for Money3 includes activities from Paid International Ltd brands Cash Train and First Stop Money, which were acquired by Money3 midway through FY2015.

## SACC characteristics

With the exception of Credit Corp, industry activity is heavily weighted (85%) towards loans of less than $500 with a maximum duration of six weeks. Whilst loans are being written for a period of longer than three months, these fall into two categories:

1. SACCs with a typical loan term of 12 months and repayments that are 'front-ended' and stepdown at the halfway point of the loan. These loans are structured such that the borrower repays 75% of the loan during the first half of the loan term, so payments for the first half of the term are triple the amount of payments during the second half of the term. Payments during the second half of the loan term are absorbed by the monthly fee; and

2. SACCs with ordinary, flat/fixed repayments over the course of the loan's duration.

Our analysis indicates that 8% of SACC market is comprised of 'front-ended' loans. Credit Corp's SACC loans are comprised of 4 – 12 month, flat repayment schedule SACCs.

Table 2 – Average SACC characteristics

The table below sets out the average characteristics of non-Credit Corp SACCs, splitting these into those with short durations (less than 90 days) and those with durations between 3 to 12 months, broken further into loans with front-ended repayments and loans with flat repayments throughout the term of the loan. These are then compared to the characteristics of Credit Corp's SACCs.

| Characteristic | < 90 day duration SACCs | 3 -12 month 'Front-ended' SACCs | Non Credit Corp 3 – 12 month Flat Repayment SACCs | Credit Corp SACCs |
|---|---|---|---|---|
| Average loan amount | $479 | $933 | $1,193 | $835 |
| Average total repayments | $605 | $1,547 | $1,776 | $1,103 |
| Average loan term | 37 days (1.2 months) | 348 days (11.4 months) | 201 days (6.6 months) | 181 days (6.0 months) |
| Average # fortnightly repayments | 2.6 | 24.8 | 14.4 | 13 |
| Average fortnightly repayment amount | $229 | $94 *(first half of term)* See 4 | $123 | $85 |
| Proportion of SACC market | 84.6% | 7.9% | 5.7% | 1.8% |

1. The average loan term of 85% of SACCs (153,000 loans per month) offered in Australia at present is 37 days and is repaid in an average of 2.6 repayments at an average repayment of $229 per fortnight.

2. Combining these average SACC characteristics with the volume of SACC originations presently occurring indicates that $100m in SACCs are being originated each month.

3. 7.5% of the SACCs originated are more traditional loan products – i.e. larger amounts over longer terms with consistent repayments over the term of the loan.

4. This is the average repayment over the first half of the loan term. The repayments during the second half of the loan term average one-third of this value and are absorbed by the monthly fee.

## Income & affordability

Credit Corp has analysed the SACC applicant/borrower income which provides useful insight into the affordability of SACC products presently being advanced.

Table 3 – Net income & SACC repayment affordability

| | < 90 day duration SACCs | 3 -12 month 'Front-ended' SACCs | Non Credit Corp 3 – 12 month Flat Repayment SACCs | Credit Corp SACCs |
|---|---|---|---|---|
| Median borrower fortnightly after-tax income | $1,434 | $1,361 | $1,403 | $1,521 |
| Average borrower fortnightly after-tax income | $1,659 | $1,580 | $1,649 | $1,773 |
| Average fortnightly repayment amount | $229 | $94 *(first half of term)* | $123 | $85 |
| **Repayment as a % of average after-tax fortnightly income** | **13.8%** | **5.9%** *(first half of term)* | **7.5%** | **4.8%** |
| Proportion of SACC market | 84.6% | 7.9% | 5.7% | 1.8% |

1. The median fortnightly after-tax income of a Credit Corp SACC customer is $1,521, which is equivalent to a gross pre-tax income of $47,500 per annum.

2. The average fortnightly after-tax income of a Credit Corp SACC customer is $1,773, which is equivalent to a gross pre-tax income of $57,500 per annum.

3. The average <90 day SACC written at present (85% of all originations) absorbs 14% of a borrower's after tax income.

Table 4 – SACC affordability vs. Credit Corp and NILS

It is useful to compare the affordability of <90 day duration SACCs and Credit Corp's SACCs against a NILS loan. For this analysis we have utilised data included in the award winning "Life Changing Loans at No Interest", an outcomes evaluation of Good Shepherd Microfinance's No Interest Loan Scheme (NILS) which was prepared by the Centre for Social Impact, University of New South Wales and published in March 2014.

The average SACC borrower's income is significantly higher than that of the average NILS borrower and NILS borrowers are not highly represented within SACC applicant or borrower data.

| | < 90 day duration SACCs | Credit Corp SACCs | NILS Loan |
|---|---|---|---|
| Average loan amount | $479 | $835 | $930 |
| Average total repayments | $605 | $1,103 | $930 |
| Average loan term | 37 days (1.2 months) | 181 days (6.0 months) | 546 days (17.9 months) |
| Average # fortnightly repayments | 2.6 | 13 | 39 |
| Average fortnightly repayment amount | $229 | $85 | $24 |
| Average borrower fortnightly after-tax income | $1,659 | $1,773 | $857 See 3 |
| **Repayment as a % of fortnightly after-tax income** | **13.8%** | **4.8%** | **2.8%** |

1. The average Credit Corp SACC borrower has a fortnightly after tax income $916 higher than an average NILS borrower, and Credit Corp SACCs absorb only an additional $61, or less than 7%, of that additional income.

2. The average borrower of a <90 day duration SACC has a fortnightly after tax income $802 higher than an average NILS borrower and the SACC repayments are absorbing an additional $205, or over one-quarter of the borrower's additional income. Such loans absorb roughly four times as much of a borrower's additional 'above NILS' income as the average Credit Corp SACC and may present a question as to affordability.

3. Note that it is unclear whether this figure, quoted on page 42 of the outcomes evaluation, is before or after tax, however it is likely to be heavily comprised of government benefits income and thus has been considered after tax for the purposes of this comparison.

4. The average NILS loan absorbs less than 3% of a borrower's fortnightly income and based on this analysis a Credit Corp SACC is closer to a NILS loan in terms of affordability than it is to 85% of SACCs being originated in the market at present, with loan terms of four to six weeks.

Table 5 – Income stratification by SACC volume

Credit Corp has made substantial enquiry into the income characteristics of SACC borrowers. Provided below is a comparison of the after tax income stratification of Credit Corp's borrowers with those accessing <90 day SACCs and 3 – 12 month non-Credit Corp SACCs.

| After Tax Income Band | < 90 day duration SACCs | 3 -12 month 'Front-ended' SACCs | Non Credit Corp 3 – 12 month Flat Repayment SACCs | Credit Corp SACCs |
|---|---|---|---|---|
| <$25k | 22% | 25% | 24% | 8% |
| $25k - $35k | 22% | 24% | 23% | 22% |
| $35k - $45k | 23% | 22% | 23% | 32% |
| $45k - $55k | 13% | 12% | 13% | 19% |
| $55k - $65k | 7% | 6% | 7% | 9% |
| >$65k | 12% | 10% | 12% | 11% |
| Proportion of SACC market | 84.6% | 7.9% | 5.7% | 1.8% |

1. Less than 10% of Credit Corp's SACC customers are on incomes below $25,000, which would suggest that they may be the sort of vulnerable consumers who would qualify for a NILS loan.

2. Borrowers of non-Credit Corp SACCs appear to exhibit similar income stratification regardless of the characteristics of the SACCs they are accessing and almost one-quarter of these borrowers overlap the income levels of a NILS borrower.

Table 6 – Loan repayments as a % of income

There is a substantial affordability difference between Credit Corp's SACCs and those SACCs originated by the majority of the SACC industry. The table below compares the proportion of a borrower's after tax income absorbed by each SACC for Credit Corp's borrowers versus those accessing <90 day SACCs and 3 – 12 month non-Credit Corp SACCs.

| Percentage of after tax income | < 90 day duration SACCs | 3 -12 month 'Front-ended' SACCs | Non Credit Corp 3 – 12 month Flat Repayment SACCs | Credit Corp SACCs |
|---|---|---|---|---|
| <5% | 11% | 39% | 30% | 40% |
| 5% - 10% | 22% | 38% | 39% | 48% |
| 10% - 15% | 21% | 16% | 17% | 10% |
| 15% - 20% | 15% | 5% | 7% | 2% |
| >20% | 30% | 3% | 7% | 1% |
| Proportion of SACC market | 85% | 8% | 6% | 2% |

1. 88% of Credit Corp's SACCs absorb less than 10% of a borrower's after tax income, in contrast to <90 day loans where only one in three SACCs absorbs less than 10% of a borrower's after tax income.

2. Less than 3% of Credit Corp's SACCs absorb more than 15% of a borrower's after tax income, in contrast to <90 day loans where almost half (45%) absorb more than 15% of a borrower's after tax income. Our analysis indicates that it is at this point that affordability becomes a significant concern and where the risk of repeat borrowing and a debt spiral increases.

   An infographic published by the Consumer Action Law Centre in July 2013 (available at http://consumeraction.org.au/new-infographic-illustrates-the-harm-of-payday-loans/) provides an appropriate representation of irresponsible lending. This infographic highlights the unaffordability of SACC repayments which, in the example used, absorb 16.3% of a borrower's after tax income. Indeed in the example used, even an SACC which absorbs 14.2% of a borrower's after tax income would provide no financial buffer to deal with unanticipated expenses during the fortnightly pay cycle. Whilst this infographic is based on a borrower whose after tax income is $30,000 per annum, affordability remains a risk for borrowers on higher incomes and our analysis suggests that where loan repayments on an individual SACC exceed 15% of after-tax income, affordability may be questionable.

## Repeat borrowing

A major concern in relation to SACCs is that of a debt spiral. All the data presented within the preceding sections has looked at individual SACCs and their borrowers. The reality, however, is that where there is a <90 day SACC there is also a high incidence of repeated borrowing and multiple concurrent SACCs within 90 days. This exacerbates affordability issues as unsustainably high repayments associated with a large proportion of <90 days SACCs lead to repeat borrowing and a debt spiral. Unsuitability presumptions exist to protect borrowers from these risks. The data suggests the presumption is being rebutted in a large number of instances.

### Table 7 - Applicants with SACCs evident

The following table stratifies Credit Corp's loan applicants based on the number of SACCs they had been a debtor under in the 90 days immediately before the date of their application to Credit Corp.

| # SACCs | % of Applications |
|---|---|
| 0 | 36% |
| >=1 | 64% |
| >=2 | 49% |
| >=3 | 36% |
| >=4 | 27% |
| >=5 | 20% |
| >=6 | 15% |
| >=7 | 11% |
| >=8 | 9% |
| >=9 | 6% |
| >=10 | 5% |

1. 64% of Credit Corp applications received show that the applicant has been a debtor under at least one SACC in the 90 days prior to their application.

2. Half (49%) of Credit Corp applications trigger the presumption of unsuitability in Section 133 (3A) of the Credit Act as the applicant has been a debtor under two or more SACCs in the 90 days prior to their application.

3. More than one in three (36%) of Credit Corp's applications show that the applicant has been a debtor under at least three SACCs in the 90 days prior to their application, indicating at least one other lender as overcome the presumption of unsuitability.

4. More than one in four (27%) of Credit Corp's applications show that the applicant has four or more SACCs in the 90 days prior to their application – i.e. these consumers are averaging more than one SACC per month.

Table 8 – Repeat borrowing from the same lender

Where a Credit Corp application has other SACCs evident in verified application data, it is very common that there are multiple SACCs evident from the same lender.

The table below is based on any Credit Corp application which shows that the applicant has been a debtor under at least one SACC from one of the three largest industry participants in the 90 days prior to their application. It sets out the proportion of SACCs where the borrower has been a debtor under more than one SACC from that same lender in that same 90 day period. This data has been de-identified.

| | Lender A | Lender B | Lender C |
|---|---|---|---|
| Proportion of instances of only one SACC from this lender, if there is at least one SACC from this lender | 38% | 36% | 56% |
| Proportion of instances of two SACCs from this lender, if there is at least one SACC from this lender | 24% | 28% | 26% |
| Proportion of instances of three SACCs from this lender, if there is at least one SACC from this lender | 15% | 20% | 11% |
| Proportion of instances of four or more SACCs from this lender, if there is at least one SACC from this lender | 22% | 15% | 8% |
| **Total proportion of instances of repeat SACC borrowing from this lender within 90 days** | **62%** | **64%** | **44%** |
| **Average # SACCs in 90 days from this lender, if there is at least one SACC from this lender** | **2.50** | **2.24** | **1.76** |

1. On average, when a consumer is a debtor under an SACC to one of the three largest SACC lenders, there is a high probability that that lender will originate at least one more SACC to that consumer within the next 90 days.

2. Note that this data excludes consideration of repeat borrowing from a different lender, which is included within the data presented within Table 7 above.

Table 9 – Affordability of repeat borrowing

The primary risk of repeat borrowing is that of a debt spiral, as SACC repayments become progressively less affordable. Credit Corp has analysed the affordability of SACC repayments relative to a borrower's income as the volume of SACCs over a 90 day period increases.

This analysis is based on the whole 90 day period rather than a consumer's specific pay cycle, thus during some pay cycles the percentage of income absorbed by SACC repayments is likely to be substantially higher than represented below. For example, the data presented within Table 6 above shows 30% of each individual non Credit Corp originated SACCs have repayments which absorb greater than 20% of a borrower's after tax income during the term of the loan.

| # SACCs within 90 days | 1 SACC | 2 SACCs | 3 SACCs | 4 SACCs | 5 SACCs | >5 SACCs |
|---|---|---|---|---|---|---|
| Proportion of consumers where SACC repayments absorb >10% of income over 90 days | 12% | 35% | 58% | 74% | 85% | 96% |
| Proportion of consumers where SACC repayments absorb >20% of income over 90 days | 3% | 9% | 20% | 34% | 48% | 80% |
| Proportion of consumers where SACC repayments absorb >30% of income over 90 days | 1% | 3% | 7% | 14% | 22% | 59% |
| Proportion of consumers where SACC repayments absorb >40% of income over 90 days | 1% | 2% | 3% | 6% | 10% | 40% |
| Proportion of consumers where SACC repayments absorb >50% of income over 90 days | 1% | 1% | 2% | 3% | 5% | 28% |

1. Credit Corp's view is that repayments on a single SACC should not commonly absorb more than 15% of a borrower's after tax income. The data presented in Tables 6 through 9 above evidences that 85% of SACCs are being written over terms of four to six weeks and 45% of these SACCs have repayments which absorb over 15% of a borrower's after tax income. Credit Corp believes these repayments may be unaffordable and are leading to a high incidence of repeat borrowing and the increased risk of a debt spiral.

Credit Corp Group

Table 10 – Volume of customers relying on repeat borrowing

Credit Corp has sought to identify the volume of applications we receive from consumers who are likely to be in a debt spiral and are facing the prospect of severe financial exclusion as a consequence. We have measured the volume of loan applications where a large percentage of the consumer's income over the preceding 90 days has been directed to SACC repayments. For this analysis we have analysed loan applications received during the final quarter of FY2015 and the results have been annualised by multiplying by a factor of four.

For the purpose of this analysis we have considered that any consumer diverting more than 30% of their income to SACC debt repayment over a three month duration is likely to be in a debt spiral and suffering severe financial exclusion.

| Proportion of total after tax income received in 90 days being absorbed by SACC repayments | Number of consumer loan applications during FY2015 Q4 | Annualised number of consumer loan applications | Proportion of all consumer loan applications |
|---|---|---|---|
| >20% | 23,200 | 92,800 | 30% |
| >30% | 13,900 | 55,600 | 18% |
| >40% | 8,800 | 35,200 | 11% |
| >50% | 5,900 | 23,600 | 8% |

1. On an annualised basis, Credit Corp receives 56,000 applications from consumers in a situation where more than 30% of their after tax income has been absorbed by SACC repayments for at least the last three months and are highly likely to be in a debt spiral.

## Market size by customer volume

Credit Corp has reviewed verified application data received for applicants where we have received multiple applications across a 12 month period, enabling us to combine multiple 90 day periods and remove duplicate transactions. A sample of 40,000 applicants evidences a total of 157,000 SACCs over a six month period (3.9 loans in six months). A smaller sample set shows a return rate of 4.6 loans per nine month period which extrapolates to 4.9 loans per 12 month period.

As this methodology is biased toward repeat borrowing, our estimates conclude that the average SACC borrower is accessing four SACCs within a 12 month period. As a total of 180,000 SACCs are being originated each month (2,160,000 per year) this indicates 540,000 consumer are accessing SACCs on an annual basis at an average of four SACCs per consumer.

# Appendix C – Proposed Amendments to Credit Act

| Section | Amendment | Purpose |
|---|---|---|
| 5 | Add new definition:<br><br>***payday loan contract***: a credit contract is a *payday loan contract* if:<br><br>(a) the contract is not a continuing credit contract; and<br>(b) the contract provider under the contract is not an ADI; and<br>(c) the credit limit of the contract is $2,000 (or such other amount as prescribed by the regulations) or less; and<br>(d) the term of the contract is 16 to 90 days. | The purpose of the definition is to:<br><br>(a) include a definition of the product comprising the majority of the market (85%), being loans for <three months in duration (‘payday loans’);<br>(b) differentiate between ‘payday loans’, which present a concentration of risk for consumers, and longer term loans >three months duration which are more affordable and should be encouraged;<br>(c) remove barriers to responsible lenders from entering and remaining in the market and providing competition by enabling such lenders to distinguish their products from ‘payday loans’. |
| 118 | Delete subsection (3A) and replace with:<br><br>(3A) If the contract is a small amount credit contract (the ***relevant contract***) and at the time of the assessment:<br><br>(a) the consumer is a debtor under another small amount credit contract; and<br>(b) the consumer is in default in payment of an amount under that other contract;<br><br>then, for the purposes of paragraph (2)(a), it is presumed that the consumer could only comply with the consumer’s financial obligations under the relevant contract with substantial hardship.<br><br>Add new subsection:<br>(3B) If the contract is a small amount credit contract (the ***relevant contract***) and at the time of the assessment the consumer has been a debtor under 2 or more other small amount credit contracts in the 90-day period before the time of the assessment, then for the purposes of paragraph (2)(a), it is presumed that the consumer could only comply with the consumer’s financial obligations under the relevant contract with substantial hardship, unless the contrary is proved. | The purpose of the prohibition is to:<br><br>(a) encourage lending at durations of >three months, thereby increasing affordability of loans;<br>(b) provide additional protection to consumers from the risk of being exposed to a debt spiral;<br>(c) enable consumers to refinance through longer and more affordable loans, break the cycle of repeat borrowing and to reduce market’s reliance on repeat lending. |

| Section | Amendment | Purpose |
|---|---|---|
| | Add new subsection:<br>(3C) If the contract is a payday loan contract (the ***relevant contract***) and the circumstances referred to in subsection (3B) apply, then, for the purposes of subsection (2), the relevant contract will be unsuitable. | |
| 123 | Delete subsection (3A) and replace with:<br>(3A) If the contract is a small amount credit contract (the ***relevant contract***) and at the time of the assessment:<br><br>(a) the consumer is a debtor under another small amount credit contract; and<br>(b) the consumer is in default in payment of an amount under that other contract;<br><br>then, for the purposes of paragraph (2)(a), it is presumed that the consumer could only comply with the consumer's financial obligations under the relevant contract with substantial hardship.<br>Add new subsection:<br><br>(3B) If the contract is a small amount credit contract (the ***relevant contract***) and at the time of the assessment the consumer has been a debtor under 2 or more other small amount credit contracts in the 90-day period before the time of the assessment, then for the purposes of paragraph (2)(a), it is presumed that the consumer could only comply with the consumer's financial obligations under the relevant contract with substantial hardship, unless the contrary is proved.<br><br>Add new subsection:<br>(3C) If the contract is a payday loan contract (the ***relevant contract***) and the circumstances referred to in subsection (3B) apply, then, for the purposes of subsection (2), the relevant contract will be unsuitable | As above. |

| Section | Amendment | Purpose |
|---|---|---|
| 131 | Delete subsection (3A) and replace with:<br>(3A) If the contract is a small amount credit contract (the ***relevant contract***) and at the time of the assessment:<br><br>(a) the consumer is a debtor under another small amount credit contract; and<br>(b) the consumer is in default in payment of an amount under that other contract;<br><br>then, for the purposes of paragraph (2)(a), it is presumed that the consumer could only comply with the consumer's financial obligations under the relevant contract with substantial hardship.<br><br>Add new subsection:<br><br>(3B) If the contract is a small amount credit contract (the ***relevant contract***) and at the time of the assessment the consumer has been a debtor under 2 or more other small amount credit contracts in the 90-day period before the time of the assessment, then for the purposes of paragraph (2)(a), it is presumed that the consumer could only comply with the consumer's financial obligations under the relevant contract with substantial hardship, unless the contrary is proved.<br><br>Add new subsection:<br>(3C) If the contract is a payday loan contract (the ***relevant contract***) and the circumstances referred to in subsection (3B) apply, then, for the purposes of subsection (2), the relevant contract will be unsuitable | As above. |
| 133 | Delete subsection (3A) and replace with:<br><br>(3A) If the contract is a small amount credit contract (the ***relevant contract***) and at the time of the assessment:<br><br>(a) the consumer is a debtor under another small amount credit contract; and<br>(b) the consumer is in default in payment of an amount under that other contract;<br><br>then, for the purposes of paragraph (2)(a), it is presumed that the consumer could only comply with the consumer's financial obligations under the relevant contract with substantial hardship.<br><br>Add new subsection: | As above. |

| Section | Amendment | Purpose |
|---|---|---|
| | (3B) If the contract is a small amount credit contract (the ***relevant contract***) and at the time of the assessment the consumer has been a debtor under 2 or more other small amount credit contracts in the 90-day period before the time of the assessment, then for the purposes of paragraph (2)(a), it is presumed that the consumer could only comply with the consumer's financial obligations under the relevant contract with substantial hardship, unless the contrary is proved.<br><br>Add new subsection:<br>(3C) If the contract is a payday loan contract (the ***relevant contract***) and the circumstances referred to in subsection (3B)apply, then, for the purposes of subsection (2), the relevant contract will be unsuitable | |
| 133CC | Add new subsection:<br>(1A) A licensee must not enter into, or offer to enter into, a small amount credit contract with a consumer who will be the debtor under the contract if:<br><br>(a) the circumstances in subsection 133(3B) apply; and<br><br>(b) the repayments in each payment cycle of income under the contract would exceed 5% of the debtor's after tax income for that payment cycle. | The purpose of the additional income test is to:<br><br>(a) protect consumers from the risks associated with repeat borrowing, through introducing an affordability requirement that the repayments for a third (or further) SACC is not more that 5% of the debtor's after tax income;<br><br>(b) encourage longer term loans. |
| 133CC | Amend subsection (2) as follows:<br><br>(2) A person commits an offence if:<br><br>(a) the person is subject to a requirement under subsection<u>s</u> (1) <u>or (1A)</u>; and<br><br>(b) the person engages in conduct; and<br><br>(c) the conduct contravenes the requirement. | This is a consequential amendment required to give effect to the proposed new subparagraph 133CC(1A). |